

16 November 2021

## Conduct of Business Rulebook Revisions

Reference is made to the Conduct of Business Rulebook ("Rulebook") originally issued by the Malta Financial Services Authority ("the Authority") on 20 December 2017. A copy of the revised Rulebook can be found on the Authority's website and can be accessed [here](#).

The changes carried out to the Rulebook are the following:

### **Requirements Applicable to the Investments Sector**

#### **1. Article 1 of Directive (EU) 2021/338<sup>1</sup>**

Article 1 of Directive (EU) 2021/338 amends Directive 2014/65/EU ("MIFID II") as regards information requirements, product governance and position limits and is often referred to as "**MIFID II Quick-Fix**". This legislative proposal amending MiFID II is part of a set of measures to facilitate the economic recovery post COVID-19 pandemic.

The purpose of the MIFID II Quick Fix is primarily to amend certain requirements set out in Directive 2014/65/EU in order to strike a more appropriate balance between, on the one hand, facilitating the provision of investment services and the performance of investment activities, and on the other ensuring protection of each category of investors. Some of the amendments focus on providing alleviations for Professional Clients and Eligible Counterparties.

***Kindly note that the amendments carried out in the Conduct of Business Rulebook to transpose Article of Directive (EU) 2021/338 shall apply as from 28 February 2022.***

The main amendments to be carried out are outlined as follows:

#### **(a) Phase-out of Paper Based Information as the Default Method of Communication**

In order to facilitate communication between investment firms and their clients, thereby facilitating the investment process itself, a **new Article 24(5a) of MIFID II** was introduced, so that investment information is no longer to be provided on paper (as per current default option under a "durable medium") but needs to be provided, as a default option, in electronic format (for instance, E-Mail, a dedicated webpage or an electronic mailbox). The aim is to phase-out paper-based communication. However, Retail Clients shall be able to opt-in and request the provision of investment information on

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<sup>1</sup> Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending Directive 2014/65/EU as regards information requirements, product governance and position limits, and Directives 2013/36/EU and (EU) 2019/878 as regards their application to investment firms, to help the recovery from the COVID-19 crisis

paper. The chosen option is then to be used for the provision of all information documents to the client. This has been included in **new Rule R.1.3.16** in Part A of Section 3 of Chapter 1 on Disclosure of the Conduct of Business Rulebook. In addition, **a new definition of “electronic format”** was inserted in the Glossary.

**(b) Costs and Charges Disclosure Requirements**

**(i) Introducing an Exemption from the Costs and Charges Information for Eligible Counterparties and Professional Clients**

Currently, the information requirements on costs and charges apply for all client categories. However, Professional clients and Eligible Counterparties often do not need standardised and mandatory costs information, particularly since information provided to them is tailored to their needs and often more detailed.

By means of a **new Article 29a and an amendment to Article 30(1) of MiFID II**, services provided to Professional Clients and Eligible Counterparties should therefore be exempted from the costs and charges disclosure requirements, *except with regard to the services of investment advice and portfolio management*. For Retail Clients the relevant requirements remain unchanged. These have been included in the following provisions of the Conduct of Business Rulebook:

- **New Proviso in R.1.4.20** of Part A of Section 4 of Chapter 1 on Disclosure;
- **Paragraph (a) of new proviso in R.1.4.27** of Part A of Section 4 of Chapter 1 on Disclosure
- **New Proviso in R.4.4.24** of Part A of Section 4 of Chapter 4 on Sales Process and Selling Practices; and
- **amended Rule R.4.2.12** of Section 2 of Chapter 4 on Sales Process and Selling Practices

**(ii) Allow for a Delayed Transmission of Cost Information when using Distant Communication Channels**

Article 24 of MiFID II provides for detailed information requirements. Given that the current application of the *ex-ante* costs disclosure requirements could lead to delays in the execution of transactions for clients for whom time is of essence (and these effects may therefore have a negative impact on best execution) clients should be enabled to provide their consent to a delayed transmission of the costs information documents.

Therefore, **new subparagraphs have been inserted in Article 24(4) of MIFID II** so that, in case of distance selling communications, all clients using all services should be able, under certain conditions, to receive costs and charges information just after the transaction. This has been included in **Rule R.1.4.27** of Part A of Section 4 of Chapter 1 on Disclosure of the Conduct of Business Rulebook.

**(c) Alleviating Ex-Post Reporting Requirements – Mandatory Service Reports**

Clients with an ongoing relationship with an investment firm receive mandatory service reports, either periodically or based on triggers. In fact, Article 25(6) of MiFID II requires firms to provide post-transaction service reports to clients. Pursuant to the **new Article 29a(2) of MIFID II**, Eligible Counterparties and Professional Clients should be exempted from receiving the ex-post transaction reports in terms of the said Article 25(6). However, Professional Clients should have the possibility to opt-in to receive such reports. This has been included in a **new proviso in R.4.4.24** of Part A of Section 4 of Chapter 4 on Sales Process and Selling Practices and a **new proviso in R.1.4.20** of Part A of Section 4 of Chapter 1 on Disclosure, of the Conduct of Business Rulebook.

**(d) Suspension of Best Execution Reports**

Article 27(3) of MiFID II currently requires that each trading venue and systematic internaliser for financial instruments subject to the trading obligation in Articles 23 and 28 of Regulation (EU) No 600/2014 (“MIFIR”) and each execution venue for other financial instruments, makes available to the public data relating to the quality of execution of transactions on that venue periodically.

However, due to the exceptional circumstances created by the COVID-19 pandemic, a **new subparagraph was added to the said Article 27(3)** in order to temporarily dis-apply this reporting obligation requiring the publication of the best execution report. In the context of the upcoming review of MiFID II, the European Commission will then assess whether the requirement to publish the report is to be deleted permanently, or if it needs to be re-introduced in a revised manner. This has been included in a **new proviso in Rule R.5.53** of Part C of Chapter 5 on Execution of Clients’ Orders of the Conduct of Business Rulebook.

**(e) Alleviate Cost-Benefit Analysis in the case of Switching**

In terms of Article 25(2) of MiFID II firms need to perform a suitability assessment when they provide investment advice or portfolio management. Investment firms are also currently required to undertake a cost-benefit analysis of certain portfolio activities in cases of ongoing relationships with their clients in which financial instruments are switched. In this context, before executing a product switch firms are required to obtain the necessary information from clients and be able to demonstrate that the benefits of such switching outweigh the costs. However, these requirements may be overly burdensome with regard to Professional Clients, who tend to switch on a frequent basis

A **new paragraph to Article 25(2) of MIFID II** is inserted so that services provided to Professional Clients are exempted from the cost-benefit analysis requirement. To this end, the substantive requirements as currently laid down in Article 54(11) of Delegated Regulation (EU) 2017/565 (“MIFIR”) will be added. However, Professional Clients

should have the possibility to opt-in to the cost-benefit analysis in the case of switching. This has been included in a new paragraph added in **Rule R.4.4.24** of Part A of Section 4 of Chapter 4 on Sales Process and Selling Practices of the Conduct of Business Rulebook. In addition, a **new definition of “switching of financial instruments”** was inserted in the Glossary.

**(f) Partial Reversal of the Research Unbundling Rule**

MiFID II introduced the so-called ‘research unbundling rule’. However, research on small and middle-capitalisation issuers is essential to help issuers to connect with investors, particularly since it increases the visibility of issuers thereby ensuring a sufficient level of investment and liquidity.

With the insertion of a **new article 24(9a) in MiFID II**, investment firms are going to be allowed to receive research from third parties without having to pay separately for it, subject to three conditions, each of which assumes that the third-party research provider is also providing execution services to the investment firm. This has been included in **new Rules R.3.24 and R.3.25** in Part B of Chapter 3 on Conflicts of Interest of the Conduct of Business Rulebook.

**(g) Product Governance Exemption**

The issuance of bonds is crucial in order to raise capital and to overcome the COVID-19 crisis. Given that product governance requirements can restrict the sale of bonds, such requirements should no longer apply to bonds with no other embedded derivative than a make-whole clause (which are investor-protective features). In addition, since eligible counterparties are considered to have sufficient knowledge of financial instruments, It is therefore justified to provide for an exemption with respect to the product governance requirements applicable to financial instruments exclusively marketed or distributed to them.

Therefore, in terms of **new Article 16a** of MIFID II, Article 16(3) (subparagraphs 2 to 6 thereof) and Article 24(2) of MIFID II will not apply to corporate bonds with make-whole clauses. This has been covered by means of a **new R.2.100** in Part B of Chapter 2 on Financial Product Governance of the Conduct of Business Rulebook. In addition, a **new definition of “make-whole clause”** was inserted in the Glossary.

## **Summary of Amendments**

The below table summarises the amendments made:

New definition “switching of financial instruments” Included in R.4.4.24	New subparagraph in Article 25(2) MIFID II relating to the Suitability assessment: opt-in regime for professional clients when switching investments.
New definition “make-whole clause” New R.2.100	New Article 16a MIFID II relating to exemptions from product governance requirements.
New definition “electronic format” New R.1.3.16	New Article 24(5a) MIFID II relating to electronic communication as the default option.
Included in R.1.4.27	New subparagraphs, Article 24(4) MIFID II, relating to delayed transmission of cost information when using distant communication channels.
NEW R.3.24 and R.3.25	New Art 24(9a) relating to partial reversal of research unbundling.
Included in R.5.53	New subparagraph in Article 27(3) MIFID II relating to suspension of Best Execution Reports.
Included in R.1.4.27, R.4.4.24 and R.1.4.20	New Article 29a relating to services provided to professional clients.
Included in R.4.2.12	Substitution of first subparagraph of Article 30(1) MIFID II.

## **Requirements Applicable to the Investments Sector and Insurance Sector**

### **2. Requirements related to the Submission of Conduct-Related Data**

In the Rulebook specific requirements have been inserted to expressly reflect the submissions to MFSA of conduct-related reporting which investment firms and insurance undertakings respectively have been complying with based on relevant MFSA Circulars which had been issued in this respect.

With respect to **Investment Firms** a new Rule R.4.1.25<sup>2</sup> provides that these are required to submit to the MFSA:

<sup>2</sup> Provided that, the requirements set out in paragraph (a) and (b) do not apply to: (i) a firm authorised to act as custodians/depositories; and (ii) to a firm dealing for its own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets, or dealing for the accounts of other members of those markets and being guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such a firm is assumed by clearing members of the same markets.

- (a) on a quarterly basis, that is, within 42 days after quarter end, all the information in Part A (Conduct-Related Data) of the MiFID Firms Quarterly Reporting. This information is to be submitted pursuant to the [Circular on MiFID Firms Quarterly Reporting of 30 September 2021](#) and the [Guidelines on the compilation and submission of the MiFID Firms Quarterly Reporting of 29 September 2021](#);
- (b) on a bi-annual basis, that is, within 42 days after the end of the reporting period, the List of Financial Instruments pursuant to the [Circular on MiFID Firms Quarterly Reporting of 30 September 2021](#) and the [Guidelines on the compilation and submission of the list of financial instruments of 30 March 2021](#).

With respect to **Insurance Undertakings** a new Rule R.4.1.26 provides that these are required to submit to the MFSA on an annual basis, within 42 days after year end, the Conduct Related Data Return pursuant to the [Circular on the Submission of the Conduct-Related Data Return for Insurance Undertakings of 26 May 2020](#).

### **Contacts**

Any queries or requests for clarifications on the contents of this Circular should be addressed to Conduct Supervision on [financialpromotion@mfsa.mt](mailto:financialpromotion@mfsa.mt).