

11 May 2022

Clarification Note addressed to MiFID II Investment Firms Operating on a Freedom of Services (FoS) Cross-Border Basis on Conduct-Related Disclosures in the MiFID Firms Quarterly Reporting and Other Important Regulatory Clarifications

Introduction

The purpose of this circular is to clarify several common issues which we have come across when reviewing the MiFID Firms Quarterly Reporting ('Return') as submitted by Investment Firms, which are as follows:

- I. **Issue#1** We have noticed several cases wherein Investment Firms have reported inaccurate Client Figures in the Passporting Survey (which has been renamed in 'Cross-border activity') of the Return.
- II. **Issue#2** We have also come across certain Investment Firms claiming to resort to Article 42 of MiFID II on Reverse Solicitation so as to be exempted from the requirements of Article 39 of MiFID II and thereby use this as a basis to service clients either within the EU/EEA area and/or outside of it (i.e. in third countries).

Tackling Issue#1 - Important considerations before the completion of the Passporting Survey vis-à-vis the Freedom of Services Regime

For the purposes of compiling the 'Cross-border activity' tab and the third country clients' information within the 'Additional details' tab in the Return, Investment Firms are guided to consider the habitual residence of the client, based on information collected in their client-onboarding process as part of the Know-Your-Customer assessment. This clarification is harmonised in line with ESMA's interpretation which can be found in Section 17 of [ESMA's Questions and Answers document](#) on MiFID II and MiFIR investor protection and intermediaries topics. The Key Officials signing off the Return must ensure that a reconciliation exercise is undertaken against client data (as available in the Client

Relationship Management system) to make sure that the data provided to MFSA is accurate and factual.

Furthermore, the Compliance Function is to ensure that the Investment Firm has the necessary permissions to service EU and non-EU clients prior to a client (irrespective of the MiFID II client categorisation) being on-boarded.

In case of **EU & EEA clients**, the Compliance Officer is bound to check that the necessary cross-border passporting notifications are in place before an EU/EEA client is on-boarded.

If an Investment Firm intends to service clients based in a particular EU/EEA member state and it is not authorised to do so, then it must notify the MFSA in terms of Article 34(2) of MiFID II and submit [Schedule DI](#) – Notification Letter for Investment Services Licence Holders wishing to provide cross-border services under the freedom to provide services in another EU or EEA Member State. Investment Firms are required to submit Schedule DI to mifidnotifications@mfsa.mt. As per article 34(3) of MiFID II, the MFSA shall, within one month from receipt of a **correct and complete notification**, forward it to the competent authority of the host Member State designated as contact point in accordance with Article 79(1) of MiFID II.

In cases where the Investment Firms are servicing EU & EEA clients without the necessary cross-border passporting rights in place, the Compliance Officers should report to MFSA on the below referred email address, the said oversight and remediate in an expedited manner by following the steps outlined above.

In relation to **third country clients**, the Compliance Officer is expected to check in advance with the relevant third country regulators and/or experienced legal counsel (in the third country jurisdiction) as to whether any permissions are required to service third country clients, prior to on boarding a third country client.

It should be highlighted that the concept of reverse solicitation is highly unlikely to be applicable in the context of third country clients, as third country regulators are likely to trigger licensing requirements if a foreign investment firm is servicing clients residing in that country.

Special attention should be paid in the case of the UK's Regulator (Financial Conduct Authority) vis-à-vis the Temporary Permission Regime that was implemented at the outset of Brexit (for further info kindly refer to <https://www.fca.org.uk/brexit/temporary-permissions-regime-tpr>).

In this regard, we expect Compliance Officers to make the necessary checks and if need be, to consult with specialized regulatory lawyers operating in third country jurisdictions.

Tackling Issue#2 - A clarification on the concept of Reverse Solicitation as quoted within the MiFID II package

In view of the above findings, the Authority would like to draw the attention of Investment Firms to Article 42 of MiFID II. **The Authority is also concerned to note that certain Investment Firms are applying a broad interpretation to the reverse solicitation concept and may not be applying it in line with MiFID II requirements when reporting their submissions.**

The ‘reverse solicitation’ exemption referred to in Article 42 of MiFID II applies in a scenario where a retail client or professional client located in the EU initiates at its own exclusive initiative the provision of an investment service or activity by a third-country firm. The client’s own exclusive initiative is required to be assessed on a case-by-case basis for each investment service or activity provided, regardless of any contractual clause or disclaimer purporting to state, for example, that the third country firm will be deemed to respond to the exclusive initiative of the client. If after assessing the circumstances on a case-by-case basis it transpires that the request for provision of an investment service has been triggered at the exclusive initiative of the client (i.e. an EU national), then the third country firm may not apply for authorization under Article 39 MiFID II to provide the investment service or activity to that person. **Therefore, the Authority would like to clarify that the reverse solicitation exemption applies in very limited circumstances and in the context of third country firms targeting EU nationals.**

We expect Investment Firms to take note of this circular which provides an explanation clarifying when the ‘reverse solicitation’ exemption is applied.

To note that ESMA has issued guidance on the applicability of the ‘reverse solicitation’ concept through its [ESMA Questions and Answers](#) on MiFID II and MiFIR investor protection and intermediaries topics. Section 13 sets out a number of requirements that must be met in order for an investment firm to rely on the reverse solicitation rule and provides guidance on the application of the MiFID II requirements on the provision of investment services and activities by third country firms, including how the notion of a client initiating “**at its own exclusive initiative the provision of an investment service or activity by a third-country firm**” laid down in Article 42 of MiFID II is to be understood and applied.

Furthermore, ESMA has also issued a [Public Statement](#) on 13th February 2021 reminding Firms of their MiFID II obligations on ‘reverse solicitation’

The Authority expects Investment Firms to follow ESMA’s Q&As and the referred Public Statement and reiterates that it does not tolerate any activity or practice that would allow possible circumvention of MiFID II rules on reverse solicitation.

Additional Remarks

Allow us to reiterate that back in February 2021, the Authority had issued a circular which provided a suggested way forward on **unexercised passporting rights** (which can be found in this link: <https://www.mfsa.mt/wp-content/uploads/2021/04/Circular-for-Licence-Holders-availing-of-Freedom-of-Services.pdf>). In light of the above, this circular needs to be considered alongside the provisions of the aforementioned circular, which clarifies that cross-border passporting notifications of Investment Firms need to be in line with their target market of clients and thus, Investment Firms should not be make blanket cross-border passporting requests for all EU member states when it comes to the application of passporting rights.

In case of any queries, please do not hesitate to contact us on: financialpromotion@mfsa.mt