

L.N. _____ of 2017

INVESTMENT SERVICES ACT
(CAP. 370)

Investment Services Act (Control of Assets) (Amendment) Regulations, 2017

IN exercise of the powers conferred by article 12 of the Investment Services Act, the Minister for Finance, acting on the advice of the Malta Financial Services Authority, has made the following regulations:

Citation.
S.L. 370.05

1. The title of these regulations is the Investment Services Act (Control of Assets) (Amendment) Regulations, 2017, and these regulations shall be read and construed as one with the Investment Services Act (Control of Assets) Regulations, hereinafter referred to as “the principal regulations”.

Amends regulation 1 of the principal regulations.

2. Immediately after subregulation (2) of regulation 1 of the principal regulations there shall be inserted the following subregulation:

“(3) The objective of these regulations is to implement the relevant provisions of articles 1(3) and (4) and articles 2 to 8 of the Commission Delegated Directive of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance, obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.”.

Amends regulation 2 of the principal regulations.

3. Regulation 2 of the principal regulations shall be amended as follows:

(a) subregulation (2) thereof shall be amended as follows:

(i) immediately before the definition “assets”, there shall be inserted the following definition:

“ “the Act” means the Investment Services Act;”;

(ii) immediately after the definition “assets”, there shall be inserted the following definition:

“ “Commission Delegated Directive” means Commission Delegated Directive (EU)/..... of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits, as amended from time to time;”,

(iii) immediately after the definition “customer”, there shall be inserted the following definitions:

“ “Directive 2009/65/EC” means Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), as amended from time to time and includes any implementing measures that have been or may be issued thereunder;

“Directive 2013/36/EU” means Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, as amended from time to time and includes any implementing measures that have been or may be issued thereunder;”;

(iv) immediately after the definition “Investment Services Rules”, there shall be added the following definitions:

“ “MiFID” means Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, as amended from time to time, and includes any implementing measures that have been or may be issued thereunder;

“professional client” means a client meeting the criteria laid down in Annex II of MiFID;

“qualifying money market fund” means a collective investment undertaking authorised under Directive 2009/65/EC, or which is subject to supervision and, if applicable, authorised by the competent authority under the Act, and which satisfies all of the following conditions:

- (a) its primary investment objective must be to maintain the net asset value of the undertaking either constant at par (net of earnings), or at the value of the investors’ initial capital plus earnings;
- (b) it must, with a view to achieving that primary investment objective, invest exclusively in high quality money market

instruments with a maturity or residual maturity of no more than 397 days, or regular yield adjustments consistent with such a maturity, and with a weighted average maturity of 60 days. It may also achieve this objective by investing on an ancillary basis in deposits with credit institutions:

Provided that for the purposes of paragraph (b), a money market instrument shall be considered to be of high quality if the collective investment scheme or the management company on behalf of the collective investment scheme performs its own documented assessment of the credit quality of money market instruments that allows it to consider a money market instrument as high quality. Where one or more credit rating agencies registered and supervised by ESMA have provided a rating of the instrument, the internal assessment carried out by the collective investment scheme or the management company on behalf of the collective investment scheme shall have regard to, *inter alia*, those credit ratings;

- (c) it must provide liquidity through same day or next day settlement;

“Regulation (EU) 2015/2365” means Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 as amended from time to time;

“retail client” means a client who is not a professional client as defined in Annex II of MiFID;

“securities financing transaction” means transactions as defined in article 3(11) of Regulation (EU) 2015/2365;” and

- (b) immediately after subregulation (2) thereof, there shall be inserted the following new subregulation:

“(3) Words and expressions used in these regulations which are also used in the Act but which are not defined herein shall have the same meaning as in the Act.”.

Amends regulation 5 of the principal regulations.

- 4.** Immediately after subregulation (3) of regulation 5 of the principal regulations, there shall be inserted the following:

“(4) Security interests, liens or rights of set-off over instruments or money belonging to a customer and enabling a third party to dispose of the customer’s instruments or money in order to recover debts that do not relate to the customer or provision of services to the customer are not

permitted except where this is required by the applicable law in a third country jurisdiction in which the money or instruments belonging to the customer are held.

(5) Where a subject person is obliged to enter into agreements that create such security interests, liens or rights of set-off, it shall disclose that information to customers indicating to them the risks associated with those arrangements.

(6) Where security interests, liens or rights of set-off are granted by the subject person over instruments or money belonging to the customer, or where the subject person has been informed that they are granted, these shall be recorded in customer's contracts and the subject person's own accounts to make the ownership status of customer's assets clear, such as in the event of an insolvency."

Amends regulation 7 of the principal regulations.

5. Regulation 7 of the principal regulations shall be amended as follows:

(a) in subregulation (3) thereof, for the words, "distinct form", there shall be substituted the words, "distinct from";

(b) subregulations (4) to (6) thereof shall be renumbered as subregulations (6) to (8) respectively;

(c) immediately after subregulation (3) thereof, there shall be inserted the following new subregulations (4) and (5):

"(4) The subject person shall maintain accurate records and accounts in a way that ensures accuracy, and in particular their correspondence to the instruments and money held for the customers and that they may be used as an audit trail.

"(5) The subject person shall conduct, on a regular basis, reconciliations between its records and accounts and those of any third parties with whom customer's instruments and money have been deposited in accordance with regulations 8 and 9.";

(d) in subregulation (6) thereof, as renumbered, for the words, "form the assets", there shall be substituted the words, "from the assets";

(e) immediately after subregulation (8) thereof, as renumbered, there shall be inserted the following new subregulations:

"(9) The subject person shall take the necessary steps to ensure that any customer instruments deposited with a third party in accordance with regulation 8 of these regulations are identifiable separately from the instruments belonging to the subject person and from the instruments belonging to that third

party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection.

(10) The subject person shall take the necessary steps to ensure that the money belonging to the customer deposited in accordance with regulation 9 of these regulations with a central bank, a credit institution or a bank authorised in a third country or a qualifying money market fund, are held in an account or accounts separately identifiable from any accounts used to hold money belonging to the subject person.

(11) The subject person shall implement adequate organisational arrangements to minimise the risk of the loss or diminution of assets belonging to the customer, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.

(12) If, for reasons of applicable law, including the law relating to property or insolvency, a subject person cannot comply with the provisions of this regulation to safeguard customers' rights to satisfy the requirements of articles 16(8) and (9) of MiFID, the subject person shall implement arrangements to ensure that customers' assets are safeguarded to meet the objectives outlined in this regulation.

(13) The competent authority shall issue Investment Services Rules providing requirements which have an equivalent effect in terms of safeguarding customers' rights if the applicable law of the jurisdiction in which the money or instruments belonging to the customer are held prevents the subject persons from complying with the provisions of subregulation (9) or (10) of this regulation.:

Provided that when relying on such equivalent requirements as prescribed in subregulations (9) or (10), the subject persons shall inform customers that in such instances they do not benefit from the provisions envisaged under MiFID and the Commission Delegated Directive.”.

Renumbering of regulations 8,9, 10, 11 and 12 of the principal regulations.

6. Regulations 8, 9, 10, 11, and 12 of the principal regulations shall be renumbered as regulations 15, 16, 17, 18 and 19 respectively.

Inserts regulations 8 to 13 to the principal

7. Immediately after regulation 7 of the principal regulations, there shall be inserted the following new regulations: .

“Deposit of customer instruments with third parties.

8. (1) A subject person may deposit instruments held by it on behalf of its customers into an account or accounts opened with a third party.

(2) The subject person shall exercise all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of those instruments.

(3) The subject person shall, in particular, take into account the expertise and market reputation of the third party as well as any legal requirements or market practices related to the holding of instruments that could adversely affect the rights of its clients.

(4) Where the subject person proposes to deposit customer instruments with a third party, the subject person shall only deposit instruments with a third party in a jurisdiction where the safekeeping of instruments for the account of another person is subject to specific regulation and supervision and that third party is subject to this specific regulation and supervision.

(5) The subject person shall not deposit financial instruments held on behalf of customers with a third party in any jurisdiction that does not regulate the holding and safekeeping of instruments for the account of another person unless one of the following conditions is met:

- (a) the nature of the instruments or of the investment services connected with those instruments requires them to be deposited with a third party in that third country; or
- (b) the instruments are held on behalf of a professional client and that professional client requests the subject person, in writing, to deposit them with a third party in that third country.

(6) The provisions of subregulations (4) and (5) shall also apply when the third party has delegated any of its functions concerning the holding and safekeeping of instruments to another third party.

Deposit of client money.

9. (1) A subject person shall, on receiving any customer money, promptly place such money with any of the following:

- a) a central bank;
- b) a credit institution authorised in accordance with the provisions of Directive 2013/36/EU;
- c) a bank authorised in a third country; or

d) a qualifying money market fund:

Provided that paragraph (b) above shall not apply to a credit institution authorised under Directive 2013/36/EU in relation to deposits within the meaning of the aforementioned Directive and held by that institution.

(2) Where the subject person does not deposit customer money with a central bank, it shall exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or money market fund where the money are placed and the arrangements for the holding of such money. The subject person shall furthermore, consider the need for diversification as part of its due diligence.

(3) Where the subject person deposits customer money in accordance with subregulation (2) , it shall, in particular, take into account the expertise and market reputation such institutions or money market funds with a view to ensuring the protection of the rights of its customers as well as any legal or regulatory requirements or market practices related to the holding of customers' money that could adversely affect such rights.

(4) The subject person shall ensure that customers give their explicit consent to the placement of their money in a qualifying money market fund. Furthermore, for the purposes of ensuring that this right to consent is effective, the subject person shall inform customers that money placed with a qualifying money market fund will not be held in accordance with the requirements for safeguarding customer money prescribed in the Commission Delegated Directive and these regulations.

(5) Where the subject person deposits customer money with a credit institution, bank or money market fund of the same group as the subject person, it shall limit the money deposited with any such group, entity or combination of any such group entities so that money does not exceed 20% of all such monies.

(6) The requirement prescribed in subregulation (5) can be waived by the Authority where the subject person is able to demonstrate that, in view of the nature, scale and complexity of its business, and also the safety offered by the third parties considered in subregulation (5) and including in any case the small balance of customer money the subject person holds, the requirement prescribed in subregulation (5) is not

proportionate.

(7) The subject person shall periodically review the assessment made in accordance with subregulation (6) and shall notify the initial and reviewed assessments to the competent authority.

Use of clients' instruments.

10. (1) A subject person shall not enter into arrangements for securities financing transactions in respect of instruments which it holds on behalf of a customer nor shall the subject person otherwise use such instruments for its own account or for the account of any other person or customer of the subject person, unless both of the following conditions are met:

- (a) the customer has given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively executed by signature or equivalent; and
- (b) the use of that customer's instruments is restricted to the specific terms to which the customer consents.

(2) The subject person shall not enter into arrangements for securities financing transactions in respect of instruments which are held on behalf of a customer in an omnibus account maintained by a third party, nor shall the subject person otherwise use instruments held in any such account for its own account or for the account of any other person, unless, in addition to the conditions set prescribed in subregulation (1), at least one of the following conditions is met:

- (a) each customer whose instruments are held together in an omnibus account has given prior express consent in accordance with subregulation (1)(a); or
- (b) the subject person has in place systems and controls which ensure that only instruments belonging to customers who have given prior express consent in accordance with subregulation (1)(a) are so used.

(3) The records of the subject person shall include details of each customer on whose instructions the use of instruments has been effected as well as the number of instruments belonging to each customer who has given his consent, so as to enable the correct allocation of any loss.

(4) The subject person shall take appropriate measures to prevent the unauthorised use of customer instruments for its own account or the account of any other person, such

as:

- (a) the conclusion of agreements with customers on measures to be taken by the subject person in case the customer does not have enough provision on its account on the settlement date, such as borrowing of the corresponding securities on behalf of the customer or unwinding the position;
- (b) the close monitoring by the subject person of its projected ability to deliver on the settlement date and the putting in place of remedial measures if this cannot be done; and
- (c) the close monitoring and prompt requesting of undelivered securities outstanding on the settlement day and beyond.

(5) The subject person shall adopt specific arrangements for all customers to ensure that the borrower of customer instruments provides the appropriate collateral.

(6) The subject person shall monitor the continued appropriateness of the collateral referred to in subregulation (5) and take the necessary steps to maintain the balance with the value of customer instruments.

(7) The subject person shall not enter into arrangements which are prohibited under Article 16(10) of MiFID.

Inappropriate use of title transfer collateral arrangements.

11. (1) The subject person shall properly consider the use of title transfer collateral arrangements in the context of the relationship between the customer's obligation to the subject person and the customer's assets subjected to title transfer collateral arrangements by the subject person. The subject person shall furthermore be able to demonstrate that it has carried out such considerations.

(2) When considering, and documenting, the appropriateness of the use of title transfer collateral arrangements, the subject person shall take into account all of the following factors:

- (a) whether there is only a very weak connection between the customer's obligation to the subject person and the use of title transfer collateral arrangements, including whether the likelihood of a customers' liability to the subject person is low or negligible;
- (b) whether the amount of customer money or instruments subject to title transfer collateral arrangements far exceeds the customer's obligation, or is even unlimited if the customer

has any obligation at all to the subject person; and

- (c) whether all customers' instruments or money are made subject to title transfer collateral arrangements, without consideration of what obligation each customer has to the subject person.

(3) Where using title transfer collateral arrangements, the subject person shall highlight to professional clients and eligible counterparties the risks involved and the effect of any title transfer collateral arrangement on the customer's instruments and money.

Governance arrangements concerning the safeguarding of customer assets.

12. (1) The subject person shall appoint a single officer of sufficient skill and authority with specific responsibility for matters relating to the compliance by the subject person with its obligations regarding the safeguarding of customer instruments and money.

(2) The subject persons shall decide, whilst ensuring full compliance with Commission Delegated Directive, whether the appointed officer is to be dedicated solely to this task or whether the officer can discharge responsibilities effectively whilst having additional responsibilities.

Reports by external auditors.

13. The subject person shall ensure that its external auditors report at least annually to the competent authority on the adequacy of the subject person's arrangements under Article 16(8), (9) and (10) of MiFID and Chapter II of the Commission Delegated Directive as transposed in these regulations.

Provision of information.

14. (1) The subject person shall make information pertaining to customers' instruments and money readily available to the following entities:

- a) the competent authority;
- b) appointed insolvency practitioners; and
- c) the resolution authority.

(2) The information to be made available in terms of subregulation (1) shall include the following :

- (a) related internal accounts and records that readily identify the balances of money and instruments held for each customer;
- (b) where customer money are held by the subject person in accordance with regulation 9, as well as details of the accounts where customer money are held and the relevant agreements with those entities;
- (c) where instruments held by the subject person in

accordance with regulation 8, as well as details of accounts opened with third parties and the relevant agreements with those entities;

- (d) details of third parties carrying out any related outsourced tasks and details of any outsourced tasks;
- (e) key individuals of the subject person involved in related processes, including those responsible for oversight of the subject person's requirements in relation to the safeguarding of customer assets; and
- (f) agreements relevant to establish customer ownership over assets.”.

Amends regulation 15 of the principal regulations.

8. In subregulation (2) of regulation 15 of the principal regulations, as renumbered, for the words “regulation 9”, there shall be substituted the words, “regulation 16”.

Insertion of a new Part 4

9. Immediately following regulation 19 of the principal regulations as renumbered, there shall be inserted the following:

“Part 4

Administrative Penalties, other administrative measures and Appeals

20. (1) Where a person falling within the scope of these regulations fails to comply with any provisions of such regulations or any rules issued thereunder further implementing such regulations, the competent authority may, by notice in writing and without recourse to a court hearing, impose on such person an administrative penalty and other administrative measures in accordance with the provisions of the Investment Services Act (MiFID and MiFIR Administrative Penalties, Measures and Investigatory Powers).

(2) A right of appeal to the Financial Services Tribunal shall lie from the decisions which the competent authority shall take under these regulations and the provisions of article 19 of the Act shall apply *mutatis mutandis*.”