MFSA

MALTA FINANCIAL SERVICES AUTHORITY

The EU Markets in Financial Instruments Directive ('MiFID')

Feedback Statement further to Industry Responses to MFSA Consultation Document dated 13th November 2006

25th January 2007

1.0 Background

On the 13th November 2006, the MFSA circulated to the Financial Services Consultation Council ['FSCC'] as well as to Investment Services Licence Holders ['ISLHs'], the first consultation document on Malta's transposition of the MiFID. This first consultation document outlined the proposed amendments to a number of Sections of Part C I of the Investment Services Guidelines ['Part C I'], which Guidelines are to be renamed as Investment Services Rules.

The MFSA received comments from a member of the FSCC and from two ISLHs. An outline of the main comments received and the MFSA's position in relation thereto, is provided in Section 2.0.

2.0 Main Comments Received and MFSA's position

[2.1] Promotion & Selling / Investment Advice – Current SLCs 1.05 / 1.08 [j]

Industry Comments: Guidance was sought with respect to how the MiFiD regime would affect the current practice known as "promotion and selling". In brief, this involves the description of the features of specific products (mostly collective investment schemes) without the provision of advice to the client who then decides whether to make the investment in a particular product or not. MFSA was requested to clarify its position as to whether this practice will continue to be allowed and/or regulated by MFSA once the MiFID is implemented.

MFSA Remarks:

<u>Background – Current Regime</u>

In terms of the current SLC 1.08 (j) of Part C I of the Investment Services Guidelines, ISLHs are required to obtain the written consent of the MFSA before employees are engaged in any of the services of arranging of deals or investment advice, amongst others. As per the said SLC, the request for authorisation must 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 must be provided together with the request.

Moreover, in terms of the current SLC 1.05 of Part C I of the Investment Services Guidelines, ISLHs promoting collective investment schemes must be able to demonstrate that appropriate training has been undertaken by the relevant staff members to be involved in arranging deals and/ or giving advice in relation to such products.

There is an exemption to SLC 1.05 in respect of staff members who are considered by the Authority – on the basis of qualifications, training and experience – to be competent to provide general investment advice in respect of such Instruments.

At present, a number of ISLHs have authorised employees who are approved either: **[i]** to provide investment advice together with the arranging of deals, which may include product promotion; or **[ii]** to arrange deals only, which may include product promotion [the activity of product promotion may be described as involving staff in explaining the features of specific products to customers or prospective customers].

Whereas a client requesting investment advice must be serviced by an employee authorised to provide advice, a client merely interested in receiving information on investment products, may be serviced by employees who fall within category [ii] above.

Investment Advice / Promotion and Selling under MiFID

With the transposition of MiFID, the above-quoted SLCs will be replaced by MiFID-compliant rules. In this regard, SLC 1.05 will not remain applicable and SLC 1.08 (j) will be revised to retain MFSA's prior consent requirement only for staff involved in the provision of investment advice and/or portfolio or fund management.

The introduction of MiFID-compliant rules will also introduce a new definition of the meaning of investment advice which is defined in article 4 [4] of the Directive as *'the provision of personal recommendations to a client either upon its request or at the initiative of the investment firm, in respect of one or more transaction relating to financial instruments.'*

The MiFID Implementing Directive further defines a **personal recommendation** as: *'a recommendation that is made to a person in his capacity as an investor or a potential investor, or in his capacity as an agent for an investor for potential investor. The recommendation must be suitable for that person, or must be based on a consideration of the circumstances of that person and must constitute a recommendation to take one of the following sets of steps: [a] to buy, sell, subscribe for, exchange, redeem, hold or underwrite a particular financial instrument; [b] to exercise or not to exercise any right conferred by a particular financial instrument to buy, sell, subscribe for, exchange or redeem a financial instrument. A recommendation is not a personal recommendation of it is issued exclusively through distribution channels or to the public.'*

MiFID will also enhance present conduct of business rules by providing for *'suitability and appropriateness'* tests**.**

Suitability Test – Before providing investment advice or portfolio management, Investment Services Licence Holders are required to assess the suitability of the financial instrument for a particular client. This is done by assessing the client or potential client's knowledge and experience in the investment field relevant to the specific product or service, his financial situation and his investment objectives. The principles of this requirement already exist in terms of the current standard licence conditions.

Appropriateness Test – The concept of the appropriateness test is new. In terms of the proposed new Rules, when providing investment services other than the provision of investment advice or portfolio management services, ISLHs will now be required to assess whether the transaction is appropriate for the client by evaluating his knowledge and experience. Where the product or service offered is not considered by the ISLH to be appropriate for the client or potential client, the ISLH is required in terms of the new Rules to warn the client or potential client. In the case of certain execution only transactions, ISLHs can be exempted from carrying out an appropriateness test for their clients if specific conditions are met, including disclosure to the client that the ISLH is not required to assess the suitability of the product and that he/she consequently does not benefit from the corresponding protection of the relevant conduct of business rules.

The MiFID-compliant rules also include a number of client disclosure requirements to regulate the provision of information to clients and potential clients which staff providing information to clients whilst promoting investment products, would be required to comply with.

Under the MiFID scenario, ISLHs will still be able to have staff who are not authorised investment advisors, promoting and selling investment products i.e. limiting themselves to providing information on such products and arranging deals, without providing any investment advice. However, given the deletion of SLC 1.05 and amendment to SLC 1.08 (j) referred to above, MFSA's prior consent (including training details), will no longer be required for such staff. Rather, such ISLHs will be made subject to licence conditions, [to be included in the section of the new Rules implementing MiFID which deals with provision of information to clients and potential clients], which:

[a] requires ISLHs to have appropriate internal controls and compliance checks to ensure that no investment recommendations are issued/advice provided by staff who are not authorised to provide advice, but that only factual details regarding investment products are provided to clients, ensuring also that the relevant Rules on provision of information are observed. ISLHs will also be required to have documented procedures to be followed by staff identified to provide only product specific information to clients;

[b] clarifies – for the avoidance of doubt – that the activity of product promotion [promotion and selling] would be subject to the relevant provisions of the new MiFID

Rules which will deal with the provision of information to clients and potential clients;

[c] requires clear disclosure to clients: **[i]** that the information provided does not constitute advice and that should clients require advice, they may be referred to an authorised advisor (in the case of face to face meetings with clients, this disclosure should be provided in writing, countersigned by the client); and **[ii]** of the ISLH's connections – if any - with the product provider/ the nature of its interest in promoting the particular products;

[d] requires record-keeping by ISLHs pertaining to staff who are not authorised advisors but who provide information to clients and promote and sell products, together with details of the training provided to such persons (along the lines of the information which to date is submitted to MFSA in terms of SLC 1.05), as well as records evidencing internal compliance checks undertaken by the Licence Holder, including any disciplinary action against such staff. Such records should be available for inspection during compliance visits.

A draft of the proposed new licence conditions will shortly be circulated to ISLHs for their information and any comments.

[2.2] Certificate of Compliance – Current SLC 1.11 of Part C I

Industry Comment: It was queried whether the current requirement to submit a certificate of compliance will cease to exist.

MFSA remarks: It is MFSA's policy to keep, as much as possible, the local notification requirements in line with the MiFID provisions. The MiFID does not stipulate that Investment Firms should be required to submit a certificate confirming their compliance with the provisions of MiFID. Accordingly, once the Rules implementing MiFID come into force, this requirement will not remain applicable.

[2.3] Disclosure Requirements Concerning Publication of unit prices of Collective Investment Schemes ['CISs'] – Current SLC 1.19 of Part C I

Industry Comment: Clarification is being requested as to whether the current requirements of the existing SLC 1.19 relating to the publication of unit prices in the local press, would cease to exist.

MFSA Remarks: In line with the MFSA's MiFID transposition policy as explained in Section [2.2] above, this SLC will also be deleted. This notwithstanding, the area of publication of unit prices of CISs is one of the areas which the MFSA intends to deal with in its Guidance Notes.

[2.4] Risk Management – New SLCs 1.23/ 1.24 of Part C I

[a] Industry Comment: Confirmation was requested that the risk management requirement set in the New SLC 1.23 of Part C I, will not apply directly to Collective Investment Schemes.

MFSA Remarks: The MiFID regulates the activity of Investment Firms. The transposition of a substantial part of MiFID is being effected through changes to Part C I, which part of the Guidelines only applies to ISLHs. Therefore, the risk management requirements will not apply directly to Collective Investment Schemes but must be complied with by all ISLHs including the Managers of such Schemes.

[b] Industry Comment: Guidance is being sought regarding the manner in which banks should proceed in complying with the risk management requirements set in SLC 1.23/ 1.24, in particular, whether they will be required to set up a specific risk management function.

MFSA Remarks: The MFSA wishes to clarify that the requirements of SLC 1.23 and 1.24 will apply to banks providing investment services in the same manner as they will apply to ISLHs which are not banks. The MFSA intends to issue guidance in this area in due course. Nonetheless, it should be emphasized that risk management is an essential feature of good business practice which is very much in ISLHs' interest to have in place. Moreover, ISLHs are best placed to identify the risks they face and to draw up appropriate and effective mechanisms to manage and monitor such risks.

[2.5] Responsibility of Senior Management – New SLC 1.27 of Part C I

Industry Comment: It has been recommended that an interpretation of the term '*on a regular basis*' should be made in the New SLC 1.27 of Part C I. and that such term should be interpreted as meaning 'at least annually' as per the New SLC 1.26 of Part C I.

MFSA Remarks: MFSA agrees with the above recommendation. The New SLC 1.27 of Part C I will be revised to read as follows:

'The Licence Holder shall ensure that the supervisory function, if any, receives on a regular basis ***[at least annually]*** *written reports on the same matters.*

For the purpose of this section, 'supervisory function' means the function within a Licence Holder responsible for the supervision of its senior management.'

[2.6] Internal Audit – New SLC 1.28 of Part C I

Industry Comment: Where the ISLH forms part of Group of Companies, confirmation was requested as to whether such ISLH would be considered as complying with the requirements of the New SLC 1.28 of Part C I where it is subject to its Group's internal audit function.

MFSA Remarks: MFSA confirms that as long as the Internal Audit function of a Group of Companies complies with the requirements of SLC 1.28 of Part C I, the ISLH forming part of the said Group of Companies will be considered as being in compliance with the requirements of the said SLC.

[2.7] Conduct of Business – General Requirements – New SLC 2.02 of Part C I

[a] Industry Comment: - An ISLH commented that it is the recipient rather than the payer of an intermediary commission who must satisfy the requirement that the intermediary commission is in fact "enhancing the quality of the relevant service to the client". MFSA was requested to clarify: [a] what specific provisions or considerations will be adopted with respect to commissions received as opposed to commissions paid out by the same ISLH; and [b] what are the expectations and criteria which MFSA will adopt regarding the enhancement test.

MFSA Remarks: This SLC is faithful to the wording found in Article 26 of Commission Directive 2006/73/EC ("the Implementing Directive") which refers to both the payers and the receivers of commissions. In drawing up the appropriate guidance, the MFSA intends following guidance to be issued by the Committee of European Securities Regulators ['CESR'] later on this year following a review of the feedback received in response to CESR's consultation paper entitled "Inducements under MiFID" and published on 22nd December 2006 (consultation deadline is the 9th February 2007). In the interim, ISLHs may refer to the practical examples included in CESR's Consultation Paper for an indication of what will and will not be permitted inducements.

[b] Industry Comment: - It was pointed out that although in terms of Rule 2.02(b)(i), Licence Holders are required to provide clients with information regarding any fees, commissions or benefits paid to or by a third party ***prior to the provision*** of the relevant services, in practice, however, it is not possible to provide clients with such information before the provision of the relevant investment services. Rather, it was argued that as a rule such information is provided **simultaneously** with the provision of the service.

MFSA Remarks: MFSA would like to point out that it is important to bear in mind that the whole objective of the requirement for "prior" disclosure to be made to the prospective client as set out in Article 26 of the Implementing Directive, is to enable such prospective client to make an informed choice as to whether or not to accept the provision of the investment service offered by the investment firm – whether it is the provision of advice and/or the reception and transmission of an order to trade in a particular instrument on behalf of a client etc. Accordingly, disclosure should be made at a point in time before the client commits himself/herself to being serviced by the firm which in turn is to give or receive the inducement.

[2.8] Conduct of Business – Client Classification – New SLCs 2.03/ 2.04/ 2.05/ 2.08/ 2.09/ 2.10/ 2.11/ 2.12 of Part C I

[a] Industry Comment: Guidance is being sought as to whether SLC 2.03 applies to customers making requests to subscribe for units in a collective investment scheme.

MFSA Remarks: MFSA confirms that this SLC also applies with respect to investments in units of a collective investment schemes, given these are financial instruments included in Section C of Annex 1 to MiFID.

[b] Industry Comment: Guidance is being sought as to whether a Group of Companies may share the client classification exercise required by SLC 2.03.

MFSA Remarks: MFSA confirms that this is possible subject to any applicable data-protection requirements.

[c] Industry Comment: Guidance is being sought as to whether ISLHs may roll-out the client classification exercise in stages as part of their periodic contact with customers. Guidance is also being sought as to whether SLC 2.03 applies to customers of ISLHs existing before the coming into force of MiFID

MFSA Remarks: In the case of clients serviced prior to the coming into force of MiFID, and who are not being offered a continuous investment advisory or portfolio management service, ISLHs would only be required to re-categorise such clients if and before they are offered a new investment service e.g. if such clients approach the ISLH to trade on their behalf on or after 1st November 2007. Naturally, clients whose contractual arrangements with an ISLH are for the provision of an investment advisory or portfolio service on a continuous basis, would need to be re-categorised before 1st November 2007. MiFID and its Implementing Directive do not provide any transitional provisions allowing for the phasing of such re-categorisation post 1st November 2007. Accordingly, it is highly recommended that ISLHs commence the client classification exercise for existing clients who are currently offered a continuous service, as soon as possible, so as to ensure that their records are updated prior to the 1st November, 2007.

[d] Industry Comment: MFSA was requested to confirm that clients to whom investment services are not provided on an ongoing basis, and for whom transactions were conducted on an execution-only basis in the past, need to be notified of any classification unless, going forward, another investment service is offered to such client.

MFSA Remarks: MFSA confirms that this is the case and that the client classification exercise need only be completed if and when a new investment service is offered to such clients. Please also refer to the remarks made under [c] above.

[e] Industry Comment: MFSA has been requested to confirm that with respect to the need to inform clients "about any limitations to the level of client protection" which a different categorisation would entail, any such limitations need only be outlined in broad terms at the stage when the client is merely informed of his right to request a different categorisation. It was also requested to confirm that if and when such a request is actually made, the implications may be explained in detail in the course of fulfilling the procedures spelt out in SLCs 2.09 to 2.12.

MFSA Remarks: MFSA confirms that this understanding is correct.

[f] Industry Comment: MFSA was requested to clarify the interpretation of the provisions of SLC 2.04 and 2.12.

MFSA Remarks: MFSA would like to clarify that for the purposes of SLC 2.12, investors who are currently classified as "Non-Private Clients" in terms of the current

Investment Services Guidelines would be considered as professional clients for the purposes of MiFID on the basis that the current criteria for the determination of whether clients may be considered to be "Non-Private", are similar to those established by MiFID. Although the requirements of SLC 2.04 will be implemented on 1st November 2007, it is recommended that ISLHs advise clients who are currently classified as "Non-Private" that it is their (i.e. the clients') responsibility to keep the ISLH informed about any changes which could affect their current categorisation. Moreover, it is up to the ISLH to take the appropriate action should it become aware that a particular client no longer fulfils the initial conditions which made him eligible for professional treatment.

[g] Industry Comment: The MFSA was asked to clarify whether an investor who has been considered to be a professional investor with another ISLH under the current regime, and subsequently decides to initiate a relationship with another ISLH after the MiFID transposition, would be considered to have fulfilled the initial conditions for professional clients or whether categorisation under the new Rules would be necessary.

MFSA Remarks: In terms of SLC 2.03, and subject to possible reliance on a prior classification in the case of group companies (see comments under [b] above), before providing an investment service, an ISLH is required to carry out a client classification exercise irrespective of any prior categorisation having been undertaken by another ISLH under the 'old' Guidelines. Moreover, in this regard, CESR is in the process of drafting Level 3 Recommendations on the ist of minimum records to be held in terms of article 51(3) of the MiFID Implementing Directive, which are to expected to be published in the coming weeks and according to such Recommendations, ISLHs will be expected to keep on record sufficient information to support the client's categorisation. These Recommendations also state that such records must be created when the client relationship begins with the ISLH or upon re-categorisation, including as a result of any review.

[h] Industry Comment: Guidance is being sought about the information which should be provided to clients regarding their right to request a different categorisation and the limitations to the level of protection which such change would bring about.

MFSA Remarks: When informing clients of their categorisation as per SLC 2.03, ISLHs shall in terms of SLC 2.05, also inform the client of his/her right to request a different categorisation. In addition, as per the same SLC, an ISLH must also disclose the limitations to the level of client protection this would entail. The latter disclosure necessitates a proper analysis of the New SLCs in Part C I which apply specifically to a particular category of clients. For example, where a client who presently is being categorised as retail requests to be re-categorised as professional, such client must be informed of all the SLCs which only apply to services provided to retail clients and which, in light of the client's new status as a professional client will no longer apply with respect to services which are provided to the said client (e.g. SLC 2.28 requiring the ISLH to disclose certain information only applies with respect to retail clients).

[i] Industry Comment: MFSA was requested to propose objective criteria which could be used by ISLHs to make an adequate assessment of the expertise, experience and knowledge of a client in terms of SLC 2.09.

MFSA Remarks: The assessment by an ISLH of the expertise, experience and knowledge of the client is by nature a subjective test for which ISLHs are expected to have their own internal policies and procedures. MFSA considers that it is up the ISLH to ensure that these policies and procedures provide them with reasonable assurance, in the light of the nature of the transactions or services envisaged, that the client is capable of making his/her own investment decisions and of understanding of the risks involved. MFSA does not intend to intervene in this process by prescribing objective criteria.

[j] Industry Comment: MFSA was requested to reconsider the reference made to the fit and proper test in SLC 2.09 as an example of the assessment of experience and knowledge which ISLHs are required to conduct in order to classify clients, as this is too onerous.

MFSA Remarks: The wording of SLC 2.09 reflects that of Section II.I of Annex II of the MiFID. However, MFSA would like to point out that the fit and proper test is only mentioned by way of example. Accordingly, ISLHs may use other methods to assess clients' experience, knowledge and expertise as long as such methods lead to the satisfaction of the ISLH as to the client's suitability and/or appropriateness for the financial instruments being considered.

[k] Industry Comment: A Licence Holder requested MFSA to reconsider the criteria in SLC 2.10, for assessing whether clients which have opted not to be treated as retail clients, possess the necessary expertise, experience and knowledge to make their own investment decisions and understand the risks involved, as these are deemed as being too onerous for the local market.

MFSA Remarks: MFSA would like to clarify that these criteria are established in Annex II of MiFID and must be faithfully transposed in Maltese law. Hence MFSA has no discretion to change these criteria.

[l] Industry Comment: With reference to SLC 2.11(c) which requires clients who waive the benefit of detailed rules of conduct to state in writing in a separate document from the contract, that they are aware of the consequences of losing such protections, MFSA was requested to justify the rationale of using such a document separate from the contract.

MFSA Remarks: This SLC mirrors the requirements laid down in this regard in Annex II of MiFID. The client choosing to waive certain protections afforded to retail clients must attest his/her awareness of the consequences making such a choice on a separate document in order to ensure that the client is fully aware of the consequences of his choice and the specific declaration being made.

[m] Industry Comment: A Licence Holder queried whether "opting up" to professional status for one service/transaction could be avoided since it will cause operational and systems complications.

MFSA Remarks: MFSA would like to point out that this option is being granted to clients in terms of Annex II of MiFID. Accordingly, it must also be made available to investors in Malta.

[2.9] Conduct of Business – Assessment of Suitability and Appropriateness – New SLCs 2.14/ 2.15/ 2.16/ 2.20/ 2.21/ 2.23/ 2.24/ 2.26 of Part C I.

[a] Industry Comment: MFSA was requested to clarify whether the requirements of SLC 2.14 would also apply to "execution only" transactions and whether verbal communications of the required information would suffice for the purposes of this SLC.

MFSA Remarks: As per SLC 2.25, "execution only" transactions are exempted from the requirements of SLC 2.14 only if **all** the four conditions indicated in SLC 2.25 are met. Furthermore, MFSA expects that, in line with SLC 2.83, ISLHs retain written records of all the information required for the purposes of SLC 2.14. In this regard, it is relevant to note that records pertaining to the appropriateness test are included in the minimum list of records CESR Members are recommended to require of their authorised firms in terms of Article 51(3) of the Implementing Directive. Therefore, although the information required from the client may be requested verbally, a written record is to be kept as evidence of compliance with SLC 2.14.

[b] Industry Comment: It was queried whether UCITS are covered by SLC 2.15.

MFSA Remarks: MFSA would like to clarify that UCITS would not fall under SLC 2.15 on the basis of the fact that they are not subject to any Community legislation or European standards of the nature referred to in this SLC.

[c] Industry Comment: A Licence Holder queried whether, in the light of the requirement of SLC 2.16(c), namely that in assessing the suitability of the investment/transaction for the client, the ISLH must ensure that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio, a client who has never invested in a property fund would be barred from investing in such a product because he/she never had the "necessary experience".

MFSA Remarks: MFSA would like to clarify that although it is important that in assessing the suitability of a transaction for a particular client, an ISLH must satisfy *all* the criteria set out in SLC 2.16, it is not necessary for the client to have invested previously in an instrument identical to that being currently proposed for investment.

[d] Industry Comment: Reference was made to SLC 2.20 which states that where providing the service of investment advice or portfolio management, the ISLH shall not recommend investment services or financial instruments to clients or potential clients if it does not obtain the information required in terms of SLC 2.13. A question was raised whether, in cases where the client refuses to disclose certain information; such refusal may be recorded by the ISLH who would also warn the client in writing that this lack of information may impinge on the advice ultimately given.

MFSA Remarks: MiFID makes the suitability test mandatory for ISLHs providing the services of investment advice and/or portfolio management – hence, in terms of this Directive, it is not possible to provide these services unless the client's suitability is assessed to the satisfaction of the ISLH. Therefore, for the avoidance of doubt, irrespective of any written warning provided to client, the ISLH would not be permitted to provide an investment advisory or portfolio management service if it does not obtain the information required in terms of SLC 2.13

[e] Industry Comment: It was suggested that SLC 2.23 is rather superfluous in the light of the requirements of SLC 2.20.

MFSA Remarks: SLC 2.23 transposes article 37(2) of the Implementing Directive.

[f] Industry Comment: Reference was made to SLC 2.24 and guidance was sought from the MFSA as to how the ISLH should proceed in the case where the ISLH is aware that the information provided by a client or potential client is outdated, inaccurate or incomplete. Moreover, MFSA was also requested to confirm whether ISLHs are expected to solicit a written confirmation to this effect, or whether a verbal confirmation would suffice.

MFSA Remarks: In such cases, MFSA considers that unless the client information is completed/updated, the ISLH should not recommend investment services or financial instruments to the client or potential client. Please see also our comments in paragraph [d] above. When providing investment services other than investment advice or portfolio management services, the ISLH shall warn the client that the information provided is incomplete or inaccurate and that unless this is completed or updated, the ISLH will not be in a position to determine whether the service or product envisaged is appropriate for him or her. Furthermore, MFSA would like to clarify that, in line with SLC 2.83, all information collected from clients or potential clients should be recorded in writing and verbal confirmations, including warnings that such information is outdated, inaccurate or incomplete would not be sufficient to satisfy the applicable requirements.

[g] Industry Comment: It was pointed out that in Rule 2.26 (a) the phrase "paragraphs (3) to (10) of the Schedule 2" should read ""paragraphs (3) to (7) of the Schedule 2"

MFSA Remarks: MFSA confirms that the reference to paragraphs (3) to (10) of Schedule 2 to the Investment Services Act is correct in the light of the proposed amendments to the said schedule which is currently envisaged to include a longer list of instruments in order to bring it more in line with the instruments listed in Section C of Annex 1 of MiFID.

[2.10] Conduct of Business - Client Disclosure Requirements – New SLC 2.27/ 2.28/ 2.29/ 2.31/ 2.32/ 2.33/ 2.35/ 2.36 of Part C I.

[a] Industry Comment: MFSA was requested to clarify the meaning of: [a] the term "the Licence Holder and its services" and [b] the phrase *"proposed investment strategies"* in the context of SLC 2.27 concerning client disclosure requirements.

MFSA was also required to confirm whether it is acceptable to provide this information in the order form.

MFSA Remarks: MFSA would like to clarify that [a] SLC 2.27 requires the ISLH to provide information about itself (i.e. name, address, contact details etc.) and the nature of the services it provides to clients (e.g. investment advice, portfolio management etc.) and [b] the phrase "*proposed investment strategies*" refers to the investment strategies to be followed by the Licence Holder when managing or advising the client's investment portfolio. Moreover, MFSA would like to point out that this SLC would still be applicable in the case of execution only transactions. Accordingly, in such cases, although it is not necessary to provide information about the proposed investment strategies, the ISLH is still bound to provide all the other information mentioned in SLC 2.27. Finally, it is possible to provide this information in the order form as long as this is provided to the client or potential client in good time prior to the actual provision of the service.

[b] Industry Comment*:* MFSA was also requested to clarify whether it is correct to presume that the definition of "execution venues" provided in SLC 2.59 would also apply to SLC 2.27 (c).

MFSA Remarks: MFSA confirms that this understanding is correct

[c] Industry Comment*:* With reference to SLC 2.28, an ISLH asked whether it was acceptable to reserve the right not to accept the order transmitted by a client by means of a "non-secure" method of communication (e.g. email, fax) or to accept these insecure methods of communication subject to provision of adequate indemnities in its favour.

MFSA Remarks: SLC 2.28 (c) states that the methods of communication to be used between the ISLH and the client, including, where relevant, those for the sending and reception of orders should be made clear to the client. This SLC does not prohibit an ISLH from imposing conditions with respect to the use of certain methods of communication as long as these conditions and any associated rules are made clear to the client before the provision of any service to the said client.

[d] Industry Comment*:* MFSA was requested to clarify whether the requirements of SLC 2.29 apply also to collective investment schemes.

MFSA Remarks: MFSA would like to clarify that SLC 2.29 applies only to the provision of portfolio management services on a client by client basis and not to management services for collective investment schemes..

[e] Industry Comment: MFSA was requested to clarify whether SLC 2.29 and the SLCs under the section titled Reporting Obligations in Respect of Portfolio Management Services applies to portfolio management provided both on a discretionary basis as well as on a non-discretionary basis.

MFSA Remarks: Article 4 [1] [9] of MiFID defines 'portfolio management' as '*managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial*

instruments'. Accordingly, the Rules which transpose MiFID including the SLCs mentioned above are only applicable to Licence Holders which provide discretionary portfolio management.

[f] Industry Comment: Guidance was sought from the MFSA as to the interpretation of the provision of the relevant information to clients "in good time", in particular whether this requirement is satisfied if the information in question is provided at the point when the investment advice/recommendations to the client are made.

MFSA Remarks: Reference is made to Recital 48 of the Implementing Directive which states that in determining what constitutes the provision of information "in good time", an ISLH should take into account, having regard to the urgency of the situation and the time necessary for the client to absorb and react to the specific information provided, the client's need for sufficient time to read and understand such information before taking an investment decision. In any case, this information should be provided to the client before he or she is required to make an investment decision.

[g] Industry Comment: An enquiry was made as to whether MFSA intends to specify, in due course, the exact interpretation of "time-limits" specified in SLCs 2.31 and 2.32.

MFSA Remarks: Reference to the time limits specified in SLC 2.31 and 2.23 relates to the requirement that information must be provided to the client in good time prior to the provision of the investment services by the ISLH. Please refer to our comments in point [f] above for further details as to what constitutes "in good time".

[h] Industry Comment: MFSA was requested to clarify which clients would need to be notified of material changes in terms of SLC 2.36

MFSA Remarks: Clients who are already in a relationship with the ISLH by virtue of the fact that they are in the process of receiving a service from the ISLH (for example clients for whom the ISLH manages a portfolio) should be notified of any changes in the information initially provided to the client prior to the latter's initial decision to procure an investment service from the ISLH

[2.11] Conduct of Business - Client Reporting – New SLC 2.40/ 2.41/ 2.43/ 2.44/ 2.46 to 2.49/ 2.51 of Part C I

[a] Industry Comment: An ISLH queried whether the fact that it advises its clients that its half yearly interim Financial Statements are available free of charge from its offices and that moreover these documents are uploaded on the said ISLH's website, would satisfy the requirements of SLC 2.40.

MFSA Remarks: MFSA would like to point out that while it is commendable that ISLHs freely make available such information to their clients, such reports are not relevant to the requirements of SLC 2.40. This SLC refers to reports which are specific in nature to the service provided by the ISLH to the client as more fully detailed in the SLCs which follow SLC 2.40. Hence, the reports referred to in SLC 2.40 should relate to the services provided by the ISLH to the individual client.

[b] Industry Comment: A point was raised as to whether paragraphs (a) and (b) of SLC 2.41 refer to the same category of client, given that point (b) refers specifically to "retail clients" while point (a) does not.

MFSA Remarks: MFSA clarifies that the SLCs which indicate that they apply to retail clients need not be applied with respect to professional clients. Accordingly, with respect to this particular query, whilst point (a) would apply to both retail and professional clients, point (b) is mandatory only for retail clients.

[c] Industry Comment: MFSA was requested to clarify whether the reference in SLC 2.43 that the ISLH may comply with the requirements of point (b) of SLC 2.41 means that the contents of the details sent to the ISLH's clients have to be different from those listed in SLC 2.44. Moreover, an ISLH queried whether it would be able to stop sending the annual valuation statement summarising the transactions executed during the year in the light of the requirements of SLC 2.41 (b).

MFSA Remarks: MFSA points out that SLC 2.44 lists the contents of the notice referred to in SLC 2.41 (b). Hence, the contents of the notice to be sent to clients in terms of the requirements of SLC 2.43, would be the same, irrespective of whether the licence holder elects to take the action specified in point (b) of SLC 2.41 or provide the retail client, at least once every six months, with the information listed in SLC 2.44. Moreover, MFSA would like to clarify that with respect to the execution of orders other than for portfolio management services, ISLHs need no longer send annual valuation statements on condition that all the relevant SLCs are observed.

[d] Industry Comment: A question was raised as to whether in terms of SLC 2.44 (m), only the sum of the commissions and expenses charged directly to the client has to be disclosed on the transaction statement sent to the client.

MFSA Remarks: MFSA confirms that this understanding is correct.

[e] Industry Comment: With respect to the requirements in SLC 2.46 to 2.49, MFSA was requested to confirm whether in the case of a collective investment scheme, the reporting obligations in respect of portfolio management services refer to the SICAV (through its Independent Board of Directors) rather than to the underlying investors.

MFSA Remarks: MFSA would like to clarify that portfolio management should not be interpreted as including management of collective investment schemes / fund management, but the management of portfolios on an individual client by client basis. Hence the provisions of SLCs 2.46 to 2.49 do not apply to ISLHs providing fund management services but only to ISLH who offer portfolio management services, including those which may invest part of their clients' portfolios in collective investment schemes. Please refer to our comments under point 2.4 [a] above.

[f] Industry Comment: MFSA was requested to confirm that it is correct to understand that where an ISLH holds clients' money for eventual subscription into Collective Investment Schemes or as redemption proceeds therefrom, that ISLH is not required to send the annual statement mentioned in SLC 2.51.

MFSA Remarks: MFSA would like to clarify that it interprets SLC 2.51 to refer to situations where an ISLH holds clients money on a more permanent basis (for example as the liquid portion of a client's portfolio which it manages) rather than to situations where the ISLH is in possession of clients' money for the very brief period between the payment of the funds to the ISLH and the actual subscription into a collective investment scheme.

[2.12] Conduct of Business - Best Execution Requirements – New SLC 2.64/ 2.71 of Part C I

[a] Industry Comment: A query was raised with respect to implications on the duties of best execution of ISLHs who merely receive and transmit orders for execution (arrange deals) and who, because they form part of a group which includes a firm to whom orders are transmitted for execution, are not in a position to use the services of a third party for the execution of the orders they receive.

MFSA Remarks:
Such ISLHs are not exempted from the best execution requirement in any manner and must be able to show that they obtain the best possible result by transmitting their clients' orders to their affiliated trading firm. In this case, such ISLHs are still required to monitor and review the quality of execution provided and to take appropriate action to correct any deficiencies. This position is in line with that taken by CESR in the discussions leading to the drafting of a Consultation Paper on Best Execution which is to be published in the near future.

[b] Industry Comment: MFSA was requested to confirm whether SLC 2.71 would apply also to prospective clients in Collective Investment Schemes and whether if this was the case, a description of the Execution Policy in the relative Scheme's prospectus would suffice.

MFSA Remarks: Reference is made to Recital 70 of the Implementing Directive which states that the obligation to deliver the best possible result when executing client orders applies in relation to all types of financial instruments, which consequently includes units in a collective investment scheme. However, this obligation should be applied in a manner which takes into account the different circumstances associated with the execution of orders related to particular types of financial instruments. Accordingly, the requirements of SLC 2.71 should be complied with bearing in mind the fact that in the case of open ended collective investment schemes, execution of orders may only be effected through the Manager or Administrator of such schemes,

[c] Industry Comment: Concern was voiced that the proposed requirements relating to best execution are rather onerous on local ISLHs and MFSA was requested to revisit these requirements.

MFSA Remarks: MFSA would like to clarify that the requirements dealing with best execution mirror the relevant provisions of MiFID and the Implementing Directive which need to be faithfully transposed in Maltese Law. One of the effects of this transposition is the harmonisation of best execution requirements across the EU. Accordingly, it is not possible to tailor different requirements for local ISLHs.

[d] Industry Comment: MFSA was requested to confirm whether it would accept a situation where an ISLH would be able to obtain the best possible results on a consistent basis to its clients with only one execution venue

MFSA Remarks: MFSA considers that it is up to the ISLH to ensure and to demonstrate that it obtains the best possible execution for its clients bearing in mind the factors listed in SLC 2.54. If, on an analysis of these factors, the ISLH is consistently satisfied that only one execution venue offers the best possible result for the client, then MFSA will have no objection in this regard. However, the ISLH is under an obligation, in terms of SLC 2.57, to ***regularly monitor*** the effectiveness of its order execution arrangements and execution policy and to make any necessary changes thereto in order to ensure that the best possible result for the client is consistently ensured.

[2.13] Conduct of Business - Staff Dealing – New SLC 2.103 (a) (i) / 2.105 (b) of Part C I

[a] Industry Comment: It was recommended that in SLC 2.103 (a) (i) the word 'it' after the phrase 'that person is prohibited' should be deleted.

MFSA Remarks: MFSA agrees with the above recommendation and will be effecting the required change to the said SLC.

[b] Industry Comment: MFSA was requested to clarify the interpretation of the phrase "*not involved in the management of* [a UCITS*] undertaking*" for the purposes of SLC 2.105 (b).

MFSA Remarks: MFSA clarifies that this phrase refers to persons who have control over the investment decisions of the UCITS.

[2.14] Conduct of Business - Conduct of Business Rules for Licence Holders Producing and Disseminating Investment Research – New SLC 2.109/ 2.111/ 2.112 [c] and [d of Part C I

[a] Industry Comment: Reference was made to 2.109 which defines 'investment research' as "*research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers of financial instrument…"* However point (b) of this SLC states that in order to qualify as 'investment research' the recommendation in question should not constitute the provision of investment advice for the purposes of the Investment Services Act if it is made by an ISLH to a client. In this regard MFSA's guidance was sought as to how such suggestions/recommendations would not constitute investment advice at the same time.

MFSA Remarks: MFSA would like to clarify that the term "investment advice" presupposes a personal recommendation made to a particular individual in respect of a specific financial instrument/s. Moreover, ISLHs are required to assess the client's suitability prior to giving advice with respect to specific instrument/s. In this regard, although the definition of investment research in SLC 2.109 refers to, *inter alia,*

recommendations or suggestions made in respect of financial instruments or to the issuers of financial instruments, such recommendations are not personal to a particular client since no suitability test is conducted prior to the issue of such recommendations. These are therefore made in the abstract and not having taken into account the circumstances of a specific client. Hence, in terms of SLC 2.109 (b), if such an abstract recommendation is made to a client, it would not constitute investment advice and provided that the requirement in point (a) of SLC 2.109 is also satisfied, such a recommendation would fall under the definition of "investment research".

[b]Industry Comment: Rule 2.111 is referring to SLC 2.100. A member of the industry indicated that this is a misprint and reference should be made to SLC 2.112.

MFSA Remarks: MFSA has considered the wording of article 25 of the Implementing Directive, which article is the source of SLC 2.111 and confirms that the cross reference to SLC 2.100 is correct.

[c]Industry Comment: The requirement in paragraph (e) of the New SLC 2.112 (c) has been replicated in paragraph (d) of the same SLC. Paragraph (d) should be deleted and hence, paragraph (e) should read paragraph (d).

MFSA Remarks: MFSA agrees with the above recommended amendment and will be effecting the required changes to the said SLC.

[2.15] Disclosure Requirements for Information to clients, including Marketing Communications – New Section 3 of Part C I

[a] Industry Comment: Clarification was requested from MFSA as to whether the assumption that investors categorised as professional investors have the necessary experience and knowledge in order to understand the risks involved in relation to particular instruments and/or services and would therefore not benefit from the protection available to retail clients, applies also with respect to the proposed Rules in Section 3 entitled Disclosure Requirements for Information to Clients, Including Marketing Communications**.**

MFSA Remarks: The fact that a client has been categorised as a professional client and hence deemed to possess sufficient knowledge and experience to understand the risks involved in a particular transaction, does not exonerate the ISLH from providing clients or potential clients with adequate information on the nature of financial instruments and the risk associated with investing in them such that clients can make properly informed investment decisions. As indicated in recital 45 of the Implementing Directive, the level of detail of such information may vary according to the client's categorisation and the nature and risk profile of the financial instruments on offer, but should never be so general as to omit any essential elements. It is pertinent to point out that certain SLCs in Section 3 clearly apply solely to information provided to retail clients.

[b] Industry Comment: Confirmation was requested from MFSA as to whether any factual information can be used in making comparisons between investment or

ancillary services, financial instruments or persons providing investment or ancillary services, in terms of SLC 3.03.

***MFSA Remarks**:* MFSA confirms that this understanding is correct provided that all the conditions indicated in SLC 3.03 are satisfied by the ISLH making such comparisons.

[c] Industry Comment: A query was raised as to whether in terms of SLC 3.08, ISLHs should not mention the MFSA in the standard licensing text adopted in their marketing information.

***MFSA Remarks**:* MFSA considers that it is still appropriate that the ISLH discloses its status as an entity licensed by the MFSA in all its marketing material. Indeed, the scope of SLC 3.08 is to prevent ISLH from using the name of the MFSA in such a way as to influence clients in making their decisions by giving the impression that MFSA approves or endorses the products or services of that particular ISLH.

[2.16] Outsourcing – New SLCs 4.01/ 4.02 of Part C I

Industry Comment: Guidance was sought from the MFSA as to the nature of services which are to be considered critical or important for the purposes of SLC 4.01 and 4.02

***MFSA Remarks**:* In terms of Recital 19 of the Implementing Directive, for the purposes of the Rules setting out conditions for outsourcing critical or important operational functions or investment services or activities, outsourcing that would involve the delegation of functions to the extent that the ISLH becomes a letter box entity should be considered to undermine the conditions with which the ISLH must comply. Moreover, as per the guidelines on outsourcing issued by Committee of European Banking Supervisors ['CEBS'], critical or important functions include: (i) activities of such importance that any weakness or failure in the provision of these activities could have a significant effect on the ISLH's ability to meet its regulatory responsibilities and/or to continue in business; (ii) any other activities requiring a licence from the MFSA; (iii) any activities having a significant impact on its risk management; and (iv) the management of risks related to these activities.

[2.17] Professional Investor Funds

Industry Comment: A query was raised as to whether the changes brought about by MiFID produce any impact at all on the current Professional Investor Fund (PIF) regime and whether the new "Client Classification" Rules impact the current client classification adopted for PIFs.

MFSA Remarks: Although the MFSA considers that there should be no impact, it is to be noted that relevant issues relating to the interaction between MiFID and product selling restrictions in general, are currently being considered and discussed at EU fora and should the position change, the industry will be notified accordingly.

[2.18] Marketing Communications / Cold Calling

Industry Comment: It was pointed out that when using certain types of advertising it may not be possible, due to space and time constraints, to comply with all the requirements included in the revised Rules. Moreover, the new Rules do not cater for "cold calling" procedures.

MFSA Remarks. The provisions relating to marketing communications mirror the relative requirements in MiFID and the Implementing Directive and which need to be faithfully transposed into Maltese Law. However, having said that, these requirements as well as the issue of "cold calling" shall be further amplified and explained in the MiFID Guidance Notes which MFSA plans to issue later on this year.

[2.19] Workshops

Industry Comment: MFSA was requested to organise regular workshops for ISLHs up to November 2007, in order to discuss in more detail the proposed amendments and to provide more detailed guidelines regarding the implementation of the revised Rules.

MFSA Remarks: Over the course of this year, MFSA plans to organise a series of seminars dealing with the implementation of various aspects of the proposed Rules which the MFSA plans to clarify and amplify by means of Guidance Notes. Further details with respect to these seminars will be notified to ISLHs in due course.

Contacts

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