INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS

PART BI: RULES APPLICABLE TO INVESTMENT SERVICES LICENCE HOLDERS WHICH QUALIFY AS MiFID FIRMS

Chapter 1 General

Title 1 Introduction

Section 1 Scope

R1-1.1.1 Part BI of the Investment Services Rules for Investment Services Providers shall apply to Investment Services Licence Holders which provide services in terms of the Market in Financial Instruments Directive. Therefore, Part BI does not apply to Investment Services Licence Holders which qualify as UCITS Fund Managers, Alternative Investment Fund Managers or Custodians.

R1-1.1.2 Provided that a Licence Holder which is a credit institution licensed in terms of the Banking Act, 1994 or a branch established in Malta of a credit institution authorised in a EU Member State or EEA State, or of an overseas credit institution which is subject to prudential requirements at least equivalent to the requirements applicable to Maltese credit institutions, is not subject to these Rules except for Rule R3-5.4.2.13, Rule R4-5.3.2 and Sections 2 and 3 of Title 1 of Chapter 4.

Section 2 High Level Principles

R1-1.2.1 When providing Investment Services, a Licence Holder shall act honestly, fairly and professionally and shall comply with the relevant provisions of the Act, the Regulations issued thereunder, and these Rules as well as with other relevant legal and regulatory requirements.

R1-1.2.2 Pursuant to the above, the Licence Holder is also expected to take due account and, where applicable comply with, any relevant EU Regulations and Directives, Commission Delegated Regulations, Regulatory Technical

Standards and Implementing Technical Standards, as well as any Guidance Notes which may be issued by the EBA, ESMA and EIOPA.

R1-1.2.3 Furthermore, Licence Holders are also expected to make reference to, and where applicable comply with the applicable Maltese Legislation, regulations and rules issued thereunder as well as any 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.

Section 3 Definitions

R1-1.3.1 This Section should be read in conjunction with the Investment Services Act and Regulations issued thereunder. In the event that definitions contained in hereunder conflict with those stipulated in the Investment Services Act or regulations issued thereunder, the definitions set out in the Investment Services Act or the regulations issued thereunder shall prevail.

1. The "*Act*", or the "*ISA*" means the Investment Services Act;

2. "*Ancillary Services*" are any of the services listed in the third schedule of the Investment Services Act;

3. "*Asset Management Company*" - "Asset Management Company" shall have the same meaning as that assigned in point (19) of Article 4 (1) of the CRR, i.e. an asset management company as defined in regulation 2 of the Financial Conglomerates Regulations, 2013 and an AIFM including, unless otherwise provided, third country entities, that carry out similar activities, that are subject to the laws of a third country which applies supervisory and regulatory requirements at least equivalent to those applied in the Union;

4. "*Asset-backed commercial paper (ABCP) programme*" means a programme of securitisations the securities issued by which predominantly take the form of commercial paper with an original maturity of one year or less';

5. "*Beneficial Owners*" are individuals who ultimately own or control the proposed acquirer and/ or the persons on whose behalf the proposed acquisition is being conducted. It also includes persons who exercise ultimate effective control over a proposed acquirer which is a legal person or a legal arrangement such as a trust.

6. "*Branch*" - Branch means a place of business which forms a legally dependent part of an investment firm and which carries out directly all or some of the transactions inherent in the business of investment firms.

7. "*capital conservation buffer*" means the own funds that an investment firm is required to maintain in accordance with Section 2 of Title 5 of Chapter 2 of these Rules [Article 129 of the CRD];

8. "*Capital Requirements Directive*", or "*CRD*" means Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC;

9. "*Capital Requirements Regulation*", or "*CRR*", means Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012;

10. "*CBM Directive*" means the Central Bank of Malta Directive No. 11 on Macro-prudential policy;

11. "*Central Bank of Malta*" means:

    i. the 'designate authority' in conjunction with the authority, in charge of identifying on a consolidated basis, global systemically important investment firms (G-SIIs) and, on an individual, sub-consolidated or consolidated basis, as applicable, other systemically important institutions (O-SIIs) which have been authorised in Malta in terms of Article 131 of the CRD as appointed by the Central Bank of Malta Act (Appointment of Designate Authority to implement Macro-Prudential Instruments) Regulations, 2014; and

    ii. the 'designate authority' responsible for setting the countercyclical buffer rate in accordance with Article 136 of the CRD as appointed by the Central Bank of Malta Act (Appointment of Designate Authority to implement Macro-Prudential Instruments) Regulations, 2014;

12. "*Civil Partner*" means a partner bound by a civil union or a union of equivalent status in terms of the Civil Unions Act;

13. "*Civil Union*" means a civil union or a union of equivalent status in terms of the Civil Unions Act;

14. "*Client*" means any natural or legal person to whom a licence holder provides investment or ancillary services;

15. "*Close Links*" shall have the same meaning as that assigned to it in the Investment Services Act;

16. "*combined buffer requirement*" means the total Common Equity Tier 1 capital required to meet the requirement for the capital conservation buffer extended by the following as applicable:

    i. an institution-specific countercyclical capital buffer;

    ii. G-SII buffer;

    iii. an O-SII buffer;

    iv. a systemic risk buffer.

17. "*Commission Regulation*": Commission Regulation (EC) No 1287/2006 of 10th August 2006 implementing the MIFID (Directive 2004/39/EC) of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive;

18. "*Common Equity Tier 1 capital*" shall have the same meaning as that assigned to it in Article 50 of the CRR;

19. "*Compliance Officer*"-The Compliance Officer is the person appointed by the Investment Services Licence Holder, responsible for ensuring compliance by the Licence Holder with its applicable Licence Conditions;

20. "*Consolidated Basis*"- shall have the same meaning as that assigned to it in point (48) of Article 4 (1) of the CRR, i.e. on the basis of the

consolidated situation;

21. "*Consolidated Group*" means a group of entities which is subject to Part One, Title II Chapter 2 of the CRR. When determining consolidation status, Licence Holders should refer to regulation 3 of the Banking Act and the Investment Services Act (Supervisory Consolidation Regulations) 2014;

22. "*Consolidating Supervisor*" shall have the same meaning as that assigned to it in point (41) of Article 4(1) of the CRR, i.e. where the MFSA is responsible for the exercise of supervision on a consolidated basis of EU parent institutions and of institutions controlled by EU parent financial holding companies or EU parent mixed financial holding companies, in accordance with regulation 3 of the Banking Act and the Investment Services Act (Supervisory Consolidation Regulations), 2014;

23. "*Control*" means the relationship between a parent undertaking and a subsidiary undertaking as defined in Article 2 of the Companies Act, or a similar relationship between any natural or legal person and an undertaking;

24. "*countercyclical buffer rate*" means the rate that investment firms must apply in order to calculate their institution-specific countercyclical capital buffer, and that is set in accordance with Articles 136 and 137 of the CRD or by a relevant third-country authority, as the case may be;

25. "*Custodian*": The Custodian is the person appointed by the Scheme responsible for safekeeping of the assets of the Scheme and for carrying a monitoring function over the activities of the Manager;

26. "*Customer*": The term 'customer' includes a potential customer and a recipient of documents from a Licence Holder including a policyholder and a potential policyholder in relation to linked long term contracts of insurance;

27. "*discretionary pension benefits*" means enhanced pension benefits granted on a discretionary basis by the Licence Holder to an employee as part of that employee's variable remuneration package, which do not include accrued benefits granted to an employee under the terms of the company pension scheme;

28. "*Durable Medium*" means any instrument which:
    i. enables a client to store information addressed personally to that a client in a way accessible for future reference; and for a period of time adequate for the purposes of the information; and

    ii. allows the unchanged reproduction of the information stored.

29. "*EBA*" means the European Banking Authority as established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24th November 2010;

30. "*EEA*" means European Economic Area;

31. "*ESMA*" means The European Securities and Markets Authority established by Regulation (EU) no 1095/2010 of the European Parliament and of the Council of 24 November 2010;

32. "*EU*" means European Union;

33. "*EU Member State*" means A Member State of the European Union;

34. "*Financial Holding company*" shall have the same meaning as that assigned to it in point (20) of Article 4(1) of the CRR, i.e. a financial institution, the subsidiaries of which are exclusively or mainly institutions or financial institutions, at least one of such subsidiaries being an institution, and which is not a mixed financial holding company;

35. "*Financial Institution"* shall have the same meaning as that assigned to it in point (26) of Article 4(1) of the CRR, i.e. an undertaking other than an institution, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points 2 to 12 and point 15 of Annex I to Directive 2013/36/EU, including a financial holding company, a mixed financial holding company, a payment institution within the meaning of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market, and an asset management company, but excluding insurance holding companies and mixed-activity insurance holding companies as defined in point (g) of Article 212(1) of Directive 2009/138/E;

36. "*Group*" (when used in relation to a Licence Holder) shall mean the group of which that Licence Holder forms a part, consisting of a parent undertaking, its subsidiaries and the entities in which the parent undertaking or its subsidiaries hold a participation, as well as undertakings linked to each other by a relationship within the meaning of Article 2(11) of Directive 2013/34/EU;

37. "*G-SII buffer*" means the own funds that are required to be maintained in accordance with Rule R2-5.5.4 [Article 131(4) of the CRD];

38. "*Holding Company*" means a company with shareholdings in one or more other companies, the commercial purpose of which is to carry out a business strategy or strategies through its subsidiaries, associated companies or participations in order to contribute to their long-term value, and which is either a company:

    i. Operating on its own account and whose shares are admitted to trading on a regulated market in the Union; or

    ii. Not established for the main purpose of generating returns for its investors by means of divestment of its subsidiaries or assorted companies as evidenced in its annual report or other official documents.

39. "*Home Member State*" shall have:

    i. the meaning assigned to "home Member State or EEA State" in Regulation 2 of the European Passport Right for Investment Firms Regulations 2007, as may be amended from time to time; or

    ii. the meaning assigned to "home Member State or EEA State" in Regulation 2 of the Investment Services Act (UCITS Management Company Passport) Regulations, 2011, as may be amended from time to time; or the meaning assigned to "home Member State or EEA State" in Regulation 2 of the Investment Services Act (Alternative Investment Fund Manager Passport) Regulations, 2013;

as applicable.

40. "*Institution*" shall have the same meaning as that assigned to it in point (3) of Article 4(1) of the CRR, i.e. a credit institution or an investment firm for the purpose of CRD and CRR;

41. "*institution-specific countercyclical capital buffer*" means the own funds that an investment firm is required to maintain in accordance with Rules R2-5.3.1 to R2-5.3.3 of these Rules [Article 130 of the CRD];

42. "*Instrument*" shall have the same meaning as that assigned to it in Article 2 of the Act;

43. "*Introducer*" means a person who enters into a written arrangement with a Licence Holder, whereby such person introduces a potential customer to the Licence Holder. As a consequence of this introduction, the Licence Holder may remunerate the introducer by means of commission;

44. "*Investment*" means any instrument, contract or right falling within the Second Schedule to the Act and whether or not issued or entered into in Malta;

45. "*Investment Service*" shall have the same meaning as that assigned to it in Article 2 of in the Investment Services Act;

46. "*Investment Services Licence Holder*" means a person who holds an Investment Services Licence;

47. "*Investment Services Licence*" shall have the same meaning as that assigned to it in Article 2 of the Act;

48. "*Investment Services Rules for Investment Services Providers*" shall mean the Investment Services Rules issued by the MFSA in terms of Article 6 of the Investment Services Act, 1994 applicable to Investment Services Licence Holders and equivalent authorised persons;

49. "*Licence Holder*" shall have the same meaning as an Investment Services Licence Holder;

50. "*Management Body*" means:

i. the governing body of an AIFM; or

ii. the body or bodies appointed in accordance with Maltese law which, is empowered to set the strategy, objectives and overall direction of an investment firm, and which oversees and monitors management decision-making, and includes the persons who effectively direct the business of the investment firm, including the Board of Directors.

51. "*Management body in its supervisory function*" means the Management Body acting in its role of overseeing and monitoring management decision-making;

52. "*Management Company*" shall mean a company, the regular business of which is the management of UCITS in the form of common fund, unit trusts or of investment companies or one or more AIFs as applicable depending whether the Management Company is a UCITS Fund Manager or an Alternative Investment Fund Manager;

53. "*MFSA*" means the Malta Financial Services Authority;

54. "*MIFID*" or "*the Directive*" means Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU;

55. "*MIFIR*" means Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012;

56. "*Mixed Activity Holding Company*" shall have the same meaning as that assigned to it in point (22) of Article 4(1) of the CRR, i.e. a parent undertaking, other than a financial holding company or an institution or a mixed financial holding company, the subsidiaries of which include at least one institution;

57. "*Mixed Financial Holding Company*" shall have the same meaning as that assigned to it in point (21) of Article 4(1) of the CRR, i.e. a mixed financial holding company as defined in point (15) of Article 2 of Directive 2002/87/EC;

58. "*Money Laundering Reporting Officer*" or "*MLRO*" means the person

appointed by an Investment Services Licence Holder in terms of Regulation 10 of the Prevention of Money Laundering and Funding of Terrorism Regulations, 2003;

59. "*Multilateral Trading Facility*" or " " means a multilateral system, operated by a licence Holder or a market operator, which brings together multiple third-party buying and selling interests in financial instruments - in a system and in accordance with non-discretionary rules – In a way that results in a contract in accordance with the provisions of the MIFID;

60. "*Organised Trading Facility*" or "*OTF*" means a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract in accordance with the provisions of MiFID;

61. '*originator*' means either of the following: (a) an entity which, either itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised; or (b) an entity which purchases a third party's exposures for its own account and then securitises them;

62. "*O-SII buffer*" means the own funds that may be required to be maintained in accordance with Rule R2-5.5.6 of these Rules [Article 131(5) of the CRD];

63. "*Outsourcing*" means an arrangement of any form between a Licence Holder and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the Licence Holder himself;

64. "*Parent Financial Holding Company in a Member State*" shall have the same meaning as that assigned to it in point (30) of Article 4(1) of the CRR, i.e. a financial holding company which is not itself a subsidiary of an institution authorised in the same Member State, or of a financial holding company or mixed financial holding company set up in the same Member State;

65. "*Parent Investment Firm*" means an investment firm licensed in terms

of the Act which has an institution or a financial institution as a subsidiary or which holds a participation in such an institution or financial institution, and which is not itself a subsidiary of another institution licensed in terms of the Act, or of a financial holding company or mixed financial holding company established in Malta;

66. "*Parent Mixed Financial Holding Company in a Member State*" shall have the same meaning as that assigned to it in point (32) of Article 4(1) of the CRR, i.e. a mixed financial holding company which is not itself a subsidiary of an institution authorised in the same Member State, or of a financial holding company or mixed financial holding company set up in that same Member State.

67. "*Parent Undertaking*" means a parent undertaking within the meaning of Article 2(9) and 22 of Directive 2013/34/EU of the European Parliament and of the Council."

68. "*Participation*" shall have the same meaning as that assigned to it in point (35) of Article 4(1) of the CRR, i.e. participation within the meaning of the first sentence of Article 17 of Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies, or the ownership, direct or indirect, of 20% or more of the voting rights or capital of an undertaking;

69. "*Personal Questionnaire*" or "*PQ*" means the Personal Questionnaire, which is available in Schedule F to Part A of the Investment Services Rules for Investment Services Providers;

70. "*Qualifying Shareholder*" means a person who has a Qualifying Shareholding;

71. "*Qualifying Shareholding*" shall have the same meaning as that assigned to it by Article 2 of the Act;

72. "*Relevant person*" (when used in relation to a Licence Holder) means any of the following:

    i. director, partner or equivalent, manager of the Licence Holder;

    ii. an employee of the Licence holder , as well as any other natural person whose services are placed at the disposal and under the control of the Licence Holder and who is involved in the

provision by the Licence Holder of investment services and activities;

iii. a natural person who is directly involved in the provision of services to the Licence Holder under an outsourcing arrangement for the purpose of the provision by the Licence Holder of investment services and activities.

73. "*Retail Client*" means a client who is not a professional client;

74. "*Remuneration Bracket*" refers to the range of the total remuneration of each of the staff members in the senior manager and risk taker categories – from the highest paid to the lowest paid in these categories;

75. "*Senior Management*" means those natural persons who exercise executive functions within the Licence Holder and who are responsible , and accountable to the Management Body, for the day-to-day management of the Licence Holder, including for the implementation of the policies concerning the distribution of services and products to clients by the firm and its personnel;

76. "*Significant Influence*" means influence which is exercised where a proposed acquirer's shareholding, although below the 10% threshold, allows it to exercise a significant influence over the management of the Investment Services Licence Holder (for example, allows it to have a representative on the board of directors);

77. "*Significant Licence Holder*" shall mean a Licence Holder which is considered significant in terms of size, internal organisation and the nature, the scope and the complexity of its Investment Services and activities, if it meets all of the following conditions:

i. its total balance sheet assets exceed Euro 43 million;

ii. the annual turnover relating to its investment services activities exceeds Euro 50 million;

iii. the clients' money that it holds or controls exceeds Euro 100 million; and

iv. the assets belonging to its clients that it holds or controls in the

course of, or connected with its investment services activities exceeds Euro 3 billion.

The Licence Holder shall regularly assess, whether at any time, it becomes a significant Licence Holder in terms of Paragraph and shall notify the MFSA regarding any change of status as soon as practicable thereafter.

The MFSA may, on a case by case basis, exempt a significant Licence Holder from the requirements of Rule R3-1.3.1.8 to R3-1.3.1.11, Rule R3-1.3.4.1 and Rule R3-1.3.4.3, if it believes the rules that apply to a significant Licence Holder may be disproportionate to it, taking into account the size, internal organisation and the nature, the scope and the complexity of its Investment Services and activities.

On the other hand, if a Licence Holder exceeds one or more of the thresholds referred to in the conditions in the first paragraph of this definition the MFSA may, at its discretion, on a case by case basis, waive a requirement or requirements, if it is of the opinion that the granting of a waiver is justified and appropriate.

The MFSA in exercising these discretions may also consider non-quantitative criteria including but not limited to, the complexity of its Investment Services and activities, market share, level of cross border activity and staff headcount of the Licence Holder and shall be guided by principles of investor protection and protection of market integrity.

This point shall not apply to credit institutions which are also Licence Holders.

78. "*Small and medium-sized investment firms*" means an investment firm which employs fewer than two hundred and fifty (250) persons and which has an annual turnover not exceeding Euro 50 million, and / or an annual balance sheet total not exceeding Euro 43 million, as defined in Article 2 of Title 1 of the Annex to the Commission Recommendation 2003/361/EC of the 6th May 2003;

79. "*sponsor*" means a Licence Holder other than an originator Licence Holder that establishes and manages an asset-backed commercial paper programme or other securitisation scheme that purchases exposures from third party entities;

80. "*Spouse*" includes a partner bound by a civil union or by a union of equivalent status in terms of the Civil Unions Act;

81. "*Sub-consolidated basis*" shall have the same meaning as that assigned to it in point (49) of Article 4(1) of the CRR, i.e. on the basis of the consolidated situation of a parent institution, financial holding company or mixed financial holding company , excluding a sub-group of entities, or on the basis of the consolidated situation of a parent institution, financial holding company or mixed financial holding company that is not the ultimate parent institution, financial holding company or mixed financial holding company;

82. "*Supervisory function*" means the relevant persons or body or bodies responsible for overseeing and monitoring management decision making including the assessment and periodical review of the adequacy and effectiveness of the risk management process and of the policies, arrangements and procedures put in place to comply with the Licence Holders' obligations, including its obligations where applicable under the CRD/ CRR, UCITS and MiFID Directives;

83. "*systemically important institution*" means an EU parent institution, an EU parent financial holding company, an EU parent mixed financial holding company or an institution the failure or malfunction of which could lead to systemic risk as defined in point (30) of Article 3 (1) of the CRD;

84. "*systemic risk buffer*" means the own funds that an investment firm is or may be required to maintain in accordance with paragraphs 14 to 32 of the CBM Directive [Article 133 of the CRD];

85. "*Tied Agent*" means a natural or legal person, who under the full and unconditional responsibility of only one Investment Services Licence Holder or European Investment Firm and on whose behalf it acts, promotes investment and, or ancillary services to clients or prospective clients, receives and transmits instructions or orders from the client in respect of investment services or instruments, places instruments and, or provides investment advice to clients or prospective clients in respect of those instruments or services;

86. "*Third Country*" means a country which is not an EU or an EEA Member State;

87. "*tranche*" means a contractually established segment of the credit risk associated with an exposure or a number of exposures, where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in each other such segment, without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments;

88. "*variable remuneration*" refers to additional payments or benefits depending on performance or, in certain cases, other contractual criteria.

Title 2 General Obligations

Section 1 Scope and Application

R1-2.1.1 Title 2 of Chapter 1 applies to all Investment Services Licence Holders falling within scope of these Rules.

Section 2 General Obligations

R1-2.2.1 The Licence Holder shall commence its Investment Services business within twelve months of the date of issue of the Investment Services Licence.

R1-2.2.2 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.

R1-2.2.3 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.

R1-2.2.4 Where any Rule 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.

R1-2.2.5 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, possess sufficient knowledge and experience, commit sufficient time to perform their functions and be sufficiently experienced so as to ensure the sound and prudent management of the Licence Holder.

R1-2.2.6 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.

R1-2.2.7 The MFSA may grant a derogation from the requirements of Rule R1-2.2.5, where a Licence Holder is a natural person or a legal person managed by a single natural person, provided that the Licence Holder provides, to the satisfaction of the Authority:

i. alternative arrangements which ensure its sound and prudent management and the adequate consideration of the interest of clients and the integrity of the market;

ii. confirmation that the natural persons concerned are of sufficient good repute, possess sufficient knowledge, skills and experience and commit sufficient time to perform their duties.

R1-2.2.8 The Licence Holder shall maintain sufficient records to be able to demonstrate compliance with the conditions of its Investment Services Licence and as required.

R1-2.2.9 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.

R1-2.2.10 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:

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

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

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

Alternatively, the matter can be taken to Court.

R1-2.2.11 The Licence Holder shall promptly pay all amounts due to the MFSA.

R1-2.2.12 The Annual Supervisory Fee shall be payable by the Licence Holder on the day when the Licence is first issued and, and thereafter upon submission of the annual audited financial statements.

R1-2.2.13 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 ensure investor protection and protection of market integrity.

Chapter 2 Prudential Requirements

Title 1 Initial Capital Requirement

Section 1 Scope and Application

R2-1.1.1 Title 1 of Chapter 2 shall apply to all Investment Services Licence Holders falling within scope of these Rules, as applicable.

R2-1.1.2 Without prejudice to these rules, the Licence Holder shall also refer to Part Two (Articles 25 to 91) of the CRR when determining its Own Funds. Furthermore, reference should also be made to Part One 'General Provisions' (Articles 1 to 24) and Part Ten 'Transitional Provisions, Reports, Reviews and Amendments' (Articles 465 to 520) of the CRR. This is without prejudice to other Articles of the CRD IV and the CRR (CRDIV package) which may be relevant/applicable.

R2-1.1.3 Category 2 and Category 3 Licence Holders which qualify as MiFID Firms including Operators of an MTF shall also take into account Title 1 of Chapter 5 on the Transitionary Arrangements on Initial Capital.

Section 2 Initial Capital

R2-1.2.1 In accordance with Article 93 (1) of the CRR, Licence Holders shall at all times ensure that their Own Funds as defined in these Rules shall not fall below the amount of initial capital required at the time of authorisation.

R2-1.2.2 For the purpose of these Rules, the initial capital shall comprise only of Common Equity Tier 1 items which consist of one or more of the items referred to in points (a) to (e) of Article 26 (1) of the CRR, as follows:

i. capital instruments provided that the conditions laid down in Article 28 of the CRR or, where applicable, Article 29 of the CRR are met;

ii. share premium accounts as defined in point (124) of Article 4 (1) of the CRR relating to the instruments referred to in point (i);

iii. retained earnings as defined in point (123) of Article 4 (1) of the CRR;

iv. accumulated other comprehensive income as defined in point (100) of Article 4 (1) of the CRR;

v. other reserves as defined in point (117) of Article 4 (1) of the CRR.

R2-1.2.3 The initial capital requirements applicable to each Category are indicated in **Table R2.1**.

Table R2.1 – Initial Capital in Euro

Licence Holder Category	***Description***	***Initial Capital In Euro***
1A	Licence Holders authorised to receive and transmit orders in relation to one or more instruments and/or to provide investment advice, and/or to place instruments without a firm commitment basis but not to hold or control Clients' Money or Customers' Assets.	50,000
	Provided that where a Category 1A Licence Holders are also insurance intermediaries enrolled in the Insurance Intermediaries Act, (Cap.487) and do not hold client's monies pursuant to insurance intermediaries activities, such Licence Holders shall be required to maintain a reduced initial capital requirement of Euro 25,000. This is without prejudice to any higher capital requirements applicable to these Licence Holders under the Insurance Intermediaries Act (Cap.487)	25,000
1B with PII	Licence Holders authorised to receive and transmit orders, and/or to provide investment advice in relation to one or more instruments, and/or to place instruments without a firm commitment basis solely for professional clients and, or eligible counterparties but not to hold or control Clients' Money or Customers' Assets.	20,000
1B without PII	Licence Holders authorised to receive and transmit orders, and/or to provide investment advice in relation to one or more instruments, and/or to place instruments without a firm commitment basis solely for professional clients and, or eligible counterparties but not to hold or	50,000

	control Clients' Money or Customers' Assets.	
	Provided that where a Category 1B Licence Holders are also insurance intermediaries enrolled in the Insurance Intermediaries Act, (Cap.487) and do not hold client's monies pursuant to insurance intermediaries activities, such Licence Holders shall be required to maintain a reduced initial capital requirement of Euro 25,000. This is without prejudice to any higher capital requirements applicable to these Licence Holders under the Insurance Intermediaries Act (Cap.487).	25,000
2	Licence Holders authorised to provide any Investment Service and to hold or control Clients' Money or Customers' Assets, but not to operate a multilateral trading facility or deal for their own account or underwrite or place instruments on a firm commitment basis.	125,000
3	Licence Holders authorised to provide any Investment Service and to hold and control Clients' Money or Customers' Assets.	730,000

Title 2 Financial Resources Requirement

Section 1 Scope

R2-2.1.1 Title 2 of Chapter 2 shall apply exclusively to Category 1A and Category 1B Investment Services Licence Holders falling within scope of these Rules.

R2-2.1.2 Without prejudice to these Rules, Licence Holders shall make reference to and where applicable comply with the provisions of the CRR, as well as national legislation transposing the CRD. Licence Holders shall also make reference and where applicable comply with Rules and Regulations issued under the aforesaid national legislation. The Licence Holder shall also refer to the Guidance notes when calculating the Fixed Overhead Requirement on the Interim Financial Returns as well as Annual Financial Returns.

R2-2.1.3 Licence Holders shall also take into account Title 2 of Chapter 5 on the Transitionary Arrangements.

Section 2 *Financial Resources Requirement*

R2-2.2.1 The Licence Holders shall at all times maintain Own Funds equal to or in excess of their capital resources requirement. This shall constitute the Licence Holder's Financial Resources Requirement.

R2-2.2.2 The meaning of Own Funds and the capital resources requirement applicable to Category 1 Licence Holders, as well as the methodology for calculating such a Licence Holder's satisfaction of its Financial Resources Requirement, are set out in Sections 3 to 5 of this Title.

R2-2.2.3 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.

R2-2.2.4 Pursuant to point (xix)(a) of Rule R4-1.2.1, 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.

Section 3 ***Own Funds***

R2-2.3.1 For the purposes of these Rules, Own Funds means the sum of Tier 1 capital and Tier 2 capital as specified in Rule R2-2.3.1.1 and R2-2.3.1.2, respectively.

R2-2.3.1.1 **Tier 1 Capital**

R2-2.3.1.1.1 Tier 1 capital consists of the sum of the Common Equity Tier 1 capital and Additional Tier 1 capital.

R2-2.3.1.1.2 *Common Equity Tier 1 Capital*

R2-2.3.1.1.2.1 Common Equity Tier 1 capital is made up of Common Equity Tier 1 items (as defined in Article 26 of the CRR), after applying the prudential filters (laid down in Articles 32 to 35 of the CRR) and the deductions from Common Equity Tier 1 items (Articles 36 to 49 of the CRR).

R2-2.3.1.1.2.2 Pursuant to Rule R2-2.3.1.1.2.1, Common Equity Tier 1 items shall include:

i. Capital instruments provided that the conditions laid down in Article 28 of the CRR or, where applicable, Article 29 of the CRR are met.

ii. Share premium account as defined in point (124) of Article 4 (1) of the CRR.

iii. Retained earnings as defined in point (123) of Article 4 (1) of the CRR.

iv. Accumulated other comprehensive income as defined in point (100) of Article 4 (1) of the CRR.

v. Other reserves as defined in point (117) of Article 4 (1) of the CRR.

R2-2.3.1.1.2.3 For the purposes of point (ii) of Rule R2-2.3.1.1.2.2, the Share premium account shall consider any amount received in excess of the nominal value of any capital instruments referred to in point (i) of Rule R2-2.3.1.1.2.2

R2-2.3.1.1.2.4 For the purposes of point (iii) of Rule R2-2.3.1.1.2.2, Licence Holders shall include interim or year-end profits as identified in Rule R2-2.3.1.1.2.5 before a formal decision has been taken only if these profits have been verified by persons responsible for the auditing of the accounts (i.e. external auditors) and if it is proved to the satisfaction of the Authority that the amount thereof has

been evaluated in accordance with International Financial Reporting Standards as adopted by the European Union.

R2-2.3.1.1.2.5 Interim or year-end profits shall be included after deduction of any foreseeable charge, tax or dividend. Licence Holders should refer to the Commission Delegated Regulation (EU) No 241/2014 on Regulatory Technical Standards for Own Funds requirements for institutions as amended by Commission Delegated Regulation (EU) 2015/923 and Commission Delegated Regulation (EU) 2015/850 for the meaning of foreseeable when determining whether any foreseeable charge or dividend has been deducted.

R2-2.3.1.1.2.6 Pursuant to Rule R2-2.3.1.1.2.1, the following prudential filters shall be applied to Common Equity Tier 1 items:

i. Securitised assets - *Any increase in equity resulting from securitised assets should be deducted from Common Equity Tier 1 capital in accordance with Article 32 of the CRR.*

ii. Cash flow hedge reserve - *The amount to be reported should be added to Common Equity Tier 1 capital if the cash flow hedges result in a loss (i.e. if it reduces accounting equity), and vice versa.*

iii. Cumulative gains and losses due to changes in own credit risk on fair valued liabilities - *The amount to be reported should be added to Common Equity Tier 1 capital if there is a loss due to changes in the Licence Holder's own credit risk (i.e. if it reduces accounting equity), and vice versa.*

iv. Fair value gains and losses arising from the Licence Holder's own credit risk related to derivative liabilities - *The amount to be reported should be added to Common Equity Tier 1 capital if there is a loss due to changes in the Licence Holder's own credit risk (i.e. if it reduces accounting equity), and vice versa.*

v. Additional value adjustments - *Adjustments to all the assets measured at fair value due to stricter standards for prudent valuation set in Article 105 of CRR should be deducted from Common Equity Tier 1 capital.*

R2-2.3.1.1.2.7 Pursuant to Rule R2-2.3.1.1.2.1, the following deductions shall be applied to Common Equity Tier 1 items:

i. Losses for the current financial year.

ii. Intangible assets as defined in point (115) of Article 4 (1) of the CRR, which are calculated in accordance with Article 37 of the CRR.

iii. Deferred tax assets that rely on future profitability as defined in point (107) of Article 4 (1) of the CRR, determined in accordance with Article 38 of the CRR, taking into account the threshold exemptions set out in Article 48 of the CRR.

iv. Defined benefit pension fund assets within the meaning of point (109) of Article 4 (1) of the CRR, as reported in the Licence Holder's balance sheet and calculated in accordance with Article 41 of the CRR.

v. Direct, indirect and synthetic holdings of the Licence Holder's own Common Equity Tier 1 capital instruments, determined in accordance with Article 42 of the CRR.

vi. Reciprocal cross holdings in Common Equity Tier 1 capital instruments within the meaning of point (122) of Article 4 (1) of the CRR and calculated in accordance with Article 44 of the CRR.

vii. Direct, indirect and synthetic holdings by the Licence Holder of Common Equity Tier 1 capital instruments of financial sector entities where the Licence Holder does not have a significant investment.

viii. Direct, indirect and synthetic holdings by the Licence Holder of Common Equity Tier 1 capital instruments of financial sector entities where the Licence Holder has a significant investment.

ix. Excess of deduction from Additional Tier 1 items pursuant to Article 56 of the CRR over Additional Tier 1 capital.

x. Qualifying holdings outside the financial sector.

xi. Any tax charge relating to Common Equity Tier 1 items foreseeable at the moment of its calculation, except where the Licence Holder suitably adjusts the amount of Common Equity Tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to cover risks or losses

R2-2.3.1.1.2.8 For the purposes of points (v), (vii) and (viii) of Rule R2-2.3.1.1.2.7, Licence

Holders should refer to point (114) of Article 4 (1) of the CRR for the meaning of the term 'indirect holding' and to point (126) of Article 4 (1) of the CRR for the meaning of the term 'synthetic holding'.

R2-2.3.1.1.2.9 For the purpose of points (vii) and (viii) of Rule R2-2.3.1.1.2.7, Licence Holders are required to refer to Article 43 of the CRR to determine the conditions, which contribute to a significant investment; and Articles 44 to 49 of the CRR for the calculation methodology of direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of financial sector entities.

R2-2.3.1.1.2.10 For the purpose of applying all the deductions presented in Rule R2-2.3.1.1.2.7 from Common Equity Tier 1 items, Licence Holders should also refer to Articles 36 to 39, 41 to 49 of the CRR and the Commission Delegated Regulation (EU) No 241/2014 on Regulatory Technical Standards for Own Funds requirements for institutions as amended by Commission Delegated Regulation (EU) 2015/923 and Commission Delegated Regulation (EU) 2015/850.

R2-2.3.1.1.3 *Additional Tier 1 capital*

R2-2.3.1.1.3.1 Additional Tier 1 capital is made up of Additional Tier 1 items (as defined in Article 51 of the CRR), after applying the deductions from Additional Tier 1 items (laid down in Articles 56 to 60 of the CRR) and the application of Article 79 of the CRR.

R2-2.3.1.1.3.2 Pursuant to Rule R2-2.3.1.1.3.1, Additional Tier 1 items shall include:

i. Capital instruments where the conditions laid down in Articles 52 (1), 53 and 54 of the CRR are met.

ii. Share premium account as defined in point (124) of Article 4 (1) of the CRR.

R2-2.3.1.1.3.3 For the purpose of points (i) of Rule R2-2.3.1.1.2.7, Licence Holders should refer to the Commission Delegated Regulation (EU) No 241/2014 on Regulatory Technical Standards for Own Funds requirements for institutions as amended by Commission Delegated Regulation (EU) 2015/923 and Commission Delegated Regulation (EU) 2015/850 in order to determine the appropriate classification of capital instruments.

R2-2.3.1.1.3.4 For the purpose of points (ii) of Rule R2-2.3.1.1.3.2, the Share premium account shall consider any amount received in excess of the nominal value of

any capital instruments referred to in point (i) of R2-2.3.1.1.3.2

R2-2.3.1.1.3.5 Pursuant to Rule R2-2.3.1.1.3.1, the following deductions shall be applied to Additional Tier 1 items:

i. Direct, indirect and synthetic holdings of the Licence Holder's own Additional Tier 1 capital instruments calculated in accordance with Article 57 of the CRR.

ii. Reciprocal cross holdings in Additional Tier 1 capital instruments within the meaning of point (122) of Article 4 (1) of the CRR determined in accordance with Article 58 of the CRR.

iii. Direct, indirect and synthetic holdings by the Licence Holder of Additional Tier 1 capital instruments of financial sector entities where the Licence Holder does not have a significant investment, determined in accordance with Article 60 of the CRR.

iv. Direct, indirect and synthetic holdings by the Licence Holder of Additional Tier 1 capital instruments of financial sector entities where the Licence Holder has a significant investment.

v. Excess of deduction from Tier 2 items pursuant to Article 66 of the CRR over Tier 2 capital.

vi. Any tax charge relating to Additional Tier 1 items foreseeable at the moment of its calculation, except where the Licence Holder suitably adjusts the amount of Additional Tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to cover risks or losses.

R2-2.3.1.1.3.6 For the purpose of point (iii) and (iv) of Rule R2-2.3.1.1.3.5, Licence Holders are required to refer to Articles 58 and 59 of the CRR for the calculation methodology of direct, indirect and synthetic holdings of Additional Tier 1 instruments of financial sector entities.

R2-2.3.1.1.3.7 For the purpose of applying the deductions presented in Rule R2-2.3.1.1.3.5, from Additional Tier 1 items, Licence Holders should refer to Articles 56 to 60 of the CRR and the Commission Delegated Regulation (EU) No 241/2014 on Regulatory Technical Standards for Own Funds requirements for institutions as amended by Commission Delegated Regulation (EU) 2015/923 and Commission Delegated Regulation (EU) 2015/850.

R2-2.3.1.2 **Tier 2 Capital**

R2-2.3.1.2.1 Tier 2 capital consists of instruments that combine the features of debt and equity wherein they are structured like debt but exhibit some of the loss absorption and funding flexibility forms of equity.

R2-2.3.1.2.2 Tier 2 capital is made up of Tier 2 items (as defined in Article 62 of the CRR), after applying the deductions from Tier 2 items (laid down in Articles 66 to 70 of the CRR) and the application of Article 79 of the CRR.

R2-2.3.1.2.3 Pursuant to Rule R2-2.3.1.2.2, Tier 2 items shall include:

i. Capital instruments and subordinated loans where the conditions laid down in Article 63 of the CRR are met.

ii. Share premium account as defined in point (124) of Article 4 (1) of the CRR.

R2-2.3.1.2.4 For the purpose of points (i) of Rule R2-2.3.1.2.3, The extent to which capital instruments and subordinated loans qualify as Tier 2 items during the final five years of maturity of the instruments shall be calculated in accordance with Article 64 of the CRR

R2-2.3.1.2.5 Subordinated loans, as referred to in point (i) of Rule B2-3.1.1.4.3, must be approved by the MFSA and must be in the form set out in Annex 1 to these Rules.

R2-2.3.1.2.6 For the purpose of point (ii) of Rule R2-2.3.1.2.3, the Share premium account shall consider any amount received in excess of the nominal value of any capital instruments referred to in point (i) of Rule R2-2.3.1.2.3.

R2-2.3.1.2.7 Pursuant to Rule R2-2.3.1.2.2, the following deductions shall be applied to Additional Tier 1 items:

i. Direct, indirect and synthetic holdings of the Licence Holder's own Tier 2 capital instruments calculated in accordance with Article 67 of the CRR.

ii. Reciprocal cross holdings in Tier 2 capital instruments within the meaning of point (122) of Article 4 (1) of the CRR determined in accordance with Article 68 of the CRR.

iii. Direct, indirect and synthetic holdings by the Licence Holder of Tier 2 capital instruments of financial sector entities where the Licence Holder does not have a significant investment, determined in accordance with Article 70 of the CRR.

iv. Direct, indirect and synthetic holdings by the Licence Holder of Tier 2 capital instruments of financial sector entities where the Licence Holder has a significant investment.

R2-2.3.1.2.8 For the purpose of point (iii) and (iv) of Rule B2 (3.1.1.4.6), Licence Holders are required to refer to Articles 68 and 69 of the CRR for the calculation methodology of direct, indirect and synthetic holdings of Tier 2 instruments of financial sector entities.

Section 4 The Capital Resources Requirement

R2-2.4.1 The Capital Resources Requirement shall be the higher of points (i) and (ii) below:

i. Initial Capital as defined in Title 1 of this Chapter;

ii. The fixed overheads requirement as defined in Section 5 of this Title;

Section 5 Fixed Overhead Requirement

R2-2.5.1 The fixed overhead requirement shall be calculated by holding eligible capital of at least one quarter of the fixed overheads of the preceding year.

R2-2.5.2 For the purposes of Rule R2-2.5.1, eligible capital means the sum of the following:

i. Tier 1 capital;

ii. Tier 2 capital that is equal to or less than one third of Tier 1 capital.

R2-2.5.3 For the purposes of Rule R2-2.5.1, the fixed overheads of the preceding year shall be calculated by deducting by the following items of expenditure from the total expenditure reported in their most recent audited annual financial statements:

i. fully discretionary staff bonuses;

ii. employees', directors' and partners' shares in profits, to the extent that they are fully discretionary;

iii. other appropriation of profits and other variable remuneration, to the extent that they are fully discretionary;

iv. shared commissions and fees payable which are directly related to commission and fees receivable, which are included within total revenue, and where the payment of the commission and fees payable is contingent upon the actual receipt of the commission and fees receivable;

v. fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registered or clearing transactions;

vi. fees to tied agents;

vii. interest paid to customers on clients' money; and

viii. non-recurring expenses from non-ordinary activities

R2-2.5.4 Where the Licence Holder makes use of tied agents, the Licence Holder shall add 35% of all the fees related to the tied agents to its fixed overheads.

R2-2.5.5 For the purposes of calculating the fixed overhead requirement, Licence Holders should also refer to Article 97 of the CRR and to Commission Delegated Regulation (EU) 2015/488 of 4 September 2014 amending Delegated Regulation (EU) No 241/2014 as regards own funds requirements for firms based on fixed overheads.

R2-2.5.6 If the Licence Holder has not completed business for one year, starting from the day it starts trading, the Licence Holder shall hold eligible capital of at least one quarter of the fixed overheads projected in its business plan, except where the Authority requires the business plan to be adjusted. In this case, the Licence Holder should refer to Article 34(c) of Commission Delegated Regulation (EU) 2015/488 of 4 September 2014 amending Delegated Regulation (EU) No 241/2014 as regards own funds requirements for firms based on fixed overheads to determine how to arrive at the projected fixed

overheads.

R2-2.5.7 The Authority may require the Licence Holder to adjust the fixed overhead requirement, where there is a material change in the business of the Licence Holder since the preceding year.

R2-2.5.8 For the purposes of Rule R2-2.5.7, the term material change shall have the same meaning as defined in Article 34b of the Commission Delegated Regulation (EU) 2015/488 of 4 September 2014 amending Delegated Regulation (EU) No 241/2014 as regards own funds requirements for firms based on fixed overheads to determine how to arrive at the projected fixed overheads.

Title 3 Capital Resources Requirements

Section 1 Scope and Application

R2-3.1.1 Title 3 of Chapter 2 shall apply exclusively to Category 2 and Category 3 Investment Services Licence Holders falling within scope of these Rules, except for:

i. Rule R2-3.5.4 which shall apply solely to Category 3 Licence Holders;

ii. Rule R2-3.5.8 which shall apply solely to Category 2 Licence Holders;

iii. Rule R2-3.5.9 which shall apply solely to Category 3 Licence Holders.

R2-3.1.2 Without prejudice to these Rules, Licence Holders shall make reference to and where applicable comply with the provisions of the CRR as well as national legislation transposing the CRD. Licence Holders shall also make reference and where applicable comply with Rules and Regulations issued under the aforesaid national legislation. The Licence Holder shall also refer to the relevant Guidance notes when calculating the Fixed Overhead Requirement on the Interim Financial Returns as well as Annual Financial Returns.

R2-3.1.3 Licence Holders shall also take into account Title 2 of Chapter 5 on the Transitionary Arrangements.

Section 2 Capital Resources Requirement

R2-3.2.1 The Licence Holder shall at all times maintain own funds at least equal to its Capital Resources Requirement. The own funds of the Licence Holder may not fall below the amount of initial capital required at the time of its authorisation.

R2-3.2.2 The meaning of own funds, the capital resources requirement applicable to Category 2 and Category 3 Licence Holders, as well as the methodology for calculating such a Licence Holder's Total Risk Exposure as applicable, are set out from Section 3 to Section 5 of this Title.

R2-3.2.3 The Licence Holder shall immediately advise the MFSA if at any time it is in breach of its Capital 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.

Section 3 ***Own Funds***

R2-3.3.1 The Licence Holder shall refer to Part Two (Articles 25 to 91) of the CRR when determining its Own Funds. Furthermore, reference should also be made to Part One 'General Provisions' (Articles 1 to 24) and Part Ten 'Transitional Provisions, Reports, Reviews and Amendments' (Articles 465 to 520) of the CRR. This is without prejudice to other Articles of the CRDIV and the CRR (CRDIV package) which may be relevant/applicable.

R2-3.3.2 In addition, the Licence Holder shall also refer to any related Regulatory/Implementing Technical Standards (R/ITS) and any other Guidelines or any other relevant EU legislation relating to Own Funds that may be issued from time to time.

R2-3.3.3 Pursuant to Rule R2-3.3.1 and for the purposes of Section 3 of this Title, Own Funds shall mean the sum of Tier 1 capital and Tier 2 capital as identified in Rule R2-3.3.4 and Rule R2-3.3.5, respectively.

R2-3.3.4 **Tier 1 capital**

R2-3.3.4.1 Tier 1 capital consists of the sum of the Common Equity Tier 1 capital and Additional Tier 1 capital.

R2-3.3.4.2 *Common Equity Tier 1 capital*

R2-3.3.4.2.1 Common Equity Tier 1 capital is made up of Common Equity Tier 1 items (as defined in Article 26 of the CRR), after applying the prudential filters (laid down in Articles 32 to 35 of the CRR) and the deductions from Common Equity Tier 1 items (Articles 36 to 49 of the CRR).

R2-3.3.4.2.2 Pursuant to Rule R2-3.3.4.2.1, Common Equity Tier 1 items shall include:

i. Capital instruments provided that the conditions laid down in Article 28 of the CRR or, where applicable, Article 29 of the CRR are met.

ii. Share premium account as defined in point (124) of Article 4 (1) of the CRR,

iii. Retained earnings as defined in point (123) of Article 4 (1) of the

CRR.

iv. Accumulated other comprehensive income as defined in point (100) of Article 4 (1) of the CRR.

v. Other reserves as defined in point (117) of Article 4 (1) of the CRR.

vi. Minority Interests (applicable for the scope of consolidation).

R2-3.3.4.2.3 For the purpose of points (ii) of Rule R2-3.3.4.2.2, the Share premium account shall consider any amount received in excess of the nominal value of any capital instruments referred to in point (i) of Rule R2-3.3.4.2.2.

R2-3.3.4.2.4 For the purpose of point (iii) of Rule R2-3.3.4.2.2, Licence Holders shall include interim or year-end profits before a formal decision has been taken only if these profits have been verified by persons responsible for the auditing of the accounts (i.e. external auditors) and if it is proved to the satisfaction of the Authority that the amount thereof has been evaluated in accordance with International Financial Reporting Standards as adopted by the European Union.

R2-3.3.4.2.5 Pursuant to Rule R2-3.3.4.2.4, interim or year-end profits shall be included after deduction of any foreseeable charge, tax or dividend. Licence Holders should refer to the Commission Delegated Regulation (EU) No 241/2014 on Regulatory Technical Standards for Own Funds requirements for institutions as amended by Commission Delegated Regulation (EU) 2015/923 and Commission Delegated Regulation (EU) 2015/850 for the meaning of foreseeable when determining whether any foreseeable charge or dividend has been deducted.

R2-3.3.4.2.6 For the purpose of point (vi) of Rule R2-3.3.4.2.2, the amount of Common Equity Tier 1 capital of a subsidiary of a Licence Holder that is attributable to natural or legal persons other than those included in the prudential scope of consolidation of the Licence Holder.

R2-3.3.4.2.7 Pursuant to Rule R2-3.3.4.2.6, the amount of minority interests to be included in consolidated Common Equity Tier 1 capital should be calculated in accordance with Articles 81 and 84 of the CRR.

R2-3.3.4.2.8 Pursuant to Rule R2-3.3.4.2.1, the following prudential filters shall be applied to Common Equity Tier 1 items:

i. Securitised assets - *Any increase in equity resulting from securitised*

assets should be deducted from Common Equity Tier 1 capital in accordance with Article 32 of the CRR.

ii. Cash flow hedge reserve - *The amount to be reported should be added to Common Equity Tier 1 capital if the cash flow hedges result in a loss (i.e. if it reduces accounting equity), and vice versa*.

iii. Cumulative gains and losses due to changes in own credit risk on fair valued liabilities - *The amount to be reported should be added to Common Equity Tier 1 capital if there is a loss due to changes in the Licence Holder's own credit risk (i.e. if it reduces accounting equity), and vice versa.*

iv. Fair value gains and losses arising from the Licence Holder's own credit risk related to derivative liabilities - *The amount to be reported should be added to Common Equity Tier 1 capital if there is a loss due to changes in the Licence Holder's own credit risk (i.e. if it reduces accounting equity), and vice versa.*

v. Additional value adjustments - *Adjustments to all the assets measured at fair value due to stricter standards for prudent valuation set in Article 105 of CRR should be deducted from Common Equity Tier 1 capital.*

R2-3.3.4.2.9 Pursuant to point (iv) of Rule R2-3.3.4.2.8, Licence Holders should refer to Commission Delegated Regulation (EU) No 523/2014 to determine what constitutes close correspondence between the value of the bonds and the value of the assets relating to the Licence Holder's own credit risk, referred to in paragraph 3 (c) of Article 33 of the CRR.

R2-3.3.4.2.10 Pursuant to point (v) of Rule R2-3.3.4.2.8, in terms of Article 35 of the CRR, Licence Holders shall not make adjustments to remove from their own funds unrealised gains or losses on their assets or liabilities measured at fair value.

R2-3.3.4.2.11 Pursuant to Rule R2-3.3.4.2.1, the following deductions shall be applied to Common Equity Tier 1 items:

i. Losses for the current financial year.

ii. Intangible assets as defined in point (115) of Article 4 (1) of the CRR, which are calculated in accordance with Article 37 of the CRR.

iii. Deferred tax assets that rely on future profitability as defined in point (107) of Article 4 (1) of the CRR, determined in accordance with Article 38 of the CRR, taking into account the threshold exemptions set out in Article 48 of the CRR.

iv. IRB shortfall of credit risk adjustments to expected losses laid down in Articles 158 and 159 of the CRR.

v. Defined benefit pension fund assets within the meaning of point (109) of Article 4 (1) of the CRR, as reported in the Licence Holder's balance sheet and calculated in accordance with Article 41 of the CRR.

vi. Direct, indirect and synthetic holdings of the Licence Holder's own Common Equity Tier 1 capital instruments, determined in accordance with Article 42 of the CRR.

vii. Reciprocal cross holdings in Common Equity Tier 1 capital instruments within the meaning of point (122) of Article 4 (1) of the CRR and calculated in accordance with Article 44 of the CRR.

viii. Direct, indirect and synthetic holdings by the Licence Holder of Common Equity Tier 1 capital instruments of financial sector entities where the Licence Holder does not have a significant investment.

ix. Direct, indirect and synthetic holdings by the Licence Holder of Common Equity Tier 1 capital instruments of financial sector entities where the Licence Holder has a significant investment.

x. Excess of deduction from Additional Tier 1 items pursuant to Article 56 of the CRR over Additional Tier 1 capital.

xi. Qualifying holdings outside the financial sector, which can alternatively be subject to 1 250% risk weight.

xii. Securitisation positions, in accordance with Article 243 (1) (b), Article 244 (1) (b) and Article 258 of the CRR, which can alternatively be subject to 1 250% risk weight.

xiii. Free deliveries, in accordance with Article 379 (3) of the CRR, which can alternatively be subject to 1 250% risk weight.

xiv. Positions in a basket for which the Licence Holder cannot determine

the risk weight under the IRB approach, in accordance with Article 153 (8) of the CRR, and can alternatively be subject to 1 250% risk weight.

xv. Equity exposures under an internal models approach, in accordance with Article 155 (4) of the CRR, which can alternatively be subject to 1 250% risk weight.

xvi. Any tax charge relating to Common Equity Tier 1 items foreseeable at the moment of its calculation, except where the Licence Holder suitably adjusts the amount of Common Equity Tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to cover risks or losses.

R2-3.3.4.2.12 Point (iv) of Rule R2-3.3.4.2.11, shall only be applicable only for Licence Holders availing of the internal ratings based approaches in the calculation of credit risk. These approaches are explained in Rule R2-3.5.2.1.2.8.

R2-3.3.4.2.13 For the purposes of points (vii) and (viii) of Rule R2-3.3.4.2.11, Licence Holders should refer to point (114) of Article 4 (1) of the CRR for the meaning of the term 'indirect holding' and to point (126) of Article 4 (1) of the CRR for the meaning of the term 'synthetic holding'.

R2-3.3.4.2.14 For the purpose of points (vii) and (ix) of Rule R2-3.3.4.2.11, Licence Holders are required to refer to: (i) Article 43 of the CRR to determine the conditions which contribute to a significant investment; and (ii) Articles 44 to 49 of the CRR for the calculation methodology of direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of financial sector entities.

R2-3.3.4.2.15 For the purpose of applying the deductions as specified in Rule R2-3.3.4.2.11, from Common Equity Tier 1 items, Licence Holders should, in addition to Articles 36 to 49 of the CRR, also make reference to the Commission Delegated Regulation (EU) No 241/2014 on Regulatory Technical Standards for Own Funds requirements for institutions as amended by Commission Delegated Regulation (EU) 2015/923 and Commission Delegated Regulation (EU) 2015/850.

R2-3.3.4.3 *Additional Tier 1 capital*

R2-3.3.4.3.1 Additional Tier 1 capital is made up of Additional Tier 1 items (as defined in Article 51 of the CRR), after applying the deductions from Additional Tier 1 items (laid down in Articles 56 to 60 of the CRR) and the application of

Article 79 of the CRR.

R2-3.3.4.3.2 Pursuant to Rule R2-3.3.4.3.1, Additional Tier 1 items shall include:

i. Capital instruments where the conditions laid down in Articles 52 (1), 53 and 54 of the CRR are met.

ii. Share premium account as defined in point (124) of Article 4 (1) of the CRR.

iii. Instruments issued by subsidiaries that are given recognition in Additional Tier 1 capital (applicable for the scope of consolidation).

R2-3.3.4.3.3 For the purpose of points (i) of Rule R2-3.3.4.3.2, Licence Holders should make reference to the Commission Delegated Regulation (EU) No 241/2014 on Regulatory Technical Standards for Own Funds requirements for institutions as amended by Commission Delegated Regulation (EU) 2015/923 and Commission Delegated Regulation (EU) 2015/850 in order to determine the appropriate classification of capital instruments.

R2-3.3.4.3.4 For the purpose of points (ii) of Rule R2-3.3.4.3.2, the Share premium account shall consider any amount received in excess of the nominal value of any capital instruments referred to in point (i) of Rule R2-3.3.4.3.2.

R2-3.3.4.3.5 For the purpose of points (iii) of Rule R2-3.3.4.3.2, the Licence Holder shall consider the sum of all the amounts of qualifying Tier 1 capital of subsidiaries that is included in consolidated Additional Tier 1 capital, calculated in accordance with Articles 82, 85 and 86 of the CRR.

R2-3.3.4.3.6 Pursuant to Rule R2-3.3.4.3.1, the following deductions shall be applied to Common Equity Tier 1 items:

i. Direct, indirect and synthetic holdings of the Licence Holder's own Additional Tier 1 capital instruments calculated in accordance with Article 57 of the CRR.

ii. Reciprocal cross holdings in Additional Tier 1 capital instruments within the meaning of point (122) of Article 4 (1) of the CRR determined in accordance with Article 58 of the CRR.

iii. Direct, indirect and synthetic holdings by the Licence Holder of Additional Tier 1 capital instruments of financial sector entities where

the Licence Holder does not have a significant investment, determined in accordance with Article 60 of the CRR.

iv. Direct, indirect and synthetic holdings by the Licence Holder of Additional Tier 1 capital instruments of financial sector entities where the Licence Holder has a significant investment.

v. Excess of deduction from Tier 2 items pursuant to Article 66 of the CRR over Tier 2 capital.

vi. Any tax charge relating to Additional Tier 1 items foreseeable at the moment of its calculation, except where the Licence Holder suitably adjusts the amount of Additional Tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to cover risks or losses.

R2-3.3.4.3.7 For the purpose of point (iii) and (iv) of Rule R2-3.3.4.3.6, Licence Holders are required to refer to Articles 58 and 59 of the CRR for the calculation methodology of direct, indirect and synthetic holdings of Additional Tier 1 instruments of financial sector entities.

R2-3.3.4.3.8 For the purpose of applying the deductions specified in Rule R2-3.3.4.3.6, from Additional Tier 1 items, Licence Holders should, in addition to Articles 56 to 60 of the CRR, also make reference to the Commission Delegated Regulation (EU) No 241/2014 on Regulatory Technical Standards for Own Funds requirements for institutions as amended by Commission Delegated Regulation (EU) 2015/923 and Commission Delegated Regulation (EU) 2015/850

R2-3.3.5 **Tier 2 capital**

R2-3.3.5.1 Tier 2 capital consists of instruments that combine the features of debt and equity wherein they are structured like debt but exhibit some of the loss absorption and funding flexibility forms of equity.

R2-3.3.5.2 Tier 2 capital is made up of Tier 2 items (as defined in Article 62 of the CRR), after applying the deductions from Tier 2 items (laid down in Articles 66 to 70 of the CRR) and the application of Article 79 of the CRR.

R2-3.3.5.3 Pursuant to Rule R2-3.3.5.2, Tier 2 items shall include:

i. Capital instruments and subordinated loans where the conditions laid

down in Article 63 of the CRR are met.

ii. Share premium account as defined in point (124) of Article 4 (1) of the CRR.

iii. Standardised Approach General credit risk adjustments, calculated in accordance with Article 62 (c) of the CRR.

iv. IRB Excess of provisions over expected losses eligible, calculated in accordance with Articles 158 and 159 of the CRR.

v. Instruments issued by subsidiaries that are given recognition in Tier 2 capital (applicable for the scope of consolidation).

R2-3.3.5.4 For the purpose of points (i) of Rule R2-3.3.5.3, Licence Holders shall consider the extent to which capital instruments and subordinated loans qualify as Tier 2 items during the final five years of maturity of the instruments should be calculated in accordance with Article 64 of the CRR.

R2-3.3.5.5 Furthermore, pursuant to point (i) of Rule R2-3.3.5.2, Subordinated loans must be approved by the MFSA and must be in the form set out in Annex 1 to the Rules.

R2-3.3.5.6 For the purpose of points (ii) of Rule R2-3.3.5.3, the Share premium account shall consider any amount received in excess of the nominal value of any capital instruments referred to in point (i) of Rule R2-3.3.5.3.

R2-3.3.5.7 Point (iii) of Rule R2-3.3.5.3, applicable only for Licence Holders availing of the standardised approach in the calculation of credit risk. This approach is explained in Rule R2-3.5.2.1.2.8.

R2-3.3.5.8 Point (iv) of Rule R2-3.3.5.3, applicable only for Licence Holders availing of the internal ratings based approaches in the calculation of credit risk. These approaches are explained in Rule R2-3.5.2.1.2.8.

R2-3.3.5.9 The sum of all the amounts of qualifying own funds of subsidiaries that is included in consolidated Tier 2 capital, calculated in accordance with Articles 82, 87 and 88 of the CRR.

R2-3.3.5.10 Pursuant to Rule R2-3.3.5.2, the following deductions shall be applied to Tier 2 items:

i. Direct, indirect and synthetic holdings of the Licence Holder's own Tier 2 capital instruments calculated in accordance with Article 67 of the CRR.

ii. Reciprocal cross holdings in Tier 2 capital instruments within the meaning of point (122) of Article 4 (1) of the CRR determined in accordance with Article 68 of the CRR.

iii. Direct, indirect and synthetic holdings by the Licence Holder of Tier 2 capital instruments of financial sector entities where the Licence Holder does not have a significant investment, determined in accordance with Article 70 of the CRR.

iv. Direct, indirect and synthetic holdings by the Licence Holder of Tier 2 capital instruments of financial sector entities where the Licence Holder has a significant investment.

R2-3.3.5.11 For the purpose of points (iii) and (iv) of Rule R2-3.3.5.10, Licence Holders are required to refer to Articles 68 and 69 of the CRR for the calculation methodology of direct, indirect and synthetic holdings of Tier 2 instruments of financial sector entities.

Section 4 Capital Resources Requirement

R2-3.4.1 Pursuant to Rule R2-3.2.1, Licence Holders shall at all times satisfy the following Capital Resources Requirement:

i. A Common Equity Tier 1 capital ratio of 4.5%, which is calculated as follows:

$$\frac{Common\ Equity\ Tier\ 1\ Capital}{Total\ Risk\ Exposure\ Amount}$$

ii. A Tier 1 capital ratio of 6%, which is calculated as follows:

$$\frac{Tier\ 1\ Capital}{Total\ Risk\ Exposure\ Amount}$$

iii. A total capital ratio of 8%, calculated as follows:

$$\frac{\textit{Own Funds}}{\textit{Total Risk Exposure Amount}}$$

R2-3.4.2 Provided that for the purposes of Rule R2-3.4.1, Category 2 Investment Services Licence Holders shall calculate the Total Exposure Amount as the sum of the non-trading book business risk components, the trading book business risk components, the commodities instruments - risk component, the foreign exchange risk component, the settlement risk component, the credit valuation adjustment risk component and the fixed overheads requirement.

R2-3.4.3 Provided that for the purposes of Rule R2-3.4.1, Category 3 Investment Services Licence Holders including Operators of an MTF, shall calculate the Total Exposure Amount as the sum of the non-trading book business risk components, the trading book business risk components, the commodities instruments - risk component, the foreign exchange risk component, the settlement risk component, the credit valuation adjustment risk component and the operational risk component.

R2-3.4.4 Pursuant to Rule R2-3.4.2 and Rule R2-3.4.3 all risk components should be calculated in accordance with Section 5 of this Title.

Section 5 Total Risk Exposure Amount Calculation

R2-3.5.1 **Non –Trading Book Risk Component**

R2-3.5.1.1 For the purposes of these Rules, the Licence Holder consider the following risk components within the non-trading book business:

i. The credit/ counterparty risk component in accordance with Rule R2-3.5.1.2.2; and

ii. Free deliveries in accordance with Rule R2-3.5.1.3.3

R2-3.5.1.2 *Credit/ Counterparty Risk Component*

R2-3.5.1.2.1 Credit/counterparty risk is the possibility of a loss occurring due to:

i. the failure of a debtor of a Licence Holder to meet its contractual debt obligations; or

ii. the loss in value of any other asset (excluding derivatives which are exclusively dealt with in the sections on trading book business and commodities instruments – risk component) which forms part of the Licence Holder's balance sheet except for: (a) intangible assets including goodwill; (b) cash in hand and at bank; (c) those financial instruments which fall within the category of trading book business; and (d) commodity positions.

R2-3.5.1.2.2 Measuring the Credit/Counterparty Risk

R2-3.5.1.2.2.1 The credit/ counterparty risk can be measured through any one of the following two methods: (i) the Standardised Approach; and (ii) the Internal Ratings Based Approach (IRB), as referred to in Part Three, Title II of the CRR.

R2-3.5.1.2.2.2 The Standardised Approach calculates the credit risk component by applying a broad category of risk weights to non-trading book business asset exposures.

R2-3.5.1.2.2.3 Pursuant to Rule R2-3.5.1.2.2.2, the computation of the credit/counterparty risk component using the standardised approach is calculated as follows:

i. identify the exposure value of the asset item in accordance with Article 111 of the CRR;

ii. assign each exposure to one of the exposure classes referred to in Section 3.10 (b);

iii. calculate the risk weighted exposure amounts by multiplying the exposure value by an applicable risk weight specified or determined in accordance with Part Three, Title II, Chapter 2, Section 2 of the CRR, or the transitional provisions set out in Part Ten of the CRR, as applicable;

iv. add the total risk weighted exposure amounts; and

v. the credit/counterparty risk capital component is 8% of the total risk weighted exposure amounts.

R2-3.5.1.2.2.4 The IRB approach is based on the Licence Holder's assessments of the risks to which it is exposed. It is strongly recommended that Licence Holders which are significant in terms of their size, internal organisation and the nature, scale

and complexity of their activities develop an internal credit risk assessment capacity and increase the use of the IRB approach for the purposes of calculating the credit/counterparty risk component, where their exposures are material in absolute terms and where they have at the same time a large number of material counterparties. This is without prejudice to the fulfilment of criteria laid down in Part Three, Title II, Chapter 3, Section 1 of the CRR.

R2-3.5.1.2.2.5 Licence Holders are advised to seek the MFSA's guidance prior to adopting the IRB approach, which method is to be approved by the MFSA. Licence Holders which have obtained the Authority's approval to use the IRB approach must report annually to the MFSA:

i. the results of the calculations of their internal approaches for their exposures that are included in the benchmark portfolios; and

ii. an explanation of the methodologies used to produce those calculations in (i) above.

R2-3.5.1.2.2.6 Licence Holders must submit the results referred to in (i) above, in line with the template developed by EBA in accordance with Article 78 (8) of CRD IV to the MFSA and to EBA.

R2-3.5.1.2.2.7 Where the MFSA has chosen to develop specific portfolios in accordance with Article 78 (2) of CRD IV, the Licence Holder must report the results of the calculations separately from the results of the calculations for EBA portfolios.

R2-3.5.1.3 *Free deliveries*

R2-3.5.1.3.1 For the purpose of these Rules, free deliveries transactions shall mean non-delivery versus payment transactions in financial instruments.

R2-3.5.1.3.2 Free Deliveries caters for the risk that the Licence Holder has either:

i. paid for securities, foreign currencies or commodities before receiving them; or has delivered securities, foreign currencies or commodities before receiving payment for them;

ii. in the case of cross-border transactions, one day or more has elapsed since it made that payment or delivery.

R2-3.5.1.3.3 <u>Measuring Free Deliveries</u>

R2-3.5.1.3.3.1 The applicable free deliveries risk factor is calculated in accordance with Article 379 of the CRR as follows:

R2-3.5.1.3.3.2 Multiply the market value of the financial instrument by the applicable discount factor as detailed in the following table:

Period	Risk Discount Factor
Up to first contractual payment/ delivery leg.	0%
From first contractual payment/ delivery leg up to four days after second contractual payment/ delivery leg.	Treat as an exposure risk weighted at 100% if positive exposure is not material
From five business days post second contractual payment/ delivery leg until extinction of transaction.	Treat as an exposure risk weighted at 1 250%

R2-3.5.2 **Trading Book Risk Components and Requirements**

R2-3.5.2.1 *Trading Book Risk Components*

R2-3.5.2.1.1 For the purposes of these Rules, the Licence Holder consider the following risk components within the non-trading book business:

i. the position risk component; and

ii. the counter party credit risk component

R2-3.5.2.1.2 Position Risk

R2-3.5.2.1.2.1 The risk of losses in on and off balance sheet investments in financial instruments, which qualify as trading book business, arising from the movement in market prices. 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.

R2-3.5.2.1.2.2 The position risk component can be measured through the Licence Holder's own internal risk-management model. Licence Holders are advised to seek the MFSA's guidance prior to adopting this internal risk-management model in terms of Part Three, Title IV, Chapter 5 of the CRR, which model is to be approved by the MFSA.

R2-3.5.2.1.2.3 It is strongly recommended that Licence Holders which are significant in terms of their size, internal organisation and the nature, scale and complexity of their investment services activities develop an internal specific risk assessment capacity and increase the use of internal models for calculating the specific risk component of traded debt instruments in the trading book, together with internal models to calculate own funds requirements for default and migration risk where their exposures to specific risk are material in absolute terms and where they hold a large number of material positions in traded debt instruments of different issuers. This shall be without prejudice to the fulfilment of the criteria laid down in Part Three, Title IV, Chapter 5, Sections 1 to 5, of the CRR.

R2-3.5.2.1.2.4 Licence Holders shall refer to the Commission Delegated Regulation (EU) No 530/2014 on the regulatory technical standards further defining material exposures and thresholds for internal approaches to specific risk in the trading book for: (i) the definition of 'exposures to specific risk which are material in absolute terms'; and (ii) the definition of 'large number of material positions in traded debt instruments of different issuers'.

R2-3.5.2.1.2.5 Licence Holders which have obtained the Authority's approval to use their own internal risk-management model to calculate the position risk component must report annually to the MFSA:

i. the results of the calculations of their internal approaches for their positions that are included in the benchmark portfolios; and

ii. an explanation of the methodologies used to produce those calculations in (i) above.

R2-3.5.2.1.2.6 Licence Holders must submit the results referred to in (i) above, in line with the template developed by EBA in accordance with Article 78 (8) of CRD IV to the MFSA and to EBA.

R2-3.5.2.1.2.7 Where the MFSA has chosen to develop specific portfolios in accordance with Article 78 (2) of CRD IV, the Licence Holder must report the results of the calculations separately from the results of the calculations for EBA portfolios.

R2-3.5.2.1.2.8 Measuring the Position Risk Component

R2-3.5.2.1.2.8.1 The methodology for measuring the position risk component varies depending on the type of financial instrument. The following explains briefly the manner in which the position risk component is calculated in the CRR.

I. Traded Debt Instruments / Traded Equities

R2-3.5.2.1.2.8.2 The calculation of the position risk component for Traded Debt Instruments and Traded Equities is based on two factors being:

i. the specific risk factor which is the risk of a price change in the instrument concerned due to factors related to its Issuer; and

ii. the general risk factor being the risk of a price change in the instrument due in the case of a traded debt instrument to a change in the level of interest rates or in the case of equity to a broad equity-market movement unrelated to any specific attributes of individual securities.

R2-3.5.2.1.2.8.3 Licence Holders should refer to Articles 334 to 340 in the CRR for the purpose of calculating the position risk component of traded debt instruments and to Articles 341 to 344 for the calculation of the position risk component of traded equities.

R2-3.5.2.1.2.8.4 Where the Licence Holder has positions in stock indices, it shall also refer to the Commission Implementing Regulation (EU) No 945/2014 regarding to relevant appropriately diversified indices for the purposes of calculating the position risk component of traded equities under Article 344 of the CRR.

II. Collective Investment Schemes: Specific and General Risk

R2-3.5.2.1.2.8.5 The specific and general risk factor of the position risk component in the case of collective investment schemes is combined. In this case, the position risk component is the equivalent of the market value of the units in the collective investment scheme multiplied by the applicable position risk weighting of 32%.

R2-3.5.2.1.2.8.6 Licence Holders should refer to Articles 348 to 350 of the CRR for the

detailed calculation of the collective investment schemes risk component.

III. Derivatives

R2-3.5.2.1.2.8.7 The position risk component for financial derivative instruments is set out in Part Three, Title IV of the CRR.

R2-3.5.2.1.2.8.8 Licence Holders who provide investment services in relation to financial derivative instruments should contact the MFSA for guidance as to how the derivatives related position risk component should be catered for in the automated COREP Return.

R2-3.5.2.1.3 Counterparty Credit Risk Component

R2-3.5.2.1.3.1 In terms of Article 272 of the CRR, counterparty credit risk means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

R2-3.5.2.1.3.2 Licence Holders should refer to Chapter 6 of Title II of Part Three of the CRR for the calculation of the counterparty credit risk component in relation to derivative instruments listed in Annex II to the CRR.

R2-3.5.2.2 *Trading Book Risk Requirements*

R2-3.5.2.2.1 General Requirements

R2-3.5.2.2.1.1 The trading book of a Licence Holder shall consist of all positions in financial instruments and commodities held either with trading intent or in order to hedge positions held with trading intent and which are either free of any restrictive covenants on their tradability or are able to be hedged.

R2-3.5.2.2.1.2 Provided that where the following requirements in accordance with Article 94 of the CRR are met, trading book positions may be accounted for as non-trading book positions:

i. the trading book business of the Licence Holder does not normally exceed 5% of the total assets; and

ii. their trading-book positions do not normally exceed Euro 15 Million; and

iii. the trading book business of the Licence Holder never exceeds 6% of

total assets (being the combined off and on balance sheet business) and total trading book positions never exceed Euro 20 million.

R2-3.5.2.2.1.3 In order to calculate the proportion that trading book business bears to total business for the purposes of points (i) and (iii) of Rule R2-3.5.2.2.1.2, the Licence Holders shall apply the following:

i. debt instruments shall be valued at their market prices or their nominal values, equities at their market prices and derivatives according to the nominal or market values of the instruments underlying them.

ii. the absolute value of long positions shall be combined with the absolute value of short positions

R2-3.5.2.2.1.4 If a Licence Holder subject to the exemption from the trading book requirement, fails to meet the condition in point (iii) of Rule R2-3.5.2.2.1, the Licence Holder is required to notify the MFSA immediately. If following assessment, the MFSA determines and notifies the Licence Holder that the requirement in points (i) and (ii) of Rule R2-3.5.2.2.1.2 are not met, the Licence Holder shall meet the requirements outlined in R2-3.5.2.2.1.1 from the next reporting date.

R2-3.5.2.2.1.5 In complying with R2-3.5.2.2.1.1, a Licence Holder shall abide by Rules R2-3.5.2.2.2 to R2-3.5.2.2.2.

R2-3.5.2.2.2 Positions held with trading intent

R2-3.5.2.2.2.1 Positions held with trading intent have the same meaning as in point (85) of paragraph (1) of Article 4 of the CRR and comprise any of the following:

i. proprietary positions and positions arising from client servicing and market making;

ii. positions intended to be resold short term;

iii. positions intended to benefit from actual or expected short term price differences between buying and selling prices or from other price or interest rate variations.

R2-3.5.2.2.2 Trading intent

R2-3.5.2.2.2.1 Trading intent shall be evidenced on the basis of the strategies, policies and

procedures set up by the Licence Holder to manage the position or portfolio in accordance with Article 103 of the CRR. These shall include the following:

i. The Licence Holder shall have in place a clear documented trading strategy for the position/instrument or portfolios. Such strategy shall be approved by senior management, and shall include the expected holding period;

(a) The Licence Holder shall have in place clearly defined policies and procedures for the active management of positions, which shall include the following:

(b) positions entered into on a trading desk;

(c) position limits are set and monitored for appropriateness;

(d) autonomy for dealers to enter into/manage the position within agreed limits and according to the approved strategy;

(e) positions are reported to senior management as an integral part of the Licence Holder's risk management process; and

(f) positions are actively monitored with reference to market information sources and an assessment made of the marketability or hedge-ability of the position or its competent risks, including the assessment, the quality and availability of market inputs to the valuation process, level of market turnover, sizes of positions traded in the market;

(g) active anti-fraud procedures and controls; and

ii. The Licence Holder shall have in place a clearly defined policy and procedures to monitor the positions against the Licence Holder's trading strategy including the monitoring of turnover and positions for which the originally intended holding period has been exceeded.

R2-3.5.2.2.3 Systems and controls

R2-3.5.2.2.3.1 All trading book positions shall be subject to the standards for prudent valuation specified in Article 105 of the CRR. Licence Holders shall in particular ensure that the prudent valuation of their trading book positions achieves an appropriate degree of certainty having regard to the dynamic

nature of trading book positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of trading book positions. In this regard, Licence Holders should refer to the Commission Delegated Regulation (EU) 2016/101 with regard to regulatory technical standards for prudent valuation under Article 105(14) or the different approaches that can be applied in order to achieve an appropriate degree of certainty in accordance with Article 105 of the CRR.

R2-3.5.2.2.3.2 Licence Holders shall establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates and shall include:

I. Documented policies and procedures for the process of valuation

R2-3.5.2.2.3.2.1 The Licence Holder should clearly defined within documented policies and procedures for the process of valuation the responsibilities of the various areas involved in the determination of the valuations, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the Licence Holders' assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures; and reporting lines for the department accountable for the valuation process that are clear and independent of the front office. The reporting line shall ultimately be to the management body.

II. Prudent valuation methods

R2-3.5.2.2.3.2.2 The Licence Holder shall maintain prudent valuation methods, as follows:

i. Licence Holders shall mark their positions to market whenever possible, including when applying trading book capital treatment. The term 'marking to market' is defined in point (68) of paragraph (1) of Article 4 as the valuation of positions at readily available close out prices that are sourced independently, including exchange prices, screen prices, or quotes from several independent reputable brokers;

ii. When marking to market, the more prudent side of bid/offer shall be used unless the Licence Holder can close out at mid market. Where Licence Holders make use of this derogation, they shall inform the MFSA every six months of the positions concerned and furnish evidence that they can close out at mid-market;

iii. Where marking to market is not possible, Licence Holders shall conservatively mark to model their positions/portfolios, including when calculating the position risk component. The term 'marking to model' is defined as any valuation which has to be benchmarked, extrapolated or otherwise calculated from one or more market inputs;

iv. The following requirements must be complied with when marking to model:

(a) senior management shall be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and shall understand the materiality of the uncertainty thereby created in the reporting of the risk/performance of the business;

(b) market inputs shall be sourced, where possible, in line with market prices, and the appropriateness of the market inputs of the particular position being valued and the parameters of the model shall be assessed on a frequent basis;

(c) where available, valuation methodologies which are accepted market practice for particular financial instruments or commodities shall be used;

(d) where the model is developed by the Licence Holder itself, it shall be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process;

(e) there shall be formal change control procedures in place and a secure copy of the model shall be held and periodically used to check valuations;

(f) the person/s responsible for risk management shall be aware of the weaknesses of the models used and how best to reflect those in the valuation output; and

(g) the Licence Holder's models shall be subject to periodic review to determine the accuracy of its performance, which shall include assessing the continued appropriateness of assumptions, analysis of profit and loss versus risk factors, and comparison of actual close out values to model outputs.

R2-3.5.2.2.3.2.3 The model shall be developed or approved independently of the trading desk and shall be independently tested, including validation of the mathematics, assumptions and software implementation.

R2-3.5.2.2.3.2.4 Independent price verification should be performed in addition to daily marking to market or marking to model. This is the process by which market prices or marking to model inputs are regularly verified for accuracy and independence. Verification of market prices and model inputs should be performed by a person or department independent from persons or departments that benefit from the trading book, at least monthly (or, depending on the nature of the market/ trading activity, more frequently). Where independent pricing sources are not available or pricing sources are more subjective, prudent measures such as valuation adjustments may be appropriate.

III. Procedures for considering valuation adjustments

R2-3.5.2.2.3.2.5 The Licence Holders shall establish procedures for considering valuation adjustments, which make provision for (i) unearned credit spreads; (ii) close-out costs; (iii) operational risks; (iv) market price uncertainty; (v) early termination; (vi) investing and funding costs; (vii) future administrative costs and (viii) where relevant, model risk.

IV. Standards for less liquid positions

R2-3.5.2.2.3.2.6 The Licence Holder shall maintain Standards for less liquid positions, as follows:

i. Less liquid positions could arise from both market events and institution-related situations e.g. concentrated positions and/or positions for which the originally intended holding period has been exceeded.

ii. Licence Holders shall establish and maintain procedures for calculating an adjustment to the current valuation of any less liquid positions. Such adjustments shall where necessary be in addition to any changes to the value of the position required for financial reporting purposes and shall be designed to reflect the illiquidity of the position. Under these procedures, Licence Holders shall consider several factors when determining whether a valuation adjustment is necessary for less liquid positions. These factors include the amount of time it would take

to hedge out the position/risks within the position, the volatility and average of bid/offer spreads, the availability of market quotes (number and identity of market makers) and the volatility and average of trading volumes including trading volumes during periods of market stress, market concentrations, the ageing of positions, the extent to which valuation relies on marking-to-model, and the impact of other model risks.

iii. When using third party valuations or marking to model, Licence Holders shall consider whether to apply a valuation adjustment. In addition, Licence Holders shall consider the need for establishing adjustments for less liquid positions and on an ongoing basis review their continued suitability. Licence Holders shall also explicitly assess the need for valuation adjustments relating to the uncertainty of parameter inputs used by models.

iv. With regard to complex products including securitisation exposures and nth-to-default credit derivatives , Licence Holders shall explicitly assess the need for valuation adjustments to reflect the model risk associated with using a possibly incorrect valuation methodology and the model risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.

V. Policies and procedures covering inclusion in the trading book

R2-3.5.2.2.3.2.7 The Licence Holders shall establish policies and procedures covering inclusion in the trading book, as follows:

i. Licence Holders shall have in place clearly defined policies and procedures for determining which position to include in the trading book for the purposes of calculating their capital requirements, in accordance with the requirements set out in Article 102 of the CRR and the definition of trading book in accordance with point (86) of paragraph (1) of Article 4, taking into account the Licence Holder's risk management capabilities and practices. Compliance with these policies and procedures shall be fully documented and for those Licence Holders having an internal audit function, they shall subject these policies and procedures to periodic internal audit.

ii. Licence Holders shall have in place clearly defined policies and procedures for the overall management of the trading book. As a minimum these policies and procedures shall address:

(a) the activities the Licence Holder considers to be trading and as constituting part of the trading book for capital requirement purposes;

(b) the extent to which a position can be marked-to-market daily by reference to an active, liquid two-way market;

(c) for positions that are marked-to-model, the extent to which the Licence Holder can: (i) identify all material risks of the position; (ii) hedge all material risks of the position with instruments for which an active, liquid two-way market exists; and (iii) derive reliable estimates for the key assumptions and parameters used in the model;

(d) the extent to which the Licence Holder can, and is required to, generate valuations for the position that can be validated externally in a consistent manner;

(e) the extent to which legal restrictions or other operational requirements would impede the Licence Holder's ability to effect a liquidation or hedge of the position in the short term;

(f) the extent to which the Licence Holder can, and is required to, actively manage the risks of positions within its trading operation; and

(g) the extent to which the Licence Holder may transfer risk or positions between the non-trading and trading books and the criteria for such transfers.

R2-3.5.2.2.4 Internal Hedging

R2-3.5.2.2.4.1 When including internal hedging in the calculation of the position risk component, Licence Holders shall comply with the requirements of Articles 103 to 106 of the CRR, which include the following:

i. An internal hedge is a position that materially offsets the component risk elements between a trading book and a non-trading book position or sets of positions. Positions arising from internal hedges may be included in the calculation of the position risk component, provided that they are held with trading intent and that the general criteria on trading intent and prudent valuation specified in Rules R2-3.5.2.2.1 to

R2-3.5.2.2.1 are met. In particular:

(a) internal hedges shall not be primarily intended to avoid or reduce capital requirements;

(b) internal hedges shall be properly documented and subject to particular internal approval and audit procedures

(c) the internal transaction shall be dealt with at market conditions;

(d) the market risk that is generated by the internal hedge shall be dynamically managed in the trading book within the authorised limits;

(e) internal transactions shall be carefully monitored; and

(f) monitoring must be ensured by adequate procedures.

ii. The treatment referred to in point (i) of this Rule applies without prejudice to the requirements applicable to the hedged position in the non-trading book.

R2-3.5.2.2.4.2 By way of derogation from points (i) and (ii) of Rule R2-3.5.2.2.4.1, when the Licence Holder hedges its non-trading book credit risk exposure or counterparty risk exposure using a credit derivative booked in its trading book (using an internal hedge), the non-trading book exposure or counterparty risk exposure shall not be deemed to be hedged for the purposes of calculating the risk components unless the Licence Holder purchases from an eligible third party protection provider a corresponding credit derivative meeting the requirements for unfunded credit protection in the non-trading book. Without prejudice to point (h) of Article 299 (2) of the CRR, 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 the external credit derivative hedge shall be included in the trading book for the purposes of calculating capital requirements.

R2-3.5.3 **Commodities Instruments - Risk Component**

R2-3.5.3.1 Commodities Risk is the risk component required to cover the Licence Holder's risk of holding or taking positions in commodities such as physical products which are and can be traded in the secondary market including commodity derivatives.

R2-3.5.3.2 Some traditional examples of commodities include grains, gold, beef, oil and natural gas. More recently, the definition has been expanded to include: (i) financial products such as foreign currencies and indices, and (ii) cell phone minutes and bandwidth.

R2-3.5.3.3 The commodities risk component can be measured through the Licence Holder's own internal risk-management model. It is strongly recommended that MFSA's guidance is sought prior to adopting this internal risk-management model in terms of Part Three, Title IV, Chapter 5 of the CRR, which model is to be approved by the MFSA.

R2-3.5.3.4 Licence Holders which have obtained the Authority's approval to use their own internal risk-management model to calculate the commodities risk component must report annually to the MFSA:

i. the results of the calculations of their internal approaches for their exposures or positions that are included in the benchmark portfolios; and

ii. an explanation of the methodologies used to produce those calculations in (i) above.

R2-3.5.3.5 Licence Holders must submit the results referred to in (i) above, in line with the template developed by EBA in accordance with Article 78 (8) of CRD IV to the MFSA and to EBA.

R2-3.5.3.6 Where the MFSA has chosen to develop specific portfolios in accordance with Article 78 (2) of CRD IV, the Licence Holder must report the results of the calculations separately from the results of the calculations for EBA portfolios.

R2-3.5.3.7 *Measuring the Commodities Instruments - Risk Component*

R2-3.5.3.7.1 Licence Holders shall calculate the commodities instruments – risk component with one of the methods laid down in Part Three, Title IV, Chapter 4 of the CRR: (i) Maturity Ladder Approach (as referred to in Article 359 of the CRR); (ii) Extended Maturity Ladder Approach (as referred to in Article 361 of the CRR); or (iii) Simplified Approach (as referred to in Article 360 of the CRR).

R2-3.5.3.7.2 A Licence Holder's commodities instruments - risk component calculation shall include the following items, referred to in Table 2 of Article 361 of the CRR:

i. precious metals (excluding gold);

ii. base metals;

iii. agricultural products (softs);

iv. other, including energy products such as oil and gas.

R2-3.5.4 **Large Exposures Risk Component**

R2-3.5.4.1 Licence Holders shall ensure that they comply with the provisions of Part Four of the CRR for the purposes of monitoring their large exposures and for calculating the large exposures risk component with respect to their trading book business.

R2-3.5.4.2 Provided that for a transitional period until the entry into force of any legal act following the European Commission's review of Article 400 (2) of the CRR in accordance with Article 507 of the CRR, but not after 31 December 2028, the exposures referred to in points (i) to (xvii) of R2-3.5.4.12.1, shall be considered fully exempt from the calculation of the large exposures risk component

R2-3.5.4.3 The purpose of the large exposures requirement is to ensure that a firm 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.

R2-3.5.4.4 A large exposure means the exposure to: (a) an individual client; or (b) a group of connected clients, where its value is equal to or exceeds 10% of the Licence Holder's Eligible Capital.

R2-3.5.4.5 For the purposes of these Rules, an individual client may be either a natural or a legal person. Examples of individual clients include:

i. the client which includes governments, local authorities, public sector entities, individual trusts, corporations, unincorporated businesses and non-profit making bodies and individual clients;

ii. where the Licence Holder is providing a guarantee, the person guaranteed;

iii. for a derivatives contract, the person with whom the contract was made; and

iv. the company in which a Licence Holder acquires shares which are traded on a regulated market either as principal or on behalf of clients.

R2-3.5.4.6 For the purposes of these Rules, a group of connected clients is defined in Article 4 (39) of the CRR and it means any of the following:

i. 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

ii. two or more natural or legal persons between whom there is no relationship of control as described in point (i) 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 also be likely to encounter funding or repayment difficulties.

Examples of relationships between individual counterparties which might be considered to constitute a single risk for the purposes of the definition of group of connected clients include: schemes in the same group; companies whose ultimate owner (whether wholly or significantly) is the same individual or individuals, and which do not have a formal group structure; companies having common directors or management; and counterparties linked by cross guarantees.

R2-3.5.4.7 In terms of Article 4 (71) of the CRR, Eligible Capital means the sum of the following:

i. Tier 1 capital as referred to in Article 25 of the CRR;

ii. Tier 2 capital as referred to in Article 71 of the CRR that is equal to or less than one third of Tier 1 capital.

R2-3.5.4.8 For the purposes of this Section, the term 'exposure' shall have the same meaning as referred to in Article 389 of the CRR, and the calculation of the exposure value shall be made in accordance with Article 390 of the CRR.

R2-3.5.4.9 The following items will not be included in the measurement of a large exposure, as set out in Article 390 (6) of the CRR:

i. Claims arising in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the two working days following payment;

ii. Claims arising in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during five working days following payment or delivery of the securities, whichever is earlier;

iii. Claims arising in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking or financial instruments clearing, settlement and custody services to clients, delayed receipts in funding and other exposures arising from client activity which do not last longer than the following business day;

iv. Claims arising in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking, intra-day exposures to institutions providing those services;

v. Exposures deducted from own funds in accordance with Article 36, 56 and 66 of the CRR.

R2-3.5.4.10 Licence Holders which have exposures to clients in respect of transactions with underlying assets under Article 390 (8) of the CRR should refer to Commission Delegated Regulation (EU) No 1187/2014 with regard to regulatory technical standards further defining material exposures and thresholds for internal approaches to specific risk in the trading book.

R2-3.5.4.11 *Condition regarding Individual Large Exposures*

R2-3.5.4.11.1 Licence Holders shall adopt policies within which exposures (after taking into account the effect of the credit risk mitigation in accordance with Articles 399 to 403 of the CRR) to any class of the above-mentioned categories of counterparties do not exceed 25% of their Eligible Capital.

R2-3.5.4.11.2 Where that individual client is either a credit institution or an investment firm, or where a group of connected clients includes one or more credit institutions

or investment firms, that value shall not exceed 25% of the Licence Holder's Eligible Capital or €150 million, whichever is the higher, provided that the sum of exposure values, after taking into account the effect of the credit risk mitigation, in accordance with Articles 399 to 403 of the CRR, to all connected clients that are not credit institutions or investment firms, does not exceed 25% of the Licence Holder's Eligible Capital.

R2-3.5.4.11.3 Where the amount of €150 million is higher than 25% of the Licence Holder's Eligible Capital, the value of the exposure, after taking into account the effect of credit risk mitigation, in accordance with Articles 399 to 403 of the CRR, shall not exceed a reasonable limit in terms of the Licence Holder's Eligible Capital. That limit shall be determined by Licence Holder, in accordance with the policies and procedures to address and control concentration risk referred to in Section 3, Title 2 of Chapter 3, and shall not be higher than 100% of the Licence Holder's Eligible Capital.

R2-3.5.4.11.4 Notwithstanding the above, the Authority retains the right to set a limit lower than the €150 million referred to in the preceding paragraph.

R2-3.5.4.11.5 As stipulated in Article 395 (3) of the CRR, the Licence Holder shall at all times comply with the above-mentioned limit. This limit may be exceeded for the exposures on the Licence Holder's trading book if all the conditions in Article 395 (5) of the CRR are met. In this regard, the Licence Holder shall be required to hold an additional own funds requirement (i.e. the Large Exposures Risk Component) on the excess in respect of this limit, which shall be calculated in accordance with Articles 397 and 398 of the CRR.

R2-3.5.4.11.6 Should the Licence Holder find that, for reasons beyond its control, it has incurred an exposure to an individual client or a group of connected clients, (e.g. following merger, amalgamation or buy-out), which results in it exceeding any of the above-mentioned limits, it should report the matter to the Authority without delay in accordance with Article 396 of the CRR, . Upon considering the circumstances of any such exposures, the Authority may, at its discretion, allow the Licence Holder a limited period of time within which to comply with the limits.

R2-3.5.4.11.7 Where the amount of €150 million referred to above is applicable, the Authority may at its discretion allow on a case-by-case and strictly on an exceptional basis, the 100% limit in terms of the Licence Holder's Eligible Capital, to be exceeded.

R2-3.5.4.12 *Large Exposures - Exempt Exposures*

R2-3.5.4.12.1 The following exposures are to be fully exempt from the calculation of the large exposure calculation, in accordance with Article 400 (1) and Article 493 (3) of the CRR:

i. asset items constituting claims on central governments, central banks or public sector entities which, unsecured, would be assigned a 0% risk weight under the Credit/Counterparty Risk Calculation;

ii. asset items constituting claims on international organisations or multilateral development banks which, unsecured, would be assigned a 0% risk weight under the Credit/Counterparty Risk Calculation;

iii. 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 the Credit/Counterparty Risk Calculation;

iv. 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 the Credit/Counterparty Risk Calculation;

v. asset items constituting claims on regional governments or local authorities of Member States where those claims would be assigned a 0% risk weight under Part Three, Title II, Chapter 2 and other exposures to or guaranteed by those regional governments or local authorities, claims on which would be assigned a 0% risk weight under Credit/Counterparty Risk Calculation;

vi. exposures to counterparties referred to in Article 113(6) or (7) of the CRR if they would be assigned a 0% risk weight under Credit/Counterparty Risk Calculation. Exposures that do not meet those criteria, whether or not exempted from Article 395(1) of the CRR shall be treated as exposures to a third party;

vii. asset items and other exposures secured by collateral in the form of

cash deposits placed with the lending institution or with an institution which is the parent undertaking or a subsidiary of the lending institution;

viii. asset items and other exposures secured by collateral in the form of certificates of deposit issued by the lending institution or by an institution which is the parent undertaking or a subsidiary of the lending institution and lodged with either of them;

ix. exposures arising from undrawn credit facilities that are classified as low-risk off-balance sheet items in Annex I and provided that an agreement has been concluded with the client or group of connected clients under which the facility may be drawn only if it has been ascertained that it will not cause the limit applicable under Article 395(1) of the CRR to be exceeded;

x. trade exposures to central counterparties and default fund contributions to central counterparties;

xi. covered bonds falling within Article 129(1), (3) and (6) of the CRR

xii. asset items constituting claims on regional governments or local authorities of Member States where those claims would be assigned a 20% risk weight under Part Three, Title II, Chapter 2 and other exposures to or guaranteed by those regional governments or local authorities, claims on which would be assigned a 20% risk weight under Part Three, Title II, Chapter 2 of the CRR.

xiii. exposures, including participations or other kinds of holdings, incurred by an 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 institution itself is subject, in accordance with the CRR, Directive 2002/87/EC or with equivalent standards in force in a third country. Exposures that do not meet those criteria, whether or not exempted from Article 395(1) of the CRR, shall be treated as exposures to a third party;

xiv. asset items constituting claims on and other exposures to institutions, provided that those exposures do not constitute such institutions' own funds, do not last longer than the following business day and are not denominated in a major trading currency;

xv. asset items constituting claims on central banks in the form of required minimum reserves held at those central banks which are denominated in their national currencies;

xvi. asset items constituting claims on central governments in the form of statutory liquidity requirements held in government securities which are denominated and funded in their national currencies provided that, at the discretion of the competent authority, the credit assessment of those central governments assigned by a nominated ECAI is investment grade;

xvii. assets items constituting claims on and other exposures to recognised exchanges.

R2-3.5.5 **Foreign Exchange Risk Component**

R2-3.5.5.1 Foreign Exchange Risk is the risk that an asset or liability denominated in a currency other than the reporting currency may be adversely affected by a change in the value of the foreign currency.

R2-3.5.5.2 To calculate the Foreign Exchange Risk component which will form part of the applicable capital resources requirement, a Licence Holder shall identify the foreign currencies to which it is exposed and then calculate the open currency position by:

i. calculating the net (long/short) open currency position in each foreign currency to which the Licence Holder is exposed;

ii. converting each net open position into its base currency equivalent at current spot rates;

iii. summing all short net positions and summing all long net positions and selecting the larger sum; and

iv. multiplying the sum of the net open currency position in base currency equivalent by 8%, subject that it exceeds 2% of its total own funds.

R2-3.5.5.3 A Licence Holder's Foreign Exchange Risk component calculation shall include the following items, regardless of whether they are trading book business positions or non-trading book business positions or commodity positions:

i. all financial instruments which are denominated in a foreign currency;

ii. all spot positions in foreign currency (including accrued interest); and

iii. other assets/liabilities including gold positions.

R2-3.5.5.4 In addition to the above, the Licence Holder shall also refer to Part Three, Title IV, Chapter 3 of the CRR for the purposes of calculating the Foreign Exchange Risk component under the Standardised Approach.

R2-3.5.5.5 Where the Licence Holder has positions in closely correlated currencies, it shall also refer to the Commission Implementing Regulation (EU) 2015/2197 laying down implementing technical standards with regard to closely correlated currencies in accordance.

R2-3.5.5.6 The Foreign Exchange Risk component can also be measured through the Licence Holder's own internal risk-management model. It is strongly recommended that MFSA's guidance is sought prior to adopting this internal risk-management model in terms of Part Three, Title IV, Chapter 5 of the CRR. Prior to adopting its risk-management model, a Licence Holder shall obtain the approval of the MFSA.

R2-3.5.5.7 Licence Holders which have obtained the Authority's approval to use their own internal risk-management model to calculate the foreign exchange risk component must report annually to the MFSA:

i. the results of the calculations of their internal approaches for their exposures or positions that are included in the benchmark portfolios; and

ii. an explanation of the methodologies used to produce those calculations in (i) above.

R2-3.5.5.8 Licence Holders must submit the results referred to in (i) above, in line with the template developed by EBA in accordance with Article 78 (8) of CRD IV to the MFSA and to EBA.

R2-3.5.5.9 Where the MFSA has chosen to develop specific portfolios in accordance with Article 78 (2) of CRD IV, the Licence Holder must report the results of the calculations separately from the results of the calculations for EBA portfolios.

R2-3.5.5.10 Licence Holders which would like to undertake transactions in derivatives should contact the MFSA for guidance on how the derivatives relating to foreign exchange risk component should be calculated and catered for in the COREP Return.

R2-3.5.6 **Settlement/Delivery Risk Component**

R2-3.5.6.1 Settlement Risk is the risk that the Licence Holder's cash against documents transactions in financial instruments are unsettled after their due delivery dates.

R2-3.5.6.2 For the purpose of these rules, 'cash against documents transactions' shall mean transactions where the purchaser takes ownership of the financial instrument the moment when cash is handed over to the seller (delivery versus payment).

R2-3.5.6.3 *Measuring the Settlement Risk Component*

R2-3.5.6.3.1 The Settlement Risk Component is equivalent to the difference between the agreed settlement price for the debt instrument, equity, foreign currency or commodity in question and its current market value, where the difference could involve a loss for the Licence Holder, multiplied by the relevant risk weight. The applicable risk weights are outlined in the following table below:

Number of working days after the due settlement date	Risk Weight
5-15	8%
16 - 30	50%
31 – 45	75%
46 or more	100%

R2-3.5.6.3.2 The Licence Holder shall calculate the Settlement Risk Component in accordance with Part Three, Title V of the CRR, with the exception of Article 379 of the CRR (which relates to the free deliveries risk component).

R2-3.5.7 **Credit Valuation Adjustment – Risk Component**

R2-3.5.7.1 Licence Holders that provide investment services in relation to over-the-counter (OTC) derivatives (except for credit derivatives recognised to reduce risk-weighted exposure amounts for credit risk) shall be required to hold Own Funds for credit valuation adjustment risk (CVA). The CVA risk component

shall be calculated in accordance with Part Three, Title VI of the CRR

R2-3.5.7.2 The term 'CVA' is defined in Article 381 of the CRR as an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. That adjustment reflects the current market value of the credit risk of the counterparty to the Licence Holder, but does not reflect the current market value of the credit risk of the Licence Holder to the counterparty.

R2-3.5.7.3 Certain transactions are exempt from the calculation of the CVA risk component. Licence Holders are requested to refer to Article 382 of the CRR to determine which transactions are excluded from the scope of this calculation.

R2-3.5.7.4 Provided that, in respect of those transactions referred to in Article 89 of Regulation (EU) No 648/2012 (EMIR) and entered into with a pension scheme arrangement as defined in Article 2 of that Regulation, Licence Holders shall not calculate the CVA risk component, as provided for in Article 382 (4) (c) of the CRR.

R2-3.5.7.5 The CVA risk component can be measured through any one of the following three methods:

i. the Advanced method - this method allows Licence Holders to measure the CVA risk through the internal market risk model, as referred to in Article 383 of the CRR and Commission Delegated Regulation (EU) No 526/2014 with regard to regulatory technical standards for determining proxy spread and limited smaller portfolios for credit valuation adjustment risk.

ii. the Standardised method - this method should be used by Licence Holders which do not have the Authority's approval to calculate the specific risk of traded debt instruments using their own internal risk management model in accordance with point (d) of Article 363 (1) of the CRR. Licence Holders are requested to refer to Article 384 of the CRR to calculate the CVA risk component.

iii. the Alternative method - The Alternative method [Article 385 of the CRR] applies a multiplication factor of 10 to the resulting risk-weighted exposure amounts for counterparty credit risk under the Original Exposure Method as laid down in Article 275 of the CRR in relation to instruments referred to in Article 382 of the CRR, instead of calculating the CVA risk component.

R2-3.5.8 **Fixed overhead requirement**

R2-3.5.8.1 The fixed overhead requirement is calculated by holding eligible capital of at least one quarter of the fixed overheads of the preceding year, in accordance with Article 97 of the CRR.

R2-3.5.8.2 If the Licence Holder has not completed business for one year, starting from the day it starts trading, the Licence Holder shall hold eligible capital of at least one quarter of the fixed overheads projected in its business plan, except where the Authority requires the business plan to be adjusted. In this case, the Licence Holder should refer to Article 34d of the Commission Delegated Regulation (EU) 2015/488 of 4 September 2014 amending Delegated Regulation (EU) No 241/2014 as regards own funds requirements for firms based on fixed overheads in order to determine how to arrive at the projected fixed overheads.

R2-3.5.8.3 The Authority may require the Licence Holder to adjust the fixed overhead requirement, where there is a material change in the business of the Licence Holder since the preceding year.

R2-3.5.8.4 For the purposes of these rules:

i. eligible capital means the sum of the following:

(a) Tier 1 capital;

(b) Tier 2 capital that is equal to or less than one third of Tier 1 capital.

ii. the term *material change* shall have the same meaning as determined in Article 34(c) of Commission Delegated Regulation (EU) 2015/488 of 4 September 2014 amending Delegated Regulation (EU) No 241/2014 as regards own funds requirements for firms based on fixed overheads.

R2-3.5.8.5 The following items of expenditure shall be deducted from the total expenditure reported in their most recent audited annual financial statements:

i. fully discretionary staff bonuses;

ii. employees', directors' and partners' shares in profits, to the extent that

they are fully discretionary;

iii. other appropriation of profits, to the extent that they are fully discretionary;

iv. shared commissions and fees payable which are directly related to commission and fees receivable, which are included within total revenue, and where the payment of the commission and fees payable is contingent upon the actual receipt of the commission and fees receivable;

v. fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registered or clearing transactions;

vi. fees to tied agents;

vii. interest paid to customers on clients' money; and

viii. extraordinary non-recurring expenses.

R2-3.5.8.6 Where the Licence Holder makes use of tied agents, the Licence Holder shall add 35% of the costs related to the tied agent to its fixed overheads.

R2-3.5.9 **Own funds Requirements for Operational Risk**

R2-3.5.9.1 Operational Risk means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk.

R2-3.5.9.2 The operational risk capital requirement ("ORCR") for a Licence Holder is an amount calculated in accordance with one of the following methods, as outlined in Part Three, Title III of the CRR:

i. The Basic Indicator Approach ('BIA') as set out in Chapter 2 of Title III, Part Three of the CRR;

ii. The Standardised Measurement Approach ('SMA') as laid down in Chapter 3 of Title III, Part Three of the CRR; and

iii. The Advanced Measurement Approach ('AMA') as outlined in Chapter 4 of Title III, Part Three of the CRR.

Title 4 Consolidated Capital Requirement

Section 1 Scope and Application

R2-4.1.1 This Title shall apply to Category 2 and Category 3 Licence Holders which fall within the scope of the Rules and which form part of a Consolidated Group in accordance with Section 2 of this Title.

R2-4.1.2 Licence Holders shall also take into account Title 2 of Chapter 5 on the Transitionary Arrangements.

Section 2 Determination of a Consolidated Group

R2-4.2.1 A Consolidated Group shall exist where a group of entities is subject to Part One, Title II, Chapter 2 of the CRR. For further guidance on determining consolidation status, Licence Holders should refer to regulation 3 of the Banking Act and the Investment Services Act (Supervisory Consolidation Regulations), 2014.

R2-4.2.2 Not all members of a group which is a Consolidated Group should be considered part of the Consolidated Group. Only the following types of entities within a group which is a Consolidated Group should be considered as members of the said Consolidated Group:

i. Licence Holders and foreign investment services providers (being entities established outside Malta which carry out activities that are similar to licensable activities carried out by a Licence Holder);

ii. Financial institutions licensed in terms of the Financial Institutions Act 1994 and entities carrying out similar activities to those carried out under the Financial Institutions Act 1994 and which are licensed in other EU member states or in third countries;

iii. Credit institutions licensed in Malta or outside Malta;

iv. A financial holding company, which has the same meaning as that assigned to it in point (20) of Article 4 (1) of the CRR;

v. A mixed financial holding company, which has the same meaning as that assigned to in point (21) of Article 4 (1) of the CRR;

vi. A mixed activity holding company, which has the same meaning as

that assigned to it in point (22) of Article 4 (1) of the CRR;

vii. An ancillary services undertaking, which has the same meaning as that assigned to it in point (18) of Article 4 (1) of the CRR; and

viii. An asset management company, which has the same meaning as that assigned to it in point (19) of Article 4 (1) of the CRR.

Section 3 The Consolidated Capital Resources Requirement

R2-4.3.1 A Licence Holder which forms part of a Consolidated Group is required to ensure that the Consolidated Group at all times maintains consolidated own funds which are at least equal to the consolidated capital resources requirement. The consolidated own funds of the Licence Holder may not fall below the amount of initial capital required at the time of authorisation on a consolidated basis.

R2-4.3.2 The MFSA considers consolidated supervision as complimentary to and not a substitute for supervision on an individual basis.

Section 4 Consolidated Own Funds

R2-4.4.1 Consolidated Own Funds means the sum of Consolidated Tier 1 capital and Consolidated Tier 2 capital. Licence Holders should refer to Section 3, Title 3 of this Chapter for the meaning and the components of Tier 1 capital and Tier 2 capital.

R2-4.4.2 For the purposes of the Consolidated Total Own Funds computation, the Licence Holder shall treat a Consolidated Group as a single institution, as provided in point (47) of Article 4 (1) of the CRR, and shall determine the amount of consolidated own funds in accordance with Title II of Part Two of the CRR.

Section 5 The Components of the Consolidated Capital Resources Requirement

R2-4.5.1 The components of the Consolidated Capital Resources Requirement vary depending on the category of the Licence Holder which forms part of the Consolidated Group. Where two or more Licence Holders holding a different category of licence form part of the same Consolidated 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:

R2-4.5.2 Investment Services Licence Holders falling within scope of the Consolidated Requirements shall at all times satisfy the following Consolidated Capital Resources Requirement:

i. A Consolidated Common Equity Tier 1 capital ratio of 4.5%, which is calculated as follows:

$$\frac{Consolidated\ Common\ Equity\ Tier\ 1\ Capital}{\text{Consolidated Total Risk Exposure}}$$

ii. A Consolidated Tier 1 capital ratio of 6%, which is calculated as follows:

$$\frac{Consolidated\ Tier\ 1\ Capital}{\text{Consolidated Total Risk Exposure}}$$

iii. A Consolidated total capital ratio of 8%, calculated as follows:

$$\frac{Consolidated\ Own\ Funds}{\text{Consolidated Total Risk Exposure}}$$

R2-4.5.3 Provided that for the purposes of Rule R2-4.5.2, Category 2 Investment Services Licence Holders shall calculate the Consolidated Total Risk Exposure as 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 consolidated foreign exchange risk, the consolidated settlement risk component, the consolidated credit valuation adjustment risk component and the consolidated fixed overhead requirement.

R2-4.5.4 Provided that for the purposes of Rule R2-4.5.2, Category 3 Investment Services Licence Holders including Operators of MTFs shall calculate the Consolidated Total Risk Exposure is 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 consolidated foreign exchange risk, the consolidated settlement risk component, the consolidated credit valuation adjustment risk component and the consolidated operational risk component.

Section 6 ***Total Risk Exposure***

R2-4.6.1 **Risks associated with non-trading book business**

R2-4.6.1.1 This category is made up of two risk components: (i) the consolidated credit/counterparty risk component; and (ii) the consolidated free deliveries.

R2-4.6.1.2 *The consolidated credit/counterparty risk component*

R2-4.6.1.2.1 The consolidated credit/ counterparty risk component, is the possibility of a loss occurring due to:

i. the failure of a debtor of the group to meet its contractual debt obligations; or

ii. the loss in value of any other asset (excluding derivatives which are exclusively dealt within the sections on trading book business and the consolidated commodities instruments – risk component) which forms part of the consolidated balance sheet except for: (a) intangible assets including goodwill; (b) cash in hand and at bank; (c) those financial instruments which fall within the category of trading book business; and (d) commodity positions.

R2-4.6.1.2.2 The consolidated credit/ counterparty risk can be measured through any one of the following two methods: (i) the Standardised Approach; and (ii) the Internal Ratings Based Approach (IRB), as referred to in Part Three, Title II of the CRR.

R2-4.6.1.2.3 For an explanation of the Standardised Approach and the IRB approach to the calculation of the credit/counterparty risk component, the Licence Holder shall refer to Rule R2-3.5.1.2.2. The computation of the consolidated credit/counterparty risk is the same as the credit/counterparty risk applied on an individual basis.

R2-4.6.1.3 *Consolidated free deliveries*

R2-4.6.1.3.1 Free Deliveries caters for the risk that the Licence Holder has either: (a) paid for securities, foreign currencies or commodities before receiving them or has delivered securities, foreign currencies or commodities before receiving payment for them; (b) in the case of cross-border transactions, one day or more has elapsed since the Licence Holder made that payment or delivery.

R2-4.6.1.3.2 The free deliveries risk component calculation for a Consolidated Group is the same as that applied for the free deliveries risk component on an individual basis. Measurement of this risk component and the steps to be followed in the automated Consolidated COREP Return are illustrated in refer to Rule R2-3.5.1.3.3.

R2-4.6.2 **Risks associated with trading book business**

R2-4.6.2.1 This category is made up of two risk components: (i) The consolidated position risk component; and (ii) the consolidated counterparty credit risk component.

R2-4.6.2.2 *The consolidated position risk component*

R2-4.6.2.2.1 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. Licence Holders should refer to Rule R2-3.5.2 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 Rule R2-3.5.1.2.9.

R2-4.6.2.2.2 Licence Holders which form part of a Consolidated Group which provide investment services in relation to financial derivative instruments should contact the MFSA for guidance as to how the derivatives related consolidated position risk component should be catered for in the automated Consolidated COREP Return.

R2-4.6.2.3 *The consolidated counterparty credit risk component*

R2-4.6.2.3.1 Counterparty Credit Risk is the amount of capital which any of the members within the Consolidated Group hold against exposures in financial derivative instruments and credit derivatives.

R2-4.6.2.3.2 In terms of Article 272 of the CRR, counterparty credit risk means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

R2-4.6.2.3.3 The computation of the consolidated counterparty credit risk is the same as the counterparty credit risk applied on an individual basis, which is explained in Rule R2-3.5.2.1.3.

R2-4.6.3 **Foreign Exchange Risk Component-The Market Risk: Standardised Approach Approaches for Foreign Exchange Risk**

R2-4.6.3.1 Foreign Exchange Risk is the risk that an asset or liability in the consolidated financial statements of the Consolidated Group denominated in a currency other than the reporting currency may be adversely affected by a change in the value of the foreign currency.

R2-4.6.3.2 The consolidated foreign exchange risk component calculation for a Consolidated Group is the same as that applied for this risk component when calculated on an individual basis. The manner in which the foreign exchange risk component should be calculated is explained in Rule R2-3.5.5.

R2-4.6.4 **Commodities Instruments - Risk Component - The Market Risk: Standardised Approach for Commodities**

R2-4.6.4.1 Commodities Risk is the risk component required to cover the risk associated with the holding or taking positions, by a member/s of a Consolidated 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 a Consolidated Group is the same as that applied for this risk component when calculated on an individual basis. Measurement of this risk component and the steps to be followed in the automated Consolidated COREP Return are illustrated in Rule R2-3.5.2.4.

R2-4.6.5 **The Consolidated Market Risk Internal Risk Models**

R2-4.6.5.1 Licence Holders which are permitted to have an internal risk measurement model should refer to the Implementing Technical Standards on Supervisory Reporting.

R2-4.6.6 **Consolidated Fixed Overheads Requirement**

R2-4.6.6.1 The consolidated fixed overheads requirement calculation for a Consolidated

Group is the same as that applied for the fixed overheads requirement on an individual basis. Measurement of the calculation of the fixed overheads requirement and the steps to be followed in the automated Consolidated COREP Return are illustrated in Rule R2-3.5.8.

R2-4.6.7 **Consolidated Operational Risk Component**

R2-4.6.7.1 Operational Risk means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk.

R2-4.6.7.2 The operational risk capital requirement ("ORCR") for a Licence Holder is an amount calculated in accordance with one of the following methods:

i. The Basic Indicator Approach ('BIA') as set out in Chapter 2 of Title III, Part Three of the CRR;

ii. The Standardised Measurement Approach ('SMA') as laid down in Chapter 3 of Title III, Part Three of the CRR; and

iii. The Advanced Measurement Approach ('AMA') as outlined in Chapter 4 of Title III, Part Three of the CRR.

R2-4.6.7.3 The consolidated operational risk component calculation for a Consolidated Group is the same as that applied on an individual basis. The manner in which the consolidated operational risk component should be calculated is explained in Rule R2-3.5.9.

R2-4.6.8 **Consolidated settlement/delivery risk component**

R2-4.6.8.1 Settlement risk is the risk that cash against documents transactions in financial instruments undertaken by members of a Consolidated Group are unsettled after their due delivery dates. The settlement risk component calculation for a Consolidated Group is the same as that applied for the settlement risk component on an individual basis. Measurement of this risk component and the steps to be followed in the automated Consolidated COREP Return are illustrated in Rule R2-3.5.6.3.

R2-4.6.9 **Consolidated Credit Valuation Adjustment Risk Component**

R2-4.6.9.1 Licence Holders that provide investment services in relation to over-the-counter (OTC) derivatives (except for credit derivatives recognised to reduce

risk-weighted exposure amounts for credit risk) shall be required to hold own funds for credit valuation adjustment risk (CVA).

R2-4.6.9.2 The term 'CVA' is defined in Article 381 of the CRR as an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. That adjustment reflects the current market value of the credit risk of the counterparty to the Licence Holder, but does not reflect the current market value of the credit risk of the Licence Holder to the counterparty.

R2-4.6.9.3 The CVA risk component calculation for a Consolidated Group is the same as that applied for the CVA risk component on an individual basis. Measurement of this risk component and the steps to be followed in the automated Consolidated COREP Return are illustrated in Rule R2-3.5.7.

R2-4.6.10 **Large Exposures Risk Component**

R2-4.6.10.1 The purpose of the large exposure requirement is to ensure that a Consolidated 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.

R2-4.6.10.2 A large exposure means the exposure by a Consolidated Group to: (a) an individual client; or (b) a group of connected clients, where its value is equal to or exceeds 10% of the group's Consolidated Eligible Capital (the terms 'individual client' and 'group of connected clients' are defined in Rule R2-3.5.4.5 and R2-3.5.4.6, respectively).

R2-4.6.10.3 Consolidated Eligible Capital means the sum of Tier 1 capital and Tier 2 capital that is equal to or less than one third of Tier 1 capital.

R2-4.6.10.4 For the purposes of the Consolidated Eligible Capital computation, the Licence Holder shall treat a Consolidated Group as a single institution, as provided in point (47) of Article 4 (1) of the CRR.

R2-4.6.10.5 *Condition regarding Individual Large Exposures*

R2-4.6.10.5.1 Exposures by a Consolidated Group to any class of the above-mentioned categories of counterparties should not exceed 25% of the Group's Eligible Capital (after taking into account the effect of credit risk mitigation in accordance with Articles 399 to 403 of the CRR).

R2-4.6.10.5.2 Where that individual client is either a credit institution or an investment firm or where a group of connected clients includes one or more credit institutions or investment firms, that value shall not exceed 25% of the Group's Eligible Capital or €150 million, whichever is the higher, provided that the sum of exposure values, after taking into account the effect of the credit risk mitigation, in accordance with Articles 399 to 403 of the CRR, to all connected clients that are not credit institutions or investment firms, does not exceed 25% of the Group's Eligible Capital.

R2-4.6.10.5.3 Where the amount of €150 million is higher than 25% of the Group's Eligible Capital, the value of the exposure, after taking into account the effect of credit risk mitigation, in accordance with Articles 399 to 403 of the CRR, shall not exceed a reasonable limit in terms of the Group's Eligible Capital. That limit shall be determined by the Consolidated Group, in accordance with the policies and procedures to address and control concentration risk referred to in Section 3, Title 2 of Chapter 3, and shall not be higher than 100% of the Group's Eligible Capital.

R2-4.6.10.5.4 Notwithstanding Rules R2-4.5.10.5.2 and R2-4.5.10.5.3, the Authority retains the right to set a lower limit than the €150 million referred to in the preceding paragraph.

R2-4.6.10.5.5 As stipulated in Article 395 (3) of the CRR, the Consolidated Group shall at all times comply with the above-mentioned limit. This limit may be exceeded for the exposures on the Group's trading book if all the conditions in Article 395 (5) of the CRR are met. In this regard, the Consolidated Group shall be required to hold an additional own funds requirement (i.e. the Large Exposures Risk Component) on the excess in respect of this limit, which shall be calculated in accordance with Articles 397 and 398 of the CRR.

R2-4.6.10.5.6 Should the Consolidated Group find that, for reasons beyond its control, it has incurred an exposure to an individual client or a group of connected clients, (e.g. following merger, amalgamation or buy-out), which results in it exceeding any of the above-mentioned limits, it should report the matter without delay to the Authority. Upon considering the circumstances of any such exposures, the Authority may allow the Consolidated Group a limited period of time in which to comply with the limits.

R2-4.6.10.5.7 Where the amount of €150 million referred to above is applicable, the Authority may at its discretion, on a case-by-case and strictly on an exceptional basis, allow the 100% limit in terms of the Group's Eligible Capital, to be exceeded.

R2-4.6.10.5.8 The consolidated large exposures risk component calculation for a Consolidated Group is the same as that applied for this risk component when calculated on an individual basis. The types of Counterparties, the measurement of this risk component, exempt exposures and the steps to be followed in the automated COREP Return for Consolidations are illustrated in Rule R2-3.5.4.

Title 5 Capital Buffers Requirement Applicable to Category 3 Investment Services Licence Holders

Section 1 *Scope and Application*

R2-5.1.1 This Title shall apply to Category 3 Investment Services Licence Holders licensed under the Act.

R2-5.1.2 These Rules transpose paragraph 30 of Article 3(1), Articles 128(1) – (8), 129, 130, 131, 140, 141, 142, 160(2)(b), (3)(b) (4)(b), (5), (6) and (7), 162(5) of the CRD:

R2-5.1.3 Provided that Article 131 of the CRD is hereby being transposed by the Authority in conjunction with the Central Bank of Malta.

Section 2 Capital Conservation Buffer

R2-5.2.1 In addition to the Common Equity Tier 1 capital maintained to meet the own funds requirement imposed by Article 92 of the CRR, investment firms shall maintain a capital conservation buffer of Common Equity Tier 1 capital equal to 2.5% of their total risk exposure amount, calculated in accordance with Article 92(3) of the CRR on an individual and consolidated basis, as applicable in accordance with Part One, Title II of the CRR.

R2-5.2.2 Investment firms shall not use Common Equity Tier 1 capital that is maintained to meet the requirement prescribed in terms of Rule R2-5.2.1 to meet any requirements prescribed in terms of Schedule III of the Investment Services Act (Supervisory Review) Regulations, 2013 [Legal Notice 30 of 2014] [Article 104 of the CRD].

R2-5.2.3 Where an investment firm fails to meet fully the requirement prescribed in terms of Rule 4.1 of this Title, it shall be subject to the restrictions on distributions set out in Rules R2-5.7.1 to R2-5.7.10. [Article 141(2) and (3) of the CRD].

R2-5.2.4 By way of derogation from Rule R2-5.2.1, small and medium-sized investment firms shall be exempted from the requirements set out in that paragraph if such an exemption does not threaten the stability of Malta's financial system.

Provided that for the purposes of this Rule, small and medium-sized investment firms shall be defined in accordance with the European Commission

Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises.

Section 3 ***Institution Specific Countercyclical Buffer***

R2-5.3.1 Investment firms shall maintain an institution-specific countercyclical capital buffer equivalent to their total risk exposure amount, calculated in accordance with Article 92(3) of the CRR multiplied by the weighted average of the countercyclical buffer rates, calculated in accordance with Rules R2-5.4.1 to R2-5.4.8 [Article 140 of the CRD] on an individual and consolidated basis, as applicable in accordance with Part One, Title II of the CRR.

R2-5.3.2 Investment firms shall meet the requirement imposed by Rule R2-5.3.1of this Title with Common Equity Tier 1 capital, which shall be additional to:

i. any Common Equity Tier 1 capital maintained to meet the own funds requirement imposed by Article 92 of the CRR;

ii. the requirement to maintain a capital conservation buffer in terms of Rules 4.1 to 4.3 of this Title [Article 129 of the CRD]; and

iii. any requirement imposed in terms of Schedule III of the Investment Services Act (Supervisory Review) Regulations, 2013 [L.N. 30 of 2014] [Article 104 of the CRD].

R2-5.3.3 Where an investment firm fails to meet fully the requirement prescribed in terms of Rule R2-5.3.1 of this Title, it shall be subject to the restrictions on distributions set out in Rules R2-5.7.1 to R2-5.7.10 [Article 141(2) and (3) of the CRD].

R2-5.3.4 By way of derogation from Rule R2-5.3.1, small and medium-sized investment firms shall be exempted from the requirements set out in that paragraph if such an exemption does not threaten the stability of Malta's financial system:

Provided that for the purposes of this Rule, small and medium-sized investment firms shall be defined in accordance with the European Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises.

Section 4 ***Calculation of Institution-Specific Countercyclical Capital Buffer Rates***

R2-5.4.1 For the purposes of Rules R2-5.4.1 to R2-5.4.8, the institution-specific countercyclical capital buffer rate shall consist of the weighted average of the countercyclical buffer rates that apply in the jurisdictions where the relevant credit exposures of the investment firm are located or are applied by virtue of paragraphs 62 and 63 of the CBM Directive [Article 139(2) or (3) of the CRD].

R2-5.4.2 In order to calculate the weighted average referred to in Rule R2-5.4.1, investment firms shall apply to each applicable countercyclical buffer rate its total own funds requirements for credit risk, determined in accordance with Part Three, Titles II and IV of the CRR, that relates to the relevant credit exposures in the territory in question, divided by its total own funds requirements for credit risk that relates to all of its relevant credit exposures.

R2-5.4.3 If, in accordance with paragraph 55 of the CBM Directive, the Central Bank of Malta sets a countercyclical buffer rate in excess of 2.5% of total risk exposure amount calculated in accordance with Article 92(3) of the CRR, investment firms shall apply that buffer rate in excess of 2.5% of total risk exposure amount to relevant credit exposures located in Malta for the purposes of the calculation prescribed in terms of Rules R2-5.4.1 and R2-5.4.2 including, where relevant, for the purposes of the calculation of the element of consolidated capital that relates to the investment firm in question.

R2-5.4.4 If, in accordance with Article 136(4) of the CRD, a designated authority in another Member State sets a countercyclical buffer rate in excess of 2.5% of total risk exposure amount calculated in accordance with Article 92(3) of the CRR, the following buffer rates shall apply to relevant credit exposures located in the Member State of that designated authority for the purposes of the calculation prescribed in terms of Rules R2-5.4.1 and R2-5.4.2 including, where relevant, for the purposes of the calculation of the element of consolidated capital that relates to the investment firm in question:

i. investment firms shall apply a countercyclical buffer rate of 2.5% of total risk exposure amount if the Central Bank of Malta has not recognised the buffer rate in excess of 2.5% in accordance with paragraph 59 of the CBM Directive [Article 137(1) of the CRD];

ii. investment firms shall apply the countercyclical buffer rate set by the designated authority of another Member State appointed for the purposes of Article 136(1) of the CRD if the Central Bank of Malta has recognised the buffer rate in accordance with paragraph 59 and 60 of the CBM

Directive [Article 137 of the CRD].

R2-5.4.5 If the countercyclical buffer rate set by the relevant third-country authority for a third country exceeds 2.5% of total risk exposure amount calculated in accordance with Article 92(3) of the CRR, the following buffer rates shall apply to relevant credit exposures located in that third country for the purposes of the calculation prescribed in terms of Rules R2-5.4.1 and R2-5.4.2 including, where relevant, for the purposes of the calculation of the element of consolidated capital that relates to the investment firm in question:

i. investment firms shall apply a countercyclical buffer rate of 2.5% of total risk exposure amount if the Central Bank of Malta has not recognised the buffer rate in excess of 2.5% in accordance with paragraph 59 of the CBM Directive [Article 137(1) of the CRD];

ii. investment firms shall apply the countercyclical buffer rate set by the relevant third-country authority if the Central Bank of Malta has recognised the buffer rate in accordance with paragraphs 59 and 60 of the CBM Directive [Article 137 of the CRD].

R2-5.4.6 Relevant credit exposures shall include all those exposure classes, other than those referred to in points (a) to (f) of Article 112 of the CRR, that are subject to:

i. the own funds requirements for credit risk under Part Three, Title II of the CRR;

ii. where the exposure is held in the trading book:

(a) own funds requirements for specific risk under Part Three, Title IV, Chapter 2 of the CRR; or

(b) incremental default and migration risk under Part Three, Title IV, Chapter 5 of the CRR;

iii. where the exposure is a securitisation, the own funds requirements under Part Three, Title II, Chapter 5 of the CRR.

R2-5.4.7 Investment firms shall identify the geographical location of a relevant credit exposure in accordance with Commission Delegated Regulation (EU) No 1152/2014 of 4 June 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards on the identification of the geographical location of the relevant credit exposures

for calculating institution-specific countercyclical capital buffer rates. Moreover, pursuant to Article 440 of the CRR, investment firms shall disclose key elements of the calculation of their countercyclical capital buffer in accordance with the Commission Delegated Regulation (EU) 2015/1555 of 28 May 2015 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for the disclosure of information in relation to the compliance of institutions with the requirement for a countercyclical capital buffer.

R2-5.4.8 For the purposes of the calculation prescribed in terms of Rules R2-5.4.1 and R2-5.4.2:

i. a countercyclical buffer rate for Malta shall apply from the date specified in the information published in accordance with paragraphs 58(e) or 60(c) of the CBM Directive if the effect of that decision is to increase the buffer rate;

ii. a countercyclical buffer rate for another Member State shall apply from the date specified in the information published in accordance with Article 136(7)(e) or Article 137(2)(c) of the CRD if the effect of that decision is to increase the buffer rate;

iii. subject to point (iv), a countercyclical buffer rate for a third country shall apply 12 months after the date on which a change in the buffer rate was announced by the relevant third-country authority, irrespective of whether that authority requires institutions incorporated in that third country to apply the change within a shorter period, if the effect of that decision is to increase the buffer rate;

iv. where the Central Bank of Malta sets the countercyclical buffer rate for a third country pursuant to paragraphs 62 and 63 of the CBM Directive [Article 139(2) or (3) of the CRD], or recognises the countercyclical buffer rate for a third country pursuant to paragraphs 59 and 60 of the CBM Directive [Article 137 of the CRD], that buffer rate shall apply from the date specified in the information published in accordance with paragraphs 65(c) or 60(c) of the CBM Directive [Article 139(5)(c) or Article 137(2)(c) of the CRD], if the effect of that decision is to increase the buffer rate;

v. a countercyclical buffer rate shall apply immediately if the effect of that decision is to reduce the buffer rate.

For the purposes of point (iii) of this Rule, a change in the countercyclical buffer rate for a third country shall be considered to be announced on the date that it is published by the relevant third-country authority in accordance with the applicable national rules.

Section 5 Global and Other Systemically Important Institutions

R2-5.5.1 The Authority shall, in accordance with Article 12(1)(k) and (l) of the Act, together with the Central Bank of Malta, appointed as the designate authority for the purposes of Article 131(1) of the CRD in terms of the Central Bank of Malta Act (Appointment of Designate Authority to implement Macro-Prudential Instruments) Regulations, 2014 [Legal Notice 29 of 2014], be responsible for identifying, on a consolidated basis, global systemically important institutions (G-SIIs), and, on an individual, sub-consolidated or consolidated basis, as applicable, other systemically important institutions (O-SIIs), which have been licensed in terms of the Act.

G-SIIs shall be an EU parent institution, an EU parent financial holding company, an EU parent mixed financial holding company or an institution as defined in the CRR. G-SIIs shall not be an institution that is a subsidiary of an EU parent institution, of an EU parent financial holding company or of an EU parent mixed financial holding company.

O-SIIs can either be an EU parent institution, an EU parent financial holding company, an EU parent mixed financial holding company or an institution as defined in the CRR.

R2-5.5.2 The identification methodology for G-SIIs shall be based on the following categories:

i. size of the group;

ii. interconnectedness of the group with the financial system;

iii. substitutability of the services or of the financial infrastructure provided by the group;

iv. complexity of the group;

v. cross-border activity of the group, including cross border activity between Member States and between a Member State and a third

country.

Each category shall receive an equal weighting and shall consist of quantifiable indicators.

The methodology shall produce an overall score for each entity assessed as referred to in Rule R2-5.5.1, which allows G-SIIs to be identified and allocated into a sub-category as described in Rule R2-5.5.10.

R2-5.5.3 O-SIIs shall be identified in accordance with Rule R2-5.5.1, Systemic importance shall be assessed on the basis of at least any of the following criteria:

i. size;

ii. importance for the economy of the Union or of Malta;

iii. significance of cross-border activities;

iv. interconnectedness of the investment firm or group with the financial system.

In determining the conditions for the application of Rule R2-5.5.3 in relation to the assessment of O-SIIs, the Authority may be guided, *inter alia*, by any guideline/s published by the EBA in accordance with Article 131(3) of the CRD.

R2-5.5.4 Each G-SII shall, on a consolidated basis, maintain a G-SII buffer which shall correspond to the sub-category to which the G-SII is allocated. That buffer shall consist of and shall be supplementary to Common Equity Tier 1 capital.

R2-5.5.5 The Authority, acting jointly with the Central Bank of Malta, may require each O-SII, on a consolidated or sub-consolidated or individual basis, as applicable, to maintain an O-SII buffer of up to 2% of the total risk exposure amount calculated in accordance with Article 92(3) of the CRR, taking into account the criteria for the identification of the O-SII:

Provided that such buffer shall consist of and be supplementary to the Common Equity Tier 1 capital.

R2-5.5.6 When requiring an O-SII buffer to be maintained the Authority, acting jointly with the Central Bank of Malta, shall comply with the following:

i. the O-SII buffer must not entail disproportionate adverse effects on the

whole or parts of the financial system of other Member States or of the Union as a whole forming or creating an obstacle to the functioning of the internal market;

ii. the authority, acting jointly with the Central Bank of Malta, shall review the O-SII buffer at least annually.

R2-5.5.7 Before setting or resetting an O-SII buffer, the authority, acting jointly with the Central Bank of Malta, shall notify the European Commission, the ESRB, the EBA, and the competent and designated authorities of the Member States concerned one month before the publication of the decision referred to in Rule R2-5.5.6.

The said notification shall describe in detail:

i. the justification for why the O-SII buffer is considered likely to be effective and proportionate to mitigate the risk;

ii. an assessment of the likely positive or negative impact of the O-SII buffer on the internal market, based on information which is available to the authority and the Central Bank of Malta;

iii. the O-SII buffer rate that the authority, acting jointly with the Central Bank of Malta, wishes to set.

R2-5.5.8 Without prejudice to paragraphs 14 to 32 of the CBM Directive [Article 133 of the CRD] and Rule R2-5.5.5, where an O-SII is a subsidiary of either a G-SII or an O-SII which is an EU parent institution and subject to an O-SII buffer on a consolidated basis, the buffer that applies at individual or sub-consolidated level for the O-SII shall not exceed the higher of:

i. 1% of the total risk exposure amount calculated in accordance with Article 92(3) of the CRR; and

ii. the G-SII or O-SII buffer rate applicable to the group at consolidated level.

R2-5.5.9 The Authority, acting jointly with the Central Bank of Malta, shall establish at least five subcategories of G-SIIs.

The lowest boundary and the boundaries between each sub-category shall be determined by the scores under the identification methodology.

The cut-off scores between adjacent sub-categories shall be defined clearly and shall adhere to the principle that there is a constant linear increase of systemic significance, between each sub-category resulting in a linear increase in the requirement of additional Common Equity Tier 1 capital, with the exception of the highest sub-category.

The lowest sub-category shall be assigned a G-SII buffer of 1% of the total risk exposure amount calculated in accordance with Article 92(3) of the CRR and the buffer assigned to each sub-category shall increase in gradients of 0.5% of the total risk exposure amount calculated in accordance with Article 92(3) of the CRR up to and including the fourth sub-category.

The highest sub-category of the G-SII buffer shall be subject to a buffer of 3.5% of the total risk exposure amount calculated in accordance with Article 92(3) of the CRR.

For the purposes of this paragraph, "systemic significance" is the expected impact exerted by the G-SII's distress on the global financial market.

R2-5.5.10 Without prejudice to Rule R2-5.5.1 and R2-5.5.9, the Authority, acting jointly with the Central Bank of Malta, may, in the exercise of sound supervisory judgment:

i. re-allocate a G-SII from a lower sub-category to a higher sub-category;

ii. allocate an entity as referred to in Rule R2-5.5.1, which has an overall score that is lower than the cut-off score of the lowest sub-category, to that sub-category or to a higher sub-category, thereby designating it as a G-SII.

R2-5.5.11 Where the Authority, acting jointly with the Central Bank of Malta, takes a decision in accordance with point (ii) of Rule R2-5.5.10, it shall notify the EBA accordingly, providing reasons.

R2-5.5.12 The authority, acting jointly with the Central Bank of Malta, shall notify the names of the G-SIIs and O-SIIs and the respective sub-category to which each G-SII is allocated, to the European Commission, the ESRB and the EBA, and shall disclose their names to the public. The authority, acting jointly with the Central Bank of Malta, shall disclose to the public the sub-category to which each G-SII is allocated.

The Authority, acting jointly with the Central Bank of Malta, shall review annually the identification of G-SIIs and O-SIIs and the G-SII allocation into the respective sub-categories and report the result to the systemically important institution concerned, to the European Commission, the ESRB and the EBA and disclose the updated list of identified systemically important institutions to the public.

The Authority, acting jointly with the Central Bank of Malta, shall disclose to the public the sub-category into which each identified G-SII is allocated.

R2-5.5.13 Systemically important institutions shall not use the Common Equity Tier 1 capital which is maintained in terms of Rule R2-5.5.5 and R2-5.5.6, to meet any of the following requirements:

i. requirements imposed under Article 92 of the CRR;

ii. requirements to maintain a capital conservation buffer as prescribed in Section 2 of Title 5 of Chapter 2;

iii. requirements to maintain an institution-specific countercyclical capital buffer as prescribed in Rules R2-5.3.1to R2-3.3.; and

iv. any requirements imposed in terms of Article 16 of the Investment Services Act (Supervisory Review) Regulations, 2013 [L.N. 30 of 2014] [Article 102 of the CRD].

v. any requirements imposed in terms of Schedule III of the Investment Services Act (Supervisory Review) Regulations, 2013 [L.N. 30 of 2014] [Article 104 of the CRD].

R2-5.5.14 Where a group, on a consolidated basis, is subject to the following, the higher buffer shall apply in each case:

i. a G-SII buffer and an O-SII buffer;

ii. a G-SII buffer, an O-SII buffer and a systemic risk buffer in accordance with Article 133 of the CRD.

Where an investment firm, on an individual or sub-consolidated basis is subject to an O-SII buffer and a systemic risk buffer in accordance with Article 133 of the CRD, the higher of the two shall apply.

R2-5.5.15 Notwithstanding the provisions of Rules R2-5.5.14, where the systemic risk buffer applies to all exposures located in Malta, but does not apply to exposures outside Malta, that systemic risk buffer shall be cumulative with the O-SII or G-SII buffer that is applied in accordance with Rules R2-5.5.1 to R2-5.5.18.

R2-5.5.16 Where Rules R2-5.5.15 applies and an investment firm is part of a group or a sub-group to which a G-SII or an O-SII belongs, this shall never imply that such investment firm is, on an individual basis, subject to a combined buffer requirement that is lower than the sum of the capital conservation buffer, the countercyclical capital buffer, and the sum of the O-SII buffer and systemic risk buffer applicable to it on an individual basis.

R2-5.5.17 Where Rules R2-5.5.16 applies and an investment firm is part of a group or a sub-group to which a G-SII or an O-SII belongs, this shall never imply that such investment firm is, on an individual basis, subject to a combined buffer requirement that is lower than the sum of the capital conservation buffer, the countercyclical capital buffer, and the sum of the O-SII buffer and systemic risk buffer applicable to it on an individual basis.

R2-5.5.18 The authority, acting jointly with the Central Bank of Malta, shall identify an EU parent institution or EU parent financial holding company or EU parent mixed financial holding company as a G-SII and shall define the sub-categories and the allocation of G-SIIs in sub-categories based on their systemic significance in accordance with the methodology specified in the Commission Delegated Regulation (EU) No 1222/2014 of 8 October 2014 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to Regulatory Technical Standards for the specification of the methodology for the identification of global systemically important institutions and for the definition of subcategories of global systemically important institutions:

Provided that, pursuant to Article 441 of the CRR, investment firms identified as G-SIIs shall disclose indicator values used in the identification process in accordance with the Commission Implementing Regulation (EU) No 1030/2014 of 29 September 2014 laying down Implementing Technical Standards with regard to the uniform formats and date for the disclosure of the values used to identify globally systemic important institutions according to Regulation (EU) No 575/2013 of the European Parliament and Council and the Guidelines on Disclosure of Indicators of Global Systemic Importance, which were published by the EBA on the 5 June 2014.

Section 6 ***Systemic Risk Buffer***

R2-5.6.1 Investment firms are to refer to the Central Bank of Malta Act (Appointment of Designate Authority to implement Macro-Prudential Instruments) Regulations, 2014 [Legal Notice 29 of 2014] and to the CBM Directive with regards to the maintenance of a systemic risk buffer under Article 133 of the CRD.

Section 7 ***Restrictions on Distributions***

R2-5.7.1 An investment firm that meets the combined buffer requirement shall be prohibited from making a distribution in connection with Common Equity Tier 1 capital to an extent that would decrease its Common Equity Tier 1 capital to a level where the combined buffer requirement is no longer met.

R2-5.7.2 An investment firm that fails to meet the combined buffer requirement shall be required to calculate the Maximum Distributable Amount ('MDA') in accordance with Rule R2-5.7.4. Such investment firms shall be required to notify the authority of that MDA.

In such circumstances the investment firm shall be prohibited from undertaking any of the following actions before it has calculated the MDA:

i. make a distribution in connection with Common Equity Tier 1 capital;

ii. create an obligation to pay variable remuneration or discretionary pension benefits or pay variable remuneration if the obligation to pay was created at a time when the investment firm failed to meet the combined buffer requirements;

iii. make payments on Additional Tier 1 instruments.

R2-5.7.3 An investment firm that fails to meet or exceed its combined buffer requirement shall be prohibited from distributing more than the MDA calculated in accordance with Rule R2-5.7.4 through any action referred to in points (i), (ii) and (iii) of Rule R2-5.7.2.

R2-5.7.4 An investment firm shall calculate the MDA by multiplying the sum calculated in accordance with Rule R2-5.7.5 by the factor determined in accordance with Rule R2-5.7.6.

The MDA shall be reduced by any of the actions referred to in points (i), (ii) or (iii) of Rule R2-5.7.2.

R2-5.7.5 The sum to be multiplied in accordance with Rule R2-5.7.4 of this Title shall consist of:

i. interim profits not included in Common Equity Tier 1 capital pursuant to Article 26(2) of the CRR that have been generated since the most recent decision on the distribution of profits or any of the actions referred to in points (i), (ii) or (iii) of Rule R2-5.7.2;

plus

ii. year-end profits not included in Common Equity Tier 1 capital pursuant to Article 26(2) of the CRR that have been generated since the most recent decision on the distribution of profits or any of the actions referred to in points (i), (ii) or (iii) of Rule R2-5.7.2;

minus

iii. amounts which would be payable by tax if the items specified in points (i) and (ii) of this Rule were to be retained.

R2-5.7.6 The factor shall be determined as follows:

i. where the Common Equity Tier 1 capital maintained by the investment firm which is not used to meet the own funds requirement under Article 92(1)(c) of the CRR, expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of the CRR, is within the first (that is, the lowest) quartile of the combined buffer requirement, the factor shall be 0;

ii. where the Common Equity Tier 1 capital maintained by the investment firm which is not used to meet the own funds requirement under Article 92(1)(c) of the CRR, expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of the CRR, is within the second quartile of the combined buffer requirement, the factor shall be 0.2;

iii. where the Common Equity Tier 1 capital maintained by the investment firm which is not used to meet the own funds requirement under Article 92(1)(c) of the CRR, expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of the CRR, is within the third quartile of the combined buffer requirement, the factor shall be

0.4;

iv. where the Common Equity Tier 1 capital maintained by the investment firm which is not used to meet the own funds requirement under Article 92(1)(c) of the CRR, expressed as a percentage of the total risk exposure amount calculated in accordance with Article 92(3) of the CRR, is within the fourth (that is, the highest) quartile of the combined buffer requirement, the factor shall be 0.6;

The lower and upper bounds of each quartile of the combined buffer requirement shall be calculated as follows:

$$\text{Lower bound of quartile} = \frac{Combined\ buffer\ requirment}{4} \times (Q_n - 1)$$

$$\text{Upper bound of quartile} = \frac{Combined\ buffer\ requirment}{4} \times (Q_n)$$

Where Q_n indicates the ordinal number of the quartile concerned.

R2-5.7.7 The restrictions imposed by Rules R2-5.7.1 to R2-5.7.10 shall only apply to payments that result in a reduction of Common Equity Tier 1 capital or in a reduction of profits, and where a suspension of payment or failure to pay does not constitute an event of default or a condition for the commencement of proceedings under the insolvency regime applicable to the investment firm.

R2-5.7.8 Where an investment firm fails to meet the combined buffer requirement and intends to distribute any of its distributable profits or undertake an action referred to in points (i), (ii) or (iii) of Rule R2-5.7.2, it shall notify the authority and provide the following information:

i. the amount of capital maintained by the investment firm, subdivided as follows:

(a) Common Equity Tier 1 capital,

(b) Additional Tier 1 capital,

(c) Tier 2 capital;

ii. the amount of its interim and year-end profits;

iii. the MDA calculated in accordance with Rule R2-5.7.4;

iv. the amount of distributable profits it intends to allocate between the following:

(a) dividend payments,

(b) share buybacks,

(c) payments on Additional Tier 1 instruments,

(d) the payment of variable remuneration or discretionary pension benefits, whether by creation of a new obligation to pay, or payment pursuant to an obligation to pay created at a time when the investment firm failed to meet its combined buffer requirements.

R2-5.7.9 Investment firms shall maintain arrangements to ensure that the amount of distributable profits and the MDA are calculated accurately, and shall be able to provide the Authority with the necessary information relating to such calculation upon request.

R2-5.7.10 For the purposes of Rules R2-5.7.1 and R2-5.7.2, a distribution in connection with Common Equity Tier 1 capital shall include the following:

i. a payment of cash dividends;

ii. a distribution of fully or partly paid bonus shares or other capital instruments referred to in Article 26(1)(a) of the CRR;

iii. a redemption or purchase by an investment firm of its own shares or other capital instruments referred to in Article 26(1)(a) of the CRR;

iv. a repayment of amounts paid up in connection with capital instruments referred to in Article 26(1)(a) of the CRR;

v. a distribution of items referred to in points (b) to (e) of Article 26(1) of the CRR.

Section 8 ***Capital Conservation Plan***

R2-5.8.1 Where an investment firm fails to meet its combined buffer requirement, it shall prepare a capital conservation plan and submit it to the Authority no later than five working days after it identified that it was failing to meet that requirement, unless the Authority authorises a longer delay not exceeding ten days.

The Authority shall grant such authorisations only on the basis of the individual situation of a Licence Holder and taking into account the scale and complexity of the investment firm's activities.

R2-5.8.2 The capital conservation plan shall include the following:

i. estimates of income and expenditure and a forecast balance sheet;

ii. measures to increase the capital ratios of the investment firm;

iii. a plan and timeframe for the increase of own funds with the objective of meeting fully the combined buffer requirement;

iv. any other information that the authority considers to be necessary to carry out the assessment required in terms of Rule R2-5.8.3.

R2-5.8.3 The Authority shall assess the capital conservation plan, and shall approve the plan only if it considers that the plan, if implemented, would be reasonably likely to conserve or raise sufficient capital to enable the investment firm to meet its combined buffer requirements within a period which the authority considers appropriate.

R2-5.8.4 If the Authority does not approve the capital conservation plan in accordance with Rule R2-5.8.3, it shall impose one or both of the following:

i. require the investment firm to increase own funds to specified levels within specified periods;

ii. exercise its powers in terms of Article 17 of the Act [Article 102 of the CRD] to impose more stringent restrictions on distributions than those required by Rules R2-5.7.1 to R2-5.7.10.

Section 9 ***Entry into Force***

R2-5.9.1 The capital conservation buffer shall apply from 1 January 2016, subject to the transitional periods prescribed in Rule R5-3.2.1.

Notwithstanding the provisions of this paragraph and the transitional periods prescribed in Rule R5-3.2.1, the Authority may, in accordance with Article 106(6) of the CRD, impose a shorter transitional period and thereby implement the capital conservation buffer prior to 1 January 2016. Where the Authority imposes such shorter transitional period, it shall inform the relevant parties, including the European Commission, the ESRB, the EBA and the relevant supervisory colleges, accordingly.

The Authority may also recognise shorter transitional periods than those prescribed by Article 160(2)(a), (3)(a) and (4)(a) concerning the introduction of the capital conservation buffer imposed by other Member States. Where the authority recognises such a shorter transitional period, it shall notify the European Commission, the ESRB, the EBA and the relevant supervisory college, accordingly.

R2-5.9.2 The institution-specific countercyclical capital buffer shall apply from the 1st January 2016 subject to the transitional periods prescribed in Rule R5-3.3.1 and to any shorter transitional periods which may be imposed in accordance with paragraph 66 of the CBM Directive in respect of the countercyclical capital buffer.

R2-5.9.3 Subject to the transitional periods prescribed in Rule R5-3.5.1, the G-SII buffer shall apply from the 1st January 2016.

R2-5.9.4 The authority, acting jointly with the Central Bank of Malta, may require each O-SII, on a consolidated or sub-consolidated or individual basis, as applicable, to maintain, as from the 1st January 2016, an O-SII buffer as prescribed in Rule R2-5.5.5.

Title 6 Liquidity Requirements

Section 1 Scope and Application

R2-6.1.1 This Title shall apply to Category 3 Licence Holders falling within scope of the Rules, on the following basis:

i. *Exemptions from Part Six of the CRR on a solo basis:*

(a) For the purpose of Article 6(4) of the CRR, a Category 3 Licence Holder, which is not significant in terms of the nature, scale and complexity of its investment services activities, is exempt from compliance with the obligations in Part Six of the CRR (Liquidity) on a solo basis.

ii. *Exemptions from Part Six of the CRR on a consolidated basis:*

(a) In terms of the CRR, a Category 3 Licence Holder which forms part of a Consolidated Group is required to comply with Part Six (Liquidity) on a consolidated basis.

(b) For the purpose of Article 11 (3) of the CRR, a Consolidated Group, which comprises only of investment firms, that are not significant in terms of the nature, scale and complexity of their investment services activities, are exempt from compliance with the obligations in Part Six of the CRR (Liquidity) on a consolidated basis.

Section 2 Liquidity Requirements

R2-6.2.1 Licence Holders shall be subject to the obligations in Part Six of the CRR (Liquidity) on a solo basis and consolidated basis as applicable.

Title 7 Leverage Requirements

Section 1 Scope and Application

R2-7.1.1 This Title shall apply to Category 3 Licence Holders falling within scope of the Rules.

Section 2 Leverage Ratio

R2-7.2.1 Licence Holders shall calculate the Leverage Ratio in accordance with the obligations in Part Seven of the CRR (Leverage).

R2-7.2.2 In this respect, the Licence Holder is required to complete the Leverage Ratio Templates, which are included in the automated COREP Return, by making reference to the Commission Implementing Regulation (EU) 2016/428 of 23 March 2016 amending Implementing Regulation (EU) No 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions as regards the reporting of the Leverage Ratio.

R2-7.2.3 By way of derogation from Articles 429 and 430 of the CRR, during the period between 1 January 2014 and 31 December 2021, Category 3 Licence Holders shall calculate and report the leverage ratio by using both of the following as the capital measure:

R2-7.2.4

i. Tier 1 capital;

ii. Tier 1 capital, subject to the derogations laid down in Chapters 1 and 2 of Title I of Part Ten of the CRR, as implemented in the Investment Services Rules.

R2-7.2.5 Pursuant to Article 451(1) of the CRR, Licence Holders are required to publically disclose information on their leverage ratio calculated in accordance with Article 429 and management of the risk of excessive leverage in the annual financial statements as specified in Rule R4-7.7.1.

Chapter 3 Organisational Requirements

Title 1 Governance

Section 1 *Scope and Application*

R3-1.1.1 Title 1 of Chapter 3 applies to all Investment Services Licence Holders falling with in scope of the Rules.

i. Rules R3-1.3.1.3 to R3-1.3.1.15 and Rules R3-1.3.2 to R3-1.3.4, shall apply only to Category 2 and Category 3 Licence Holders as well as Licence Holders, which are members of a Consolidated Group pursuant to Section 2, Title 4 of Chapter 2.

ii. Rule R3-1.3.4.2, shall apply to Category 2 and Category 3 Licence Holders falling within scope of the Rules, at group, parent company and subsidiary levels, including those established in offshore financial centres.

Section 2 *General Principles*

R3-1.2.1 The Licence Holder shall:

i. 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;

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

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

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

v. establish, implement and maintain effective internal reporting and

communication of information at all relevant levels of the Licence Holder;

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

vii. 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.

R3-1.2.2 The Licence Holder shall ensure that it has sound administrative and accounting procedures, internal control mechanisms, effective procedures for risk assessment, and effective control and safeguard arrangements for information processing systems.

R3-1.2.3 Without prejudice to R3-1.2.1, the Licence Holder shall establish, implement and maintain:

i. 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;

ii. an adequate business continuity process in accordance with Section 5, Title 5 of Chapter 3. The business continuity policy shall be 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;

iii. 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;

iv. adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and tied agents with its obligations under MiFID;

v. appropriate rules governing personal transactions by its managers,

employees and tied agents.

R3-1.2.4 The Licence Holder shall have sound security mechanisms in place to guarantee the security and authentication of the means of transfer of information, minimise the risk of data corruption and unauthorised access and to prevent information leakage maintaining confidentiality of data at all times.

R3-1.2.5 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 Rules R3-1.2.1 and R3-1.2.3above and take appropriate measures to address any deficiencies.

Section 3 ***Governance Arrangements***

R3-1.3.1 Establishment of Management Body

R3-1.3.1.1 Licence Holders shall ensure that they comply with Article 88 and Article 91 of CRD (Directive 2013/36/EU)

R3-1.3.1.2 Without prejudice to Rule R3-1.3.1.1, Licence Holders shall also ensure that the management body define, approve and oversee:

i. the organisation of the firm for the provision of investment services and activities and ancillary services, including the skills, knowledge and expertise required by personnel, the resources, the procedures and the arrangements for the provision of services and activities, taking into account the nature, scale and complexity of its business and all the requirements the firm has to comply with;

ii. a policy to services, activities, products and operations offered or provided in accordance with the risk tolerance of the firm and the characteristics and needs of the clients for the firm to whom they will be offered or provided including carrying out appropriate stress testing, where appropriate;

iii. a remuneration policy of persons involved in the provision of services to clients aiming to encourage responsible business conduct, fair treatment of clients as well as avoiding conflict of interest in the relationship with clients.

R3-1.3.1.3 The Licence Holder shall ensure that the management body monitors and periodically assesses the adequacy and implementation of the firm's strategic objectives in the provision of investment services and ancillary services, the

effectiveness of the investment firm's governance arrangements and the adequacy of the policies relating to the provision of services to clients and take appropriate steps to address any deficiencies.

R3-1.3.1.4 The Licence Holder shall ensure that members of the management body have adequate access to information and documents which are needed to oversee and monitor management decision-making.

R3-1.3.1.5 The Licence Holder shall ensure that members of the Management Body shall at all times be of sufficiently good repute, possess sufficient knowledge, skills and experience and commit sufficient time to perform their duties and be able to understand the Licence Holder's activities, including the main risks.

In this regard, the Licence Holder shall devote adequate human and financial resources to the induction and training of members of the management body.

R3-1.3.1.6 The Licence Holder shall require that the members of the Management Body of a financial holding company or mixed financial holding company be of sufficiently good repute, possess sufficient knowledge, skills and experience and commit sufficient time to perform their duties and be able to understand the Licence Holder's activities, including the main risks.

In this regard, the Licence Holder shall devote adequate human and financial resources to the induction and training of members of the management body.

R3-1.3.1.7 The number of directorships which may be held by a member of the Management Body at the same time shall take into account individual circumstances and the nature, scale and complexity of the Licence Holder's activities.

R3-1.3.1.8 Unless acting in a national representative capacity, members of the Management Body of a Licence Holder that is significant in terms of internal organization and the nature, the scope and the complexity of its activities shall, from 1 July 2014, not hold more than one of the following combinations of directorships at the same time:

i. one executive directorship with two non-executive directorships;

ii. four non-executive directorships.

R3-1.3.1.9 For the purposes of the R3-1.3.1.8, the following shall count as a single directorship:

i. executive or non-executive directorships held within the same group;

ii. executive or non-executive directorships held within:

(a) institutions which are members of the same institutional protection scheme provided that the conditions set out in Article 113(7) of the CRR are fulfilled; or

(b) undertakings (including non-financial entities) in which the Licence Holder holds a qualifying holding.

R3-1.3.1.10 Directorships in organizations which do not pursue predominantly commercial objectives shall be disregarded for the purposes of the limitations specified above.

R3-1.3.1.11 Without prejudice to the limitations specified in Rules R3-1.3.1.8 and R3-1.3.1.9 the MFSA may authorise members of the Management Body to hold one additional non-executive directorship.

R3-1.3.1.12 The Licence Holder shall ensure that each member of the Management Body shall act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of the senior management where necessary and to effectively oversee and monitor management decision-making.

R3-1.3.1.13 The Licence Holder and its nomination committee, where applicable, shall ensure to engage a broad set of qualities and competences when recruiting members to the Management Body and for that purpose to put in place a policy promoting diversity on the Management Body. This requirement is without prejudice to any national requirement on the representation of employees on the Management Body.

R3-1.3.1.14 The Licence Holder shall ensure that the Management Body defines, oversees and accounts for the implementation of the governance arrangements that ensure effective and prudent management of the Licence Holder, including the segregation of duties in the organisation and the prevention of conflicts of interest.

R3-1.3.1.15 The governance arrangements referred to above shall comply with the following principles:

i. the Management Body must have the overall responsibility for the Licence Holder and approve and oversee the implementation of the Licence Holder's strategic objectives, risk strategy and internal

governance;

ii. the Management Body must ensure the integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant standards;

iii. the Management Body must oversee the process of disclosure and communications;

iv. the Management Body must be responsible for providing effective oversight of senior management;

v. the chairman of the Management Body in its supervisory function of the Licence Holder must not exercise simultaneously the functions of a chief executive officer within the same Licence Holder, unless justified by the Licence Holder and authorised by the MFSA.

vi. the Management Body shall monitor and periodically assesses the effectiveness of the Licence Holder's governance arrangements and take appropriate steps to address any deficiencies.

R3-1.3.2 **Responsibility of Senior Management**

R3-1.3.2.1 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.

R3-1.3.2.2 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 Title 2 of this Chapter, as applicable; Title 3 of this Chapter; Section 2 and Section 3 of Title 5 of this Chapter, as applicable; indicating in particular whether the appropriate remedial measures have been taken in the event of any deficiencies.

R3-1.3.2.3 The Licence Holder shall ensure that the supervisory function receives on a regular basis written reports on the same matters at least annually.

R3-1.3.2.4 For the purposes of this Section 3, Title 2 of Chapter 3, "supervisory

function" means the function within a Licence Holder responsible for the supervision of its senior management.

R3-1.3.3 **Risk Consideration**

R3-1.3.3.1 The Management Body shall approve and periodically review the strategies policies for taking up, managing, monitoring and mitigating the risks the Licence Holder is or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle.

R3-1.3.3.2 The Management Body shall devote sufficient time to consideration of risk issues. The Management Body shall be actively involved in and ensure that adequate resources are allocated to the management of all material risks addressed in the CRD and the CRR as well as in the valuation of assets, the use of external credit ratings and internal models relating to those risks. The Licence Holder shall establish reporting lines to the Management Body that cover all material risks and risk management policies and changes thereof.

R3-1.3.3.3 The Management Body in its supervisory function and, where a risk committee has been established, the risk committee shall have adequate access to information on the risk situation of the Licence Holder and, if necessary and appropriate, to the risk management function and to external expert advice.

R3-1.3.3.4 The Management Body in its supervisory function and, where one has been established, the risk committee shall determine the nature, the amount, the format, and the frequency of the information on risk which it is to receive.

R3-1.3.3.5 The Licence Holder shall comply with the provisions of Title 2 of this Chapter, as applicable on establishing its risk management function and Section 3, Title 5 of this Chapter on establishing its remuneration policies and Rule R3-1.3.4.2 on the establishment of a Remuneration Committee, as applicable.

R3-1.3.3.6 The Licence Holder 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 their parent mixed activity holding company and its subsidiaries appropriately. The Licence Holder shall report to the MFSA any significant transactions with those entities other than those referred to in Article 394 of the CRR. These procedures shall be subject to review by the MFSA.

R3-1.3.4 **Committees**

R3-1.3.4.1 *Nomination Committee*

R3-1.3.4.1.1 Licence Holders which are considered by the Authority to be a significant Investment Services Licence Holder in terms of their size, internal organisation and the nature, scope and complexity of their activities shall establish a nomination committee composed of members of the Management Body who do not perform any executive function in the Licence Holder concerned.

R3-1.3.4.1.2 The nomination committee shall:

i. identify and recommend, for the approval of the Management Body or for approval of the general meeting, candidates to fill Management Body vacancies, evaluate the balance of knowledge, skills, diversity and experience of the Management Body and prepare a description of the roles and capabilities for a particular appointment, and assess the time commitment expected.

ii. Furthermore, the nomination committee shall decide on a target for the representation of the underrepresented gender in the Management Body and prepare a policy on how to increase the number of the underrepresented gender in the Management body in order to meet that target. The target, policy and its implementation shall be made public in accordance with Article 435 (2)(c) of the CRR;

iii. periodically, and at least annually, assess the structure, size, composition and performance of the Management Body and make recommendations to the Management Body with regard to any changes;

iv. periodically, and at least annually, assess the knowledge, skills and experience of individual members of the Management Body and of the Management Body collectively, and report to the Management Body accordingly;

v. periodically review the policy of the Management Body for selection and appointment of senior management and make recommendations to the Management Body;

vi. in performing its duties, the nomination committee shall, to the extent possible and on an ongoing basis, take account of the need to ensure that the Management Body's decision making is not dominated by any one individual or small group of individuals in a manner that is

detrimental to the interests of the Licence Holder as a whole;

the nomination committee shall be able to use any form of resources that it considers to be appropriate, including external advice, and shall receive appropriate funding to that effect.

R3-1.3.4.2 *Remuneration Committee*

R3-1.3.4.2.1 The Licence Holder, which is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities, shall establish a remuneration committee. The remuneration committee shall be constituted in such a way as to enable it to exercise competent and independent judgement on remuneration policies and practices and the incentives created for managing risk, capital and liquidity.

R3-1.3.4.2.2 The remuneration committee shall be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the Licence Holder concerned and which are to be taken by the management body. The chairperson and the members of the remuneration committee shall be members of the Management Body who do not perform any executive function in the Licence Holder concerned. If employee representation on the management body is provided for by Maltese law, the remuneration committee shall include one or more employee representatives. When preparing such decisions, the remuneration committee must take into account the long-term interests of shareholders, investors and other stakeholders in the Licence Holder and the public interest.

R3-1.3.4.3 *Risk Committee*

R3-1.3.4.3.1 Licence Holders that are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities shall establish a risk committee composed of members of the Management Body who do not perform any executive function in the Licence Holder concerned. Members of the risk committee shall have appropriate knowledge, skills and expertise to fully understand and monitor the risk strategy and the risk appetite of the Licence Holder.

R3-1.3.4.3.2 The risk committee shall:

i. advise the Management Body on the Licence Holder's overall current and future risk appetite and strategy and assist the Management Body in overseeing the implementation of that strategy by senior management. The Management Body shall retain overall

responsibility for risks;

ii. review whether prices of liabilities and assets offered to clients take fully into account the Licence Holder's business model and risk strategy. Where prices do not properly reflect risks in accordance with the business model and risk strategy, the risk committee shall present a remedy plan to the Management Body;

iii. without prejudice to the remuneration committee referred to in R3-1.3.4.2, examine whether incentives provided by the remuneration system take into consideration risk, capital, liquidity and the likelihood and timings of earnings.

R3-1.3.4.4 *Combined Risk and Audit Committee*

R3-1.3.4.4.1 The MFSA may allow a Licence Holder which is not considered significant as defined in to combine the risk committee with the audit committee as referred to in Article 41 of Directive 2006/43/EC. Members of the combined committee shall have the knowledge, skills and expertise required for the risk committee and for the audit committee.

Title 2 Risk Management

Section 1 Scope and Application

R3-2.1.1 Title 2 of Chapter 3 applies to all Investment Services Licence Holders falling within scope of these Rules, except:

i. Rule R3-2.2.2 which shall apply solely to Category 1A and 1B Investments Services Licence Holders.

ii. Rules R3-2.2.3 to R3-2.2.4 which shall apply solely to Category 2 and 3 Investments Services Licence Holders as well as Licence Holders which are members of a Consolidated Group pursuant to Section 2, Title 4 of Chapter 2.

iii. Section 3 which shall apply solely to Category 2 and 3 Investments Services Licence Holders on the following basis:

(a) Licence Holders which are neither subsidiaries nor parent undertakings and Licence Holders not included in consolidation pursuant to Article 19 of the CRR shall meet the obligations set out in this section on an individual basis.

(b) Licence Holders which are members of a Consolidated Group shall be required to comply with the obligations of this section on a consolidated or sub-consolidated basis.

(c) Where the Licence Holder is the parent investment firm or is controlled by a parent financial holding company or a parent mixed financial holding company established in a Member State it shall meet the obligations set out in this section as supplemented by the provisions of Section 3, on a consolidated basis.

(d) Where the Licence Holder is a member of a Consolidated Group which comprises also other investment firms authorised in other Member States and which are controlled by a parent financial holding company or a parent mixed financial holding company in a Member State, point (iii)(c) of this Rule shall apply only to the Licence Holder where the MFSA is the consolidating supervisor in terms of Regulation 3 of the Supervisory

Consolidation Regulations, 2014.

(e) Where the Licence Holder is a subsidiary member of a Consolidated Group and either of the following point (i) and (ii), the Licence Holder shall comply with the requirements set out in Rules in this section on a sub-consolidated basis.

i. the parent of the Licence Holder is a financial holding company or a mixed financial holding company which also holds an institution or a financial institution or an asset management company as a subsidiary in a third country or holds a participation in such an entity; or

ii. the Licence Holder itself holds an institution or a financial institution or an asset management company as a subsidiary in a third country or holds a participation in such an entity.

Section 2 ***Policies and Procedures***

R3-2.2.1 The Licence Holder shall take the following actions with a view to managing its risks:

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

ii. 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;

iii. monitor the following:

(a) the adequacy and effectiveness of the Licence Holder's risk management policies and procedures;

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

(c) 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.

R3-2.2.2 The Licence Holder is required to establish and maintain a risk management function which independently carries out the following tasks:

i. the implementation of the policy and procedures referred to in Rule R3-2.2.1 and

ii. the provision of reports and advice to senior management in accordance with Rule R3-1.3.2.

R3-2.2.3 The Licence Holder is required to establish and maintain a risk management function that operates independently and which has sufficient authority and resources, including access to the Management Body where necessary, to facilitate the carrying out of the following tasks:

i. the implementation of the policy and procedures referred to in R3-2.2.1 and Section 3 of this Title;

ii. the provision of reports and advice to senior management;

iii. the development of the Licence Holder's risk strategy and participation in all material risk management decisions;

iv. direct communication with the Management Body in its supervisory function, independently from the Licence's Holder senior management, where appropriate, regarding concerns, where specific risk developments affect or may affect the Licence Holder, without prejudice to the responsibilities of the Management Body in its supervisory and/or managerial functions.

R3-2.2.4 The Licence Holder shall appoint a head of the risk management function that shall be an independent senior manager with distinct responsibility for the risk management function and shall not be removed without the prior approval of the Management Body in its supervisory function.

R3-2.2.5 However, the MFSA may allow the Licence Holder to establish and maintain a risk management function which does not operate independently, provided this does not give rise to conflicts of interest and the Licence Holder demonstrates to the MFSA that the establishment and maintenance of a dedicated

independent risk management function with sole responsibility for the 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.

R3-2.2.6 Where a Licence Holder is granted such derogation it must nevertheless be able to demonstrate that the policies and procedures which it has adopted in accordance with Rule R3-2.2.1 satisfy the requirements thereof and are consistently effective.

Section 3 Risk Management and the Internal Capital Adequacy Assessment Process (RMICAAP)

R3-2.3.1 **General Requirements**

R3-2.3.1.1 Pursuant to Rule R3-2.2.1, a Licence Holder is inter alia required to have in place a risk management process to:

i. identify the risks to which the Licence Holder is/could be exposed; and

ii. manage those risks, in the light of the level of risk tolerance set by the Licence Holder.

R3-2.3.1.2 In addition to R3-2.3.1.1, the Licence Holder shall have in place, sound effective and complete strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that it considers adequate to cover the nature and level of the risks to which it is or might be exposed. This is hereinafter referred to as the Licence Holder's Risk Management Internal Capital Adequacy Assessment Process ("RMICAAP").

R3-2.3.1.3 The RMICAAP has the purpose of:

i. ensuring that the Licence Holder adequately identifies, measures, aggregates and monitors its risks;

ii. holding adequate internal capital in relation to its risk profile; and

iii. using sound risk management systems

R3-2.3.1.4 The Licence Holder shall, on yearly basis, review its RMICAAP with the aim of ensuring that this process remains comprehensive and proportionate to the nature, scale and complexity of the activities of the Licence Holder concerned.

R3-2.3.1.5 In preparing, reviewing and updating its RMICAAP, a Licence Holder shall refer to this Section.

R3-2.3.1.6 The RMICAAP Report shall be signed by two directors of the Licence Holder.

R3-2.3.1.7 Pursuant to Rule R3-2.3.1.3, Licence Holders shall subdivided the RMICAAP into six stages, (i) risk identification; (ii) description of risk; (iii) risk estimation; (iv) risk tolerance and evaluation; (v) risk treatment; and (vi) risk recording/ reporting as specified from Rules R3-2.3.2 to R3-2.3.7.

R3-2.3.2 **Risk Identification**

R3-2.3.2.1 Risk identification is the process whereby the Licence Holder identifies its exposure to uncertainty. This requires an intimate knowledge of the organisation, the market in which it operates, the legal, social, political and cultural environment in which it exists, as well as the development of a sound understanding of its strategic and operational objectives, including factors critical to its success and the threats and opportunities related to the achievement of these objectives.

The purpose of this initial stage in the risk management process is to record (in a structured form) as many risks as possible which might hinder the Licence Holder in attaining its goals. Risk identification should be approached in a methodical way to ensure that all significant activities within the organisation have been identified and all the risks flowing from these activities defined.

R3-2.3.2.2 Rule R3-2.3.2 is especially important given that it sets the stage for the remainder of the risk management process.

R3-2.3.2.3 The risks to which a Licence Holder may be exposed are identified in Rules R3-2.3.2.4 to R3-2.3.2.8.9.

R3-2.3.2.4 *Pillar I Financial Return - Non-Trading Book Business Risks*

R3-2.3.2.4.1 **Credit/Counterparty risk:** This being the probability of a loss occurring due to: [i] the failure of a debtor of a Licence Holder to meet its contractual debt obligations; or [ii] the loss in value of any other asset (excluding derivatives which are exclusively dealt with in the sections on trading book business and commodities instruments – risk component) which forms part of the Licence Holder's balance sheet except for: (a) intangible assets including goodwill; (b) cash in hand and at bank; (c) those financial instruments which fall within the

category of trading book business; and (d) commodity positions.

R3-2.3.2.4.2 **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.

R3-2.3.2.4.3 In relation to Credit/Counterparty risk and free deliveries, the Licence Holder shall assess whether these risks are fully captured by the Pillar I requirements as reflected in the automated COREP Return which the Licence Holder is required to submit in terms the Rules.

R3-2.3.2.5 *Pillar I Financial Return - Trading Book Business Risks*

R3-2.3.2.5.1 **Position Risk:** 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.

R3-2.3.2.5.2 **The counterparty credit risk component:** 'Counterparty Credit Risk' or 'CCR' means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

R3-2.3.2.5.3 In relation to Trading Book Business risks, the Licence Holder shall assess whether the above-mentioned risks are fully captured by the Pillar I requirements as reflected in the automated COREP Return which the Licence Holder is required to submit in terms of the applicable MFSA rules.

R3-2.3.2.6 *Other Risks covered in the Licence Holder's Pillar I Financial Return*

R3-2.3.2.6.1 **Commodities Risk:** The risk of holding or taking positions in commodities such as physical products which are and can be traded in the secondary market including commodity derivatives.

R3-2.3.2.6.2 **Large Exposures:** Is defined as an exposure to a client or group of connected clients where its value is equal to or exceeds 10% of the Licence Holder's eligible capital as applicable to Category 3 investment services licence holders.

R3-2.3.2.6.3 **Concentration Risk:** is defined in the CEBS Guidelines as and exposure(s) that may arise within or across different risk categories throughout an institution with the potential to produce: (i) losses large enough to threaten the institution's health or ability to maintain its core operations; or (ii) a material

change in an institution's risk profile. **Concentration Risk** is related to the Large Exposures risk.

R3-2.3.2.6.4 **Foreign Exchange Risk:** The risk that an asset or liability denominated in a currency other than the reporting currency may be adversely affected by a change in the value of the foreign currency.

R3-2.3.2.6.5 **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 – [applicable to Category 3 investment services licence holders].

R3-2.3.2.6.6 **Settlement Risk:** Settlement risk is the risk that the Licence Holder's cash against documents transactions in financial instruments are unsettled after their due delivery dates

R3-2.3.2.6.7 **Credit Valuation Adjustment (CVA) Risk:** The term 'CVA' is defined in Article 381 of the CRR as an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. That adjustment reflects the current market value of the credit risk of the counterparty to the Licence Holder, but does not reflect the current market value of the credit risk of the Licence Holder to the counterparty.

R3-2.3.2.6.8 In relation to the other risks covered in the Licence Holder's Pillar I Financial Return, the Licence Holder shall assess whether the above-mentioned risks are fully captured by the Pillar I requirements as reflected in the automated COREP Return which the Licence Holder is required to submit in terms of the applicable MFSA rules.

R3-2.3.2.8 *Other Possible Risks*

R3-2.3.2.8.1 **Liquidity Risk:** The risk that the Licence Holder cannot meet its financial obligations, such as payments and collateral needs, as they fall due in the short term and medium term, either at all or without incurring unacceptable losses.

R3-2.3.2.8.2 **Compliance Risk:** The risk of legal or regulatory sanctions, financial loss, or reputational impact due to a failure to comply with laws, regulations, standard or codes of conduct.

R3-2.3.2.8.3 **Technology Risk:** The risk of loss associated with failed, compromised or inadequate information technology on which the business depends and which can further expose an organisation to additional risk – legal, regulatory, reputation, revenue, and so forth.

R3-2.3.2.8.4 **Strategic Risk:** The risk of loss arising from adverse business decisions that poorly aligns to strategic goals, failed execution of policies and processes designed to meet those gaols, and inability to respond to macro-economic and industry dynamics.

R3-2.3.2.8.5 **Securitisation Risk:** The risk arising from securitisation transactions in relation to which the Licence Holder is an investor, originator or sponsor, including reputational risks (such as arise in relation to complex structures or products).

R3-2.3.2.8.5.1 Securitisation in this context means a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranched and has both following characteristics:

R3-2.3.2.8.5.2

i. Payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures; and

ii. The subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme;

R3-2.3.2.8.6 **Remuneration Risk:** The risk that the remuneration structures and the remuneration policies of the Licence Holder provide incentives to take risks that exceed the general level of risk tolerated by the Licence Holder, exacerbating excessive risk-taking behaviour.

R3-2.3.2.8.7 **Risk of Excessive Leverage:** The risk resulting from the Licence Holder's vulnerability due to leverage or contingent leverage that may require unintended corrective measures to its business plan, including distressed selling of assets which might result in losses or in valuation adjustments to its remaining assets.

R3-2.3.2.8.8 **Interest Risk arising from Non-Trading Book Activities** which for the purpose of these rules is referred to as 'interest rate risk in the banking book'.

R3-2.3.2.8.8.1 In terms of the EBA Guidelines, interest rate risk in the banking book is defined as the current or prospective risk to both the earnings and capital of institutions, in respect of the banking book only, arising from adverse movements in interest rates.

R3-2.3.2.8.9 **Residual Risk:** The risk that recognised credit risk mitigation techniques used prove less effective than expected.

R3-2.3.3 **Description of Risk**

R3-2.3.3.1 The objective of risk description is to display the risks in a structured format. The use of a well-designed structure is necessary to ensure a comprehensive risk identification and description process. This will in turn assist the Licence Holder in assessing the risk.

At this stage, the Licence Holder shall prepare a table which indicates the risk to which the Licence Holder is exposed and the nature of such risk

R3-2.3.4 **Risk Estimation**

R3-2.3.4.1 Risk estimation is a combination of IMPACT (the potential harm that could be caused) and PROBABILITY (the likelihood of the particular event occurring). It is recommended that Licence Holders assess their risks in terms of possible impact and probability.

R3-2.3.4.2 Depending on the type of risk, the impact assessment may take the form of a quantitative and/or qualitative assessment. A quantitative assessment is carried out by calculating the possible financial impact on the Licence Holder of the occurrence of a specific risk. A qualitative assessment is the assessment of a risk in terms of a possible impact:

i. which cannot be quantified e.g. impact of possible reputational risk due to the inadequate provision of an investment service; or

ii. the quantification of which cannot be calculated in its entirety e.g. impact of the imposition by the MFSA of an administrative penalty and the publication of such penalty on the MFSA's web-page.

R3-2.3.4.3 Probability is defined as the likelihood of the occurrence of a risk. This is usually based on the history of occurrences of the same risk or similar risks. The Licence Holder shall classify the probability of a risk as either:

i. High – There is more than 75% chance of occurrence; or

ii. Medium - There is from 25% to 75% chance of occurrence; or

iii. Low - There is less than 25% chance of occurrence.

R3-2.3.4.4 Where the impact of a risk is quantifiable in its entirety, the Licence Holder

shall quantify its Gross Risk, this being the multiplication of the impact assessment by the percentage probability of occurrence.

R3-2.3.5 **Risk Tolerance and Evaluation**

R3-2.3.5.1 Risk tolerance is equivalent to the amount of risk which the Licence Holder is willing to take in order to achieve its strategic and business objectives. The higher the Licence Holder's risk tolerance, the more risk such Licence Holder is willing to take.

R3-2.3.5.2 Risk evaluation is the process used to determine risk management priorities by comparing the level of risk against the Licence Holder's level of tolerance, this with the purpose of determining which risks are acceptable.

R3-2.3.5.3 Further to quantifying its risks, the Licence Holder shall establish its level of risk tolerance and evaluate its risks by comparing the estimated risks against the risk tolerance criteria which it has established. Through this risk evaluation process, the Licence Holder shall make decisions regarding the significance of risks and whether each specific risk ought to be accepted or treated.

R3-2.3.6 **Risk Treatment**

R3-2.3.6.1 Risk treatment is the process of selecting and implementing measures to mitigate the risk to which the Licence Holder is exposed with the aim of bringing such risk within the parameters of the Licence Holder's risk tolerance levels. Risk treatment can take the form of either:

i. Risk control – which are measures which aim at either reducing the likelihood or consequences or both of a risk occurring – e.g. stress testing the business of the Licence Holder by contemplating a scenario where the business of the Licence Holder is reduced by 30% and in turn:

(a) analysing the impact of such a reduction in business on the Licence Holder's capital resources – i.e. in such a scenario will the Licence Holder continue satisfying the capital resources requirement; and

(b) considering the action which the Licence Holder's person could take in order to mitigate a possible deficit of the capital resources requirement – e.g. possibly entering into a subordinated loan agreement; or

ii. Risk transfer – which is a process whereby the Licence Holder transfers risk in whole or in part to another organisation – e.g. taking a professional indemnity insurance to inter alia cover the potential risk of liability resulting from any breach of a provision of the relevant requirements which apply to the Licence Holder and any administrative penalty resulting from such breach; or

iii. Risk financing - which refers to the mechanisms for funding the financial consequences of risk - e.g. increasing the Own Funds to provide for compliance risk, which risk is not catered for in the Automated COREP Return which Licence Holders are required to submit to the Authority on a periodic basis.

R3-2.3.6.2 For the purposes of point (iii) of Rule R3-2.3.6.1, the Licence Holder shall apply risk financing to treat those risks the impact of which can be calculated in its entirety to assess the adequacy of its capital. In this regard, the Licence Holder shall assess:

i. whether the risks captured by the Pillar I capital requirement calculation, adequately reflect the actual size of the risks faced by the Licence Holder. In this regard, the Licence Holder is required to estimate the additional capital needed (if any) to protect its business operations from such risks; and

ii. the remaining risks which are not captured by the Pillar I regime – classified in section [I d] above as 'Other Possible Risks' and where relevant, to estimate any additional capital requirements to mitigate such risks.

R3-2.3.6.3 Further to the Rule R3-2.3.6.2, the assessment of the Licence Holder shall also involve an RMICAAP Risk Financing Calculation by calculating the total risk capital component required to mitigate the Total Gross Risk (i.e. the summation of all the Gross Risks to which the Licence Holder is exposed). In this regard, in making this calculation the Licence Holder shall use the table titled RMICAAP – Risk Financing Calculation Report which is outlined in the Appendices to the Guidance Notes of these Rules.

R3-2.3.6.4 The Licence Holder may choose to take a combination of points (i) to (iii) of Rule R3-2.3.6.1 in order to mitigate its risks.

R3-2.3.6.5 *Additional technical criteria on the treatment of securitisation risk*

R3-2.3.6.5.1 For the purposes of the organisation and treatment of securitisation risk as referred to in Rule R3-2.3.2.8.5, the Licence Holder is required to evaluate and address the risks arising from securitisation transactions 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.

R3-2.3.6.5.2 Liquidity plans to address the implications of both scheduled and early amortisation must exist at Licence Holders which are originators of revolving securitisation transactions involving early amortisation provisions.

R3-2.3.6.6 *Additional technical criteria on the treatment of liquidity risk*

R3-2.3.6.6.1 For the purposes of the organisation and treatment of liquidity risk as referred to in Rule R3-2.3.2.8.1, the Licence Holder is required to have robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk, over an appropriate set of time horizons, including intra-day, so as to ensure that adequate levels of liquidity buffers are maintained. The strategies, policies, processes and systems of the Licence Holder shall be tailored to business lines, currencies, branches and legal entities and shall include adequate allocation mechanisms of liquidity costs, benefits and risks.

R3-2.3.6.6.2 The strategies, policies, processes and systems referred to in Rule R3-2.3.6.6.1 shall be proportionate to the complexity, risk profile, scope of operation of the Licence Holder and risk tolerance set by the management body and reflect the Licence Holder's importance in each Member State, in which it carries out business. The Licence Holder shall communicate risk tolerance to all relevant business lines.

R3-2.3.6.6.3 The Licence Holder, taking into account the nature, scale and complexity of its investment services activities, shall establish liquidity risk profiles that are consistent with and, not in excess of, those required for a well-functioning and robust system.

R3-2.3.6.6.4 The Licence Holder is required to develop methodologies for the identification, measurement, management and monitoring of funding positions. These methodologies shall include the current and projected material cash-flows in and arising from assets, liabilities, off-balance sheet items, including contingent liabilities and the possible impact of reputational risk.

R3-2.3.6.6.5 The Licence Holder must distinguish between pledged and unencumbered assets that are available at all times, in particular during emergency situations. They shall also take into account the legal entity in which assets reside, the country where assets are legally recorded either in a register or in an account as well as their eligibility and shall monitor how assets can be mobilised in a timely manner.

R3-2.3.6.6.6 The Licence Holder must also have regard to existing legal, regulatory and operational limitations to potential transfers of liquidity and unencumbered assets amongst entities, both within and outside the EEA.

R3-2.3.6.6.7 The Licence Holder must consider different liquidity risk mitigation tools, including a system of limits and liquidity buffers in order to be able to withstand a range of different stress events and an adequately diversified funding structure and access to funding sources. Those arrangements shall be reviewed regularly.

R3-2.3.6.6.8 Alternative scenarios on liquidity positions and on risk mitigants must be considered by the Licence Holder and the assumptions underlying decisions concerning the funding position shall be reviewed at least annually. For these purposes, alternative scenarios shall address, in particular, off-balance sheet items and other contingent liabilities, including those of Securitisation Special Purpose Entities or other special purpose entities, as referred to in the CRR, in relation to which the Licence Holder acts as sponsor or provides material liquidity support.

R3-2.3.6.6.9 The Licence Holder is required to consider the potential impact of institution-specific, market-wide and combined alternative scenarios. Different time periods and varying degrees of stressed conditions must also be considered.

R3-2.3.6.6.10 The Licence Holder should adjust its strategies, internal policies and limits on liquidity risk and develop effective contingency plans, taking into account the outcome of the alternative scenarios referred to in Rule R3-2.3.6.6.8.

R3-2.3.6.6.11 In order to deal with liquidity crises, the Licence Holder must have in place liquidity recovery plans setting out adequate strategies and proper implementation measures in order to address possible liquidity shortfalls, including in relation to branches established in another Member State. Those plans should be regularly tested, at least annually, updated on the basis of the outcome of the alternative scenarios set out in Rule R3-2.3.6.6.8 above, be reported to and approved by senior management, so that internal policies and processes can be adjusted accordingly. Licence holders shall take the necessary

operational steps in advance to ensure that liquidity recovery plans can be implemented immediately.

R3-2.3.6.7 *Additional technical criteria on the treatment of remuneration risk*

R3-2.3.6.7.1 For the purposes of the organisation and treatment of remuneration risk as referred to in Rule R3-2.3.2.8.6, the Licence Holder shall refer to Rule R3-1.3.4.2 on the establishment of the Remuneration Committee and Section 3, Title 5 of Chapter 3 on Remuneration Policies, and Procedures.

R3-2.3.6.8 *Additional technical criteria on the treatment of market risk*

R3-2.3.6.8.1 For the purposes of the treatment of market risk, the Licence Holder shall implement policies and processes for the identification, measurement and management of all material sources and effects of market risks.

R3-2.3.6.8.2 Where the short position falls due before the long position, the Licence Holder shall ensure that it takes measures against the risk of a shortage of liquidity.

R3-2.3.6.8.3 The internal capital shall be adequate for material market risks that are not subject to an own funds requirement.

R3-2.3.6.8.4 The Licence Holder which has, in calculating own funds requirements for position risk in accordance with Part Three, Title IV, Chapter 2, of the CRR, netted off its positions in one or more of the equities constituting a stock-index against one or more positions in the stock-index future or other stock- index product shall have adequate internal capital to cover the basis risk of loss caused by the future's or other product's value not moving fully in line with that of its constituent equities. The Licence Holder shall also have such adequate internal capital where it holds opposite positions in stock-index futures which are not identical in respect of either their maturity or their composition or both.

R3-2.3.6.8.5 Where using the treatment in Article 345 of the CRR, the Licence Holder shall ensure that it holds sufficient internal capital against the risk of loss which exists between the time of the initial commitment and the following working day.

R3-2.3.6.9 *Additional technical criteria on the treatment of interest rate risk in the banking book*

R3-2.3.6.9.1 The Licence Holder shall implement systems to identify, evaluate and manage the risk arising from potential changes in interest rates that affect the non-

trading activities of the Licence Holder.

R3-2.3.6.10 *Additional technical criteria on the treatment of operational risk*

R3-2.3.6.10.1 The Licence Holder shall implement policies and processes to evaluate and manage the exposure to operational risk, including model risk[1], and to cover low-frequency high-severity events. The Licence Holder shall specify what constitutes operational risk for the purposes of those policies and procedures.

R3-2.3.6.10.2 In addition, the Licence Holder shall ensure that contingency and business continuity plans are in place to ensure the Licence Holder's ability to operate on an ongoing basis and limit losses in the event of severe business disruption

R3-2.3.6.11 *Additional technical criteria on the treatment of the risk of excessive leverage*

R3-2.3.6.11.1 The Licence Holder shall have policies and processes in place for the identification, management and monitoring of the risk of excessive leverage.

R3-2.3.6.11.2 The Licence Holder shall address the risk of excessive leverage in a precautionary manner by taking due account of potential increases in the risk of excessive leverage caused by reductions of the Licence Holder's own funds through expected or realised losses, depending on the applicable accounting rules. To that end, the Licence Holder shall be able to withstand a range of different stress events with respect to the risk of excessive leverage.

R3-2.3.6.11.3 In addition to the indicators for the risk of excessive leverage, the Licence Holder shall include the leverage ratio as applicable in accordance with Title 7 of Chapter 2.

R3-2.3.6.12 *Additional technical criteria on the treatment of the credit/counterparty risk*

R3-2.3.6.12.1 For the purposes of managing credit/counterparty risk as referred to in Rule R3-2.3.2.4.1, the Licence Holder shall ensure that:

i. credit-granting is based on sound and well-defined criteria and that the process for approving, amending, renewing, and re-financing credits is clearly established;

ii. internal methodologies are established which enables assessment of the

[1] Model risk means the potential loss an institution may incur, as a consequence of decisions that could be principally based on the output of internal models, due to errors in the development, implementation or use of such models.

credit risk of exposures to individual obligors, securities or securitisation positions and credit risk at the portfolio level. In particular, internal methodologies shall not rely solely or mechanistically on external credit ratings. Where own funds requirements are based on a rating applied through the Credit Quality Steps Approach or based on the fact that an exposure is unrated, this shall not exempt the Licence Holder from additionally considering other relevant information for assessing their allocation of internal capital;

iii. the ongoing administration and monitoring of the various credit risk-bearing portfolios and exposures of the Licence Holder, including for identifying and managing problem credits and for making adequate value adjustments and provisions, is operated through effective systems;

iv. diversification of credit portfolios is adequate given a Licence Holder's target markets and overall credit strategy.

R3-2.3.6.13 *Additional technical criteria on the treatment of the residual risk*

R3-2.3.6.13.1 Residual risk, as referred to in Rule R3-2.3.2.8.9, shall be addressed and controlled by means of written policies and procedures.

R3-2.3.6.14 *Additional technical criteria on the treatment of the concentration risk*

R3-2.3.6.14.1 The Licence Holder shall address and control the concentration risk arising from exposures to each counterparty, including central counterparties, groups of connected counterparties, and counterparties in the same economic sector, geographic region or from the same activity or commodity, the application of credit risk mitigation techniques, and including in particular risks associated with large indirect credit exposures such as a single collateral issuer, by means of written policies and procedures.

R3-2.3.7 **Risk Recording / Reporting**

R3-2.3.7.1 The Licence Holder is required to assess on a yearly basis whether its RMICAAP is comprehensive and proportionate to the nature, scale and complexity its activities, and to take any necessary measures to ensure this is the case.

R3-2.3.7.2 Pursuant to Rule 4-5.6.1, a Licence Holder is required to provide the Authority with a confirmation that it has an RMICAAP in place and that this is comprehensive and proportionate to the nature scale and complexity of the

activities of the Licence Holder.

R3-2.3.7.3 Licence Holder may be required by the Authority to submit an RMICAAP Report in line with the requirements of this Section.

R3-2.3.7.4 Given the above-quoted requirements, the Licence Holder shall keep a record and update on a yearly basis the following:

i. all the risks which it has identified,

ii. the estimation of such risks,

iii. its risk tolerance level and evaluation; and

iv. the manner in which these risks are being addressed.

R3-2.3.7.5 For the purposes of R3-2.3.7.4, if risk financing is used, the Licence Holder should also retain a record of the RMICAAP Risk Financing Calculation

R3-2.3.7.6 Should the Licence Holder be requested by the Authority to submit an RMICAAP Report, the Licence Holder would be expected to submit a report in the suggested format set out in the Appendices to the Guidance Notes of these Rules, which, *inter alia*, should include:

i. the Licence Holder's risk identification and monitoring process, which would include a general overview of the arrangements and processes implemented by the Licence Holder with the aim of identifying and monitoring its risks;

ii. the individual risks to which the Licence Holder is exposed; and

iii. an RMICAAP Risk Financing Calculation Report.

R3-2.3.7.7 The Licence Holder should use the example RMICAAP Report as set out in the Appendices to the Guidance Notes of these Rules in order to keep a record of:

i. its risk identification and monitoring process;

ii. all the risks which it has identified; and

iii. the RMICAAP Risk Financial Calculation.

Title 3 *Compliance*

Section 1 Scope and Application

R3-3.1.1 This Title applies to all Investment Services Licence Holders falling within scope of the Rules.

Section 2 General Requirements

R3-3.2.1 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, 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

R3-3.2.2 The Licence Holder shall establish and maintain a permanent and effective compliance function which operates independently and which has the following responsibilities:

i. 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 Rule R3-3.2.1, and the actions taken to address any deficiencies in the Licence Holder's compliance with its obligations;

ii. 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.

R3-3.2.3 In order to enable the compliance function to discharge its responsibilities properly, the Licence Holder shall ensure that the following conditions are satisfied:

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

ii. 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;

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

iv. 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.

R3-3.2.4 However, the MFSA may exempt a Licence Holder from the requirements of points (iii) or (iv) of Rule R3-3.2.3 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 independent, objective and effective.

R3-3.2.5 Moreover, with respect to (ii) of Rule R3-3.2.3, 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 point (viii) of Rule R4-1.3.1 in this regard.

R3-3.2.6 In complying with this Title, the Licence Holder is expected to take into account the Guidelines as issued by ESMA on certain aspects of the MiFID compliance function requirements. These Guidelines may be downloaded from ESMA's website: www.esma.europa.eu/sites/default/files/library/2015/11/2012-387.pdf

Title 4 Safeguarding of Clients' Assets

Section 1 Scope and Application

R3-4.1.1 Title 4 of Chapter 3 applies to Category 2 and Category 3 Licence Holders falling within scope of the Rules.

R3-4.1.2 For the Purposes of these rules, reference should also be made to SL 370.05.

Section 2 *General Requirements*

R3-4.2.1 For the purposes of these Rules, the term "Client Assets" shall mean instruments and money belonging to the client.

R3-4.2.2 The Licence Holder holding or controlling Client Assets shall comply with the Rules in this Section in addition to the relevant provisions of the Investment Services Act (Control of Assets) Regulations (Legal Notice 240 of 1998).

R3-4.2.3 For purposes of safeguarding client's rights in relation to Instruments and money belonging to them which are held or controlled by the Licence holder, a Licence Holder shall hold clients' money/financial instruments in specially created and segregated accounts entitled "Client Money Account"/'Client Financial Instruments Account and these accounts must be identified separately from any accounts used to hold money/financial instruments belonging to the Licence Holder.

R3-4.2.4 The Licence Holder shall obtain a written declaration from the Bank/Custodian that the Bank/Custodian renounces and will not attempt to enforce or execute, any charge, right of set-off or other claim against the account, or combine the account with any other account in respect of any debt owed to the Bank/Custodian by the Licence Holder, and that interest payable on the account will be credited to the account.

Section 3 *Reconciliation of Clients' Money*

R3-4.3.1 The Licence Holder shall reconcile, on a monthly basis, the balance on each client's money account as recorded by the Licence Holder with the balance on that account as set out in the statement issued by the bank.

R3-4.3.2 The Licence holder shall also reconcile the total of the balances on all clients' money bank accounts as recorded by the Licence Holder with the total of the corresponding credit balances in respect of each of its clients as recorded by the Licence Holder.

Section 4 ***Reconciliations of Clients' Assets***

R3-4.4.1 The Licence Holder shall carry out physical counts and inspections of clients' financial instruments and the subsequent reconciliation of all such assets with customers' records on regular basis and at least twice a year.

R3-4.4.2 Where the Licence Holder discovers discrepancies after carrying out the above reconciliations, it shall maintain a record of such discrepancies and the measures taken to remedy such differences.

Section 5 **Third Party Agreements**

R3-4.5.1 A Licence Holder shall not conclude title transfer financial collateral arrangements with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations of clients.

Title 5 Other Organisational Requirements

Section 1 Scope and Application

R3-5.1.1 This Title applies to all Investment Services Licence Holders falling within scope of the Rules, except for:

i. Section 3, which shall apply to Category 2 and Category 3 Licence Holders falling within scope of the Rules, at group, parent company and subsidiary levels, including those established in offshore financial centres.

ii. R3-5.4.2.2, which shall apply exclusively to Category 1A and IB Investment Services Licence Holders falling within scope of the Rules;

iii. R3-5.4.2.3, which shall apply exclusively to Category 2 and Category 3 Licence Holders falling within scope of the Rules;

iv. Section 6, which shall apply exclusively to Category 3 Investment Services Licence Holders falling within scope of the Rules at both individual and consolidated level;

v. Section 8, which shall apply solely to Category 2 and Category 3 Licence Holders falling within scope of the Rules.

Section 2 Internal Audit

R3-5.2.1 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:

i. 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;

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

iii. to verify compliance with those recommendations;

iv. to report in relation to internal audit matters in accordance with Rule R3-1.3.2.2.

R3-5.2.2 Licence Holders which do not intend to establish an internal audit function must complete the form in Appendices to the Guidance Notes of these Rules.

Section 3 ***Remuneration Policies and Procedures***

R3-5.3.1 The Licence Holder is required to establish and apply the total remuneration policies, inclusive of salaries and discretionary pension benefits, for categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact on their risk profile.

R3-5.3.2 The Licence Holder must be able to demonstrate to the MFSA how it has assessed and selected identified staff, in accordance with Commission Delegated Regulation (EU) No 604/2014 regarding the regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile.

R3-5.3.3 When establishing and applying the total remuneration policies, the Licence Holder must comply with the following principles in a way and to the extent that is appropriate to its size, internal organisation and the nature, the scope and the complexity of its activities:

i. the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the Licence Holder;

ii. the remuneration policy is in line with the business strategy, objectives, values and long-term interests of the Licence Holder, and incorporates measures to avoid conflicts of interest;

iii. the Licence Holder's management body in its supervisory function adopts and periodically reviews the general principles of the remuneration policy and is responsible for overseeing its implementation;

iv. the implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its

supervisory function;

v. staff engaged in control functions are independent from the business units they oversee, have appropriate authority, and are remunerated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control;

vi. the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee referred to in Rule R3-1.3.4.2 or, if such a committee has not been established, by the management body in its supervisory function;

vii. the remuneration policy, taking into account national criteria on wage setting, makes a clear distinction between criteria for setting:

(a) basic fixed remuneration, which should primarily reflect relevant professional experience and organisational responsibility as set out in an employee's job description as part of the terms of employment; and

(b) variable remuneration which should reflect a sustainable and risk adjusted performance as well as performance in excess of that required to fulfil the employee's job description as part of the terms of employment.

viii. In the case of a Licence Holder that benefits from exceptional government intervention:

(a) variable remuneration is strictly limited as a percentage of net revenue where it is inconsistent with the maintenance of a sound capital base and timely exit from government support;

(b) the MFSA requires the Licence Holder to restructure remuneration in a manner aligned with sound risk management and long-term growth, including, where appropriate, establishing limits to the remuneration of the members of the management body of the Licence Holder;

(c) no variable remuneration is paid to the members of the management body of the Licence Holder unless justified;

ix. where remuneration is performance related, the total amount of remuneration is based on a combination of the assessment of the performance of the individual and of the business unit concerned and of the overall results of the Licence Holder and when assessing individual performance, financial and non-financial criteria are taken into account;

x. the assessment of the performance is set in a multi-year framework in order to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-based components of remuneration is spread over a period which takes account of the underlying business cycle of the Licence Holder and its business risks;

xi. the total variable remuneration does not limit the ability of the Licence Holder to strengthen its capital base;

xii. guaranteed variable remuneration is not consistent with sound risk management or the pay-for-performance principle and shall not be a part of prospective remuneration plans;

xiii. guaranteed variable remuneration is exceptional, occurs only when hiring new staff and where the Licence Holder has a sound and strong capital base and is limited to the first year of employment;

xiv. fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy, on variable remuneration components, including the possibility to pay no variable remuneration component;

xv. the Licence Holder must set the appropriate ratios between the fixed and the variable component of the total remuneration, whereby the following principles shall apply:

(a) the variable component shall not exceed 100% of the fixed component of the total remuneration for each individual;

(b) shareholders or owners or members of the Licence Holder may approve a higher maximum level of the ratio between the fixed and variable components of remuneration provided the overall level of the variable component shall not exceed 200% of the fixed component of the total remuneration for each individual.

Any approval of a higher ratio in accordance with (xv)(a) shall be carried out in accordance with the following procedure:

– the shareholders or owners or members of the Licence Holder shall act upon a detailed recommendation by the Licence Holder giving the reasons for, and the scope of, an approval sought, including the number of staff affected, their functions and the expected impact on the requirement to maintain a sound capital base;

- shareholders or owners or members of the Licence Holder shall act by a majority of at least 66% provided that at least 50% of the shares or equivalent ownership rights are represented or, failing that, shall act by a majority of 75% of the ownership rights represented;

- the Licence Holder shall notify all shareholders or owners or members of the Licence Holder, providing a reasonable notice period in advance, that an approval under the first subparagraph of this paragraph will be sought;

- the Licence Holder shall, without delay, inform the MFSA of the recommendation to its shareholders or owners or members, including the proposed higher maximum ratio and the reasons therefore and shall be able to demonstrate to the MFSA that the proposed higher ratio does not conflict with the Licence Holder's obligations under the Investment Services Rules and the CRR, having regard in particular to the Licence Holder's own funds obligations;

- the Licence Holder shall, without delay, inform the MFSA of the decisions taken by its shareholders or owners or members, including any approved higher maximum ratio pursuant to the first subparagraph of this paragraph, and the MFSA shall use the information received to benchmark the practices of Licence holders in that regard. The MFSA shall provide this information to EBA.

- staff who are directly concerned by the higher maximum levels of variable remuneration referred to in this paragraph shall not, where applicable, be allowed to exercise, directly or indirectly, any voting rights they may have as shareholders or owners or members of the Licence Holder;

(c) Licence Holders may apply the discount rate referred to in Article 94 (1) (g) (iii) of the CRD to a maximum of 25% of total variable remuneration provided it is paid in instruments that are deferred for a period of not less than five years.

Licence Holders should make reference to EBA's Guidelines on the applicable notional discount rate for variable remuneration.

Licence Holders shall be required to apply the principles in this paragraph (xv) to remuneration awarded for services provided or performance from the year 2014 onwards, whether due on the basis of contracts concluded before or after 1 January 2014.

xvi. payments relating to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure or misconduct;

xvii. remuneration packages relating to compensation or buy out from contracts in previous employment must align with the long-term interests of the Licence Holder including retention, deferral, performance and clawback arrangements;

xviii. the measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes an adjustment for all types of current and future risks and takes into account the cost of the capital and the liquidity required;

xix. the allocation of the variable remuneration components within the Licence Holder shall also take into account all types of current and future risks;

xx. a substantial portion, and in any event at least 50%, of any variable remuneration must consist of an appropriate balance of:

(a) shares or equivalent ownership interests, subject to the legal structure of the Licence Holder concerned or share-linked instruments or equivalent non-cash instruments, in the case of a non-listed Licence Holder, and

(b) where possible, other instruments within the meaning of Articles 52 or 63 of the CRR or other instruments that can be fully converted to Common Equity Tier 1 instruments or written down, that in each case adequately reflect the credit quality of the Licence Holder as a going concern and are appropriate to be used for the purposes of variable remuneration.

Licence Holders should refer to Commission Delegated Regulation (EU) No 527/2014 to determine the classes of instruments that are appropriate to be used for the purposes of variable remuneration.

The instruments referred to in this paragraph must be subject to an appropriate retention policy designed to align incentives with the longer-term interests of the Licence Holder. The MFSA may place restrictions on the types and designs of those instruments or prohibit certain instruments as appropriate. This paragraph shall be applied to both the portion of the variable remuneration component deferred in accordance with point (xxi) and the portion of the variable remuneration component not deferred;

xxi. a substantial portion, and in any event at least 40%, of the variable

remuneration component is deferred over a period which is not less than three to five years and is correctly aligned with the nature of the business, its risks and the activities of the member of staff in question.

Remuneration payable under deferral arrangements shall vest no faster than on a pro-rata basis. In the case of a variable remuneration component of a particularly high amount, at least 60% of the amount shall be deferred. The length of the deferral period shall be established in accordance with the business cycle, the nature of the business, its risks and the activities of the member of staff in question;

xxii. the variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the financial situation of the Licence Holder as a whole, and justified on the basis of the performance of the Licence Holder, the business unit and the individual concerned.

Without prejudice to the general principles of national contract and labour law, the total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the Licence Holder occurs, taking into account both current remuneration and reductions in payouts of amounts previously earned, including through malus or clawback arrangements;

Up to 100% of the total variable remuneration shall be subject to malus or clawback arrangements. Licence Holders shall set specific criteria for the application of malus and clawback. Such criteria shall in particular cover situations where the staff member:

(a) participated in or was responsible for conduct which resulted in significant losses to the Licence Holder;

(b) failed to meet appropriate standards of fitness and propriety;

xxiii. the pension policy is in line with the business strategy, objectives, values and long-term interests of the Licence Holder.

xxiv. If the employee leaves the Licence Holder before retirement, discretionary pension benefits must be held by the Licence Holder for a period of five years in the form of instruments referred to in point (xx). In case of an employee reaching retirement, discretionary pension benefits shall be paid to the employee in the form of instruments referred to in point (xx) subject to a five-year retention period;

xxv. staff members are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;

xxvi. variable remuneration is not paid through vehicles or methods that facilitate the avoidance of the requirements of the Act, Investment Services Rules or the CRD and the CRR.

Section 4 ***Insurance Requirement***

R3-5.4.1 The Licence Holder shall take out and maintain such insurance cover as it considers appropriate.

R3-5.4.2 **Professional Indemnity**

R3-5.4.2.1 Where the Licence Holder holds a Category 1b licence, and has 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, it shall take out and maintain professional indemnity insurance to provide at least the minimum level of protection set out in Rules R3-5.4.1 and R3-5.4.2.

R3-5.4.2.2 Provided that a Category 1B Licence Holder subject to the professional indemnity insurance requirement shall submit a copy of its policy to the MFSA for approval.

R3-5.4.2.3 Where applicable, the Licence Holder shall ensure that the PII:

i. covers the minimum limits of indemnity given in Rule R3-5.4.2.5

ii. covers any legal liability in consequence of any negligent act, error or omission in the conduct of the Licence Holder's business by the Licence Holder or any person employed by it or otherwise acting for it, including consultants under a contract for service with the Licence Holder;

iii. covers legal defence costs which may arise in consequence of any negligent act, error or omission in the conduct of the Licence Holder's business by the Licence Holder or any person employed by it or otherwise acting for it, including consultants under a contract for service with the Licence Holder;

iv. the cover applies to the whole territory of the European Union and extends to all other territories from, in or to which Investment Services are provided; and

v. includes any dishonest, fraudulent, criminal or malicious act, error or omission of any person at any time employed by the Licence Holder, or otherwise acting for it, including consultants under a contract for service with the Licence Holder.

R3-5.4.2.4 The Licence Holder may, at its discretion, decide to include cover in respect of the following:

i. libel, slander and defamation;

ii. loss of and damage to documents and records belonging to the Licence Holder or which are in the care, custody or control of the Licence Holder or for which the Licence Holder is responsible; including also documents and records stored on magnetic or electronic media; including also liability and costs and expenses incurred in replacing, restoring or reconstructing the documents or records; including also consequential loss resulting from the loss or damage to the documents or records;

iii. liability resulting from any breach of a provision of the Act, any breach of a regulation made under the Act, and any award resulting from any such breach;

iv. claims made after expiry of the policy where the circumstances giving rise to the claim were notified to the insurers during the period of the policy.

R3-5.4.2.5 The required minimum limits of indemnity are:

i. In respect of any one claim, the higher of:

(a) three times Relevant Income; or

(b) €1,000,000 for Category 1b Licence Holders.

Plus legal costs limited to 20% of (i) or (ii) of this Rule, whichever is applicable.

ii. In aggregate, the higher of:

(a) three times Relevant Income; or

(b) €1,500,000for Category 1b Licence Holders.

Plus legal costs limited to 20% of (i) or (ii) of this Rule, whichever is applicable.

R3-5.4.2.6 For purposes of this rule, "Relevant Income" shall mean all gross income received or receivable which is commission, brokerage fees or other earnings arising from the Licence Holder's business activities, whether those activities are licensed under the Act or not for the last accounting year or on the basis of the business

plan agreed with the competent authority in respect of the relevant year or period. Provided that income received or receivable in the form of interest, whether in respect of bank deposits or bonds and dividends does not form part of "Relevant Income".

R3-5.4.2.7 The Licence Holder may enter into separate policies to cover activities licensed under other laws, subject to MFSA approval of the terms. Where the Licence Holder is required to maintain professional indemnity insurance cover in terms of an authorisation or licence under any other legislation, separate cover for the activities carried out under that legislation is a requirement.

R3-5.4.2.8 The excess shall not exceed the higher of €3,494.06 or 1% of Relevant Income in the case of Category 1b Licence Holders.

R3-5.4.2.9 The policy shall be governed by Maltese law.

R3-5.4.2.10 Where the Licence Holder is also registered in terms of the Insurance Mediation Directive, it shall comply with Article 4(3) of that Directive and the limits referred to in Rule R3-5.4.2.5 shall be replaced by the following:

i. In respect of any one claim, the higher of:

(a) three times Relevant Income; or

(b) €500,000 for Category 1b Licence Holders.

Plus legal costs limited to 20% of (i) or (ii), whichever is applicable.

ii. In aggregate, the higher of:

(a) three times Relevant Income; or

(b) €750,000 for Category 1b Licence Holders.

Plus legal costs limited to 20% of (i) or (ii), whichever is applicable.

R3-5.4.2.11 For the purposes of demonstrating to the satisfaction of the MFSA that the requirements in this section are being complied with on an on-going basis, the Licence Holder shall, upon request by the MFSA, 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.

R3-5.4.2.12 A Licence Holder shall within two working days from the date it becomes aware

of any of the circumstances specified in (i) to (vii) below, inform the MFSA in writing where:

i. 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;

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

iii. the policy has not been renewed or has been cancelled and another policy satisfying the requirements of this Section (Rules R3-5.4.1 and R3-5.4.1) of these Rules has not been taken out from the day on which the previous policy lapsed or was cancelled;

iv. 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 this Section (Rules R3-5.4.1 and R3-5.4.1) of these Rules;

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

vi. 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 this Section (Rules R3-5.4.1 and R3-5.4.1) of these Rules;

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

R3-5.4.2.13 An Investment Services Licence Holder which is also licensed in terms of the Banking Act, 1994 and subsidiaries of such Licence Holder, need not comply with the requirements of Rule R3-5.4.1 and R3-5.4.2, but instead shall provide MFSA with a brief summary of the nature and amount of its insurance cover.

R3-5.4.3 **Insurance Policy**

R3-5.4.3.1 Licence Holders shall be required to take out and maintain an insurance policy that covers loss of money or loss or damage to any other asset or property belonging to the Licence Holder or which is in the care, custody or control of the Licence Holder or for which the Licence Holder is responsible.

R3-5.4.3.2 The policy shall be governed by Maltese law.

Section 5 ***Business Continuity Process***

R3-5.5.1 The business continuity process shall consist of:

i. a disaster recovery plan ('DRP');

ii. a business continuity plan ('BCP'); and

iii. business continuity management ('BCM').

R3-5.5.2 The Disaster Recovery Plan shall define the resources (hardware, software, communications, data as well as human resource), actions and tasks required for the recovery of the infrastructure needed to support the Licence Holder's business functions. This document may form part of the Business Continuity Plan.

R3-5.5.3 The Business Continuity Plan is a management process to ensure the continuity of businesses and shall define the advance planning and preparations that are necessary to minimise loss and ensure continuity of the critical business functions of a Licence Holder in the event of disruption. In this regard, the Licence Holder shall ensure that the BCP is available as a formal manual which is made available for reference to all the Licence Holder's personnel.

R3-5.5.4 Business continuity management is an integral part of corporate governance and shall encompass the BCP and DRP and the Licence Holder shall integrate them into an ongoing strategic management process which identifies potential threats which may affect the licence holder. As part of BCM, the Licence holder shall also design a responsive framework to safeguard its interests as well as that of its customers.

R3-5.5.5 The Business continuity management team shall at least be composed of the executive management, and depending on the nature, scale and complexity of the Licence Holder's Business, may also include a BCP co-ordinator and the internal auditor.

R3-5.5.6 The business continuity management team shall:

i. identify key personnel and the person/s responsible for the implementation of the BCP;

ii. identify and define the critical resources and functions of the Licence Holder's business;

iii. define a process to protect the Licence Holder's critical resources and functions;

iv. define alternatives for the continuation of critical functions;

v. prepare and document the BCP, DRP and any relevant training programs promoting company-wide awareness of the recovery function;

vi. test the business continuity process on a regular basis and ensure that logs are maintained;

vii. continuously review and maintain the BCP and DRP;

viii. update personnel with any changes to the business continuity process;

ix. maintain contact with suppliers to assure support during a recovery effort;

x. act as a point of liaison for contingency planning issues between information resources and other business units; and

xi. maintain contracts for alternate facilities and/or services.

R3-5.5.7 The Business Continuity Plan shall at least include:

i. the objectives of the BCP;

ii. the person/s responsible for the BCP;

iii. key personnel required to help in the recovery process including substitutes;

iv. contact details of all the persons mentioned in the previous points;

v. details of any agreement with third parties (if applicable) required to ensure resumptions of operations and their contact details;

vi. an alternative/secondary site from which operations can be resumed;

vii. an outline of the main steps which should be taken to resume operations;

viii. data back-up and recovery (hard and electronic copy);

ix. the means to re-establish physical records;

x. financial and operational assessments;

xi. how the Licence Holder will inform the regulators in the event of non-continuation of business;

xii. how the Licence Holder will satisfy any regulatory reporting requirements to which it is subject the event of any business disruption;

xiii. how the Licence Holder will ensure its customers prompt access to their funds and securities in the event of non-continuation of business;

xiv. the planning and implementation of activities for the prevention and protection of any risks anticipated before an event occurs;

xv. the planning for activities to be implemented or executed during an emergency or disastrous event;

xvi. the strategic and tactical planning for resources, vital information and documentation of the activities for resumption, recovery, and restoration of businesses - both physical and logical, exercises/update and plan management;

xvii. an analysis of threats and impact scenarios including a step-by-step approach of how the institution would have its operational activities up and running in the least possible time in the event of a major incident which would render its current offices inoperable;

xviii. a time-table for regular review and updating of plans, resources and procedures; and

xix. a timetable for quarterly and annual testing of the plan and the requirement for testing logs to be maintained.

R3-5.5.8 Where the Licence Holder avails itself of an internal audit function, the internal auditor should:

i. evaluate whether necessary controls were followed during an actual emergency;

ii. report findings to executive management and, where applicable, the BCP

co-coordinator; and

iii. follow up on past internal audit reports to ensure compliance with previous findings.

R3-5.5.9 Firms should ensure that their BCP manual is realistic and easy to use during a crisis.

Section 6 ***Recovery and Resolution Requirements***

R3-5.6.1 The Licence Holder shall comply with the Rules in this Section in addition to the relevant provisions of the Recovery and Resolution Regulations (SL 330.09).

R3-5.6.2 In this respect the Licence Holder shall develop and maintain a Recovery Plan in accordance with Article 5 of Recovery and Resolution Regulations (SL 330.09).

R3-5.6.3 Such plan should, inter alia be proportionate to the size and business model of the Licence Holder and its interconnectedness to other institutions or to the financial system in general, including its impact on financial markets and on other institutions or on funding conditions.

R3-5.6.4 The Licence Holder shall cooperate closely with the Resolution Authority and shall provide it with all the information necessary for the preparation and drafting of viable resolution plans setting out options for the orderly resolution of the Licence Holder in the case of failure, in accordance with the principle of proportionality.

Section 7 ***Outsourcing Requirements***

R3-5.7.1 **General**

R3-5.7.1.1 A Licence Holder shall ensure, when relying on a third party for the performance of any operational function that it takes reasonable steps to avoid undue additional operational risk for the provision of continuous and satisfactory service to clients and the performance of investment activities on a continuous and satisfactory basis.

R3-5.7.1.2 A Licence Holder shall ensure that the outsourcing of important operational functions is not be undertaken in such a way as to materially impair the quality of its internal control and the ability of the supervisor to monitor the firm's compliance with all obligations.

R3-5.7.1.3 When the Licence Holder outsources any operational functions or any Investment Services or activities, the Licence Holder shall remain fully responsible for discharging all of their obligations under these Rules and shall adequately manage the risks relating to such outsourcing arrangements at all times.

R3-5.7.1.4 The Licence Holder shall carry out an on-going assessment of the operational risks and the concentration risk associated with all its outsourcing arrangements. The Licence Holder shall notify the MFSA of any material developments.

R3-5.7.1.5 The ultimate responsibility for the proper management of the risks associated with outsourcing or the outsourced activities lies with the Licence Holder.

R3-5.7.1.6 When the Licence Holder outsources any operational function or any Investment Services or activities, the Licence Holder shall ensure that the outsourcing arrangements do not result in the delegation of its senior management's responsibility.

R3-5.7.1.7 The outsourcing of operational functions may not be undertaken in such a way as to materially impair:

i. the ability of the MFSA to monitor the Licence Holder's compliance with all obligations;

ii. the orderliness of the conduct of the outsourcing Licence Holder's business or of the investment services provided;

iii. the quality of the Licence Holder's internal control;

iv. the senior management's ability to manage and monitor the Licence Holder's business and its licensed activities;

v. the ability of other internal governance bodies, such as the board of directors or the audit committee, to fulfil their oversight tasks in relation to the senior management;

R3-5.7.1.8 A Licence Holder shall inform the MFSA of any outsourcing arrangements and shall make available on request all information necessary to enable the Authority to supervise the compliance of the performance of the outsourced activities with the requirements of the Investment Services Rules

R3-5.7.1.9 A Licence Holder shall inform the MFSA of any material development affecting

an outsourced activity and the manner by which it is proposing to rectify its position in order to fulfil its obligation to its customers.

R3-5.7.1.10 Licence Holders shall not outsource management functions such as the setting of strategies and policies in respect of the Licence Holder's risk profile and control, the oversight of the operation of the Licence Holder's processes, and the final responsibility towards customers.

R3-5.7.1.11 A Licence Holder shall not outsource services and activities concerning licensable activities unless the outsourcing service provider either:

i. has an equivalent authorisation of the Licence Holder outsourcing the services; or

ii. is otherwise allowed to carry out those activities in accordance with the relevant national legal framework.

R3-5.7.1.12 The MFSA may impose specific conditions on the Licence Holder for the outsourcing of any activities.

R3-5.7.1.13 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.

R3-5.7.1.14 Without prejudice to the status of any other function, the following functions shall not be considered as critical or important for the purposes of R3-5.7.1.13:

i. 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;

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

R3-5.7.2 **The Outsourcing Policy**

R3-5.7.2.1 A Licence Holder shall have a policy on its approach to outsourcing, including

contingency plans, exit strategies as well as a general policy that covers all aspects of outsourcing, including non-material outsourcing, whether the outsourcing takes place within a corporate group or not.

R3-5.7.2.2 The Outsourcing Policy shall:

i. consider the potential effects of any outsourcing activity on the Licence Holder when conducting the risk analysis prior to the outsourcing;

ii. ensure that the outsourcing service provider's financial performance and essential changes in the service provider's organisational and ownership structures are appropriately monitored and assessed by the Licence Holder's management;

iii. identify the internal units or individuals that are responsible for monitoring and managing each outsourcing arrangement;

iv. ensure that the Licence Holder takes remedial action where it considers the outsourcing service provider's agreement to be inadequate;

v. consider the main phases that make up the life cycle of a Licence Holder's outsourcing arrangements and shall include:

vi. the decision to outsource or change an existing outsourcing arrangement;

vii. due diligence checks on the outsourcing service provider;

viii. the drafting of a written outsourcing contract and service level agreement;

ix. the implementation, monitoring, and management of an outsourcing arrangement;

x. dealing with the expected or unexpected termination of a contract and other service interruptions.

R3-5.7.3 **The Outsourcing Contract**

R3-5.7.3.1 The Licence Holder shall ensure that any outsourcing arrangement is based on a formal, clear, written contract which establishes the respective rights and obligations of the Licence Holder and of the service provider.

R3-5.7.3.2 The Licence Holder shall ensure that the outsourcing contract includes:

i. a clear definition of the operational activity that is to be outsourced;

ii. the precise requirements concerning the performance of the service being

outsourced, and the objective of the outsourcing solution.

iii. evidence of prior assessment of the outsourcing service provider's ability to meet performance requirements in both quantitative and qualitative terms;

iv. a termination and exit management clause, where appropriate and if deemed necessary, which allows the activities being provided by the outsourcing service provider to be transferred to another outsourcing service provider or to be reincorporated into the Licence Holder at the request of the Licence Holder;

v. provisions allowing the Licence Holder to cancel the contract by contractual notice of dismissal or extraordinary notice of cancellation.

vi. provisions obliging the outsourcing service provider to protect confidential information and to abide by banking secrecy and any other specific provisions relating to handling confidential information.

vii. an obligation on the Licence Holder to continuously monitor and assess the outsourcing service provider's performance;

viii. an obligation on the outsourcing service provider to allow the Licence Holder's compliance and internal audit departments complete access to its data and its external auditors full and unrestricted rights of inspection and auditing of that data;

ix. an obligation on the outsourcing service provider to allow direct access by the MFSA to relevant data and its premises as required;

x. an obligation on the outsourcing service provider to immediately inform the Licence Holder, or the MFSA directly, of any material changes in circumstances which could have a material impact on the continuing provision of services.

R3-5.7.4 **Conditions for Outsourcing Critical or Important Operational Functions or Investment Services or Activities.**

R3-5.7.4.1 When the Licence Holder outsources critical or important operational functions or any Investment Services or activities, the Licence Holder shall remain fully responsible for discharging all of their obligations under these Rules and are required to comply, in particular with the following conditions:

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

ii. the relationship and obligations of the Licence Holder towards its clients

under these Rules must not be altered;

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

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

R3-5.7.4.2 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.

R3-5.7.4.3 The Licence Holder shall in particular take the necessary steps to ensure that the following conditions are satisfied:

i. 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;

ii. 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;

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

iv. 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;

v. 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;

vi. 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;

vii. 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;

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

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

x. 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;

xi. 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.

R3-5.7.4.4 Where the Licence Holder and the service provider are members of the same group, the Licence Holder shall, 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.

R3-5.7.5 **Intra-Group Outsourcing**

R3-5.7.5.1 When a Licence holder outsources any of its activities to a company within the same group, the Licence Holder shall provide the MFSA, upon request, with a copy of the intra-group outsourcing agreement.

R3-5.7.5.2 The intra-group outsourcing agreement shall indicate the extent to which the Licence Holder controls the service provider or has the ability to influence its actions, and the extent to which the service provider is included in the consolidated supervision of the group.

R3-5.7.6 **Chain Outsourcing**

R3-5.7.6.1 The outsourcing Licence Holder shall make use of chain outsourcing only if the sub-contractor fully complies with the obligations existing between the Licence Holder and the outsourcing service provider, including obligations incurred in favour of the MFSA.

R3-5.7.6.2 The Licence Holder shall take appropriate steps to address the risk of any weakness or failure in the provision of the sub-contracted activities having a significant effect on the outsourcing service provider's ability to meet its responsibilities under the outsourcing agreement.

R3-5.7.6.3 The Licence Holder shall treat the sub-outsourcing of outsourced activities and functions to third parties (subcontractors) like a primary outsourcing measure including the requirement of a contractual agreement.

R3-5.7.6.4 The Licence Holder shall ensure that the outsourcing service provider agrees that the contractual terms agreed with the sub-contractor will always conform, or at least not be contradictory, to the provisions of the agreement with the Licence Holder.

R3-5.7.7 **Service Providers Located in Third Countries**

R3-5.7.7.1 In addition to the requirements of Rule R3-5.7.4.1 to R3-5.7.4.4, 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:

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

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

R3-5.7.7.2 When one or both of the conditions referred to in Rule R3-5.7.7.1 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 the MFSA about the outsourcing arrangement and the MFSA does not object to that arrangement within a reasonable time following receipt of that notification.

R3-5.7.7.3 The Licence Holder shall still be required to comply with the requirements of Rule R3-5.7.4.1 to R3-5.7.4.4.

Section 8 Requirements relating to the application of the Investor Compensation Scheme Regulations Issued in terms of the Act

R3-5.8.1 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.

R3-5.8.2 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 ACR The Licence Holder is not required to make any transfers to the Investor Compensation Scheme Reserve in the ICRs.

R3-5.8.3 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.

R3-5.8.4 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:

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

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

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

Section 9 Synchronisation of Business Clocks

R3-5.9.1 All licence holders being members or participants in trading venues shall synchronise the business clocks they use to record the date and time of any reportable event

Section 10 Procedures for Reporting of Breaches

R3-5.10.1 The Licence holder shall develop and maintain appropriate procedures for employees to report breaches internally through a specific, independent and autonomous channel. Such a channel may also be provided through arrangements provided for by social partners and shall include at least:

i. specific procedures for the receipt of reports on potential or actual infringements and their follow-up, including the establishment of secure communication channels for such reports;

ii. appropriate protection for employees who report breaches committed within the License Holder against retaliation, discrimination or other types of unfair treatment;

iii. protection of personal data concerning both the person who reports the breaches and the person who is allegedly responsible for a breach, in accordance with Directive 95/46/EC;

iv. clear rules ensuring that confidentiality is guaranteed in all cases in relation to the person who reports the breaches committed within the Licence Holder, unless disclosure is required by Maltese law in the context of further investigations or subsequent judicial proceedings.

R3-5.10.2 Licence Holders shall also refer to and comply with the applicable provisions of the Protection of the Protection Of The Whistleblower Act.

Title 6 Supplementary Organisational Requirements

Section 1 *Scope and Application*

R3-6.1.1 This Title shall apply to all Investment Services Licence Holders falling within scope of the Rules, as applicable.

Section 2 Provisions applicable to Licence Holders appointing Introducers

R3-6.2.1 The MFSA is to be advised by the Licence Holder of the names and addresses of the Introducers.

R3-6.2.2 The Licence Holder is responsible for "Know Your Customer" checks and cannot rely on the Introducer's opinion.

R3-6.2.3 The Licence Holder shall ensure that the Introducer is bound by confidentiality as to the means and resources of the customer if s(he) is made aware of them.

R3-6.2.4 The Licence Holder shall ensure that in no circumstances can the Introducer give investment advice, promote a certain product or undertake any Investment Services licensable activity.

R3-6.2.5 The Licence Holder shall ensure that the Introducer is not 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.

R3-6.2.6 The Licence Holder shall ensure that the Introducer is not permitted to receive any funds from clients or give any commitments on behalf of the Licence Holder.

R3-6.2.7 The Licence Holder shall ensure that 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.

R3-6.2.8 The Licence Holder shall ensure that the Introducer does not hold himself out to the general public as acting as Introducer and should not actively promote its "introducing services".

R3-6.2.9 The Licence Holder shall ensure that charges which the client/ investor will

incur should not differ irrespective of whether the client approached the Licence Holder directly or through an Introducer.

R3-6.2.10 Subject to Rule R3-6.2.11, any person authorised under the Insurance Business Act, 1998 or registered or enrolled under the Insurance Intermediaries Act, 2006 ("the IIA") cannot act as an Introducer.

R3-6.2.11 Tied Insurance Intermediaries are permitted to act as introducers for Investment Services Licence Holders wholly owned by companies authorised under the Insurance Business Act, provided that such tied insurance intermediaries are enrolled in the Tied Insurance Intermediaries List on behalf of the insurance company which also owns the Investment Services Licence Holder.

R3-6.2.12 A record of commissions paid to each introducer, is to be retained, for inspection by the MFSA.

R3-6.2.13 The Licence Holder shall ensure that the Introducer acts exclusively on its behalf. The introducer agreement should clearly contain an exclusivity clause, wherein the Introducer is bound to one Licence Holder.

Section 3 Conditions applicable to Licence Holders engaging in foreign currency lending

R3-6.3.1 The Licence Holder shall, in as far as these may be applicable to any foreign currency lending which it may carry out, abide by the high level principles on foreign currency lending as outlined in MFSA Rule 1 of 2012 on foreign currency lending which is modelled on the Recommendation of the European Systemic Risk Board on lending in foreign currencies (ESRB/2011/1).

R3-6.3.2 Foreign currency lending means lending in any currency other than the legal tender of the country in which the borrower is domiciled. This includes situations where the Euro is the foreign currency due to the borrower's domicile being outside the Euro Zone.

R3-6.3.3 When the Licence Holder has engaged in any form of foreign currency lending during the period under review, it shall submit a confirmation to this effect together with its Annual Financial Return. Any foreign currency lending activity shall be indicated as a percentage of its total lending. A Licence Holder which has not carried out any foreign currency lending during the period under review is not required to submit a 'nil' return.

R3-6.3.4 When requested to do so by the MFSA, a Licence Holder shall also submit, on the following email address: statistics@mfsa.com.mt, any statistical returns which may be required under MFSA Rule 1 of 2012 on foreign currency lending.

Section 4 Supplementary Conditions for operators of MTFs and OTFs

R3-6.4.1 The operator of an MTF or OTF 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 or that the OTF may admit as users, Licence Holders, credit institutions authorised under Directive 2000/12/EC and other persons who:

i. are fit and proper;

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

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

iv. 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.

Section 5 Supplementary Conditions for Licence Holders which form part of a Consolidated Group

R3-6.5.1 Licence Holders which are members of a Consolidated Group pursuant to Section 2, Title 4 of Chapter 2, shall be required to comply with the provisions of Title 4 of Chapter 2, Title 1 and 2 of Chapter 3 and Title 6 and 7 of Chapter 4 as applicable, on a consolidated or a sub-consolidated basis to ensure that their arrangements, processes and mechanisms required by the aforementioned Rulesare consistent and well-integrated and that any data and information relevant to the purpose of supervision can be produced.

R3-6.5.2 In particular, Licence Holders shall ensure that parent undertakings and subsidiaries implement such arrangements, processes and mechanisms in their subsidiaries which are not subject to the CRD. Such arrangements, processes and mechanisms shall also be consistent and well integrated and those subsidiaries shall also be able to produce any data and information relevant to the purpose of supervision.

R3-6.5.3 Provided that where any of the abovementioned subsidiaries is established in a

third country, the obligations arising out of this Rule, shall not apply if the Licence Holder demonstrates to the MFSA that the application of the abovementioned Rules is unlawful under the laws of the third country where the subsidiaries are established.

Chapter 4 Record Keeping, Reporting and Disclosure Requirements

Title 1 Notifications and Approvals Requirements

Section 1 Scope and Application

R4-1.1.1 This Title applies to all Investment Services Licence Holders falling within scope of the Rules.

Section 2 Requirement of MFSA Notification

R4-1.2.1 The Licence Holder shall notify the MFSA in writing of:

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

ii. the departure of a Director, Senior Manager or any other person authorised or approved by the MFSA: within 14 days of the departure.

The Licence Holder shall also request such person (Director, Senior Manager or any other person authorised or approved by the MFSA) to provide to the MFSA a written confirmation that their departure had no regulatory implications or to provide relevant details, as appropriate.

iii. a proposed adequate replacement for any person who has tendered his resignation in terms of point (ii) of Rule R4-1.2.1.

iv. The Licence Holder shall also inform the MFSA of the person who shall be temporarily taking the responsibilities of such person until such proposed replacement is appointed in terms of point (viii) of Rule R4-1.3.1.

v. 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.

vi. 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.

vii. 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:

(a) credit institutions licensed in terms of the Banking Act, 1994; or

(b) financial institutions licensed in terms of the Financial Institutions Act, 1994.

viii. any proposed material change to its business (whether that business constitutes a 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 the new Investment Services Licence has been granted or the amendment has been approved by the MFSA.

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

x. a decision to make a material claim on its professional indemnity insurance or on any insurance policy or held in relation to the Licence Holder's Investment Services business as specified in Section 4, Title 5 of Chapter 3. Notification should be provided as soon as the decision is taken.

xi. 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.

xii. 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 point (15) of Rule R1-1.3.1, between the Licence Holder and any other person.

xiii. 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.

xiv. the relevant details required in terms of Rule R3-6.2.1of these Rules pertaining to any introducers which may be appointed by the Licence Holder.

xv. 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.

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

xvii. 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.

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

xix. any breach of the following conditions, as applicable:

(a) that when the Category 1A or Category 1B Licence Holder is in breach of the requirements in respect of financial resources, records, reporting or procedures and controls; or that it is in breach of the requirements in respect of its Capital Resources Requirement, records, reporting or procedures and controls;

(b) that when the Category 1A or Category 1B Licence will be unable to submit an Annual or Interim Financial Return on the due date.

OR

(c) that when Category 2 or Category 3 Licence Holder is in breach of the requirements in respect of its Capital Resources Requirement, records, reporting or procedures and controls;

(d) that when Category 2 or Category 3 Licence Holder will be unable to submit an Annual COREP Return or an Interim COREP Return on the due date or to submit the Annual Audited COREP Return and the Audited Annual Financial Statements

without undue delay and by not later than four months of the Accounting Reference Date.

For the purpose of point (a) to (d) of paragraph xxi of Rule R4-1.2.1, the notification shall give reasons and shall explain what action is being taken to rectify matters.

xx. Any other breach of these Rules as soon as the Licence Holder becomes aware of the breach.

Section 3 ***Requirement of MFSA Approval***

R4-1.3.1 The Licence Holder shall obtain the written consent of the MFSA before:

i. making a change to the Licence Holder's name or business name (if different).

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

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

iv. establishing a branch in Malta or abroad.

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

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

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

viii. 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 Rule R3-3.2.3 and/ or Money Laundering Reporting Officer or of the Licence Holder's Risk Manager where applicable, 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 or Risk Manager where applicable include sufficient details of the individual's

background, training and/ or experience relevant to the post, to enable an adequate assessment by the MFSA. In the case of a proposed Compliance Officer and/or Money Laundering Reporting Officer and Risk Manager where applicable, the request shall also be accompanied by the Competency Form set out in Schedule I to Part A of these Rules.

Where the person proposed had within the previous five years submitted a PQ to the MFSA, 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. This confirmation is to be countersigned by an authorised official of the Licence Holder, confirming that he/she has seen the said PQ.

ix. the change in the responsibilities of a Director or Senior Manager 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).

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

(a) Portfolio or fund management;

(b) 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 A1 to these Rules).

Notwithstanding the above, the consent of the MFSA shall be required where any other MFSA approval is required in terms of the Rules.

For the purposes of the points (viii) and (ix) of Rule R4-1.3.1, '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.

Title 2 Record Keeping and Accounting Records

Section 1 Scope and Application

R4-2.1.1 This Title applies to all Investment Services Licence Holders falling within scope of the Rules, except for:

i. Section 3 of this Title, which shall apply to Category 2 and 3 Licence Holders falling within scope of the Rules.

Section 2 Record Keeping

R4-2.2.1 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.

R4-2.2.2 In this regard, records shall include the recording of telephone conversations and/or electronic communications involving transactions when dealing on own account and the provision of client order services that relate to the reception, transmission and execution of client orders.

R4-2.2.3 The Licence Holder shall take all reasonable steps to record relevant telephone conversations to record relevant telephone conversations and electronic communications, made with, sent from or received by equipment provided by the investment firm to an employee or contractor or the use of which by an employee or contractor has been accepted or permitted by the Licence Holder.

R4-2.2.4 The Licence Holder shall notify new and existing clients that telephone communications or conversations between the Licence Holder and its clients that result or may result in transactions will be recorded. Such a notification may be made once, before the provision of investment services of new and existing clients.

R4-2.2.5 The Licence Holder shall not provide, by telephone, investment services and activities to clients who have not been notified in advance about the recording of their telephone communications or conversations, where such investment services and activities relate to the receipt, transmission and execution of client orders. Orders may be placed by clients through other channels, however such

communications must be made in a durable medium such as mails, faxes, emails or documentation of client orders made at meetings. In particular, the content of relevant face-to-face conversations with a client may be recorded by using written minutes or notes. Such orders shall be considered to be equivalent to orders received by telephone.

R4-2.2.6 The Licence Holder shall take all reasonable steps to prevent an employee or contractor from making, sending or receiving relevant telephone conversations and electronic communications on privately-owned equipment which the Licence Holder is unable to record or copy.

R4-2.2.7 In complying with these Rules, the Licence Holder shall refer to the reporting requirements established by:

i. MiFIR;

ii. Delegated Acts issued under MiFIR and MiFID;

iii. the Investment Services Act;

iv. Regulations Issued under the Investment Services Act; and

v. Rules issued under the Investment Services Act.

R4-2.2.8 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. The Authority may request that such records are kept for a period of up to 7 years.

R4-2.2.9 The Licence Holder shall maintain sufficient records to be able to demonstrate compliance with the conditions of its Investment Services Licence as required by this Section.

R4-2.2.10 The Licence Holder shall retain all the records required under these Rules and the Commission Regulation for a period of at least 5 years.

R4-2.2.11 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.

R4-2.2.12 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.

R4-2.2.13 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:

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

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

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

Section 3 Customers' Accounting Records

R4-2.3.1 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.

R4-2.3.2 The records shall:

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

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

iii. 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;

iv. 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.

R4-2.3.3 Customers' accounting records shall be retained for a minimum period of ten years.

R4-2.3.4 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.

R4-2.3.5 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.

Section 4 Accounting Records

R4-2.4.1 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.

R4-2.4.2 The Licence Holder shall maintain proper accounting records to show and explain the Licence Holder's own transactions, assets and liabilities.

R4-2.4.3 The accounting records shall:

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

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

R4-2.4.4 In particular, the financial records shall contain:

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

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

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

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

R4-2.4.5 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.

R4-2.4.6 The Licence Holder shall agree with the MFSA its Accounting Reference Date (financial year end).

Title 3 Audit

Section 1 Scope and Application

R4-3.1.1 This Title applies to all Investment Services Licence Holders falling within scope of the Rules.

Section 2 Appointing an Auditor

R4-3.2.1 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

R4-3.2.2 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.

R4-3.2.3 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:

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

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

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

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

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

R4-3.2.4 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.

R4-3.2.5 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).

R4-3.2.6 The letter of engagement shall include terms requiring the auditor:

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

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

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

iv. to advise the MFSA in the event of resignation, removal or non-reappointment, 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;

v. to, in accordance with Article 18 of the Act, report immediately to the MFSA and the Management Body of the Licence Holder where applicable, any fact or decision of which he becomes aware in his capacity as auditor of the Licence Holder which:

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

(b) 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;

(c) gravely impairs the ability of the Licence Holder to continue as a going concern; or

(d) relates to any other matter which has been prescribed.

vi. to, in accordance with Article 18 of the Act, report to the MFSA and the Management Body of the Licence Holder where applicable, any facts or decision as specified in (e) above of any person having close links, s defined in point (15) of Rule R1-1.3.1, 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.

R4-3.2.7 Pursuant to the above points, where a Licence Holder holds or controls clients' assets, the letter of engagement shall also require a circularisation exercise by the Auditors in order to reconcile a representative sample of client's assets in cases where the Licence Holder holds or controls client assets.

R4-3.2.8 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.

Title 4 Reporting Requirements applicable to Category 1 Licence Holders

Section 1 Scope and Application

R4-4.1.1 This Title shall apply exclusively to Category 1A and Category 1B Licence Holders falling within scope of the Rules.

Section 2 General

R4-4.2.1 The Licence Holder shall prepare the Audited Annual Financial Return, the Annual Financial Return and Interim Financial Returns as specified in Section 3 to 5 of this Title.

R4-4.2.2 The Licence Holder shall prepare and submit such additional financial returns as the MFSA may require.

R4-4.2.3 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:

i. they shall be in the form set out in the latest version of **Automated Financial Return** applicable to Category 1 Licence Holders;

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

iii. 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 amounts in respect of items representing assets or income which 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.

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

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

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

vii. 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.

R4-4.2.4 For the purpose of these Rules, the Licence Holder shall refer to Title 2 of Chapter 2 in order for the calculation of their Financial Resources Requirement and the Guidance Notes of these Rules when compiling and submitting their financial returns.

Section 3 Audited Annual Reporting Requirements

R4-4.3.1 The Licence Holder shall be required to submit to the MFSA within four months of the Accounting Reference Date, the soft and hard copies of the following:

i. the automated Annual Audited Financial Return;

ii. the Audited annual financial statements prepared in accordance with International Financial Reporting Standards;

iii. a copy of the Auditors' management letter;

iv. a copy of the Auditors' report; and

v. the Auditors' confirmation to the MFSA as specified in Rule R4-4.3.7.

R4-4.3.2 Pursuant to point (i) of Rule R4-4.3.1, the Licence Holder should ensure that the Annual Audited Financial Return is signed by:

i. the proprietor where the Licence Holder is a sole trader; or

ii. otherwise by at least two directors or partners; or

iii. any other persons authorised to sign by way of a Board Resolution Auditor of which the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA;

and

iv. the Auditor.

R4-4.3.3 Pursuant to point (ii) of Rule R4-4.3.1, the Licence Holder shall also require its

auditor to prepare a management letter in accordance with International Standards on Auditing.

R4-4.3.4 Furthermore, pursuant to point (ii) of Rule R4-4.3.1, 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 the Ruless or other regulatory requirements which occurred during the reporting period, and which were subject to an administrative penalty or other regulatory sanction.

R4-4.3.5 The Directors' Report shall contain a summary of the breach/breaches committed and regulatory sanction imposed, if any. Where there have been no breaches, the Directors' Report shall contain a statement to that effect.

R4-4.3.6 Pursuant to point (iii) of Rule R4-4.3.1, 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.

R4-4.3.7 Pursuant to point (iv) of Rule R4-4.3.1, 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:

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

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

iii. 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;

iv. 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;

v. 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; and

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

R4-4.3.8 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.

Section 4 Annual Financial Return

R4-4.4.1 The Licence Holder shall each year prepare and submit the soft copy of the automated Annual Financial Return to the MFSA within one month of the Accounting Reference Date.

R4-4.4.2 The Licence Holder shall also submit the original Representations Sheet of the Annual Financial Return, signed in accordance with Rule R4-4.4.3.

R4-4.4.3 The Licence Holder should ensure that the Annual Financial Return is signed by:

i. the proprietor where the Licence Holder is a sole trader; or

ii. otherwise by at least two directors or partners; or

iii. any other persons authorised to sign by way of a Board Resolution Auditor of which the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA.

R4-4.4.4 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.

Section 5 ***Interim Financial Returns***

R4-4.5.1 The Licence Holder shall prepare an automated Interim Financial Return, 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.

R4-4.5.2 The soft copy of the automated Interim Financial Return shall be submitted to the MFSA within one month of the date up to which it has been prepared.

R4-4.5.3 The Licence Holder shall also submit the original Representations Sheet of the Interim Financial Return, signed in accordance with Rule R4-4.5.4.

R4-4.5.4 The Licence Holder should ensure that the Interim Financial Return is signed by:

i. the proprietor where the Licence Holder is a sole trader; or

ii. by at least two directors or partners; or

iii. any other persons authorised to sign by way of a Board Resolution Auditor of which the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA.

Title 5 Reporting Requirements applicable to Category 2 and Category 3 Licence Holders

Section 1 Scope and Application

R4-5.1.1 This Title shall apply exclusively to Category 2 and Category 3 Licence Holders falling within scope of the Rules.

Section 2 General

R4-5.2.1 The Licence Holder shall the complete the automated COREP Return referred to in this section, in accordance with the following Rules.

R4-5.2.2 The Licence Holder shall prepare and submit such additional financial returns as the MFSA may require.

R4-5.2.3 The Licence Holder shall be responsible for the correct compilation of the COREP Returns. The nature and content of the COREP returns shall be as follows:

i. they shall be in the form set out in latest version of Automated COREP Return;;

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

iii. 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:

(a) 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

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

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

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

Standards;

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

vii. in the case of an individual or individuals in partnership or association, COREP 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.

R4-5.2.4 For the purpose of these Rules, the Licence Holder shall refer to Title 3 of Chapter 2 in order for the calculation of their Capital Resources Requirement and the Guidance Notes of these Rules when compiling and submitting their COREP returns.

Section 3 ***Audited Annual Reporting Requirements***

R4-5.3.1 The Licence Holder shall be required to submit to the MFSA within four months of the Accounting Reference Date, the soft and hard copies of the following:

i. the automated Annual Audited COREP Return;

ii. the Audited annual financial statements prepared in accordance with International Financial Reporting Standards;

iii. a copy of the Auditors' management letter;

iv. a copy of the Auditors' report;

v. the Auditors' confirmation to the MFSA as specified in Rule R4-5.3.8.

R4-5.3.2 A Licence Holder which is also a credit institution in terms of the Banking Act, 1994 shall be required to submit to MFSA, together with its annual financial statements, a separate note supported by an auditor's confirmation, disclosing the net revenue derived from activities for which an investment services licence was issued to it, that is the gross revenue derived from such activities less any commissions that are directly related to the acquisition of the said gross revenue, paid or payable to third parties.

R4-5.3.3 Pursuant to point (i) of Rule R4-5.3.1, the Licence Holder should ensure that the Annual Audited COREP Return is signed by:

i. the proprietor where the Licence Holder is a sole trader; or

ii. by at least two directors or partners; or

iii. any other persons authorised to sign by way of a Board Resolution Auditor of which the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA;

and

iv. the Auditor.

R4-5.3.4 Pursuant to point (ii) of Rule R4-5.3.1, the Licence Holder shall also require its auditor to prepare a management letter in accordance with International Standards on Auditing.

R4-5.3.5 Furthermore, pursuant to point (ii) of Rule R4-5.3.1, 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 the Ruless or other regulatory requirements which occurred during the reporting period, and which were subject to an administrative penalty or other regulatory sanction.

R4-5.3.6 The Directors' Report shall contain a summary of the breach/breaches committed and regulatory sanction imposed, if any. Where there have been no breaches, the Directors' Report shall contain a statement to that effect.

R4-5.3.7 Pursuant to point (iii) of Rule R4-5.3.1, 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.

R4-5.3.8 Pursuant to point (iv) of Rule R4-5.3.1, at each annual accounting period, 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:

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

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

iii. 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;

iv. 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;

v. the Licence Holder has, either:

(a) maintained throughout the period covered by the Annual Financial Return, systems adequate to safeguard Customers' Assets and Clients' Money; or

(b) 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.

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

R4-5.3.9 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.

Section 4 Annual COREP Return

R4-5.4.1 The Licence Holder shall in each year prepare and submit the soft copy of the automated Annual COREP Return to the MFSA within 42 days of the Accounting Reference Date.

R4-5.4.2 The Licence Holder shall also submit to the MFSA within 42 days of the Accounting Reference Date the original Representations Sheet of the Annual COREP Return duly signed in accordance with Rule R4-5.4.3.

R4-5.4.3 The Licence Holder should ensure that the Annual COREP Return and is signed by:

i. the proprietor where the Licence Holder is a sole trader; or

ii. otherwise by at least two directors or partners; or

iii. any other persons authorised to sign by way of a Board Resolution Auditor of which the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA.

R4-5.4.4 Where the ACR 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 without undue delay and by not later than four months of the Accounting Reference Date.

Section 5 ***Interim COREP Returns***

R4-5.5.1 The Licence Holder shall prepare an automated Interim COREP Return ("ICR") as at dates three, six and nine months after the Accounting Reference Date. The first ICR should cover the three months immediately following the Accounting Reference Date, the second ICR should cover the six months immediately following the Accounting Reference Date and the third ICR 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 ICRs shall be agreed with the MFSA.

R4-5.5.2 The Licence Holder shall submit the soft copy of the ICR shall be submitted to the MFSA within 42 days of the date from which it has been prepared.

R4-5.5.3 The Licence Holder shall also submit to the MFSA within 42 days of the Accounting Reference Date the original Representations Sheet of the Annual COREP Return duly signed in accordance with Rule R4-5.5.4.

R4-5.5.4 The Licence Holder should ensure that Interim COREP Return is signed by:

i. the proprietor where the Licence Holder is a sole trader; or

ii. otherwise by at least two directors or partners; or

iii. any other persons authorised to sign by way of a Board Resolution Auditor, of which the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA.

Section 6 ***RMICAAP Confirmation***

R4-5.6.1 Pursuant its obligations in Section 3, Title 2 of Chapter 3, the Licence Holder shall confirm to the MFSA as at the 31st January of every calendar year, that it has an RMICAAP in place and that this is comprehensive and proportionate to the nature, scale and complexity of the activities of the Licence Holder concerned. Such confirmation shall be signed by two directors of the Licence Holder

Section 7 ***High Income Earners Confirmation***

R4-5.7.1 Pursuant to the EBA Guidelines on the data collection exercise regarding high earners, the Licence Holder shall by not later than 30th June of every calendar year submit Authority the number of individuals within the Licence Holder earning at least Euro 1 million.

R4-5.7.2 The Authority will consolidate and forward to the EBA in line with its obligations under the aforementioned Guidelines.

Title 6 Reporting Requirements applicable to Licence Holders forming part of a Consolidated Group

Section 1 Scope and Application

R4-6.1.1 This Title shall apply to Category 2 and Category 3 Licence Holders which fall within the scope of the Rules and which form part of a Consolidated Group in accordance with Section 2, Title 4 of Chapter 2.

Section 2 Consolidated Group Confirmation

R4-6.2.1 The Licence Holder shall, by not later than the end of one month from its Accounting Reference Date:

i. assess whether it forms part of a Consolidated Group as defined in the Glossary; and

ii. provide the MFSA with a detailed explanation as to whether it forms or does not form part of a Consolidated Group.

R4-6.2.2 Where the Licence Holder considers that it forms part of a Consolidated Group, it shall in turn request its auditor's confirmation in this regard. The Licence Holder's auditor shall, in its annual report made in terms of Rule R4-6.2.3, provide the MFSA with a confirmation as to whether:

i. the Licence Holder forms part of a Consolidated Group as defined in point (21) of Rule R1-1.3.1; and

ii. the Consolidated Group satisfies the Capital Resources Requirement on a consolidated basis.

R4-6.2.3 At each annual accounting period, 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:

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

ii. the Annual Financial Return has been prepared in accordance with the

MFSA's requirements and is consistent with the audited annual financial statements;

iii. 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;

iv. 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;

v. the Licence Holder has, either:

(a) maintained throughout the period covered by the Annual Financial Return, systems adequate to safeguard Customers' Assets and Clients' Money; or

(b) 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.

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

Section 3 ***Consolidated Group Annual COREP Return***

R4-6.3.1 The Licence Holder which forms part of a Consolidated Group shall prepare and submit to the MFSA the soft and hard copy of the automated Annual Consolidated COREP Return ("ACCR") in the form set out in **Automated COREP Return** in accordance with Rule R4-5.2.3.

R4-6.3.2 The ACCR shall be submitted to the MFSA within 42 days of the Accounting Reference Date.

R4-6.3.3 Pursuant to Rule R4-6.3.2, the Licence Holder should ensure that the Annual COREP Return and is signed by:

i. at least two directors;

ii. any other persons authorised to sign by way of a Board Resolution Auditor of which the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA.

Section 4 Consolidated Group Interim COREP Return

R4-6.4.1 The Licence Holder which forms part of a Consolidated Group shall, at a date, three, six and nine months after the Accounting Reference Date, prepare an automated Interim Consolidated COREP Return ("ICCR").

R4-6.4.2 The ICCR shall be submitted to the MFSA within 42 days of the date from which it has been prepared. In the event of a change in the Accounting Reference Date, the date for the preparation of the ICCR shall be agreed with the MFSA.

Title 7 Disclosure Requirements

Section 1 Scope and Application

R4-7.1.1 This Title shall apply exclusively to Category 2 and Category 3 Licence Holders falling within scope of the Rules.

Section 2 General Disclosure Requirements

R4-7.2.1 The Licence Holder shall on an annual basis publicly disclose all the information referred to in Part Eight of the CRR, as amended by the applicable transitional provisions set out in Part Ten of the CRR, which *inter alia* includes information on the Licence Holder's:

i. Own funds;

ii. Risk Components;

iii. Risk management and the internal capital adequacy assessment process, including governance arrangements; and

iv. Remuneration policy and practices.

R4-7.2.2 The Licence Holder may publish information other than the financial statements. If disclosures are not included in the financial statements, the Licence Holder shall unambiguously indicate where they can be found.

R4-7.2.3 The Licence Holder shall disclose in its Annual Report among the key indicators, its return on assets, calculated as its net profit divided by its total balance sheet.

R4-7.2.4 For the purposes of complying with the regulatory disclosure requirements Part Eight of the CRR, Licence Holders shall make reference to:

i. Articles 431 to 455 and 492 of the CRR;

ii. the relevant Technical Standards on regulatory disclosure issued by the European Commission from time to time; and

iii. the Guidelines which the EBA may issue on this matter from time to

time.

R4-7.2.5 Where the Licence Holder intends to withhold regulatory disclosure in terms of Article 432 of the CRR, it shall:

i. request its Compliance Officer to prepare a Compliance Report indicating the reasons for non-disclosure and confirming that the said non-disclosure is permitted by the above mentioned Article; and

ii. in its regulatory disclosure state the fact that the information required to be disclosed has not been disclosed and the reason for non-disclosure, in accordance with paragraph 3 of Article 432 of the CRR.

R4-7.2.6 Where the Licence Holder maintains a website, it shall disclose the manner in which it complies with the corporate governance requirements referred to in Title 1, Title 2 and Section 3, Title 5 of Chapter 3, inclusive herein and the reporting requirements referred to in this Title.

Section 3 Own Funds Disclosures

R4-7.3.1 The Licence Holder shall disclose the information regarding its Own Funds as provided for in Article 437 of the CRR.

R4-7.3.2 Provided that for the period 1 January 2014 to 31 December 2021 the requirements of Article 492 of the CRR shall be applied. For the purposes of complying with the regulatory disclosures specified in this article, the Licence Holder shall make use of the standard templates published in Commission Implementing Regulation (EU) No 1423/2013 of 20 December 2013 laying down implementing technical standards with regard to disclosure of own funds requirements for institutions according to Regulation (EU) No 575/2013.

Section 4 Risk Components Disclosure

R4-7.4.1 The Licence Holder shall explain the risk components to which it is exposed, by taking into account all the disclosure requirements specified in Articles 435, 438, 439, 445, 446, 448 and 452 to 455 of the CRR. Such explanation shall be made in the manner outlined in Rules R4-7.4.2 to R4-7.4.13 below.

R4-7.4.2 The Licence Holder shall disclose the method it has adopted for the calculation of its credit/ counterparty risk component, that is, either the Standardised Approach or the Internal Ratings Based Approach, in accordance with Article 438 of the CRR.

R4-7.4.3 Licence Holders which calculate the credit/ counterparty risk component through the Standardised Approach, shall disclose the total amount of its Credit/Counterparty Risk Component for each of the exposure classes specified in Article 112 of the CRR.

R4-7.4.4 Licence Holders which calculate the credit/counterparty risk component through the Internal Ratings Based Approach are advised to contact the MFSA for guidance on the type of information which is to be included.

R4-7.4.5 The Licence Holder shall disclose the total amount of the risk components which form part of its trading book business risk, these being: (i) position risk component; and (ii) the counterparty credit risk component. By way of a note, the Licence Holder shall also disclose a breakdown of this total amount, risk component per risk component, in accordance with Articles 438, 439 and 445 of the CRR.

R4-7.4.6 The Licence Holder shall disclose the total amount of its commodities instruments risk, in accordance with Articles 438 and 445 of the CRR.

R4-7.4.7 The Licence Holder shall disclose the total amount of its large exposures, in accordance with Article 438 of the CRR.

R4-7.4.8 The Licence Holder shall disclose the total amount of its foreign exchange risk component. The Licence Holder shall also disclose the currencies to which it is exposed, in accordance with Article 438 and 445 of the CRR.

R4-7.4.9 The Licence Holder shall disclose the total amount of its operational risk component, in accordance with Article 438 and 446 of the CRR.

R4-7.4.10 The Licence Holder shall disclose the method it has adopted for the calculation of its operational risk component, that is, either the Basic Indicator Approach, or Standardised Measurement Approach, or the Advanced Measurement Approach.

R4-7.4.11 Licence Holders which calculate the operational risk component by using the Advanced Measurement Approach shall include an explanation on how this method is being applied by the Licence Holder. Prior to preparing such explanation, the Licence Holder shall contact the MFSA for guidance on the type of information which is to be included.

R4-7.4.12 The Licence Holder shall disclose the total amount of its settlement risk, in

accordance with Article 438 and 445 of the CRR.

R4-7.4.13 The Licence Holder shall disclose the total amount of its CVA risk, in accordance with Article 438 of the CRR.

Section 5 Risk Management and the Internal Capital Adequacy Assessment Process Disclosures

R4-7.5.1 The Licence Holder shall disclose a summary of its Risk Management and Internal Capital Adequacy Assessment Process, in accordance with Articles 435 and 438 of the CRR. Such summary shall include a brief description of all the risks to which the Licence Holder is exposed and an explanation on the manner in which the Licence Holder is managing these risks.

Section 6 Remuneration policy and practices disclosure requirements

R4-7.6.1 The following information at least shall be disclosed to the public regarding the remuneration policy and practices of Licence Holders for those categories of staff whose professional activities have a material impact on their risk profile, in accordance with Article 450 of the CRR:

i. information concerning the decision-making process used for determining the remuneration policy, as well as the number of meetings held by the main body overseeing remuneration during the financial year, including, if applicable, information about the composition and the mandate of a remuneration committee, the external consultant whose services have been used for the determination of the remuneration policy and the role of the relevant stakeholders;

ii. information on the link between pay and performance;

iii. the most important design characteristics of the remuneration system, including information on the criteria used for performance measurement and risk adjustment, deferral policy and vesting criteria;

iv. the ratios between fixed and variable remuneration set in accordance with Section 3, Title 5 of Chapter 3 of these Rules;

v. information on the performance criteria on which the entitlement to shares, options or variable components of remuneration is based;

vi. the main parameters and rationale for any variable component scheme and any other non-cash benefits;

vii. aggregate quantitative information on remuneration, broken down by business area. Licence Holders shall moreover submit to the Authority information on the number of natural persons that are remunerated Euro 1 million or more per financial year, in pay brackets of €1million, including data on their work responsibilities, the business area involved and the main elements of their salary, including bonuses, long-service awards and pension contributions. The Authority is required to provide this information to the EBA which shall disclose the information on an aggregate Home Member State basis in a common reporting format;

viii. aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the Licence Holder, indicating the following:

(a) the amounts of remuneration for the financial year, split into fixed and variable remuneration, and the number of beneficiaries;

(b) the amounts and forms of variable remuneration, split into cash, shares, share-linked instruments and other types;

(c) the amounts of outstanding deferred remuneration, split into vested and unvested portions;

(d) the amounts of deferred remuneration awarded during the financial year, paid out and reduced through performance adjustments;

(e) new sign-on and severance payments made during the financial year, and the number of beneficiaries of such payments; and

(f) the amounts of severance payments awarded during the financial year, number of beneficiaries and highest such award to a single person.

ix. the number of individuals being remunerated EUR 1 million or more per financial year, for remuneration between EUR 1 million and EUR 5

million broken down into pay bands of EUR 1 million; and

x. upon demand from the Authority, the total remuneration for each member of the management body or senior management.

R4-7.6.2 For Licence Holders that are significant, the quantitative information referred to in this point shall also be made available to the public in respect of members of the management body.

R4-7.6.3 For the purposes of determining whether a Licence Holder is to be considered significant, the Authority shall apply the definition in point (77) of Rule R1-1.3.1.

R4-7.6.4 Licence Holders shall comply with the requirements set out in this Rule in a manner that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities and without prejudice to the Data Protection Act (Cap. 440).

R4-7.6.5 In order to identify categories of staff whose professional activities have a material impact on its risk profile, the Licence Holder is required to make reference to Commission Delegated Regulation (EU) No 604/2014 with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile.

Section 7 Leverage Ratio

R4-7.7.1 In addition to the risks identified within the RMICAAP as specified in Rule R4-7.5, the Licence holder shall pursuant to Article 451(1) of the CRR, publically disclose information on their leverage ratio calculated in accordance with Article 429 and management of the risk of excessive leverage in the annual financial statements as specified in Rule XX.

R4-7.7.2 The Licence Holders are also required to follow the disclosure requirements and templates provided in the Commission Implementing Regulation (EU) 2016/200 of 15 February 2016 laying down implementing technical standards with regard to disclosure of the leverage ratio for institutions, according to Regulation (EU) No 575/2013 of the European Parliament and of the Council and its respective Annexes.

Section 8 ***Disclosure requirement for Consolidated Groups***

R4-7.8.1 **Scope of application**

R4-7.8.1.1 The Licence Holder shall ensure that the Consolidated Group discloses the following information, in accordance with Article 436 of the CRR:

i. in order to avail of the provisions of Articles 7 and 9 of the CRR.

ii. the names of the company/companies which form part of the Consolidated Group;

iii. an outline of the differences in the basis of consolidation for accounting and prudential purposes, with a brief description of the entities therein, explaining whether they are:

(a) fully consolidated;

(b) proportionally consolidated;

(c) deducted from own funds;

(d) neither consolidated nor deducted.

iv. any current or foreseen material, practical or legal impediment to the prompt transfer of own funds or repayment of liabilities among the parent undertaking and its subsidiaries;

v. the aggregate amount by which the actual own funds are less than required in all subsidiaries not included in the consolidation, and the name or names of such subsidiaries; and

vi. if applicable, an explanation of the circumstances being relied

R4-7.8.2 **Governance**

R4-7.8.2.1 Parent undertakings shall ensure that a description of the legal structure, governance and organisational structure of the Consolidated Group is publicly disclosed at least on an annual basis.

R4-7.8.3 **Country-by-country reporting**

R4-7.8.3.1 Licence Holders which form part of a Consolidated Group should publicly disclose annually, on a consolidated basis, by country where they have an establishment for the financial year:

i. their name(s), nature of activities and geographical location;

ii. turnover;

iii. number of employees on a full time equivalent basis;

iv. profit or loss before tax;

v. tax on profit or loss;

vi. public subsidies received;

R4-7.8.3.2 The information listed in (i) - (iii) of Rule R4-7.8.3 above shall be disclosed commencing from 1 July 2014. The information listed at (iv) - (vi) of Rule R4-7.8.3 above shall be disclosed commencing 1 January 2015.

R4-7.8.3.3 The information referred to in this sub section shall be subject to audit and shall be published where possible, as an annex to the annual financial statements or where applicable, to the consolidated financial statements of the Licence Holder concerned.

R4-7.8.3.4 By 1 July 2014, all global systemically important institutions authorised within the Union, as identified internationally, shall submit to the European Commission the information referred to in (iv) - (vi) of Rule R4-7.8.3 on a confidential basis.

Chapter 5 Transitory Arrangements

Title 1 Transitionary Arrangements to Title 1 of Chapter 2

Section 1 Scope and Application

R5-1.1.1 Title 1 of Chapter 6 shall apply solely to Category 2 and Category 3 Licence Holders.

Section 2 Proviso to Rule R2-1.2.2 on Initial Capital

R5-1.2.1 For the period 1 January 2014 to 31 December 2021, perpetual non-cumulative preference shares issued on or prior to 31 December 2011 and the related share premium account which qualified as Tier one capital under the national transposition measures for point (a) of Article 57 of Directive 2006/48/EC, shall qualify as Common Equity Tier 1 items, subject to the following limits (determined in accordance with Article 486 (5) of the CRR):

i. 80% during the period from 1 January 2014 to 31 December 2014;

ii. 70% during the period from 1 January 2015 to 31 December 2015;

iii. 60% during the period from 1 January 2016 to 31 December 2016;

iv. 50% during the period from 1 January 2017 to 31 December 2017;

v. 40% during the period from 1 January 2018 to 31 December 2018;

vi. 30% during the period from 1 January 2019 to 31 December 2019;

vii. 20% during the period from 1 January 2020 to 31 December 2020;

viii. 10% during the period from 1 January 2021 to 31 December 2021.

Provided further that the proportion of perpetual non-cumulative preference shares and the related share premium account, which exceeds the above percentages, shall be considered as Tier 2 capital.

Title 2 Transitionary Arrangements to Title 2, Title 3 and Title 4 of Chapter 2

Section 1 Scope and Application

R5-2.1.1 This Title shall apply to all Investment Services Licence Holders falling within scope of these Rules, except:

i. Section 2 of this Title, which shall apply solely to Category 2 and Category 3 Licence Holders.

ii. Rule R5-2.6.3, which shall apply to Category 1A and Category 1B falling within scope of these Rules;

iii. Rule R5-2.6.4, which shall apply to Category 2 and Category 3 falling within scope of these Rules.

Section 2 Proviso to Rule R2-3.3.4.2 on Common Equity Tier 1 Capital

R5-2.2.1 Pursuant to point (iv) of Rule R2-3.3.4.2.1.2, in accordance with Article 480 (3) if the CRR, the multiple of the percentage of minority interest allowed under Article 84 (1) (b) of the CRR shall be as follows, during the period 1 January 2014 to 30 December 2017:

i. 1 in the period from 1 January 2014 to 31 December 2014;

ii. 1 in the period from 1 January 2015 to 31 December 2015;

iii. 1 in the period from 1 January 2016 to 31 December 2016;

iv. 1 in the period from 1 January 2017 to 31 December 2017;

R5-2.2.2 For the period 1 January 2014 to 31 December 2021, perpetual non-cumulative preference shares issued on or prior to 31 December 2011 and the related share premium account which qualified as Tier one capital under the national transposition measures for point (a) of Article 57 of Directive 2006/48/EC, shall qualify as Common Equity Tier 1 items, subject to the following limits (determined in accordance with Article 486 (5) of the CRR):

i. 80% during the period from 1 January 2014 to 31 December 2014;

ii. 70% during the period from 1 January 2015 to 31 December 2015;

iii. 60% during the period from 1 January 2016 to 31 December 2016;

iv. 50% during the period from 1 January 2017 to 31 December 2017;

v. 40% during the period from 1 January 2018 to 31 December 2018;

vi. 30% during the period from 1 January 2019 to 31 December 2019;

vii. 20% during the period from 1 January 2020 to 31 December 2020;

viii. 10% during the period from 1 January 2021 to 31 December 2021.

R5-2.2.3 Provided that the proportion of perpetual non-cumulative preference shares and the related share premium account, which exceeds the above percentages, shall be considered as Tier 2 capital.

Section 3 Transitional provisions on unrealised losses measured at fair value

R5-2.3.1 By way of derogation from Article 35 of the CRR, during the period from 1 January 2014 to 31 December 2017, Licence Holders shall include in the calculation of their Common Equity Tier 1 items the following applicable percentages of unrealised losses related to assets or liabilities measured at fair value, and reported on the balance sheet, excluding those referred to in Article 33 and all other unrealised losses reported as part of the profit and loss account, in terms of Article 467 (2) of the CRR:

i. 100% for the period from 1 January 2014 to 31 December 2014;

ii. 100% for the period from 1 January 2015 to 31 December 2015;

iii. 100% for the period from 1 January 2016 to 31 December 2016;

iv. 100% for the period from 1 January 2017 to 31 December 2017.

Section 4 Transitional provisions on unrealised gains measured at fair value

R5-2.4.1 By way of derogation from Article 35 of the CRR, during the period from 1 January 2014 to 31 December 2017, Licence Holders shall remove from their

Common Equity Tier 1 items the following applicable percentages of unrealised gains related to assets or liabilities measured at fair value, and reported on the balance sheet, excluding those referred to in Article 33 and all other unrealised gains with the exception of those related to investment properties reported as part of the profit and loss account, in terms of Article 468 (2) of the CRR:

i. 100% for the period from 1 January 2014 to 31 December 2014;

ii. 60% for the period from 1 January 2015 to 31 December 2015;

iii. 40% for the period from 1 January 2016 to 31 December 2016;

iv. 20% for the period from 1 January 2017 to 31 December 2017.

R5-2.4.2 The resulting residual amount shall not be removed from Common Equity Tier 1 items.

Section 5 Transitional provisions on unrealised gains measured at fair value from derivative liabilities on own credit risk

R5-2.5.1 By way of derogation from Article 33 (1) (c), during the period from 1 January 2013 to 31 December 2017, Licence Holders shall not include in their own funds the following applicable percentage of the fair value gains and losses from derivative liabilities arising from changes in the own credit standing of the Licence Holder, determined in accordance with Article 478:

i. 100% for the period from 1 January 2014 to 31 December 2014;

ii. 100% for the period from 1 January 2015 to 31 December 2015;

iii. 100% for the period from 1 January 2016 to 31 December 2016;

iv. 100% for the period from 1 January 2017 to 31 December 2017.

Section 6 Transitional provisions on deductions from Common Equity Tier 1 items

R5-2.6.1 In terms of Article 478 (3) of the CRR, the Authority sets out the following percentages for the deductions, which are applicable during the period 1 January 2014 to 31 December 2017:

CRR	Transitional	Rule as	From	From	From	From

article	Prvosion	applicable		Jan 2014	Jan 2015	Jan 2016	Jan 2017
469 (1) (a)	Losses for the current financial year (Article 36 (1) (a))	R2-2.3.1.1.2.7 (i)	R2-3.3.4.2.11 (i)	100%	100%	100%	100%
469 (1) (a)	Intangible assets (Article 36 (1) (b))	R2-2.3.1.1.2.7 (ii)	R2-3.3.4.2.11 (ii)	100%	100%	100%	100%
469 (1) (a)	Defined benefit pension fund assets (Article 36 (1) (e))	R2-2.3.1.1.2.7 (iv)	R2-3.3.4.2.11 (v)	100%	100%	100%	100%
469 (1) (a)	Holdings of the Licence Holder's own CET 1 capital instruments (Article 36 (1) (f)	R2-2.3.1.1.2.7 (v)	R2-3.3.4.2.11 (vi)	100%	100%	100%	100%
469 (1) (a)	Reciprocal cross holdings (Article 36 (1) (g)	R2-2.3.1.1.2.7 (v)	R2-3.3.4.2.11 (vii)	100%	100%	100%	100%
469 (1) (a)	Non-significant holdings (Article 36 (1) (h)	R2-2.3.1.1.2.7 (vi)	R2-3.3.4.2.11 (viii)	100%	100%	100%	100%
469 (1) (c)	Deferred tax assets (Article 36 (1) (c))	R2-2.3.1.1.2.7 (iii)	R2-3.3.4.2.11 (iii)	100%	100%	100%	100%
CRR article	**Transitional Prvosion**	**Rule as applicable**		**From Jan 2014**	**From Jan 2015**	**From Jan 2016**	**From Jan 2017**

469 (1) (c)	Significant holdings (Article 36 (1) (i)	R2-2.3.1.1.2.7 (viii)	R2-3.3.4.2.11 (ix)	100%	100%	100%	100%

R5-2.6.2 Pursant to R5-2.6.1, the following shall also apply to Category 1A and 1B Licence Holders falling within scope of these Rules:

CRR article	Transitional Prvosion	Rule as applicable	From Jan 2014	From Jan 2015	From Jan 2016	From Jan 2017
469 (1) (c)	Deferred tax assets that existed prior to 1 January 2014 (Article 36 (1) (c)	R2-2.3.1.1.2.7 (iii)	100%	100%	100%	100%

R5-2.6.3 Pursant to R5-2.6.1, the following shall also apply to Category 2 and 3 Licence Holders falling within scope of these Rules:

CRR article	Transitional Prvosion	Rule as applicable	From Jan 2014	From Jan 2015	From Jan 2016	From Jan 2017
469 (1) (a)	IRB shortfall of credit risk adjustments to expected losses (Article 36 (1) (d)	R2-3.3.4.2.11 (iv)	100%	100%	100%	100%

R5-2.6.4 For the purposes of the calculation of **deferred tax assets** in terms of Article 469 (1) (c), Licence Holders shall take into the provisions of Article 470 of the CRR, i.e.

i. By way of derogation from Article 48 (1) of the CRR, during the period from 1 January 2014 to 31 December 2017, Licence Holders shall not deduct (deferred tax assets that are dependent on future profitability and arise from temporary differences and in aggregate are equal to or less

than 10% of relevant Common Equity Tier 1 items), which in aggregate are equal to or less than 15% of relevant Common Equity Tier 1 items;

ii. For the purposes of paragraph (a) above, relevant Common Equity Tier 1 items shall comprise the Common Equity Tier 1 items of the Licence Holder calculated after applying the provisions of Article 32 to 35 and making the deductions pursuant to points (a) to (h), k(ii) to (v) and (l) of Article 36 (1), excluding deferred tax assets that rely on future profitability and arise from temporary differences;

iii. By way of derogation from Article 48 (4) of the CRR, the items exempt from deduction pursuant to paragraph (a) above shall be risk weighted at 250%.

R5-2.6.5 For **deferred tax assets that existed prior to 1 January 2014**, the Authority sets out the following applicable percentages for the purpose of deduction from Common Equity Tier 1 items in terms of Article 469 (1) (c) of the CRR:

i. 100% for the period from 1 January 2014 to 31 December 2014;

ii. 100% for the period from 1 January 2015 to 31 December 2015;

iii. 100% for the period from 1 January 2016 to 31 December 2016;

iv. 100% for the period from 1 January 2017 to 31 December 2017;

v. 100% for the period from 1 January 2018 to 31 December 2018;

vi. 100% for the period from 1 January 2019 to 31 December 2019;

vii. 100% for the period from 1 January 2020 to 31 December 2020;

viii. 100% for the period from 1 January 2021 to 31 December 2021;

ix. 100% for the period from 1 January 2022 to 31 December 2022;

x. 100% for the period from 1 January 2023 to 31 December 2023;

R5-2.6.6 For the residual amount of the deferred tax assets referred to in point (c) of Article 36 (1), the Licence Holder shall apply the requirement laid down in Article 472 (5) during the period 1 January 2014 to 31 December 2017 i.e. the residual amount shall not be deducted and shall be subject to a risk weight of

0%.

R5-2.6.7 In terms of Article 469 (2) of the CRR, Licence Holders shall determine the portion of the total residual amount of deferred tax assets that is subject to Article 472 (5), by dividing the amount specified in point (a) of this paragraph by the amount specified in point (b) of this paragraph:

i. The amount of deferred tax assets that are dependent on future profitability and arise from temporary differences, which in aggregate are equal to or less than 10% of the relevant Common Equity Tier 1 items of the Licence Holder;

ii. The sum of the following:

(a) The amount of deferred tax assets that are dependent on future profitability and arise from temporary differences, which in aggregate are equal to or less than 10% of the relevant Common Equity Tier 1 items of the Licence Holder;

(b) the amount of direct, indirect and synthetic holdings by the Licence Holder of the Common Equity Tier 1 instruments of financial sector entities where the Licence Holder has a significant investment, that in aggregate are equal to or less than 10% of relevant Common Equity Tier 1 items of the Licence Holder.

R5-2.6.8 For the purposes of the calculation of **significant holdings** in terms of Article 469 (1) (c), Licence Holders shall take into the provisions of Article 470 of the CRR, i.e.

(a) By way of derogation from Article 48 (1) of the CRR, during the period from 1 January 2014 to 31 December 2017, Licence Holders shall not deduct (the applicable amount of direct, indirect and synthetic holdings by the Licence Holder of the Common Equity Tier 1 instruments of financial sector entities where the Licence Holder has a significant investment, that in aggregate are equal to or less than 10% of relevant Common Equity Tier 1 items), which in aggregate are equal to or less than 15% of relevant Common Equity Tier 1 items;

(b) For the purposes of paragraph (a) above, relevant Common Equity Tier 1 items shall comprise the Common Equity Tier 1 items of the Licence Holder calculated after applying the provisions of Article 32 to 35 and

making the deductions pursuant to points (a) to (h), k(ii) to (v) and (l) of Article 36 (1), excluding deferred tax assets that rely on future profitability and arise from temporary differences;

(c) By way of derogation from Article 48 (4) of the CRR, the items exempt from deduction pursuant to paragraph (a) above shall be risk weighted at 250%. These items shall also be subject to the requirements of Title IV of Part Three of the CRR, as applicable.

R5-2.6.9 For the residual amount of significant holdings referred to in point (i) of Article 36 (1), the Licence Holder shall apply the requirement laid down in Article 472 (11) during the period 1 January 2014 to 31 December 2017, i.e.:

i. The amounts required to be deducted that relate to direct holdings are deducted half from Tier 1 items and half from Tier 2 items;

ii. The amounts that relate to indirect and synthetic holdings are not deducted and are subject to risk weights in accordance with Chapter 2 or 3 of Title II of Part Three and to the requirements laid down in Title IV of Part Three, as applicable.

R5-2.6.10 In terms of Article 469 (3) of the CRR, Licence Holders shall determine the portion of the total residual amount of significant holdings that is subject to Article 472 (11), by dividing the amount specified in point (a) of this paragraph by the amount specified in point (b) of this paragraph:

i. The amount of direct and indirect holdings of the Common Equity Tier 1 instruments of financial sector entities where the Licence Holder has a significant investment, that in aggregate are equal to or less than 10% of relevant Common Equity Tier 1 items of the Licence Holder.

ii. The sum of the following:

(a) The amount of deferred tax assets that are dependent on future profitability and arise from temporary differences, which in aggregate are equal to or less than 10% of the relevant Common Equity Tier 1 items of the Licence Holder;

(b) The amount of direct, indirect and synthetic holdings by the Licence Holder of the Common Equity Tier 1 instruments of financial sector entities where the Licence Holder has a significant investment, that in aggregate are equal to or less than

10% of relevant Common Equity Tier 1 items of the Licence Holder.

Section 7 ***Transitional provisions on deductions from Additional Tier 1 items***

R5-2.7.1 For the purposes of Article 474 (a) of the CRR, the Authority sets out the following percentages for all the deductions from Additional Tier 1 items, required pursuant to Article 56 (b) – (d) of the CRR, which are applicable during the period 1 January 2014 to 31 December 2017:

i. 100% for the period from 1 January 2014 to 31 December 2014;

ii. 100% for the period from 1 January 2015 to 31 December 2015;

iii. 100% for the period from 1 January 2016 to 31 December 2016;

iv. 100% for the period from 1 January 2017 to 31 December 2017.

R5-2.7.2 For the residual amount required to be deducted pursuant to point (a) of Article 56 of the CRR, Licence Holders shall apply the requirements laid down in Article 475 (2) of the CRR, during the period 1 January 2014 to 31 December 2017, i.e:

i. Direct holdings of own Additional Tier 1 instruments are deducted at book value from Tier 1 items;

ii. Indirect and synthetic holdings of own Additional Tier 1 instruments, including own Additional Tier 1 instruments that a Licence Holder could be obliged to purchase by virtue of an existing or contingent contractual obligation are not deducted and are risk weighted in accordance with Chapter 2 or 3 of Title II of Part Three and subject to the requirements of Title IV of Part Three, as applicable.

Section 8 ***Transitional provisions on deductions from Tier 2 items***

R5-2.8.1 For the purposes of Article 476 (a) of the CRR, the Authority sets out the following percentages for all the deductions from Tier 2 items, required pursuant to Article 66 (b) – (d) of the CRR, which are applicable during the period 1 January 2014 to 31 December 2017:

i. 100% for the period from 1 January 2014 to 31 December 2014;

ii. 100% for the period from 1 January 2015 to 31 December 2015;

iii. 100% for the period from 1 January 2016 to 31 December 2016;

iv. 100% for the period from 1 January 2017 to 31 December 2017.

R5-2.8.2 For the residual amount required to be deducted pursuant to point (a) of Article 66 of the CRR, Licence Holders shall apply the requirements laid down in Article 477 (2) of the CRR, during the period 1 January 2014 to 31 December 2017, i.e.

v. Direct holdings of own Tier 2 instruments are deducted at book value from Tier 2 items;

vi. Indirect and synthetic holdings of own Tier 2 instruments, including own Tier 2 instruments that a Licence Holder could be obliged to purchase by virtue of an existing or contingent contractual obligation are not deducted and are risk weighted in accordance with Chapter 2 or 3 of Title II of Part Three and subject to the requirements of Title IV of Part Three, as applicable.

Section 9 Transitional provisions on additional filters and deductions

R5-2.9.1 For the purposes of Article 481 (5) of the CRR:

i. The Authority is not considering to apply additional filters and deductions to the own funds of Licence Holders in terms of Article 481 (1) of the CRR. The following percentages shall therefore apply during the period 1 January 2014 to 31 December 2017:

(a) 0% for the period from 1 January 2014 to 31 December 2014;

(b) 0% for the period from 1 January 2015 to 31 December 2015;

(c) 0% for the period from 1 January 2016 to 31 December 2016;

(d) 0% for the period from 1 January 2017 to 31 December 2017;

ii. As the requirements of Article 481 (2) of the CRR are not generally

applied by Licence Holders, the Authority determines that the applicable percetage of 0% is appropriate for the period 1 January 2014 to 31 December 2014.

Section 10 ***Transitional provisions on Consolidated Own Funds***

R5-2.10.1 For the purposes of Section 4, Title 4 of Chapter 2 the follwoing shall apply:

i. Consolidated own funds that would qualify as consolidated reserves in accordance with national transposition measures for article 65 of Directive 2006/48/EC that do not qualify as Common Equity Tier 1 capital for any of the reasons specified in article 479 (1) shall qualify as consolidated Common Equity Tier 1 capital at the following applicable percentages:

(a) 0% for the period from 1 January 2014 to 31 December 2014;

(b) 0% for the period from 1 January 2015 to 31 December 2015;

(c) 0% for the period from 1 January 2016 to 31 December 2016;

(d) 0% for the period from 1 January 2017 to 31 December 2017.

iv. the multiple of the percentage of: (a) subsidiary Tier 1 capital allowed under article 85 of the CRR in consolidated own funds; and (b) subsidiary own funds allowed under article 87 of the CRR in consolidated own funds shall be as follows for the purposes of article 480 (3) of the CRR, during the period 1 January 2014 to 31 December 2017:

(a) 1 in the period from 1 January 2014 to 31 December 2014;

(b) 1 in the period from 1 January 2015 to 31 December 2015;

(c) 1 in the period from 1 January 2016 to 31 December 2016;

(d) 1 in the period from 1 January 2017 to 31 December 2017.

Title 3 Transitionary Arrangements to Title 5 of Chapter 2

Section 1 Scope and Application

R5-3.1.1 This Title shall apply to Category 3 Investment Services Licence Holders falling within scope of these Rules.

Section 2 Transitional provisions on capital conservation buffer

R5-3.2.1 The requirement for the capital conservation buffer shall be transitioned between the 1 January 2016 and the 31 December 2018 as follows:

For the period from the 1 January 2016 until the 31 December 2016 the capital conservation buffer shall consist of Common Equity Tier 1 equal to 0.625% of the total of the risk-weighted exposure amounts of the investment firm calculated in accordance with Article 92(3) of the CRR;

For the period from the 1 January 2017 until the 31 December 2017 the capital conservation buffer shall consist of Common Equity Tier 1 equal to 1.25% of the total of the risk-weighted exposure amounts of the investment firm calculated in accordance with Article 92(3) of the CRR;

For the period from the 1 January 2018 until the 31 December 2018 the capital conservation buffer shall consist of Common Equity Tier 1 equal to 1.875% of the total of the risk-weighted exposure amounts of the investment firm calculated in accordance with Article 92(3) of the CRR.

Section 3 Transitional provisions on institution-specific countercyclical capital buffer

R5-3.3.1 The requirement for an institution-specific countercyclical capital buffer shall be transitioned between the 1 January 2016 and the 31 December 2018 as follows:

For the period from the 1 January 2016 until the 31 December 2016 the institution-specific countercyclical capital buffer shall be no more than 0.625% of the total of the risk-weighted exposure amounts of the investment firm calculated in accordance with Article 92(3) of the CRR;

For the period from the 1 January 2017 until the 31 December 2017 the

institution-specific countercyclical capital buffer shall be no more than 1.25% of the total of the risk-weighted exposure amounts of the investment firm calculated in accordance with Article 92(3) of the CRR;

For the period from the 1 January 2018 until the 31 December 2018 the institution-specific countercyclical capital buffer shall be no more than 1.875% of the total of the risk-weighted exposure amounts of the investment firm calculated in accordance with Article 92(3) of the CRR.

Section 4 ***Transitional provisions on the capital conservation plan and the restrictions on distributions***

R5-3.4.1 The requirement for a capital conservation plan and the restrictions on distributions referred to in Rules R2-5.7.1 to R2-5.8.4 [Articles 141 and 142 of the CRD] shall apply during the transitional period between 1 January 2016 and 31 December 2018 where investment firms fail to meet the combined buffer requirement taking into account the requirements set out in Rule R2-5.9.1 and R2-5.9.2.

Section 5 ***Transitional provisions on the the G-SII buffer***

R5-3.5.1 The G-SII buffer shall be implemented as follows:

i. 25% of the G-SII buffer, set in accordance with Rule R2-5.5.5, in 2016;

ii. 50% of the G-SII buffer, set in accordance with Rule R2-5.5.5, in 2017;

iii. 75% of the G-SII buffer, set in accordance with Rule R2-5.5.5, in 2018;

iv. 100% of the G-SII buffer, set in accordance with Rule R2-5.5.5, , in 2019.

Chapter 6 Enforcement and Sanctions

Title 1

Section 1 *Scope and Application*

R6-1.1.1 This Title shall apply to all Investment Services Licence Holders licensed falling within scope of the Rules.

Section 2 *Enforcement and Sanctions*

R6-1.2.1 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 a Licence Holder which does not comply with its regulatory obligations. Such powers include the right to impose administrative penalties.

R6-1.2.2 Where a Licence Holder breaches or infringes a Rule, the MFSA may by virtue of authority granted to it under article16A of the Act impose administrative penalties without recourse to a court of law, up to a maximum of €150,000. The Act grants the MFSA discretion to impose administrative penalties on Licence Holders and/or on Licence Holders' directors, officers or trustees.

R6-1.2.3 Notwithstanding Rule R6-1.2.4, administrative penalties, measures and investigatory powers which the MFSA may apply, in the context of the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR), to Category 2 and Category 3 Licence Holders subject to the CRD and the CRR, are stipulated in the Investment Services Act CRD (Administrative Penalties, Measures and Investigatory Powers) Regulations.

R6-1.2.4 Notwithstanding Rule R6-1.2.3, administrative penalties, measures and investigatory powers which the MFSA may apply, in the context of the Markets in Financial Instruments Directive (MiFID) and the Markets in Financial Instruments Regulation (MiFIR), to Licence Holders, are stipulated in the Investment Services Act (MiFID and MiFIR Administrative Penalties, Measures and Investigatory Powers) Regulations.

R6-1.2.5 In determining whether to impose a penalty or other sanction, and in

determining the appropriate penalty or sanction, the MFSA shall be guided by the principle of proportionality. The MFSA shall, where relevant, take into consideration the circumstances of the specific case, which may *inter alia* include:

i. the good faith and the degree of openness of the Licence Holder in the fulfilment of his obligations under the Act, relative regulations, Rules and Licence Conditions or of decisions of the competent authority in this regard;

ii. the degree of diligence and co-operation shown by the Licence Holder;

iii. any evidence of wilful deceit on the part of the Licence Holder or its officers;

iv. the seriousness of the effects of the infringement including the losses for third parties caused by the infringement, and any potential systemic consequences of the infringement;

v. the repetition, frequency or duration of the infringement by the Licence Holder;

vi. the profits obtained and/ or losses avoided by the Licence Holder by reason of the infringement;

vii. the financial strength of the Licence Holder;

viii. previous infringements by the Licence Holder and prior sanctions imposed by MFSA or other regulatory authorities on the same Licence Holder.

R6-1.2.6 Whenever the infringement consists of a failure to perform a duty, the application of a sanction shall not exempt the Licence Holder from its performance, unless the decision of the MFSA explicitly states the contrary.

R6-1.2.7 These Rules stipulate various requirements for the submission of documents within set time-frames. In the instance when such time-frames are not complied with, and unless there are justifiable reasons for the delay, Licence Holders will be considered as breaching the relevant Rule(s) and will be penalised accordingly.

R6-1.2.8 Documents may be submitted in various ways. The date of receipt will be as

follows:

i. If it is sent by fax and/or email, the date of receipt recorded shall be the time stamp of the fax and/or email, respectively;

ii. If it is sent by post, this will be the date indicated by the MFSA stamp evidencing receipt;

iii. If it is delivered by hand, on the date such delivery was made and recorded by MFSA.

R6-1.2.9 The MFSA will use its discretion to decide what action to take in respect of Licence Holders who do not submit documents by their due date, after taking into consideration the reasons (if any) put forward by the Licence Holder for the delay.

R6-1.2.10 Late submission gives rise to liability to an initial penalty and an additional daily penalty. If the conditions imposed by MFSA are not met, the Authority reserves the right to take any further action it may deem adequate in the circumstances.

R6-1.2.11 A right of appeal to the Financial Services Tribunal is available to Licence Holders on whom penalties are imposed.