

10 December 2024

The Board of Directors,
The Compliance Officer,

You are receiving this letter as the Chief Executive Officer and/or Compliance Officer of an investment firm supervised by the Malta Financial Services Authority (referred to herein as the 'MFSA' or the 'Authority').

Re: Revision of Conduct of Business Rulebook primarily to implement the Prohibition on Investment Firms from receiving Payment for Order Flow ("PFOF") and to transpose updated provisions of MiFID II Best-Execution Reporting Requirements

I. Background

On 25 November 2021, the European Commission adopted the proposal for a review of Regulation (EU) No 600/2014 ("*MiFIR*") on enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders. This is known as the MiFIR/MiFID review and its aim review is to improve access to market data and to ensure fair and transparent operations and better data quality, thereby protecting investors from market abuse and manipulation. In this respect, on 8 March 2024 the following set of EU legislation was published in the EU Official Journal:

- (a) [Regulation \(EU\) 2024/791](#) of the European Parliament and of the Council of 28 February 2024 amending Regulation (EU) No 600/2014 as regards enhancing data transparency, removing obstacles to the emergence of consolidated tapes, optimising the trading obligations and prohibiting receiving payment for order flow, (the "*MiFIR Amending Regulation*¹"); which entered into force on 28 March 2024.

The contents of this letter will focus on the **new Article 39a of MiFIR** which introduced a **prohibition of receiving Payment For Order Flow ("PFOF")**, as outlined in further detail in **section II** below;

¹ The MiFIR Amending Regulation introduces changes other than PFOF, such as, amongst other matters, the establishment of an EU-level consolidated tape which necessitates the introduction of mandatory contributions of market data to consolidated tape providers for both equity and non-equity instruments traded in the EU by trading venues and approved publication arrangements as close to real time as technically possible. However, this subject-matter does not form part of this letter.

- (b) since MiFID II also contains provisions related to the consolidated tape and transparency, in parallel with the above certain amendments have also been reflected in MiFID II by means of [Directive \(EU\) 2024/790](#) of the European Parliament and of the Council of 28 February 2024 amending Directive 2014/65/EU on markets in financial instruments (the “**MiFID II Amending Directive**”), which Member States are required to transpose by latest 29 September 2025.

This letter will focus on Article 1(4) of the MiFID II Amending Directive which introduces amendments to **Article 27** (obligation to execute orders on terms most favourable to the client) of MiFID II. In particular, this letter will highlight the deletion of certain **reporting requirements in terms of Articles 27(3) and 27(7)**.

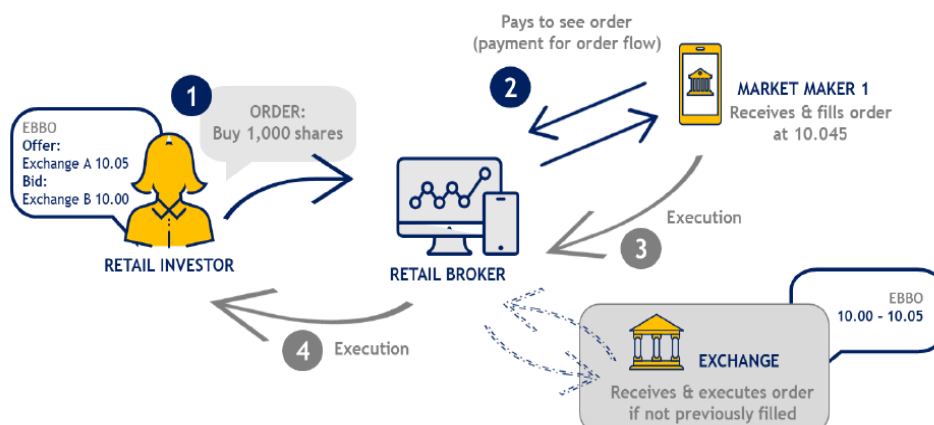
In the context of the above, the letter provides further detail on:

- the **general prohibition on PFOF** (pursuant to the MiFIR Amending Regulation), in **section II** below;
- the **updated provisions of Article 27 of MiFID II** relating to best-execution reporting requirements (particularly the deletion of Article 27(3) and 27(6) reporting), in **section III** below;
- the **necessary amendments** being carried out to **Chapter 1 and Chapter 5 of the Conduct Rulebook** to implement and/or transpose the said requirements (as described below, together with a ‘*Summary of Amendments*’ in section IV). The Revised Conduct Rulebook has been uploaded on MFSA’s website.

II. Prohibition of receiving Payment for Order Flow (known as “PFOF”)

Introduction of a PFOF Prohibition imposed on investment firms

PFOF is a practice through which brokers receive payments for forwarding client orders to certain trading platforms), such that financial intermediaries would be required to select the trading venue or counterparty for a transaction solely on the basis of achieving best execution for their clients. The below is a possible visualisation of a PFOF business model:



The European Securities and Markets Authority (ESMA) issued a [Public Statement of 13 July 2021](#) with a warning about the risks arising from PFOF whereby it was emphasised that the receipt of PFOF by firms from third parties raises **significant investor protection concerns**, (in this respect, vide [MFSA Circular of 22 July 2021](#)). For instance, a particular concern relates to the fact that PFOF arrangements are perceived as creating a clear **conflicts of interest** between the firm and its clients which would not be in accordance with MiFID II best execution requirements².

Another concern raised is that PFOF practices enabled the existence in some EU Member States of zero-commission brokers, executing clients' orders without charging explicit commissions in certain or all financial instruments on offer and who were often marketing their services as '*bearing no costs*' for investors; thereby hiding execution costs and fees to retail investors through the illusion of free trading.

Therefore, due to such concerns, ESMA at the time had concluded that it would in most cases be unlikely that receiving PFOF would be compliant with MiFID II key requirements, particularly in relation to **best execution, conflicts of interest, inducements and cost transparency**.

PFOF was a highly debated subject-matter during the EU legislative process. Ultimately, on 25 November 2021, the European Commission adopted the [MiFIR Review Proposal](#), which included a possible ban on PFOF. Following the EU legislative process on the said proposal, ultimately there was the introduction of an EU-wide PFOF ban or prohibition.

The reason behind this ban is that it was ultimately concluded that PFOF creates a clear conflict of interest between the broker and its client that cannot be managed, and that should therefore be prevented from arising in the first place. This is also in the light of the requirement on investment firms to select the trading venue or counterparty primarily on the basis of achieving best execution for their clients. Collecting a payment for ensuring the execution of client transactions on a particular execution venue is ultimately deemed to be incompatible and inconsistent with the MiFID II principles and obligations of best execution

² Since, in contrast to the obligation on firms to act in the best interest of its clients, the receipt of PFOF from third parties by a firm executing client orders would incentivise the said firm to direct and route the order flow to the third party/execution venue that offers the highest payment for order flow; rather than sourcing the best liquidity and pricing so as to consistently choose the execution venue offering the best possible price and favourable outcome for the firms' end clients and their investment goals.

Implementation of Article 39a(1) in the Conduct of Business Rulebook

In order to mitigate potential conflicts of interest and enhance investor protection, a **general prohibition on PFOF** was introduced by means of MiFIR Amending Regulation which introduces a **new Article 39a in MiFIR**³ which prohibits investment firms acting on behalf of retail clients or “opt-in” professional clients from receiving any fees, commissions or non-monetary benefits from third parties for:

- (a) the execution of orders from those clients at a particular execution venue; or
- (b) forwarding orders of those clients to any third party for their execution on a particular execution venue,

whereby, the above-mentioned criteria relate to what constitutes PFOF.

The contents of the MiFIR Amending Regulation are directly applicable. However, notwithstanding this, **new Rules R.5.34 and R.5.35 and guidance G.5.34** are being inserted in the current Conduct of Business Rules Rulebook to specifically emphasise the implementation of the new **Article 39a(1) of MiFIR** relating to the prohibition of receiving PFOF, for the purposes of completeness and better visibility. It is also being clarified in the Rulebook that the said prohibition became applicable as from 28 March 2024 (the date of entry into force of the MiFIR Amending Regulation).

Moreover, all PFOF practices in the EU shall be discontinued **by 30 June 2026** through a phased-out approach. In this respect, it is to be noted that any available temporary and limited exemption from the PFOF prohibition in terms of Article 39a(2) of MiFIR has **not** been adopted by Malta. The Authority is of the view that this approach ensures the application of the full ban immediately (that is, as from 28 March 2024, when the MiFIR Amending Regulation came into force), thereby providing greater investor protection to the clients of the investment firms concerned.

III. Evolution with respect to Best Execution Reporting

Article 1(4) of the *MiFID Amending Directive* amends **Article 27 of MiFID II** which is currently transposed in various Rules laid down in **Chapter 1 and 5 of the Conduct of Business Rulebook**.

In particular, **Article 27(3) and (6)** of MiFID II contain the requirement for execution venues to publish reports with a list of details relating to the obligation to execute orders on terms

³ It is to be noted that the second subparagraph of Article 39a(1) of MiFIR contains an exemption from the said PFOF prohibition as it stipulates that the ban shall not apply to rebates or discounts on the transaction fees of execution venues (where permitted under the approved and public tariff structure of a trading venue in the European Union or of a third-country trading venue), provided that, such discounts or rebates exclusively benefit the client and do not result in any monetary gain to the investment firm.

'most favourable to the client' (that is, 'best execution'). However, it emerged that those reports are rarely read and do not enable investors or other users of those reports to make meaningful comparisons based on the information provided in the said Reports.

Deletion of Reporting Requirement under Article 27(3) of MiFID II

As a consequence, Article 1 of Directive (EU) 2021/338 (known as "**MiFID Quick-Fix**") had suspended the reporting requirement under Article 27(3) of MiFID II for two years (that is, until 28 February 2023) in order for that requirement to be reviewed.

In addition, the MiFIR Amending Regulation will introduce an EU-level consolidated tape which is expected to disseminate data on the European best bid and offer, post-trade information regarding transactions in shares and exchange-traded funds (ETFs) and post-trade information regarding transactions in bonds and over-the-counter (OTC) derivatives. It follows that such information can be used for proving best execution.

Therefore, in the context of the above, the reporting requirement laid down in Article 27(3) of MiFID II will no longer be relevant. It follows that by means of changes introduced with Article 1(4) of the Amending MiFID Directive, **Article 27(3) was amended so that the relevant reporting information will be removed**. Consequently, the current **Rule R.5.53** of the Conduct of Business Rulebook, which currently transposes the said Article 27(3), will now be amended accordingly.

Deletion of Reporting Requirement under Article 27(6) of MiFID II

Article 27(6) of MiFID II requires investment firms to publish annually information on the identity of the top five (5) execution venues where they execute client orders in the preceding year and information on the quality of execution which investment firms have actually achieved. Commission Delegated Regulation (EU) 2017/576 (**RTS 28**) further specifies the content and format of this information in the annual reports (known as "**RTS 28 reports**").

However, the MiFID II Amending Directive includes the **deletion of Article 27(6) MiFID II and therefore, the removal of the obligation to publish the said RTS 28 reports**. Accordingly, the current **Rule R.1.3.14** of the Conduct of Business Rulebook, which transposes the said Article 27(3), will now be deleted accordingly.

In this context, on 13 February 2024, an [updated ESMA Public Statement](#) was issued on the de-prioritisation of supervisory actions on the obligation to publish RTS 28 reports⁴ in light of the agreement on the MiFID II/MiFIR review. By means of its statement ESMA sought to promote coordinated action by stating its expectation that Member State's national

⁴ Vide [MFSA Circular of 19 February 2024](#) in this respect. ESMA's Statement of 13 February 2024 was issued in addition to a previous ESMA's public statement of 14 December 2022 on the de-prioritisation of supervisory actions on the obligation to publish RTS 27 reports after 28 February 2023.

competent authorities do not prioritise supervisory actions towards investment firms relating to the obligation to publish the RTS 28 reports. However, notwithstanding this, investment firms are required, at all times, to strictly adhere to MiFID II best execution requirements.

In view of the fact that the MiFID II Amending Directive will be transposed by latest 29 September 2025, investment firms in the Member States may still have to publish the RTS 28 reports until the date of transposition of the Directive in the respective Member State. Therefore, in order to ensure clarity and efficiency for the industry (and in particular, to enable the effective deletion of Article 27(3) and (6) relating to best-execution reporting requirements), the Authority is transposing the changes to Article 27 of MiFID II pursuant to the MiFID II Amending Directive, with immediate effect by carrying out **amendments to the relevant Rules in Chapter 1 and 5 of the Rulebook** (as specified below in the 'Summary of Amendments').

Other Changes in Article 27 of MiFID II

Article 27 of MiFID II also contains more general provisions related to best execution. For instance, to ensure a more consistent approach in the application of best-execution requirements and clarify further best-execution requirements for professional clients, other changes include the fact that ESMA will, in due course, develop draft Regulatory Technical Standards on the criteria to be taken into account for the purpose of establishing and assessing the effectiveness of the order execution policy pursuant to Article 27(5) and (7) of MiFID II, taking into account the difference between retail and professional clients.

IV. Other changes in the Conduct of Business Rulebook

The Authority has also taken this opportunity to effect certain other unrelated minor, but important, changes to the Conduct of Business Rulebook as follows:

- a. in so far as the requirements relating to the treatment of a Client as an elective professional client, Indents (iii) and (iv) of Rule R.4.2.7(b) of Chapter 4 of the Conduct Rulebook have been merged into one in order to be aligned with Annex II of MiFID II, so that it now reads as follows: *"(iii) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged"*.
- b. with respect to the submission of the Financial Instrument Survey by Investment Firms, as indicated in the relative [Circular of the 4th December 2024](#), this survey will replace the List of Financial Instruments and will now be required to be submitted on an annual basis rather than half yearly. Accordingly, Rule 4.1.25 (b) shall be amended to read as follows: *"(b) on an annual basis, that is, within 42 days after the end of the reporting year, the Financial Instruments Survey pursuant to the Circular on Financial Instruments Survey of 4th December 2024 and the Guidelines on the Compilation and Submission of the Financial Instruments Survey."*

V. Summary of Amendments to the Rulebook

The below table only summarises the key amendments made:

COBR Provisions	EU Legislation
	Transposition of revised Article 27 of MiFID II as updated by the MiFID Amending Directive
Deletion of current Rule R.5.34	Deletion of Article 27(2)
Amendment of current Rule R.5.53, now renumbered as R.5.54	Amendment of Article 27(3)
Deletion of current Rule R.1.3.14	Deletion of Article 27(6)
Amendment of Rule R.5.32	Amendment of Article 27(7)
New Rules R.5.34 and R.5.35 ; new guidance G.5.34	Implementation of Article 39a(1) of MiFIR introduced by the MiFIR Amending Regulation
Rule R.4.2.7(b)(iii)	Relevant provisions in Annex II of MiFID II
COBR Provision	Regulatory Requirement
Rule R.4.1.25(b)	MFSA Circular dated 4 th December 2024 relating to submission of Financial Instruments Survey

IV: MFSA Expectations - Action Required

We expect firms to consider the requirements of the MiFIR Amending Regulation and the MiFID Amending Directive as set out in this letter. With particular reference to the general ban on the receipt of PFOF, the Authority expects that firms have carried out an assessment as to whether their business model was impacted with the introduction of the said prohibition. If a firm determines that it is impacted by such prohibition it is expected to have taken and documented the necessary steps to align its business model and adequately improve its arrangements, practices, policies, systems and controls to ensure effective compliance with the general prohibition under MiFIR and the related MiFID II requirements on best execution, conflicts of interest, inducements and cost transparency. Furthermore, kindly note that the Authority will monitor the market to assess compliance with the PFOF prohibition and MiFID-related requirements, and will eventually carry out supervisory interactions in this respect.

Yours faithfully,

Malta Financial Services Authority

Christopher P. Buttigieg
Chief Officer Supervision

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