

16 March 2020

## Circularisation Exercise - R4-3.2.7 of Part B1 of the Investment Services Rules

Reference is made to Rule R4-3.2.7 ('the Rule') of Part B1 of the Investments Services Rules for Investment Services Providers which became applicable as from 3 January 2018 and states:

*"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 clients' assets in cases where the Licence Holder holds or controls client assets."*

The circularisation exercise must be carried out by the External Auditor on an annual basis (as at financial year end) and a report on the findings of the circularisation exercise shall be submitted to the Malta Financial Services Authority within four (4) months from the end of the reporting period concerned.

Following discussions with the Malta Institute of Accountants ('MIA') and in the interest of the protection of nominee account holders, the Authority is issuing further guidance on what the Authority expects from Investment Firms to adhere to the Rule for basis year 2019, specifically: (a) the size of nominee clients who should be included in the sample; and (b) the minimum acceptable response rates per sample size. Both thresholds are based on the client population size of nominee clients of the Licence Holder as detailed below.

(i) *Methodology to determine sample sizes*

The following methodology is applied to determine the sample population size and response rates.

a) Minimum number of clients to be included in the sample

Licence Holders having between 100 and 1000 nominee clients
The minimum number of nominee clients to whom a circularisation letter is issued is 15% of the midpoint of the population.
Licence Holders having more than 1,000 nominee clients
The minimum number of nominee clients is 150

b) Minimum acceptable response rate from investors

Licence Holders having less than 500 nominee clients
The minimum response rate for the circularisation exercise relating to basis 2019 will be 20% of the sample size.
Licence Holders having between 500 and 1,000 nominee clients
The minimum applicable response rate for the circularisation exercise relating to basis 2019 will be 15% for Licence Holders of the sample size.
Licence Holders having more than 1,000 nominee clients
The minimum acceptable response rate is 55

(ii) Final Sample Sizes

(a) Population range between 1 and 1,000 nominee clients:

Population range	Number of client nominee accounts to whom a circularisation letter is issued (15% of the midpoint)	Minimum acceptable response rate for Basis Year 2019 (20% of the sample size for Licence Holders having less than 500 nominee clients)
Between 1 and 99 nominee clients	8	2
Between 100 and 200 nominee clients (150)	23	5
Between 200 and 300 nominee clients (250)	38	8
Between 300 and 400 nominee clients (350)	53	11
Between 400 and 500 nominee clients (450)	68	14
	Number of client nominee accounts to whom a circularisation letter is issued (15% of the midpoint)	(15% of the sample size for Licence Holders having more than 500 nominee clients)
Between 500 and 600 nominee clients (550)	83	15

Between 600 and 700 nominee clients (650)	98	15
Between 700 and 800 nominee clients (750)	113	17
Between 800 and 900 nominee clients (850)	128	19
Between 900 and 1000 nominee clients (950)	143	21

(b) Population range of more than 1,000 nominee clients:

For basis year 2019, the sample size of the nominee accounts to be subject to the minimum threshold of 150 and the minimum acceptable response rate of the clients circularised is capped at 55. It is at the discretion of the external Auditors to determine whether it is appropriate to request a higher minimum response rate.

<b>Population Range of Licence Holder Nominee Clients</b>	<b>Number of client nominee accounts to whom a circularisation letter is issued for basis year 2019</b>	<b>Minimum acceptable response rate for basis year 2019</b>
1,000 to 1,500 nominee clients	Minimum 150	23
1,500 to 2,000 nominee clients	Minimum 150	24
2,000 to 2,500 nominee clients	Minimum 150	26
2,500 to 5,000 nominee clients	Minimum 150	39
5,000 to 10,000 nominee clients	Minimum 150	40
10,000 to 15,000 nominee clients	Minimum 150	40
Over 15,000 nominee clients	Minimum 150	55

Licence Holders are required to carry out the circularisation exercise based on the above sample sizes and minimum response rates for their annual statutory audit for basis 2019. In this regard, circularization confirmations are expected to be submitted to the MFSA as part of the audit pack for 2019.

(iii) Matters to Consider:

- a) As a minimum, nominee clients are required to confirm their portfolio of holdings, as well as any cash balances.

- b) Client accounts having a nil balance are deemed to be a valid client for the purpose of this exercise.
- c) The external Auditor should issue a reminder after ten (10) business days from the date of the original request. A second reminder shall be issued by the Auditor within the next ten (10) business days.
- d) All client responses must be sent directly to the external Auditor and responses received by the Licence Holder shall be considered as void.
- e) In the event that client(s) do not agree with the portfolio statement, they have to provide details of the discrepancies directly to the external Auditors of the Licence Holder.
- f) Discrepancies identified by the clients shall be discussed with the Licence Holder and disclosed in the concluding report, which is forwarded to the MFSA.

The Authority will provide directions on the application of the circularisation exercise for basis year 2020 under separate communication.

#### Contacts

Should you have any queries regarding the above, please contact us on [InvestmentFirms@mfsa.mt](mailto:InvestmentFirms@mfsa.mt)