

# RAISING THE BAR FOR COMPANY SERVICE PROVIDERS

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## Table of Abbreviations

AML	Anti-Money Laundering
AMLD	Anti-Money Laundering Directive
CEO	Chief Executive Officer
CFT	Combatting the Financing of Terrorism
CPE	Continuous Professional Education
CSP	Company Service Provider
DNFBPs	Designated Non-Financial Businesses and Professions
EDC	Enforcement Decisions Committee
EU	European Union
FATF	Financial Action Task Force
FIAU	Financial Intelligence and Analysis Unit
KYC	Know Your Client
MFSA	Malta Financial Services Authority
Moneyval	Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
MLRO	Money Laundering Reporting Officer
PII	Professional Indemnity Insurance
SRO	Self-Regulatory Organisation
TCSP	Trust and Company Service Provider

## Foreword by the CEO



*Joseph Cuschieri*

*Chief Executive Officer*

It is generally accepted that Company Service Providers (CSPs) are the gatekeepers to the financial system – they are often the persons with whom individuals wishing to invest in Malta have their first interactions. They play an important role in preventing persons who are not fit and proper from gaining access to the financial services sector.

The Malta Financial Services Authority (MFSA) has, during the past months, reassessed the framework for CSPs with the intention of raising the bar for persons performing such activity. This document puts forward a number of proposals on which the Authority is seeking feedback, in line with our Strategic Plan 2019-2021, wherein it is stated that the MFSA shall be enhancing its engagement with stakeholders. The importance of the Authority's proposals is amplified by the concerns raised by the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism ('Moneyval'), in their recently-published Mutual Evaluation Report.

Prior to putting forward the Authority's proposals, this document summarises the applicable regulatory framework for Maltese CSPs in order to raise awareness of the obligations and expectations thereon. Our proposals may be categorised into two: a proposal for a holistic regulatory framework for CSPs in Malta; and proposals in relation to the Maltese institutional architecture for the regulation of CSPs.

### A proposal for a holistic regulatory framework

The Authority is proposing revisiting the regulatory framework for CSPs. The main changes being proposed in this regard are: [i] extending the role of a CSP to include a new service – the provision of professional assistance in the submission of applications for licensing, registration, recognition or any other authorisation issued by the Authority; [ii] the introduction of CSP licence classes to facilitate the adoption of a risk-based approach to regulation and supervision; [iii] revisiting the current exemptions from registration and the *de minimis* rule to eliminate any existing supervisory gaps and harmonise market entry requirements; [iv] enhanced competence assessments for directors, compliance officers, MLROs and designated persons of CSPs; [v] rigorous assessments of client on-boarding processes; [vi] raising the capital requirements to ensure financial soundness; and [vii] enhanced requirements with respect to governance, compliance and risk management.

## The Institutional Architecture for the supervision of CSPs in Malta

As part of the regulatory strategy to raise the standards of supervision, and following a proposal received by the Authority from the industry, our team also looked into the institutional architecture for the supervision of CSPs. Two options for a way forward were identified: [i] maintaining the current institutional architecture – i.e. the MFSA being responsible for authorisation of CSPs, their supervision and the enforcement of the regulatory framework in the event of there being breaches; and [ii] a hybrid supervisory model involving a Self-Regulatory Organisation for certain CSPs. This document presents both options to stakeholders; however, in view of the implications of the Moneyval report, we are of the view that the Authority should remain responsible for the authorisation, supervision and enforcement with respect to CSPs.

Given that the Authority is proposing that the scope of the CSP Act is widened, through the removal of exemptions and a rethink of the *de minimis* rule, a larger number of persons will fall within scope of the Act. The MFSA will therefore be increasing resources within its respective functions to ensure that it is capable of handling the revised framework.

By presenting the MFSA's proposals, I look forward to working with all stakeholders to raise the bar for the CSP sector in Malta. In this light, I invite you to provide your feedback so that we can put forward a robust framework which safeguards consumers of financial services, market integrity and financial soundness.

## 1 Introduction

Company Service Providers ('CSPs') are considered to have an important role in the Maltese financial system given that they are often the first port of call for persons seeking to set up their business in the country.

CSPs are regulated in Malta by virtue of a *sui generis* framework which designates the Malta Financial Services Authority ('MFSA') as the competent Authority; however, there are categories of persons, such as advocates, notaries, legal procurators, accountants and accountancy firms, who fall outside the scope of the framework, notwithstanding that they provide the services of a CSP. That being stated, national Anti-Money Laundering ('AML') legislation captures within its scope CSPs regulated by the MFSA and those categories of persons providing CSP services but falling outside the scope of the CSP Act. These are designated as 'subject persons'<sup>1</sup>, and therefore subject to all the obligations of a subject person in terms of the Prevention of Money Laundering and Financing of Terrorism framework.

As stated in the MFSA's Vision 2021, the governance, culture and conduct of all market players in the financial services industry affects the integrity and stability of the financial market. In this light the Authority is, through this discussion paper, putting forward a proposal to raise standards for CSPs in Malta and is seeking stakeholders' feedback thereon. This Consultation Document is composed of five sections as follows:

- Chapter 2 provides an overview of the current requirements and expectations for CSPs. It details: [i] the Financial Action Task Force's ('FATF') recommendations; [ii] the requirements set out within European legislation, and; [iii] an overview of the existing regulatory framework in Malta.
- Chapter 3 sets out the Authority's proposals to raise the bar for CSPs in Malta. These include: extending the role of CSPs to the submission of applications of prospective licence holders; and market entry requirements, including rigorous assessments of competence and client on-boarding processes and capital requirements.
- Chapter 4 sets out the Authority's proposal for the institutional architecture for the supervision of CSPs. Two alternatives for a way forward are set out whilst also highlighting the Authority's preferred option.
- Chapter 5 provides the action points necessary for the implementation of the Authority's proposals.
- Chapter 6 seeks feedback from the industry through a set of questions as a conclusion to the discussion paper.

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<sup>1</sup> Vide PMLFTR (SL 373.01), Regulation 2(1), definitions of 'subject person' and 'relevant activity'

It is emphasised that the proposals put forward in this discussion paper are not binding and are subject to changes and revisions following representations received from licence holders and other stakeholders. It is important that persons involved in the consultation bear these considerations in mind.

## 2 Current Requirements and Expectations for CSPs

### 2.1 Supranational Level

Even though there is no supranational framework for CSPs, both the FATF and the EU have provided requirements therefor, particularly for purposes of Anti Money Laundering and the Combating the Financing of Terrorism (AML/CFT).

#### 2.1.1 Financial Action Task Force

The FATF in its Recommendations on International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation categorises Trust and Company Service Providers (TCSPs) as designated non-financial businesses and professions (DNFBPs). Apart from clearly providing a number of requirements<sup>2</sup>, the FATF also recommends that countries ensure that TCSPs are *“subject to effective systems for monitoring and ensuring compliance with AML/CFT requirements”*<sup>3</sup> specifying that this may be performed either by a supervisor or by a self-regulatory body. Furthermore, the FATF states that the *“supervisor... should also (a) take the necessary measures to prevent criminals or their associates from being professionally accredited, or holding or being the beneficial owner of a significant or controlling interest or holding a management function, e.g. through evaluating persons on the basis of a “fit and proper” test; and (b) have effective, proportionate, and dissuasive sanctions in line with Recommendation 35 available to deal with failure to comply with AML/CFT requirements.”*<sup>4</sup>

As part of the definition of DNFBPs, the FATF Recommendations state that: *“Trust and Company Service Providers refers to all persons or businesses that are not covered elsewhere under these Recommendations, and which as a business, provide any of the following services to third parties: [i] acting as a formation agent of legal persons; [ii] acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons; [iii] providing a registered office; business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement; [iv] acting as (or arranging for another person to act as) a trustee of an express trust or performing the equivalent function for another form of legal arrangement; [v] acting as (or arranging for another person to act as) a nominee shareholder for another person.”*<sup>5</sup>

#### 2.1.2 EU Legislation

EU AML legislation, namely the AML Directive (‘AML’), designates TCSPs as obliged entities falling within its scope and defines them as persons who, by way of business, provide *“any of the following services to third parties: [a] the formation of companies or other legal persons; [b] acting as, or arranging for another person to act as, a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons; [c] providing a registered office, business address, correspondence or administrative address and other related services for a company, a partnership or any other legal person or arrangement; [d] acting as, or arranging for another person to act as, a trustee of an express trust or a similar legal arrangement; [e] acting as, or arranging for another person to act as, a nominee shareholder for*

<sup>2</sup> These include requirements on: [i] Customer Due Diligence; [ii] Record Keeping; [iii] Measures to be taken in relation to PEPs; [iv] new technologies; [v] reliance on third parties; and [vi] reporting of suspicious transactions.

<sup>3</sup> FATF Recommendation 28(b)

<sup>4</sup> Ibid.

<sup>5</sup> FATF Recommendations, General Glossary, Point (f) of the definition of DNFBPs



*another person other than a company listed on a regulated market that is subject to disclosure requirements in accordance with Union law or subject to equivalent international standards,”<sup>6</sup>*

It then sets out a requirement for Member States to ensure that: [i] TCSPs are licensed or registered;<sup>7</sup> and [ii] the persons who hold a management function therein or are beneficial owners thereof are fit and proper.<sup>8</sup>

Further to the above, AMLD also captures within its scope persons who provide the services of a CSP, such as auditors, accountants, notaries and other independent legal professionals. In this respect, the Directive obliges Member States to ensure that competent authorities take *“the necessary measures to prevent criminals convicted in relevant areas or their associates from holding a management function in or being the beneficial owners”<sup>9</sup>* of such entities.

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<sup>6</sup> Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (‘AMLD IV’) as amended by Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU (Text with EEA relevance) (‘AMLD V’) – Article 3(7)

<sup>7</sup> AMLD IV as amended by AMLD V – Article 47(1)

<sup>8</sup> AMLD IV as amended by AMLD V – Article 47(2)

<sup>9</sup> AMLD IV as amended by AMLD V – Article 47(3)

## 2.2 Regulation of CSPs in Malta

It may be stated that the Maltese regulatory framework for CSPs has two complementary facets: the regulatory framework for CSPs, for which the MFSA is designated as competent authority; and that relating to AML/CFT.

### 2.2.1 The Company Service Providers Act

In 2013, by virtue of Act XX, Malta adopted the Company Service Providers Act<sup>10</sup> ('CSP Act' or 'the Act') in order to implement Article 36<sup>11</sup> of AMLD III<sup>12,13</sup>. Unlike the AMLD, the FATF recommendations and local AML legislation, the Maltese financial services framework considers trust and company service providers separately with the former falling under a separate legislative instrument – the Trusts and Trustees Act<sup>14</sup>, complemented by any rules which may be issued by the MFSA in terms of the same Trusts and Trustees Act. It is the Authority's intention to maintain the distinction between the two frameworks and therefore this consultation document will focus solely on the local framework for CSPs.

The CSP Act sets out a requirement for registration with the MFSA for any person operating in or from Malta who acts as a company service provider by way of business<sup>15</sup>; however, it excludes from this requirement: [a] a person in possession of a warrant, or equivalent, to carry out the profession of advocate, notary public, legal procurator or certified public accountant;<sup>16</sup> and [b] a person authorised to act as a trustee or to provide other fiduciary duties in terms of the Trusts and Trustees Act ('TTA').<sup>17</sup> This approach had been taken on the basis of the interpretation of AMLD III at the time – the registration requirement was not imposed on such persons on the basis that they are subject to another regulatory body (e.g. the Accountancy Board for accountants). Nevertheless, such persons were, and still are, required to notify the Financial Intelligence Analysis Unit ('FIAU') that they are performing the activity of a CSP by way of business and that they are not required to register with the Authority.<sup>18</sup>

Furthermore, persons having a licence or registration to provide company services issued by an authority in an approved jurisdiction are also not subject to the registration requirement, but are required to notify the MFSA in writing of their intention to provide such services in Malta – such person would need a confirmation from the Authority that it does not object thereto.<sup>19</sup> Even though the Act exempts such persons from registration, there are still requirements which need to be satisfied prior to the Authority confirming its no objection, such as, for example, the requirement to appoint a Branch Manager and Money Laundering Reporting Officer ('MLRO').

The Act also sets out: [i] the procedure for the application for a registration;<sup>20</sup> [ii] the powers of the Authority to refuse or grant a registration – including on grounds of fitness and propriety;<sup>21</sup> [iii]

<sup>10</sup> Company Service Providers Act, Chapter 529 of the Laws of Malta

<sup>11</sup> Now Article 47 of AMLD IV as amended by AMLD V

<sup>12</sup> Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing ('AMLD III')

<sup>13</sup> CSP Act - Article 1

<sup>14</sup> Trusts and Trustees Act, Chapter 331 of the Laws of Malta

<sup>15</sup> CSP Act, Article 3(1)

<sup>16</sup> CSP Act, Article 3(1)(a) - In this respect it should be noted that, as per Rule 4 of the CSP Rules: "An accountancy firm formed in terms of Article 10 of the Accountancy Profession Act and/or an auditing firm authorised to practice in the field of auditing in terms of article 10 of the Accountancy Profession Act would be considered as being equivalent to those persons in possession of a warrant to carry out the profession of a certified public accountant and would therefore be exempt from registration under the Act."

<sup>17</sup> CSP Act, Article 3(1)(b)

<sup>18</sup> CSP Act, Article 3(3)

<sup>19</sup> CSP Act, Article 3(5)

<sup>20</sup> CSP Act, Article 4

<sup>21</sup> CSP Act, Article 5

instances where a person is considered not to be qualified to act as a CSP;<sup>22</sup> [iv] the power of the Authority to cancel a registration;<sup>23</sup> [v] the power of the Authority to issue Rules;<sup>24</sup> [vi] the administrative penalties and measures which the authority can impose;<sup>25</sup> [vii] the MFSA's regulatory and investigative powers;<sup>26</sup> [viii] offences;<sup>27</sup> and [ix] appeals.<sup>28</sup>

### 2.2.2 CSP Regulations and Rules

The Act is complemented by regulations<sup>29</sup> and rules<sup>30</sup>. Whilst the CSP Regulations provide the applicable registration and supervisory fees, the Rules, issued under Article 8 of the Act, give further detail and granularity with respect to: [i] the registration requirement<sup>31</sup> and the application process therefor; [ii] fitness and properness assessments conducted by the Authority; [iii] appointment and approval of involved parties; [iv] cessation of business; [v] general requirements; [vi] financial resources requirements;<sup>32</sup> [vii] organisational requirements; [viii] conduct of business; [ix] reporting; [x] fees and remuneration; [xi] disclosures; [xii] cooperation with regulatory authorities; [xiii] complaints; [xiv] outsourcing and [xv] enforcement.

### 2.2.3 AML Legislation

Under the Prevention of Money Laundering and Funding of Terrorism Regulations,<sup>33</sup> the definition of 'relevant activity'<sup>34</sup> includes the activity of TCSPs. Given that the definition of 'subject person'<sup>35</sup> encompasses any natural or legal person carrying out relevant financial business or relevant activity, TCSPs are subject persons for purposes of these Regulations. Likewise, the activities of those persons, who by virtue of Article 3(1) (a) and (b) of the CSP Act are exempt from the registration requirement, are also encompassed by the definition of 'relevant activity' under the PMLFTR.

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<sup>22</sup> CSP Act, Article 17 – grounds for disqualification include: [i] disqualifications under Article 142(1) of the Companies Act; [ii] conviction under any one of the various financial services legislative instruments listed; [iii] being a minor; and [iv] being subject to disqualification under Article 320 of the Companies Act.

<sup>23</sup> CSP Act, Article 6

<sup>24</sup> CSP Act, Article 8

<sup>25</sup> CSP Act, Article 9

<sup>26</sup> CSP Act, Article 10 to 14

<sup>27</sup> CSP Act, Article 15

<sup>28</sup> CSP Act, Article 16

<sup>29</sup> Company Service Providers Regulations, S.L. 529.01 ('the Regulations')

<sup>30</sup> MFSA Rules for Company Service Providers ('the Rules')

<sup>31</sup> It is important to note that the rules contain a *de minimis* rule for the purposes of establishing whether an individual is holding himself out as providing directorship services by way of business.

<sup>32</sup> Commercial partnerships must have an initial paid up share capital of €5,000 which must be maintained at all times; Natural persons must have a working capital, of €2,500 which must also be maintained at all times.

<sup>33</sup> Prevention of Money Laundering and Funding of Terrorism Regulations ('PMLFTR'), S.L. 373.01,

<sup>34</sup> PMLFTR, Regulation 2(1)

<sup>35</sup> Ibid.

### 3 A proposal for a holistic regulatory framework for CSPs in Malta

#### 3.1 Introduction

CSPs are crucial, within the financial services framework, for market integrity as the structures which they set up may have wide-ranging effects and uses within the financial sector as a whole. Given that they are often the first point of contact for persons wishing to undertake business activity in Malta, CSPs are in fact considered as gatekeepers. In this light they have a role of preventing persons who are not fit and proper from entering the financial system. The scrutiny of Company Service Providers is taken very seriously in view of the heightened risks which the sector may pose. Through this proposal the Authority aims to raise standards for all persons providing the services of a CSP by harmonising market entry requirements and addressing existing expectations gaps. The proposals being made also seek to address the concerns raised within the Mutual Evaluation Report<sup>36</sup> recently published by the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism ('Moneyval').

#### 3.2 Extending the Role of CSPs

To consolidate CSPs' role as gatekeepers to the local financial system, the Authority is considering extending the role of CSPs to include guidance on and the submission of documentation of all prospective applicants for authorisation with the MFSA. In this respect, prospective applicants for authorisation would be required to engage a CSP in order to proceed with their application.

Currently the CSP Act defines a CSP as:

*"... any natural or legal person which, by way of business, provides any of the following services to third parties:*

*(a) formation of companies or other legal entities;*

*(b) acting as or arranging for another person to act as director or secretary of a company, a partner in a partnership or in a similar position in relation to other legal entities;*

*(c) provision of a registered office, a business correspondence or administrative address and other related services for a company, a partnership or any other legal entity;"*

In order to extend the role of a CSP, this definition would need to be amended in order to include a new service. The following new paragraph (d) is being proposed:

*"(d) provision of guidance on and the submission of applications for licensing, registration, recognition or for any other authorisation that is required to be issued by the Authority;"*

Furthermore, sectoral legislation would also need to be amended in order to mandate that persons seeking authorisation are to submit their licence application to the Authority, through a CSP. In order not to impinge on fair competition, the Authority believes that applicants seeking authorisation to act

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<sup>36</sup> Moneyval, Fifth Round Mutual Evaluation Report, AML and CFT Measures, Malta – available online at: <https://rm.coe.int/moneyval-2019-5-5th-round-mer-malta2/168097396c>

as trustees or CSPs should be allowed to continue to apply for authorisation with the Authority directly. In this respect, the requirement to apply for authorisation with the Authority through a CSP will not be implemented with respect to trustees and CSPs.

**Q1 What are your views on the Authority’s proposal to extend the role of a CSP?**

**3.3** Categorisation of CSPs

The Authority is proposing categorising CSPs into classes as follows:

CSP Class	Activity allowed
Class A CSPs	<i>Licence holders authorised to provide the following services to third parties: (i) formation of companies or other legal entities; and/or (ii) provision of a registered office, a business correspondence or administrative address and other related services for a company, a partnership or any other legal entity</i>
Class B CSPs	<i>Licence holders authorised to provide any CSP service but not the provision of professional assistance in the submission of applications for licensing, registration, recognition or any other authorisation issued by the Authority</i>
Class C CSPs	<i>Licence holders authorised to provide any CSP service</i>

In this respect:

- Class A CSPs will be authorised to provide the following services to third parties: (i) formation of companies or other legal entities; (ii) provision of a registered office, a business correspondence or administrative address and other related services for a company, a partnership or any other legal entity.
- Class B CSPs will be authorised to provide the following services to third parties: (i) formation of companies or other legal entities; (ii) the provision of a registered office, a business correspondence or administrative address and other related services for a company, a partnership or any other legal entity; (iii) acting as or arranging for another person to act as director or secretary of a company, a partner in a partnership or in a similar position in relation to other legal entities (i.e. the same services as Class A and an additional service).
- Class C CSPs will be authorised to provide the following services to third parties: (i) formation of companies or other legal entities; (ii) the provision of a registered office, a business correspondence or administrative address and other related services for a company, a partnership or any other legal entity; (iii) acting as or arranging for another person to act as director or secretary of a company, a partner in a partnership or in a similar position in relation

to other legal entities; [iv] provision of guidance on and the submission of applications for licensing, registration, recognition or for any other authorisation that is required to be issued by the Authority (i.e. the same services as Class B and an additional service).

The authorisation will also specify the services which the CSP can provide. Different requirements will be introduced for the respective classes. This categorisation should assist the MFSA in applying a risk based supervisory approach for CSPs. That being stated, the categorisation being proposed will not affect the AML/CFT obligations of CSPs.

## Q2 What are your views on the proposed categorisation of CSPs?

### 3.4 Ancillary Activities

The Authority is aware that a number of CSPs also provide services such as compliance services, risk management, AML assistance etc. as ancillary services in terms of Article 5 of the CSP Act. Article 5 *inter alia* states that:

*“...The Authority shall not, without prejudice to article 3, grant a registration applied for under this Act unless it is satisfied that:*

*...*

*(c) where the applicant is a company or other type of legal entity:*

*(i) its objects include acting as company service provider and carrying on activities ancillary or incidental thereto, and do not include objects which are not compatible with the services of a company service provider;*

*...”*

The Authority is planning to introduce guidance on what constitutes an ancillary activity and matters which are not deemed to be compatible with the services of a CSP.

### 3.5 Market Entry Requirements

#### 3.5.1 Persons requiring Authorisation as a CSP

As stated in Section 2.2.1, the CSP Act exempts a number of persons from the registration requirement thereunder. Experience and engagement with the industry and competent authorities have shown that this has resulted in a large number of persons providing CSP services falling outside the *sui generis* framework which has, in turn, led to unequal market entry requirements. In this light it is being proposed that the authorisation requirement under the CSP Act is widened by removing: [i] the exemption from registration for advocates, notaries, legal procurators and accountants; and [ii] the notification requirement for persons having a licence or registration to provide company services in an approved jurisdiction and converting it to a full authorisation requirement. The Authority is also considering revisiting the *de minimis* rule to address the concerns raised by Moneyval<sup>37</sup> and to eliminate any existing supervisory gaps.

<sup>37</sup> In this respect reference should be made to the Moneyval Report paragraphs 420 to 422

In view of their regulated status, the exemption for persons authorised to act as a trustee or to provide other fiduciary duties in terms of the Trusts and Trustees Act will be retained. However, in such circumstances, authorised trustees or fiduciaries are required to inform the Authority if they also provide company services.

In this manner, any person providing the services of a CSP would require authorisation thereby ensuring that all CSPs are being subjected to harmonised market entry measures and more rigorous fitness and propriety assessments prior to operating.

Further to the above, given that an overlap may exist between the activity of a CSP and an Insurance Manager as defined under the Insurance Distribution Act,<sup>38</sup> the Authority is also considering introducing an exemption for such persons, solely for the purpose of the activities they provide under the said Act.

The Authority wishes to emphasise that, going forward, the Company Service Providers Act will refer to the licensing, rather than to the registration, of CSPs.

**Q3**

**Do you agree with the Authority's proposal to extend** the authorisation requirement to all persons providing the service of a CSP in or from within Malta?

### 3.5.2 Legal Personality Requirement

The Authority is cognisant that a number of requirements, such as those relating *inter alia* to systems and controls, effective financial crime compliance, the three lines of defence and the "four eyes principle", may prove difficult for natural persons to implement. In this light, the Authority is considering introducing a requirement for persons wishing to be authorised as CSPs to be a legal person established either in Malta or in another recognised jurisdiction.<sup>39</sup>

**Q4**

What are your views on the Authority's **proposal to require** CSPs to be legal persons?

<sup>38</sup> Insurance Distribution Act, Chapter 487 of the laws of Malta

<sup>39</sup> "recognised jurisdiction" means a member of the European Union or the EEA or the Organisation for Economic Co-operation and Development as well as any other jurisdiction approved by notice of the Minister from time to time for the purpose of this definition;

### 3.5.3 The Appointment of 'Designated Persons'

It is also being proposed that CSPs providing the services listed in paragraph (b)<sup>40</sup> in section 3.2 above and CSPs providing the service being proposed as a new paragraph (d) in section 3.2,<sup>41</sup> are required to appoint a minimum of two 'Designated Persons'. The Authority will be keeping the discretion to require such CSPs to appoint more than two Designated Persons depending on the nature, size and complexity of the activities carried out by the CSP in question.

For CSPs providing the service listed in paragraph (b) in section 3.2, specifically where the CSP is "*arranging for another person to act as director or secretary of a company, a partner in a partnership or in a similar position in relation to other legal entities*", the Designated Person would be that person who may be appointed to act as director or secretary of a company, a partner in a partnership or in a similar position in relation to other legal entities. In this regard, it is being proposed that the framework is amended in order to ensure that, apart from the CSP itself, only a Designated Person may be appointed to perform such a role. This requirement should lead to increased transparency by ensuring that only MFSA approved CSPs and Designated Persons, who would both be approved by the Authority, may be engaged to act in client companies.

For CSPs providing the service being proposed as a new paragraph (d), the Designated Person will be that person who is providing professional assistance in the submission of applications for licensing, registration, recognition or any other authorisation issued by the Authority.

In both cases the role of a Designated Person can be performed by an executive director of the CSP.

**Q5**

Do you agree with the requirement for a CSPs providing the services in **paragraphs (b) and (d) to appoint 'Designated Persons'?**

### 3.5.4 Enhanced Competence Assessments

In order to ensure that all CSPs are sufficiently competent to fulfil their role, the Authority is proposing enhancing competence assessments for: [i] Designated Persons; [ii] proposed MLROs and Compliance Officers; and [iii] natural persons who are members of the Board of Directors of the CSP. The proposed assessment will be based on two pillars: [i] Experience and Educational Background – the Authority will assess applicants' curriculum vitae; taking work experience, education and training attended in relation to the services such person wishes to provide, into consideration; and [ii] where the Authority deems it necessary, on the basis of a risk-based assessment, a *viva voce* Assessment – applicants will be asked to attend for an interview with the Authority whereby a number of questions on the CSP's role shall be asked and on the responsibilities associated with the office applied for. Should the Authority decide to take up this proposed way forward, it would then issue detailed guidelines and procedures thereon.

**Q6**

Do you agree with the Authority's proposal vis-à-vis competence assessments?

<sup>40</sup> acting as or arranging for another person to act as director or secretary of a company, a partner in a partnership or in a similar position in relation to other legal entities;

<sup>41</sup> providing professional assistance in the submission of applications for licensing, registration, recognition or any other authorisation issued by the Authority



### 3.5.5 Rigorous assessments of CSPs' client on-boarding processes

Given that, as per Section 3.2, the Authority is seeking to strengthen CSPs' role as gatekeepers to the Maltese financial sector, the Authority is proposing that their client onboarding systems and processes are thoroughly scrutinised by the MFSA prior to authorisation.

Furthermore, for CSPs providing the proposed new service listed in paragraph (d) in section 3.2, the MFSA is proposing that CSPs conduct a fitness and properness assessment on prospective clients seeking such service, prior to their on-boarding.<sup>42</sup> A requirement to inform the Authority where any person fails such a fitness and properness assessment would also be introduced in order to ensure that the first line of defence is not circumvented through forum shopping.

On the other hand, CSPs providing services, other than the one listed in the proposed new paragraph (d) in section 3.2 would not need to assess the fitness and properness of their clients but rather would need to comply with the applicable AML/CFT requirements on a risk sensitive basis. Any reporting that would become necessary in these circumstances should only be done to the FIAU.

#### **Q7** Do you agree with the Authority's proposals in this regard?

### 3.5.6 Capital Requirements

As stated under Section 2.2.2, under the current framework, commercial partnerships must have an initial paid up share capital of €5,000 which must be maintained at all times; natural persons must have a working capital of €2,500 which must also be maintained at all times. In view of the inherent risks of the sector, the Authority is proposing raising the initial capital requirements as follows:

CSP Class	Capital Requirement
Class A CSPs	€30,000
Class B CSPs	€50,000 + Mandatory PII
Class C CSPs	€150,000 + Mandatory PII

It is proposed that the capital requirement would be required to be fully paid up and maintained at all times.

#### **Q8** What are your thoughts on the proposed Capital Requirements?

<sup>42</sup> It is emphasised that these checks will not replace the fitness and properness assessments performed by the Authority, but would, in essence, act as a first filter.

### 3.6 Ongoing Requirements

#### 3.6.1 Governance

As part of the initiative to raise the bar for CSPs, the MFSA is proposing strengthening the governance requirements which are currently set out within the CSP rules. Whilst the Authority's expectations with respect to existent requirements<sup>43</sup> will be made clearer, new rules regarding, for example, business continuity, ongoing monitoring of policies and procedures, cyber security and risk assessment, will be proposed.

**Q9** Kindly provide us with your feedback on the above proposal.

The Authority considers strong corporate governance to be crucial. Experience has shown that weak governance structures may result in failures in institutions. In this respect, as part of the Authority's supervisory engagement for 2020, and notwithstanding the reforms being put forward in this document, the Authority is planning to conduct a thematic review on the corporate governance of CSPs.

#### 3.6.2 Risk Management

The Authority is proposing introducing requirements on risk management. These would *inter alia* include requirements, which complement those already existent under the PMLFTR and the Implementing Procedures – Part I, for CSPs to have appropriate policies and procedures in place to ensure that all risks are appropriately identified, managed and mitigated. Such policies and procedures would therefore be required to cover all aspects of CSPs' business, including but not limited to AML. The Authority is also proposing the introduction of a requirement for CSPs to keep a risk register vis-à-vis their clients<sup>44</sup> and a requirement for certain CSPs<sup>45</sup> to have a Risk and/or Audit Committee.

**Q10** Do you agree with the proposals put forward by the Authority?

#### 3.6.3 Compliance

In order to ensure high standards, it is being proposed that persons proposed to perform the roles of Compliance Officer and MLRO within a CSP are subject to the same rigorous competence assessment to which Designated Persons are subject. In order to ensure independence and avoid conflict of interests, Designated Persons may not be appointed Compliance Officer or MLRO.

Specifically, with respect to the MLRO, it will be ensured that the competence assessment complements already existing requirements under the PMLFTR and the Implementing Procedures.

<sup>43</sup> These include requirements on dual control, policies and procedures, etc.

<sup>44</sup> This register would list the CSP's clients and identify the risks inherent to the business model of each.

<sup>45</sup> In this respect a risk-based approach may be taken – the requirement may, for example, be applicable to CSPs which have a complex business model or are of a large size.

**Q11** What are your views on the Authority's proposal?

3.6.4 Time Commitment

The Authority is proposing the introduction of rules to oblige CSPs "*arranging for another person to act as director or secretary of a company, a partner in a partnership or in a similar position in relation to other legal entities*" to perform a quantitative and qualitative assessment of time commitment to ensure that Designated Persons are capable of committing sufficient time to perform their functions efficiently and effectively. In this respect one may refer to Section 5 of the [Guidance on the fitness and properness assessments applied by the Authority](#) that was issued on 2<sup>nd</sup> July 2019.

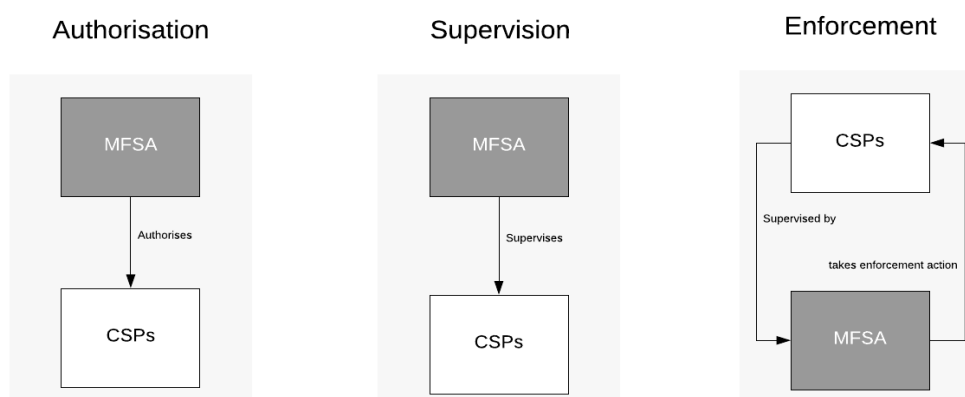
**Q12** What are your views on the introduction of this requirement?

## 4 The Institutional Architecture for the Supervision of CSPs

As part of its regulatory strategy to raise the standards of supervision, the Authority is also considering a revamp of the institutional architecture for the supervision of CSPs. All persons currently exempt from registration will fall under a framework for the authorisation and supervision of CSPs. The Authority foresees two options for a way forward as follows:

### 4.1 Option A – Maintaining the current Institutional Architecture

The first possible option is to maintain the current institutional architecture - i.e. the MFSA being the regulator for CSPs falling within scope of the CSP Act. Under this regulatory model, the Authority is responsible for the authorisation and supervision of CSPs, as well as for the enforcement of any breaches of the regulatory framework. The graphical representation below summarises this regulatory model.



### 4.2 Option B – A Hybrid Supervisory Model

The second option is to promulgate a hybrid supervisory model which involves both the Authority and Self-Regulatory Organisations ('SROs'). In this respect, reference should be made to Article 48(9) of the AML Directive, whereby it is stated that:

*"In the case of the obliged entities referred to in point (3)(a), (b) and (d) of Article 2(1), Member States may allow the functions referred to in paragraph 1 of this Article to be performed by self-regulatory bodies, provided that those self-regulatory bodies comply with paragraph 2 of this Article."*

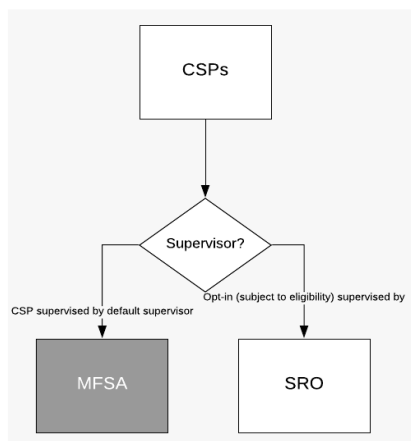
It should be noted that AMLD only makes reference to points (3) (a)<sup>46</sup>, (b)<sup>47</sup> and (d)<sup>48</sup> of Article 2(1), neither of which includes TCSPs. Given that TCSPs are explicitly excluded from Article 48(9), it is understood that only those CSPs covered by points 3(a) and (b) of Article 2(1) may be supervised by an SRO.

## 4.2.1 Authorisation

Whilst FATF Recommendation 28(b) provides for the possibility for an SRO to be involved both in the supervision and also in the authorisation of all DNFBPs (other than casinos), as stated, Article 48(9) of AMLD provides that in the case of auditors/accountants, legal professions and estate agents, Member States may allow supervision to be performed by SROs. The AMLD, however, does not permit SROs to perform the authorisation function. Indeed, Article 47 of the Directive, which deals with the necessary measures to prevent criminals or their associates from holding a management function or being the beneficial owner of auditors/accountants, legal professionals and estate agents, refers to “*competent authorities*”. In this light, the Authority is of the view that the authorisation process of all CSPs must be carried out by a competent authority and not by an SRO.

## 4.2.2 Supervision

The MFSA would be designated as the default supervisor for all CSPs; however a CSP, which is covered by points 3(a)<sup>49</sup> and (b)<sup>50</sup> of Article 2(1) of AMLD and which meets certain specified objective criteria,<sup>51</sup> may be able to opt to be supervised by an SRO of its choice. Where a CSP opts to be supervised by an SRO, the SRO would supervise that CSP on the basis of the Rules issued by the MFSA. Given that the MFSA is an agent of the FIAU in relation to the supervision of financial crime compliance, in terms of this option, SROs would also be responsible to supervise CSPs on the basis of the FIAU’s requirements vis-à-vis AML. This supervisory model is graphically represented hereunder for ease of reference.



<sup>46</sup> auditors, external accountants and tax advisors

<sup>47</sup> notaries and other independent legal professionals, where they participate, whether by acting on behalf of and for their client in any financial or real estate transaction, or by assisting in the planning or carrying out of transactions for their client concerning the: (i) buying and selling of real property or business entities; (ii) managing of client money, securities or other assets; (iii) opening or management of bank, savings or securities accounts; (iv) organisation of contributions necessary for the creation, operation or management of companies; (v) creation, operation or management of trusts, companies, foundations, or similar structures

<sup>48</sup> estate agents

<sup>49</sup> auditors, external accountants and tax advisors

<sup>50</sup> Ibid 47.

<sup>51</sup> In this respect, a risk based approach based on the size and complexity of the business of the CSP may be adopted.

In line with international standards,<sup>52</sup> SROs would be authorised and supervised by the MFSA. It is also being proposed that SROs are granted supervisory powers, through regulatory initiatives, which will enable them to effectively supervise its members (i.e. CSPs).

### 4.2.3 Enforcement

Given that supervision may be performed by the Authority or by an SRO, the enforcement process could be conducted as follows: [i] where supervision is performed by the MFSA – in the traditional manner (as set out in Section 4.1 above); and [ii] where supervision is performed by an SRO - the SRO would effectively replace the Authority's supervisory function, and report issues to the Enforcement Directorate, which would, following investigatory work, raise the matter with the Enforcement Decisions Committee ('EDC'). In both scenarios, it would be the EDC which takes enforcement action, thus ensuring that the principles of natural justice are respected. With respect to AML matters, given that the SRO would replace the MFSA's Financial Crime Compliance Function, any matters requiring further attention would be forwarded to the FIAU. It is also proposed that SROs are granted the power to terminate membership. Furthermore, given that SROs would be regulated by the Authority, they would be also be subject to enforcement action should they be in breach of their obligations – in such a case it would be the Authority, through the EDC, which takes enforcement action.

**Q13** What are your views on the above two Options?

**Q14** With respect to Option B, which CSPs should have the option to opt-out and be supervised by an SRO? Which objective criteria should be taken into consideration?

## 4.3 The Authority's preferred Option

The Authority, whilst presenting both options to stakeholders for feedback considers Option A as the preferred option in view of implications arising from the Moneyval report. The Authority would therefore be responsible for authorisation, supervision and enforcement with respect to CSPs.

**Q15** Your comments/feedback in relation to the institutional framework would be appreciated.

In its assessment of the supervisory model for CSPs, the Authority has also considered a proposal from the industry for a full self-regulatory model; however, this was not considered to be a viable option given Article 48(9) of the AML Directive (explained in Section 4.2 above).

<sup>52</sup> Reference may be made, for example, to Principle 9 of IOSCO's Principles for Securities Regulation

## 5 Implementing the reforms to the Framework

In order to implement reforms to the CSP framework, the Authority is proposing the following:

- 1) *Extensive amendments to legislation* – Amendments are required for the Act to cater for any of the above-mentioned proposals. Given that the Authority plans to raise the bar vis-à-vis competence assessments of CSPs, and to shift from a registration regime to a framework which requires licensing, it is being proposed that all persons currently providing such services are asked to reapply for authorisation. Should this course be taken, the Act would also need to include transitory provisions to give all affected persons time within which to comply with the Act and reapply, and existing CSPs who are currently exempt from registration sufficient time to align themselves with the Act and to apply for authorisation. If a decision to introduce SROs is taken, then amendments to the Act would be required accordingly. Furthermore, should the function of a CSP be extended, sectoral legislation would also need to be amended in order to make it a requirement for persons seeking authorisation to apply with the authority through a CSP.
- 2) *Revisiting the CSP Regulations* – should the decision be taken to introduce SROs, fees for their authorisation and supervision would need to be introduced.
- 3) *Rethinking the rules for CSPs* – as stated in this document, it is being proposed that the bar should be raised, *inter alia* with respect to: [i] Competence Assessments; [ii] the KYC processes employed by CSPs; [iii] more robust governance, risk, compliance and conduct of business requirements; and [iv] higher capital requirements. The implementation of any of these proposals would require changes to the Rules. The Authority shall also be putting forward further amendments to address certain matters which have come to its attention during the past years based on supervisory experience.
- 4) *The introduction of rules for SROs* – Should the decision be taken to introduce SROs into the Maltese framework, it is being proposed that rules similar to those for regulated markets, which provide requirements for [i] membership/admission to the SRO; [ii] governance; [iii] conduct of business; [iii] bye-laws, as well as; [iv] the exercise of supervisory<sup>53</sup> and enforcement powers; are introduced. Furthermore, the Authority is aware that Self-Regulation may potentially pose a risk of regulatory capture. In this regard, in order to mitigate such risk, as part of the proposed framework the Authority will be implementing a number of measures to mitigate conflicts of interest, such as requirements for: [i] robust internal conflict of interest policies; [ii] conflict of interest reporting mechanisms which include explanations of how such risks are being mitigated; [iii] operational independence; and [iv] the avoidance of anti-competitive behaviour and abuse of position. The Authority will also be putting forward rules which will assess the competence of persons involved in SROs, as well as requirements for Continuous Professional Education ('CPE').

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<sup>53</sup> In this respect, the rules may, for example, introduce a requirement for an SRO to conduct an on-site inspection at a specified percentage of its members etc.

In line with the Authority's Vision to enhance stakeholder engagement, draft versions of the proposed legislative amendments, regulations and rules, will be issued for public consultation in the coming months.

In the coming weeks the Authority shall also be reaching out to a number of groups representing stakeholders in order to discuss its proposals and any preliminary feedback they may have.

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**Q16** What are your thoughts on the above action points?

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## 6 Conclusion

The MFSA is seeking feedback from stakeholders prior to proceeding with detailed proposals on the implementation of the regulatory initiatives presented in this document.

The consultation is open to the public until 22 November 2019. Industry Participants and interested parties are invited to send their responses via email to [CSPframework@mfsa.mt](mailto:CSPframework@mfsa.mt).

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