

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Notice to applicants for a Category 2 or Category 3 Investment Services Licence that would like to carry out online forex trading in terms of the Investment Services Act, Cap. 370

The Malta Financial Services Authority is hereby setting out its updated criteria regarding the licensing of entities that would like to offer online forex trading to clients in terms of the Investment Services Act, Cap. 370 (“the Act”), and the Malta Financial Services Act, Cap. 330 (“the MFSA Act”), following various factors that the Authority has come across in handling applications in this sector as well as various risk warnings issued at EU level alerting retail investors to the main risks involved in forex trading. This Circular supersedes the Notices issued by the MFSA on 20th October 2014 and on 14th July 2015 on the same subject matter.

The issuance of these criteria are intended to give clear guidance to the industry of the aspects that applicants wanting to offer online forex trading to retail clients are expected to satisfy. Moreover the high risks associated with forex trading by retail investors due to the reliance on automated systems, the complex nature of forex products and the accessibility to such products by retail investors, have also led to a further tightening of the licensing criteria.

These licensing criteria are applicable with immediate effect to all new applications submitted to the Authority after the date of this Circular.

Applicants whose application is currently being processed by the MFSA are also required to come in line with the below-mentioned additional criteria with immediate effect with the exception of the Shareholding Structure and Capital Requirements, on which a grandfathering period of one year from the date of publication of this Circular is being granted by the Authority for such entities to regularise their position.

In this respect, apart from the conditions set out in Part A of the Investment Services Rules for Investment Services Providers, the following additional criteria shall apply to potential applicants for a Category 2 or a Category 3 Investment Services Licence that would like to engage in online forex trading:

- **Shareholding Structure** – Where an applicant for business is not authorised as an investment services provider either in Malta or in its own country of origin, and is therefore not subject to supervision, in considering whether to grant authorisation, the MFSA may require an active participation by way of shareholding interest by an investment services institution of repute or by any other entity involved in the

provision of financial services regulated activities, which is regulated to a level satisfactory to the MFSA and whose activities are relevant in the context of the application in question.

The following factors will be taken into account by the MFSA in considering the waiving or otherwise of the shareholding participation referred to in this section:

- the shareholding structure;
- the quality and track record of the proposed management team– promoters should ideally demonstrate several years of competence/experience with reputable institutions to be able to carry out their duties in an effective manner to the satisfaction of the MFSA;
- the target market;
- due diligence investigations;
- the capital structure being proposed and
- the level and nature of operational and business risk involved.

The above factors should not be interpreted as an exhaustive list of aspects which may be taken into account by the MFSA. The MFSA reserves the right to impose any condition at any time as may be deemed necessary. Each application is assessed on its own merits.

The MFSA may request any applicant to submit audited accounts, prepared by one of the major audits firms, in respect of any corporate shareholders in the proposed shareholding structure and/or entities with which the promoters are involved.

Furthermore, the Authority, in order to achieve comfort regarding the source of funds of the promoters, reserves the right to request a promoter (who is also the ultimate beneficial owner of the applicant) to provide it with a statement of wealth that should be signed by a person holding a warrant of a certified public accountant under the Accountancy Profession Act (Cap. 281) or holds professional qualifications of similar standing of an institute of repute recognised by the Authority.

- **Capital requirements** – Companies applying for a Category 2 licence will be subject to a higher minimum initial capital requirement of €730,000, similar to the initial capital requirement for Category 3 licence holders in light of the risks associated with this kind of business and potential loss of retail clients’ money. The said capital should be satisfied on an ongoing basis and not just at licensing stage.
- **Competence requirements** – (i) Board of Directors - The members of the Board of Directors are expected to collectively possess the requisite competence and experience specifically in the field of online forex trading. For this purpose, the Authority needs to be provided with comfort that the proposed Board members of an online forex company

collectively have the necessary competence to be able to effectively contribute to the decision-making process of the Board.

(ii) Other staff - The competence requirements are applicable to individuals occupying senior positions with the licence holder and who report directly to the Board of Directors, such as Senior Manager, Risk Manager or Head of Trading. These individuals need to prove to the satisfaction of the Authority that they have an adequate track record with one or more regulated firms that operate within the forex industry. The trading of one's own funds is not deemed to be sufficient for the purpose of the Authority's competence assessment and shall not be taken into account in the review of an individual's eligibility to assume any of such position within an online forex company. The level of skills and expertise required of such employees will be considered in detail, taking into account the particular circumstances of the applicant in question (including the nature of the instruments to be traded, the type of clients to be targeted and the nature of the investment services to be provided).

- **Local Presence/Corporate Governance set-up** –Whilst the Authority acknowledges that the bulk of such licence holders' business and activities is carried out through automated means, licence holders are expected to dedicate sufficient human resources as well as put in place adequate internal controls for the day-to-day management of their business, the monitoring of trades, handling of clients' enquiries and complaints and risk management.

The risk management function is considered to be an important function in such a business and is therefore a requirement for both Category 2 and Category 3 licence holders. In such scenarios, the Authority expects that the licence holder establishes a locally based risk management role responsible for designing, implementing and monitoring the risk management policies and procedures of the licence holder. In this regard, no derogation from the requirement to appoint a locally-based Risk Manager will be given to applicants engaging in online forex trading irrespective of the volume of business. While in the case of Category 2 IS Licence Holders the Authority may consider the outsourcing of such function to locally based entities, Category 3 IS Licence Holders are expected to have a full-time dedicated risk management function in place.

Moreover the Authority expects that the core licensable activities (including the setting of trading policies and parameters and monitoring of the execution of electronically-generated trades via the applicant's online trading platform/s) of licence holders that provide online forex trading are carried out in and from Malta.

With respect to Category 3 licence holders, the Authority also expects that the following activities/ functions are carried out in Malta:

- The selection of counterparties and conclusion of agreements therewith;
- The establishment of trading limits and other parameters;
- The setting of pricing policies; and
- The monitoring and control of transactions undertaken with clients.

The Board of an online forex trading company is expected to have collective acumen in the area of online forex trading. In addition, the Board of Directors of an online forex trading firm should include one or more independent directors having the necessary competence and experience in forex trading who would be able to question and challenge the activities of the executive directors and senior management. The Authority shall also require that a locally based Board member (who ideally has the necessary competence and experience in forex trading) is always appointed in satisfaction of the local presence requirements.

Moreover, the licence holder shall only be authorised by the Authority to commence its business as an online forex trading firm if it has the requisite number of personnel in place that will ensure compliance with the dual control principle on an ongoing basis. The Authority does not accept operational set-ups whereby the licensable activities, as well as the key functions of the licence holder, are concentrated in one individual.

With respect to outsourcing, although investment services providers are allowed to outsource some of their functions, the extent of outsourcing should not be such as to reduce the company to a shell entity. As required by MiFID, the applicant is required to show to the satisfaction of the Authority that the licensable activities applied for will actually be undertaken in and from Malta. The MFSA may, with respect to a limited number of support services, consider requests for time-limited outsourcing arrangements with appropriate external parties in the initial stages. In the case of applicants that will initially rely on a number of support services from their parent company or other third parties, the Authority expects the submission of a detailed plan of any planned eventual phasing out of such outsourcing/support services arrangements.

- **Expert Advisors** – Applicants are expected to have a clear policy on the use by its clients of Expert Advisors as part of their trading strategy. This policy should be clearly communicated to the licence holder’s clients from the outset.
- **Record Keeping** – Whatever the medium used to carry out transactions with clients, counterparties and other third parties, the Authority expects the licence holder to have in Malta real time access to and control over all transactional data. The Authority would require full access to this data as and when required, including during Compliance Visits.

The licence holder shall, moreover, have this data fully preserved in its records on an ongoing basis at its head office in Malta and shall have in place an appropriate offsite backup system for risk management and business continuity purposes.

In addition, the licence holder shall ensure that all other information, data and records held at its offices in Malta are consistent with the provisions the Investment Services Act and the MFSA Act, and any regulations or rules issued thereunder.

- **Systems** – If the applicant intends to use a proprietary online trading platform, whether this has been developed in-house or not, the Authority would need to be provided with evidence that such system has been certified by an independent IT Auditor duly qualified and that it has a satisfactory track record as a result of having been used by other regulated online forex companies in the EU/EEA or other recognised jurisdiction. The certification by the independent IT Auditor as to the adequacy of the systems will be required on an annual basis.

Applicants that intend to offer online trading platforms which are well-renowned in the industry or which are used by regulated entities in this sector will be considered more favourably by the Authority.

In no case shall the use of proprietary or third party platforms compromise the conditions that are required to be in place with respect to transactional data.

The Authority also requires that the core systems of the company be based at the company's offices in Malta. To the extent only that the management of any activities is permitted to be outsourced or carried out via third party platforms in accordance with this policy and under the relevant licence conditions, the licence holder shall ensure that it has access to and control over any critical data or information necessary to properly manage its licensed activities in Malta at all times. The licence holder shall also ensure that the MFSA has access to such information or data for supervisory purposes.

In addition, the licence holder should take all the necessary measures so as to ensure that all of its employees are provided with the necessary training on the trading platform(s) to be offered to clients.

- **Liquidity providers/Counterparties** – Applicants that would like to offer online forex trading to their clients should only appoint regulated financial services firms as their counterparties/liquidity providers, provided further that these are already authorised by the relevant competent authorities in an EU, EEA or other jurisdiction that has the equivalent regulatory framework as in Malta for the provision of the service/s in question. Details and regulatory status of the liquidity providers/counterparties are to be provided to the Authority as part of the application review process.

Any changes to counterparties/ liquidity providers post-licensing should be notified to the Authority.

- **Consumer Protection Measures** - The Board of Directors of the respective licensed entity would need to ensure that the entity takes adequate measures to ensure enhanced consumer protection and awareness of the risks involved in cases where online forex trading is offered to retail investors.

Without prejudice to the above the licensed entity will be required to display, at all times and in a prominent place on the homepage of its website, and on any promotional or advertising material, the following warnings:

- (i) a warning on the riskiness of engaging in forex trading; and
- (ii) a warning that trading in forex instruments runs the risk of losing the entire sum invested;
- (iii) any other warning or disclosure required under the relevant rules or regulations.

The licensed entity shall also ensure that its web-portals contain the appropriate educational material aimed at guiding consumers who are new to forex trading on the nature and specificities of this type of investment; provide a clear explanation of how an online trade can be made over the system and explain what type of skills are required to carry out online trading activity and to limit trading risk.

Applicants and licence holders are also required to abide by ESMA guidelines on the sale of complex products where online forex is specifically mentioned as a complex product. These guidelines may be accessed through the following link:

http://www.esma.europa.eu/system/files/ipisc_complex_products_-_opinion_20140105.pdf

The applicant shall ensure that any application for licence submitted to the MFSA is in line with the provisions of this policy and that it would be in a position to comply with relevant conditions upon commencement of its activities and throughout the course of its licence.

Communications Unit
Malta Financial Services Authority
30th July 2015