

# MFSA

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MALTA FINANCIAL SERVICES AUTHORITY

## CONSULTATION DOCUMENT

**PROPOSED POLICY AS APPLICABLE TO ONLINE  
BUSINESS MODELS DISTRIBUTING OR INTENDING TO  
DISTRIBUTE CONTRACTS FOR DIFFERENCE (CFDs)  
AND/OR ROLLING SPOT FOREX CONTRACTS UNDER  
THE MARKETS IN FINANCIAL INSTRUMENTS  
DIRECTIVE (MiFID) REGIME**

**[MFSA REF: 12/2016]**

**17 October 2016**

**Closing Date: 18 November 2016**

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**Note:** The documents circulated by the MFSA for the purpose of consultation are in draft form and consist of proposals. Accordingly, these proposals are not binding and are subject to changes and revisions following representations received from Licence Holders and other involved parties. It is important that persons involved in the consultation bear these considerations in mind.

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# **CONSULTATION ON THE PROPOSED POLICY**

## **Introduction**

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Over the last two years, the Malta Financial Services Authority ('MFSA') has actively undertaken policy work on investment services licence holders carrying out online forex trading activities for the purpose of introducing additional regulatory requirements at the application stage. In effect, on 30<sup>th</sup> July 2015, the MFSA issued a [public notice](#), wherein it set out the updated criteria regarding the licencing of entities that would wish to provide online forex trading to clients. The referred Notice was issued following various factors that the MFSA had 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.

In the last few years, the MFSA has observed that online business models offering MiFID investment services are also distributing Contracts for Difference (hereinafter referred to as "CFDs") on an over-the-counter (OTC) basis. Therefore for the purposes of this policy, it is hereby being proposed that MiFID online business models offering CFDs are subject to the requirements of the [public notice](#) (which is already in force) as well as the new and/or revised requirements which are being consulted upon in this paper. CFDs and rolling spot forex are collectively referred throughout this document as "*complex speculative products*". Although binary options are deemed by MFSA to be speculative in nature, it should be noted that these products will be excluded from this consultation and would therefore be subject to a separate consultation process in the near future.

The operations of online business models offering MiFID investment services in relation to *complex speculative products* pose a high risk for retail customers who may not be fully conversant with the risks associated with such speculative trading. Furthermore these types of activities give rise to investor protection concerns mainly due to the marketing strategies of such firms. In addition, retail investors do not understand the high risk, complexity and speculative nature of such products which are being provided by the above-mentioned firms. A particular concern is the fact that these *complex speculative products* are being advertised via online platforms and are being sold without investment advice. This has therefore resulted in a significant detriment and unexpected losses to a number of retail investors.

In this context, a [warning](#) has been issued by ESMA and by the MFSA reminding investors and potential investors to be very attentive and vigilant when seeking to invest in these speculative products and to ensure that the provider is duly authorised to offer such services in relation to these products.

Further to these concerns, the MFSA is proposing further regulatory requirements for investment services licence holders distributing or intending to distribute *complex speculative products*.

### **What does this consultation deal with?**

For the purpose of this Consultation Paper, the term *firm*, shall mean a Category 2 or Category 3 Investment Services Licence Holder authorised or in the process of being authorised to distribute

*complex speculative products*. MFSA is of the understanding that the majority of the referred *firms* resort to an online business model to distribute *complex speculative products*. MFSA also notes that although the population of firms offering *complex speculative products* is quite diverse, there are two main types of firm that offer *complex speculative products*: (i) firms acting as the client's counterparty, which offer the *complex speculative products* directly to retail clients; and (ii) *firms* acting as intermediaries between retail clients and liquidity providers.

Section 1 of this paper deals with the requirements regarding the shareholding structure of applicants for a Category 2 or Category 3 Investment Services Licence that would like to distribute *complex speculative products* in terms of the Investment Services Act, Cap. 370. These requirements will be applicable for new applicants only.

Section 2 of this paper deals with new requirements relating to leverage limits and slippage settings which would apply to all *firms*, including those currently licenced.

Section 3 of this paper deals with the proposed Transitory Period to be granted by the MFSA to the currently licensed *firms* in order for these to come in line with the requirements of the policy published on the 30<sup>th</sup> July, 2015. This section also includes the proposal of extending this consultation as well as the [public notice](#) to *firms* distributing CFDs.

### **Context and Sources of Proposals**

In preparing this policy, MFSA has consulted with European and non-European National Competent Authorities.

In principle, *firms* are required to abide at all times by the current Investment Services Rules for Investment Services Providers which include conduct of business requirements and other organisational and capital requirements. *Section 3* of this Consultation Paper establishes a proposed timeline whereby *firms* licensed before the 30<sup>th</sup> July will be expected to comply with the requirements as established in the [public notice](#) published on the aforementioned date. This section also includes the proposal of extending this consultation as well as the [public notice](#) to *firms* distributing CFDs.

**What are you required to do next?**

The MFSA is seeking feedback on the proposals set out in this consultation. Responses should reach the MFSA by **18 November 2016**. New applications submitted after this policy comes into effect will have to adhere with the requirements of this revised policy.

Please send your responses by email to [communications@mfsa.com.mt](mailto:communications@mfsa.com.mt) or alternatively by conventional post and addressed to: **Communications Unit, Malta Financial Services Authority, Notabile Road, Attard.**

**The next steps**

The MFSA shall consider the feedback received with respect to this Consultation Paper and will issue a feedback statement, following which an updated policy will be published.

## Section 1: Shareholding Structure.

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### *Preamble*

The purpose of this section is to inform the industry about a policy decision which has been taken by the MFSA in relation to the shareholding structure of applicants for a Category 2 or Category 3 Investment Services Licence that would like to distribute *complex speculative products* in terms of the Investment Services Act, Cap. 370.

### *Policy decision*

Reference is made to the [public notice](#) issued on the 30th July 2015, in particular to the ‘Shareholding structure’ sub-section. It should be noted that currently, the MFSA is assessing, on a case by case basis, whether the participation by another regulated entity by way of shareholding and /or active participation in the management of the proposed entity is required to ensure that companies offering these products are well equipped from a competence, governance and financial solidity perspective. Experience so far has shown that due to the high risk which is associated with this activity and more so since online forex products are accessible to retail clients, the participation of a regulated entity in the structure has invariably been required by the Authority in order to add value to the competence, governance and financial solidity of the applicant.

In view of the above, the MFSA is updating its current Notice, dated 30<sup>th</sup> July 2015, as follows:

Apart from the conditions set out in Part A of the Investment Services Rules for Investment Services Providers, the MFSA shall only accept an application for a Category 2 or a Category 3 Investment Services Licence for the purposes of offering *complex speculative products* if at least one entity holding a direct qualifying shareholding in the applicant is already regulated in the provision of financial services to a level which is satisfactory to the MFSA and whose activities are relevant in the context of the application in question. In addition, the Authority may also require active participation in the management of the proposed entity by the qualifying shareholder/s. Applicants should therefore be aware that the participation by another regulated entity by way of shareholding and /or active participation in the management of the proposed entity is applicable at the outset.

## **Section 2: New Requirements: Leverage Limits and Slippage Parameters**

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### Leverage Limits

#### *Preamble*

The MFSA has recently conducted an exercise with existing *firms* distributing *complex speculative products* in order to assess the leverage limits being offered to retail clients, professional clients as well as eligible counterparties. The MFSA is concerned to note that certain *firms* were offering the highest leverage (1:200 and possibly more) to retail clients with the least amount of deposits (margin held on account). Moreover generally, the leverage limits offered to professional clients and eligible counterparties was often less than the leverage limits offered to retail clients.

In light of the above, the MFSA is of the view that as a result, retail clients are invariably being subject to increased conduct risk by being exposed to high leverage levels. The MFSA is also concerned with the leverage limits offered to professional clients, which at times verge on the high side. As a result, the MFSA has decided to also include professional clients in its policy proposal.

In setting the proposed leverage limits, the MFSA has taken note of the current policy direction of other European National Competent Authorities as well as non-EU jurisdictions. In fact the French Financial Services Authority (Autorite des Marchés Financiers - AMF) has conducted a [study](#) in October 2014 on the investment performance of individuals trading in CFDs and forex in France. This study demonstrated that trading in Contracts for Difference (CFDs) and rolling spot foreign exchange contracts is a source of significant losses for an overwhelming majority of individuals investors, with an average rate of clients losing money over a four-year period in excess of 89%. In a similar vein, the Polish Financial Services Authority (KNF) conducted a study which found that 82% of investors who used online forex trading venues lost money in 2011.

#### *Policy proposal*

The MFSA is proposing that:

- (a) existing and newly licensed *firms* are required to set the leverage limits for retail and professional clients to a maximum of 1:50. This leverage limit shall be applicable across all platforms as made available to retail and professional clients on the *firm's* website(s).
- (b) for existing *firms*, the leverage limits policy proposal, is to come into effect within six (6) months from the date of the publication of the updated policy.

The Securities and Markets Supervision Unit jointly with the Conduct Supervisory Unit will be monitoring the implementation plan and are available to provide any assistance so that firms can regularise their position by the set deadline.

<i>Question</i>
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Do you agree with the leverage limits set for both retail and professional clients? Please give reasons for your answer.

### Slippage settings

#### *Preamble*

The MFSA is aware that issues will arise if slippage parameters are implemented in an asymmetrical manner. In this respect, a *firm* would be breaching its best execution obligations if it fills an order which has moved against the customer, as opposed to one that has moved in favour of the customer.

The MFSA notes that asymmetrical slippage parameters may be tackled in multiple ways. For instance, the MFSA is aware that in order to prevent excessive requoting in a fast moving market and to ensure timelier fills, certain *firms* (even on an international level) have built-in and clearly disclosed slippage parameters to customers that permit the execution of the order only if the slippage is within the established slippage parameters.

In drafting the under-mentioned policy proposal, MFSA has referred to the current compliance rules as currently in force by the U.S. National Futures Association.

#### *Policy proposal*

The MFSA is proposing that:

- (a) existing and newly licensed *firms* engaging or intending to engage in distributing *complex speculative products* will be required to implement procedures which would prohibit them from cheating, defrauding, or deceiving or attempting to cheat, defraud or deceive any other person. Such procedures should include the establishment of slippage parameters in order to ensure that orders are filled in a symmetrical manner.

In this way, existing and newly licensed *firms* engaging or intending to provide online forex services will be prohibited from engaging in any manipulative acts or practices regarding the price of any foreign currency or forex transaction.

- (b) With respect to existing *firms*, the slippage settings policy proposal, is to come into effect within six (6) months from the date of the publication of the updated policy.

The Securities and Markets Supervision Unit jointly with the Conduct Supervisory Unit will be monitoring the implementation plan and are available to provide any assistance so that firms can regularise their position by the set deadline.

## Section 3: Transitional Arrangements

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### *Preamble*

Reference is made to the [public notice](#) issued by the Authority on 30<sup>th</sup> July 2015, in particular to the following sub-sections:

- [i] Capital requirements;
- [ii] Competence requirements;
- [iii] Local presence/corporate governance set-up;
- [iv] Expert advisors;
- [v] Record keeping;
- [vi] Systems;
- [vii] Liquidity providers/counterparties; and
- [viii] Consumer protection measures.

The MFSA has carried out a survey with a view to assess whether existing *firms* were in line with the relative requirements in the abovementioned areas. From the replies submitted to this survey, the MFSA is aware that the majority of existing *firms* are not in line with the all and/or certain key requirements of the [public notice](#).

### *Proposal*

MFSA is proposing a six (6) month transitory period to be granted to all *firms* licensed before the 30<sup>th</sup> July, 2015 so that these come in line with the requirements of the public notice issued on the said date.

MFSA is also proposing that MiFID online business models offering CFDs are subject to the requirements of the [public notice](#) (which is already in force) as well as the new and/or revised requirements which are being consulted upon in this paper.

The Securities and Markets Supervision Unit jointly with the Conduct Supervisory Unit will be monitoring the implementation plan and are available to provide any assistance so that firms can regularise their position by the set deadline.

### *Question*

Do you agree that the requirements of the [public notice](#) (which is already in force) as well as the new and/or revised requirements which are being consulted upon in this paper are applicable to *firms* distributing CFDs?

**Communications Unit**  
**Malta Financial Services Authority**  
**MFSA Ref: 12-2016**  
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