

Circular to the financial services industry on revisions to the Investment Services Licence held by Investment Firms triggered by the implementation of Directive 2014/65/EU of the European Parliament and of the Council – Markets in Financial Instruments Directive (“MiFID II”)

The Authority would like to draw the industry’s attention to Recital 19 of the Commission Delegated Regulation (EU) 2017/565 (“Recital 19”). The said Regulation indicates that “(...) *systematic internalisers should not be allowed to bring together third party buying and selling interests in functionally the same way as a trading venue. (...)*”

Systematic internalisers (“SI”) are defined in Article 4(1) (20) of MiFID II as:

“An investment firm which, on an organised, frequent, systematic and substantial basis deals on own account by executing client orders outside a Regulated Market, Multilateral Trading Facilities or Organised Trading Facilities”.

Section 5.3 (Systematic Internalisers) of the ESMA [Questions and Answers](#) on MiFID II and MiFIR market structures topics clarifies that Recital 19 is not limited to internal matching of client orders through matched principal trading, but more generally prevents SIs from operating any system that would bring together third party buying and selling interests in functionally the same way as a trading venue (Question & Answer 17 refers).

When determining whether an SI is functionally similar to a trading venue, and hence would need to seek authorisation; the following criteria will need to be considered:

- Where arrangements go beyond a bilateral interaction between the SI and a client and where the SI does not, de facto, undertake risk facing transactions;

As explicitly explained “By crossing client trading interests with other liquidity providers’ quotes, via matched principal trading or another type of riskless back-to-back transaction, so that it is de facto not trading on risk, the SI would actually organise an interaction between its client orders on the one hand and the SI or other liquidity providers’ quotes on the other hand. The SI would be bringing together multiple third party buying and selling trading interests in a way functionally similar to the operator of a trading venue”

- Where the arrangements in place are used on a regular basis and qualify as a system or facility, as opposed to ad-hoc transactions;

“The operation of a system could also include circumstances where there is an understanding with third parties that trade by trade hedging will be available on a regular basis”; and

- Where transactions arising from bringing together multiple third party buying and selling interests are executed OTC, outside the rules of a trading venue.

Furthermore the Q&A lists criteria for undertaking matched principal trading on an occasional as opposed to a regular basis as indicated above. These are:

- the investment firm operates one or more systems or arrangements intended to match opposite client orders, but it should not have systems in place aimed at increasing opportunities for client order matching;

- when executing client orders, non-risk facing activities account for a recurrent or significant source of revenue for the investment firm's trading activity; and
- the investment firm, markets, or otherwise promotes, its matched principal trading activities

Moreover, Recital 24 of MiFID II clearly indicates that the activity of 'dealing on own account' when executing client orders should also include investment firms which execute orders from different clients by matching them on a matched principal basis (back-to-back trading). Accordingly, whilst such investment firms would be acting as a "*riskless principal*", they should nonetheless be regarded as acting as principal and should therefore be subject to the provisions of this Directive covering both the execution of orders on behalf of clients and dealing on own account.

In the light of the above and in preparation for MiFID II, existing licence holders of a Category 2 Investment Services licence are requested to evaluate the above and determine whether their activities would still remain in line with their licence and the provisions of MiFID II.

The Authority therefore requires licence holders which operate on a matched principle basis and which will be deemed to undertake the activity of '*dealing on own account*' following the implementation of MiFID II to apply for the necessary extension of the current Investment Services Licence to a Category 3.

Contact

Should you have any queries regarding the above, please do not hesitate to contact the Authorisation Unit, MFSA via email: ausecurities@mfsa.com.mt.

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