

RAISING THE BAR FOR COMPANY SERVICE PROVIDERS

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Foreword by the CEO



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Following the consultation exercise on Raising the Bar for Company Service Providers ('CSPs'), the Malta Financial Services Authority ('MFSA' or 'the Authority') has received numerous responses from a wide range of industry participants. The Authority has carefully considered all feedback received, held meetings with a number of stakeholders, and is today publishing a Feedback Statement setting out its positions.

This Feedback Statement puts forward a reform which will bring a number of persons, who are currently exempt from, or who currently do not require registration, within the scope of the Act and therefore subject to registration. The proposed reform will generally raise standards for CSPs by updating, upgrading and converging the requirements of the current framework to establish a more consistent, coordinated, robust and proportionate risk-based approach, in order to protect the integrity and improve the governance of this particular sector.

In this regard, the Authority has revisited its proposals regarding the regulatory framework for CSPs, in view of feedback received, and whilst some positions have been retained, others have been revised. In doing so, the MFSA has kept the objectives of: [i] raising standards for CSPs across the board; and [ii] addressing the concerns raised by MONEYVAL within the Mutual Evaluation Report; at the forefront of its agenda.

Specifically, with respect to the considerations regarding the institutional architecture of CSPs in Malta, the Authority will remain responsible for authorisation, supervision and enforcement with respect to the CSP Act.

We are aware that certain changes which are being proposed in this document cannot take place instantly and therefore the new framework will provide for a stepped approach which will allow stakeholders sufficient time to align themselves to the new requirements.

The Authority is also, by virtue of its proposal for a review clause, committing itself to reassess its position and re-evaluate the effectiveness and efficacy of the framework as promulgated, at a future date.

1 Introduction

On 22 October 2019, the Malta Financial Services Authority ('MFSA' or 'the Authority') issued a [Consultation Document](#) intended to raise the bar for persons offering the services of a Company Service Provider ('CSP').

To achieve this objective, the Authority put forward a number of proposals to review the regulatory framework and the institutional architecture for the regulation of CSPs. The main proposals included:

- [i] extending the role of a CSP to include guidance, on the submission of documentation of all prospective applicants for authorisation with the MFSA;
- [ii] the introduction of CSP licence classes to better apply a risk-based approach to regulation and supervision;
- [iii] revisiting the current exemptions from registration and the *de minimis* rule;
- [iv] a legal personality requirement for CSP authorisation;
- [v] the appointment of designated persons;
- [vi] enhanced competence assessments for directors, compliance officers, MLROs and designated persons of CSPs;
- [vii] rigorous assessments of client on-boarding processes;
- [viii] raising the capital requirements to ensure financial soundness; and
- [ix] strengthening requirements with respect to governance, compliance and risk management.

The Consultation Document also presented two options vis-à-vis the institutional architecture for the regulation of CSPs, as follows:

- [i] 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.

The Authority identified the first option as the preferred way forward.

The MFSA received over 50 responses from a wide range of industry participants and interested parties. Respondents included regulated entities, associations and groups, law firms and consultancy firms.

This Feedback Statement highlights the salient points of responses received and sets out the MFSA's response and position thereto. The last section outlines the next steps that will be taken to adopt and implement the changes.

The contents of this document should be read in conjunction with the Consultation Document of the 22 October 2019.

2 Feedback Statement

2.1 General

The MFSA would like to thank stakeholders for the large number of valid contributions received. These are both welcome and appreciated. Particular aspects of the consultation document attracted more feedback than others. The Authority has taken careful note of all responses even if opposing views were, at times, difficult to reconcile.

Due to the diversity of responses received, in formulating its adopted position, the Authority has sought to primarily remain faithful to the general objective put forward in the consultation document – raising standards for all persons providing CSP services and addressing the concerns raised within the Mutual Evaluation Report¹ published by the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism ('MONEYVAL'), particularly those relating to market entry requirements.

The MFSA's position seeks to update, upgrade and converge the requirements of the current framework to establish a more consistent, coordinated, robust and proportionate risk-based approach to protect the integrity and improve the governance of this particular sector.

The Authority is cognisant that certain changes which are being proposed in this document cannot take place overnight and therefore the new framework will provide for a stepped approach which will allow stakeholders sufficient time to align themselves to the new requirements.

2.2 Extending the Role of CSPs

In order to consolidate CSPs' role as gatekeepers to the local financial system, the Authority had proposed 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 duly/specifically authorised CSP to proceed with their application.

Feedback received

The majority of respondents did not agree with this proposal. Respondents expressed concerns that this would lead to higher expenses for prospective applicants and would create a barrier to entry, particularly for SMEs. It was also argued that certain entities, such as large international firms, would have in-house skills which would allow them to effectively manage the application process.

Moreover, several respondents lamented the fact that this proposal would effectively exclude warranted professionals from conducting this activity. It was highlighted that the skillset required to assist in a licence application process was different from that necessitated for CSP activity and that therefore some CSPs may not have the required experience in this respect.

¹ 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>

Respondents recommended that a separate regulatory framework should be issued to regulate persons providing guidance and assistance with the submission of applications for licensing, registration or any other authorisation that is to be issued by the Authority. In this respect, a respondent suggested that the MFSA sets up a list of accredited professional advisors, meeting pre-established criteria, who would be considered as being competent to manage and advise on applications for authorisation with the Authority.

Respondents who supported the proposal suggested that it would improve the quality of applications reaching the Authority, and that this would, in turn, improve the Authority's turnover time with respect to authorisations. Other respondents recommended that the proposal is implemented with an exemption being provided, on a case-by-case basis for entities which are already authorised by the Authority.

One respondent suggested that rather than extending the services of a CSP to cater for this new role, the Authority should provide more guidance for prospective applicants.

MFSA Position

The Authority has revised its position and the proposal made in this respect will be revisited separately at a future date. The Authority agrees that the provision of professional assistance in the submission of applications for licensing, registration, recognition or any other authorisation issued by the Authority should be considered as a service which is distinct to that of a CSP and is therefore considering an *ad hoc* standard in this respect. This would be the subject of a separate consultation exercise that would focus on the quality of applications to be submitted to the Authority and standards related to the application process.

2.3 Categorisation of CSPs

In order to better apply a risk-based approach to regulation and supervision, the Authority had proposed categorising CSPs into the following classes:

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>

Feedback received

The Authority received mixed responses in this respect. Whilst several respondents welcomed the Authority's proposed approach, others disagreed, arguing that categorisation was not necessary. In this regard, certain respondents also questioned how the respective services were

classified, arguing, for example, that company formation is riskier than the provision of a registered office.

MFSA Position

The MFSA position set out in Section 2.2 above (on Extending the role of CSPs), as well as those which will be put forward in subsequent sections, necessitate a change in the categorisation as proposed. The Authority shall therefore be categorising CSPs into the following classes:

CSP Class	Activity allowed
Class A CSP	<i>A Registered person authorised to provide, by way of its business, 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 CSP	<i>A Registered person authorised to provide, by way of its business, the following service to third parties: 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>
Class C CSP	<i>A Registered person authorised to provide, by way of its business, any CSP service.</i>

In this respect:

- A Class A CSP will be authorised to provide, by way of its business, only 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.
- A Class B CSP will be authorised to provide, by way of its business, only the following service to third parties: 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.
- A Class C CSP will be authorised to provide, by way of its business, 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; and (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. all CSP services).

2.4 Ancillary Activities

Within the Consultation Document, the Authority had stated that the introduction of guidance, on what constitutes an ancillary activity and matters which are not deemed to be compatible with the services of a CSP, was planned.

Feedback received

Whilst, as stated in Section 2.3 above, some respondents requested certain clarifications with respect to ancillary activities, this proposal was positively received by the large majority of respondents.

MFSA Position

In this respect the Authority's position remains unchanged i.e. the MFSA will introduce guidance on what constitutes an ancillary activity and matters which are not deemed to be compatible with the service of a CSP.

2.5 Market Entry Requirements

2.5.1 Persons requiring Authorisation as a CSP

The MFSA had 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; [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; and [iii] revisiting the *de minimis* rule. This proposal sought to address the concerns raised by MONEYVAL² in particular those relating to access checks and to eliminate any existing supervisory gaps. The Authority also proposed that, given 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. An exemption for Insurance Managers, as defined under the Insurance Distribution Act³, was also being considered. The Authority also proposed that the registration requirement changes to a licensing requirement.

Feedback received

Whilst some respondents agreed with the MFSA's proposal to extend the authorisation requirement to all persons providing CSPs services, most respondents expressed concern.

Several respondents stressed that warranted professionals: [i] perform CSP activity as a natural extension of their profession; [ii] are already subject to AML/CFT supervision; and [iii] are to be considered competent in view of their academic background. In this light, some respondents proposed that only an assessment on whether they can dedicate sufficient time to perform their functions effectively should be carried out.

Respondents who were in favour of the MFSA's proposal to remove exemptions generally highlighted that this would lead to better compliance, and the harmonisation of market entry requirements.

² In this respect reference should be made to the MONEYVAL Report paragraphs 420 to 422

³ Insurance Distribution Act, Chapter 487 of the Laws of Malta

Whilst some respondents suggested a threshold to allow warranted professionals to provide certain CSP services without licence, others recommended that the Authority should allow exceptions with respect to certain services, such as the formation of companies. In this respect a group representing a substantial amount of stakeholders suggested that [i] warranted professions should continue to be regulated within their respective professional environment; and that [ii] the competent authority for AML/CFT supervision should be the FIAU; and [iii] that as part of their registration, lawyers and accountants would need to declare [a] whether in the previous financial year their combined revenue from corporate services was in excess of 35% of their total revenue – to be confirmed through a self-declaration; and [b] a forecast of whether in the forthcoming financial year their combined revenue from corporate services is expected to exceed 35% of their combined revenue from the provision of all professional services; and [c] the nature of corporate services they provide. It was proposed that where the 35% threshold is exceeded, the respective professional would be regulated as a CSP (MFSA and FIAU). If not, said persons would be regulated within their respective professional environment and by the FIAU. It was also proposed that lawyers and accountants who do not exceed the threshold may still opt to obtain authorisation from the MFSA for the provision of CSP services.

Whilst some stakeholders questioned the retention of the exemption for trustees, the majority agreed with the proposal of removing 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. In their view, these persons should be subjected to the MFSA's authorisation process rather than a mere notification requirement.

The Authority also received mixed feedback with regard to the proposal of revisiting the *de minimis* rule. Several respondents stated that reducing the existing quota concerning the provision of company director services will lead to a loss of expert professionals that bring a valuable contribution to board discussions. Furthermore, it was suggested that this may bring about an increase in directors' fees. On the other hand, other participants stated that by revisiting the *de minimis* rule, the oversight of persons providing directorship services would be enhanced, given that they would fall within scope of the CSP Act. Furthermore, a group of respondents suggested a *de minimis* threshold to be applied to accountants who fall within the 35% threshold on the number of directorships as follows: [i] for regulated business – the rules which apply today should be retained; [ii] for unregulated business – based on a reasonable time allowance to enable persons providing such services adequate time to be devoted to the companies of which they are directors (full time non-executive directors having no directorships of regulated entities - 30 companies; and part-time non-executive directors having no directorships of regulated entities – 15 directorships). Directorships for companies within the same group are to be considered as one directorship.

The introduction of a passporting regime for CSPs was also suggested.

MFSA position

The Authority acknowledges that this proposal was one of the most significant within the consultation document and that responses received were mixed and numerous. The Authority's position is set out hereunder.

i. Removal of the exemption for warranted professionals

The MFSA recognises that certain respondents consider the ex-post notification to the FIAU made by those professionals currently exempt under the CSP Act to be sufficient for the purpose. However, the Authority also believes that in order to harmonise market-entry requirements all CSPs should be subject to an authorisation requirement and therefore to ex-

ante checks before they start providing CSP services in any Class or Classes. In this respect, the Authority maintains its position that the exemption from registration for advocates, notaries, legal procurators and accountants should be removed. That being stated, the Authority will be giving due recognition to the professional qualification and warrant when assessing competence as part of the fitness and properness assessment conducted by the Authority.

Furthermore, the Authority acknowledges that some of these practitioners provide corporate services within a wider portfolio of services being provided to clients. In such instances, and based on verifiable information to be obtained by the Authority, both at application stage and on an ongoing basis, such persons may be subjected to less onerous requirements and controls, wherein the Authority, in deciding whether a service provider qualifies for the lighter touch approach or not, will *inter alia* give due regard to actual and/or projected revenue from CSP activities as part of total services provided or to be provided.

- ii. Removing 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 will be proposing that the notification requirement is slightly amended. In this respect the Authority will retain the current position with respect to persons having a licence or registration to provide CSP services in EU and EEA States; however, with respect to those persons having a licence or registration to provide services in third countries, it will be made clearer that it is only those persons having such authorisation in a third country which, in the opinion of the Authority, has an equivalent authorisation framework, which can benefit from this procedure.

- iii. Revisiting the *de minimis* rule

Given that it is the Authority's position that all CSPs are to be registered, the *de minimis* rule has been re-thought.

Solely with respect to Class B CSPs, in so far as they are acting as director or secretary of a company, a partner in a partnership or in a similar position in relation to other legal entities - the Authority is putting forward the below threshold:

- o Directors or secretaries of a company, partners in a partnership or in a similar position in relation to other legal entities having no such involvements with MFS regulated entities - 5 involvements;

Persons not exceeding such thresholds, will still be subject to a registration requirement, including access checks and controls; but will be subjected to a lighter touch approach.

- i. Exemptions

The Authority is of the view that the exemption for trustees is to be retained.

Furthermore, the Authority is also considering proposing waivers from registration for:

- a) VFA Agents, registered under the Virtual Financial Assets Act - given that such persons may require to perform CSP activity as part of their business and that such persons are already subject to rigorous regulation;
- b) Persons who act as director or secretary solely of entities licensed by the Authority and whose roles are subject to a fitness and properness assessment by the competent

- authority - given that their fitness and properness assessment would already have been scrutinised;
- c) Persons who act as director or secretary solely of entities in which they are beneficial owners – this will allow someone to act as director/company secretary of his own company without requiring registration; and
 - d) Persons who act as director or secretary solely of entities in which the government of Malta is a shareholder.

The waivers listed in points (a) and (b) and those falling under the exemption for trustees shall still be required to notify the Authority of their intention to provide CSP services.

ii. Passporting

Given that there is no supra-national framework for CSPs, there is at present no specific passporting regime. In this respect, it is the freedoms concerning services in the internal market set out in the Treaty on the Functioning of the European Union and legislation implementing them which would apply.

2.5.2 Legal Personality Requirement

The Authority had been considering the introduction of a requirement for persons wishing to be authorised as CSPs to be a legal person established either in Malta or in another recognised jurisdiction.

Feedback received

Feedback received in this respect was once again mixed. Whilst some respondents agreed with the proposal stating that the establishment of legal personality is better suited to ensure effective systems and controls, others argued that the consequent shift from personal to limited liability would lead to “an erosion of standards”, as sole practitioners are generally more cautious given the possible repercussions of personal liability. Other respondents suggested that provision should be made for certain CSP services, which are considered to be low risk, to be provided by a natural person. It was also highlighted that the term ‘legal person’ should include also partnerships.

MFS

A position

The Authority considers proper internal governance of CSPs as being critical for the attainment of the objectives set. It is for this reason that a CSP needs to be structured, managed and controlled effectively and this often requires the separation of functions, management and control and setting up of a legal person. Notwithstanding, the Authority is cognisant of the impact that these requirements may have on smaller businesses and is willing to address the concerns raised by applying these requirements proportionately without compromising on regulatory objectives. In this light, the Authority envisages the possibility of allowing a CSP to be a natural person provided that, based on the risk presented by the nature, size and complexity of the business, where the Authority considers, both at authorisation stage and on an ongoing basis, that a CSP cannot meet its governance requirements, it can require the said natural person to establish legal personality.⁴

⁴ This would better allow such person to *inter alia* separate certain functions, set up adequate structures and have the necessary structures, business plans and projections in place.

Type of Legal Person

The term 'legal personality' is to include any legal person duly formed under any law for the time being in force in Malta.

2.5.3 The Appointment of 'Designated Persons'

The Authority proposed that CSPs providing the service of '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' and the proposed new service of 'providing professional assistance in the submission of applications for licensing, registration, recognition or any other authorisation issued by the Authority', would be required to appoint a minimum of two 'Designated Persons'. Specifically, with respect to the former, it had been proposed that, apart from the CSP itself, only a Designated Person may be appointed to perform directorship or company secretarial roles.

Feedback received

The majority of respondents highlighted that this proposal would be difficult for SMEs and sole practitioners to implement and would act as a barrier to entry, particularly for start-ups. Certain respondents also argued that this requirement would not provide any added value in the fight against money laundering and the financing of terrorism.

Respondents who agreed with the proposal stated that "designated persons would be the person against whose competence and experience the entity will be assessed and who would, therefore, have to take responsibility for any persons working within that entity", thus ensuring higher adherence to financial crime compliance regulation.

Whilst certain participants suggested that the requirement should be for a minimum of one Designated Person or that the minimum number is linked to the number of clients which the CSP onboards, others suggested the issuance of specific guidelines to further clarify the role and function of the 'Designated Person'.

MFSA Position

Within the context of the revised position being outlined in this document, this proposal would now only apply to those persons 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.

Under the revised position, a person who, by way of its business, acts as director or company secretary will be subject to registration and will thus be regulated. The Authority is therefore of the view that the requirement to appoint 'Designated Persons' is no longer necessitated. That being stated, requirements will be introduced within the Rules setting out the obligations for 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, *inter alia* to assess the fitness and properness of such person both *ex-ante* (prior to proposing such person) and *ex-post* (on an ongoing basis). CSPs will be required to keep record of such assessment/s.

2.5.4 Enhanced Competence Assessments

The Authority had proposed 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 proposal was to base such an assessment on: [i] experience and educational background; and [ii] where the Authority deems it necessary, on the basis of a risk-based assessment, a *viva voce* Assessment.

Feedback received

The majority of respondents agreed that competence assessments should be enhanced noting that the requirement would improve the quality of supervision and raise the bar for persons providing CSP activities, maintaining high standard in the sector. Many respondents suggested that the assessment should be proportionate and relevant to the size and nature of the business of the CSP and the role which the individual being assessed has been proposed to undertake.

Some respondents also requested clarifications vis-à-vis the methods of assessment with one respondent also suggesting that the Authority should publish the criteria it will be using to decide whether a *viva voce* assessment is required.

Participants in the consultation exercise also suggested that when assessing competence, the Authority should differentiate between those persons who are already approved by the Authority and those who are not.

MFSA Position

Competence, general and specific, is inextricably linked to good governance, effective risk management, business success and business continuity. As the business environment becomes more complex, the Authority would like to continue to foster an environment wherein the CSP itself, its key officials and/or those providing services to corporate clients have the necessary professional skills and knowledge to successfully fulfil their roles.

In this light, the Authority shall be maintaining its position that competence assessments are to be enhanced and that such assessments are to be based on two pillars: [i] experience and educational background; and [ii] where the Authority deems it necessary, on the basis of a risk-based assessment, a *viva voce* Assessment.

Furthermore, it should be noted that the Enhanced Competence Assessment is supplementary to the fitness and properness standard that will be applicable across the sector. This standard will continue to be central to the Authority's evaluation of firms and their continued authorisation.

The Authority will also seek to ensure that authorised CSPs and their approved officials remain current with their knowledge of changes in the regulatory environment and best practices, by setting out a requirement for continuous professional education.

2.5.5 Rigorous assessments of CSPs' client on-boarding processes

The Authority had proposed that CSPs' client onboarding systems and processes are thoroughly scrutinised by the MFSA prior to authorisation. The MFSA also made some proposals vis-à-vis the proposed new service of 'providing professional assistance in the submission of applications

for licensing, registration, recognition or any other authorisation issued by the Authority'; however these have been now been superseded by the position put forward in this document.

Feedback received

This proposal was well-received by the majority of respondents; however, some noted that, in relation to the client onboarding process, there is already a system of internal controls, necessitated by the AML/CFT framework, which is in place. They stated that Compliance Officers and MLROs, as part of their responsibilities, should already ensure compliance with said framework, and in this light the FIAU should remain responsible for the oversight of CSP's clients' onboarding systems, to avoid duplication of regulatory requirements.

MFSA Position

Further to the Authority's revised position to possibly address persons 'providing professional assistance in the submission of applications for licensing, registration, recognition or any other authorisation issued by the Authority' by virtue of a separate initiative, it follows that this proposal relates to the revised CSP classes.

The Authority acknowledges that CSPs are already subject persons under the Prevention of Money Laundering and Funding of Terrorism Regulations ('PMLFTRs'). However, it is also recognised that more focus and attention needs to be placed at the client onboarding junction from the pre-authorisation stage. Whilst the Authority shall be retaining its position that CSPs' client onboarding processes are thoroughly scrutinised at authorisation stage, CSPs are to ensure that their onboarding processes reflect their internal AML/CFT policies, procedures, and risk management as required by the PMLFTRs. Such processes are to be regularly updated and aligned with legal requirements, best practices, and the national and sectoral risk appetite and thresholds current at any given time, and should also be effectively implemented. The Authority and/or the FIAU will retain the right to inspect these policies and procedures at any time in terms of the law.

2.5.6 Capital Requirements

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. The Consultation document proposed 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 was also proposed that the capital requirement would be required to be fully paid up and maintained at all times.

Feedback received

The majority of respondents highlighted concerns in relation to the proposed Capital Requirements, as being too high and prohibitive for SMEs and sole practitioners. It was submitted that this requirement would lead to a marked distortion and increase the gap between SMEs and large CSPs.

Respondents stated that onerous capital requirements do not mitigate ML/FT risks, and are usually only required for entities which, unlike CSPs, hold and control clients' monies and, or assets by way of its business.

Overall, a significant number of respondents asked the MFSA to reconsider the proposed Capital Requirements.

Specifically with respect to PII, some respondents agreed with the introduction of this requirement for all CSPs irrespective of their class. Some respondents also argued that PII would ensure that the CSP would be in a position to meet any claims brought against it, thereby rendering the capital requirement unnecessary.

MFSA Position

With its proposal to increase the capital requirements, the Authority has sought to ensure that apart from operational capital required, CSPs need to retain sufficient margin above their normal operational needs to cover for their activities' exposure to risk and yet ensure business continuity. Some respondents construed this as a barrier to entry or, in cases, continuity. This was however not intended. The Authority is cautiously optimistic that by virtue of the revised regulatory framework and stricter internal risk management policies and procedures, risk exposure could be adequately managed. In this respect, the Authority is revising the capital requirements as follows:

CSP Class	<u>Minimum</u> Capital Requirement
Class A CSPs	€10,000
Class B CSPs	€15,000 + Mandatory PII ⁵
Class C CSPs	€25,000 + Mandatory PII

The Authority retains its position that the capital requirement is to be fully paid up and maintained at all times. This, notwithstanding, and while the above thresholds are minima, and therefore higher requirements may be imposed reference should also be made to Section 2.5.1 of this Feedback Statement wherein it is stated that the Authority may impose lower capital requirements, where the risk profile warrants such consideration.

In this respect, some respondents proposed that the Authority accepts the equivalent value of immovable property in lieu of the liquid capital requirement proposed. In the Authority's view this proposal would not fulfil the aim for which the requirement is being set.

⁵ As stated in previous sections, the Authority will impose lower capital requirements where the applicable thresholds are satisfied.

2.6 Ongoing Requirements

2.6.1 Governance

As part of the initiative to raise the bar for CSPs, the MFSA proposed strengthening the requirements relating to governance which are currently set out within the CSP rules. The addition of new rules regarding, for example, business continuity, ongoing monitoring of policies and procedures, cybersecurity and risk assessment, was proposed.

Feedback received

Respondents were almost unanimously in agreement on the proposal to enhance governance requirements for CSPs. They suggested that any new rules in this respect should be consistent with the existing requirements and that their application should be based on the principle of proportionality.

MFSA position

The MFSA's position remains the same as that put forward in the consultation document. The Rules for CSPs will be revisited and governance requirements strengthened. As stated in previous sections, the application of the Rules will be based on the principle of proportionality and the CSP services provided, thereby reflecting a dynamic, risk-based approach.

2.6.2 Risk Management

Within the Consultation Document, the Authority proposed introducing requirements on risk management *inter alia* including 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, covering all aspects of CSPs' business, including but not limited to AML. The Authority also proposed the introduction of a requirement for CSPs to keep a risk register vis-à-vis their clients and a requirement for certain CSPs (based on the nature, size and complexity of their business) to have a Risk and/or Audit Committee.

Feedback received

The majority of respondents agreed with the proposals put forward by the Authority; however, a significant group of respondents are of the opinion that the requirement to have and maintain a risk register would increase costs. Some respondents suggested that the register should not be required for all CSPs, but only for those provide recurring and riskier services.

With respect to the proposal regarding Risk and/or an Audit Committee, several respondents sought further clarifications on the criteria to be used to determine whether the said Committees are required to be appointed. They also suggested that the requirement to have such Committees should be proportionate to the size and business model of the CSP.

In addition to the views mentioned above, a small number of respondents highlighted that the existing framework, specifically the PLMFTR and FIAU implementing procedures already cover risk management and the imposition of new rules will result in overregulation and duplication of requirements.

MFSA Position

The MFSA shall be retaining the position set out in the consultation document. New rules on risk management will be introduced within the CSP Rulebook. These will *inter alia* include rules requiring: [i] the establishment, implementation and maintenance of adequate risk management policies and procedures, which identify risks relating to the CSP's activities, processes and systems, and set the level of risk tolerated by the CSP; the adoption of effective arrangements, processes and mechanisms to manage the risks relating to the CSP's activities processes and systems, in light of that level of risk tolerance; [iii] the monitoring of the adequacy and effectiveness of risk management policies and procedures as well as the measures taken by the CSP to address any deficiencies identified; [iv] the establishment of a risk management function which implements the aforementioned policies and procedures, provides reports to the senior management of the CSP and draws up a risk register vis-à-vis the CSP's clients. The Risk Register will be required to include a list of all the clients which the CSP has onboarded and identify the risks inherent to the business model of each client. The Risk Register should be considered a live document and will therefore require to be constantly monitored and reviewed.

2.6.3 Compliance

It was proposed that persons proposed to perform the roles of Compliance Officer and MLRO within a CSP are subject to a rigorous competence assessment as per Section 2.5.4 above.

Feedback received

The majority of respondents agreed with the proposals put forward by the Authority to subject MLRO and Compliance Officers to a rigorous assessment of competence. That stated, some respondents expressed concerns that the requirement to have a Compliance Officer would act as a barrier for sole practitioners and SMEs to act as CSPs. They argued that the increase in the human resources required would place a significant burden on such operators, effectively forcing them in some cases to cease operations.

On the other hand, some respondents who agreed with the proposal suggested that CSPs should be required to document the compliance framework they have in place, including *inter alia* the compliance monitoring programme.

MFSA position

The requirement for a CSP to appoint a Compliance Officer is one which already exists in the current framework. In this respect, the Authority shall be strengthening existing rules and *inter alia* introducing the following requirements: [i] persons involved in the compliance function of the CSP are not to be involved in the performance of the services/activities which they monitor and in this respect shall neither be client-facing nor involved in client on-boarding; and [ii] the compliance officer of a CSP shall draw up a compliance monitoring programme and present regular compliance reports to the CSP's Board.

2.6.4 Time Commitment

The Authority proposed 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.

Feedback received

The majority of respondents agreed with the proposal made. They expressed the opinion that individuals appointed as director or company secretary should take up the role only if they have sufficient time to adequately carry out the responsibilities arising therefrom. Respondents were of the view that this requirement would enhance the quality of directorships in Malta. Some respondents sought further clarity on the terms 'quantitative' and 'qualitative', recommending that the Authority provides guidance in this respect.

MFSA position

The MFSA retains the position set out in the discussion paper that it will be introducing 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. This is to ensure that Designated Persons are capable of committing sufficient time to perform their functions efficiently and effectively.

With respect to the interpretation of the terms 'quantitative' and 'qualitative', in line with Section 5 of the MFSA [Guidance on the Fitness and Propriety Assessments applied by the Authority](#), these are to be understood as follows:

- i. the quantitative assessment of time commitment involves an assessment of the number of commitments held by the person. The involvement in multiple roles is an important factor which may affect time commitment.
- ii. The qualitative assessment of time commitment involves an assessment of qualitative factors that determine the amount of time a person can dedicate to his/her function. These include: [i] the size and circumstances of the entity with whom the position is held; [ii] the nature, scale and complexity of the activities of the respective entities; [iii] the place or country where the entities are based; [iv] the travel time required for the role; [v] the number of meetings scheduled for the management body; [vi] the time needed for induction and training; and [vii] the responsibility to be borne by the person.

2.7 The Institutional Architecture for the Supervision of CSPs

As part of its regulatory strategy to raise the standards of supervision, the Authority also considered a revamp of the institutional architecture for the supervision of CSPs. The Consultation Document had put forward two options for a way forward as follows:

- i. Option A – Maintaining the current institutional architecture. Under this option, the MFSA continues being the regulator for CSPs falling within the 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.

- ii. Option B – A Hybrid Supervisory Model. This option involves both the Authority and Self-Regulatory Organisations (“SROs”).
- a. Authorisation – the proposal required the authorisation process of all CSPs to be carried out by a competent authority and not by an SRO.
 - b. Supervision – it was proposed that the MFSA would be designated as the default supervisor for all CSPs; however a CSP, which is covered by points 3(a)⁶ and (b)⁷ of Article 2(1) of AMLD and which meets certain specified objective criteria,⁸ could 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. In line with international standards,⁹ SROs would then 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).
 - c. Enforcement - under this option, the enforcement process could be conducted as follows: [i] where supervision is performed by the MFSA – in the traditional manner; 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 was also proposed that SROs are granted the power to terminate membership. Furthermore, given that SROs would be regulated by the Authority, they would 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.

Whilst presenting both options to stakeholders for feedback, the Authority identified Option A as its preferred option, in view of the implications arising from the MONEYVAL Report.

⁶ auditors, external accountants and tax advisors

⁷ 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

⁸ In this respect, a risk-based approach based on the size and complexity of the business of the CSP may be adopted.

⁹ Reference may be made, for example, to Principle 9 of IOSCO’s Principles for Securities Regulation

Feedback received

The majority of respondents supported the MFSA's preferred option – Option A. In their opinion, there should only be one body carrying out authorisation, supervision and enforcement with respect to CSPs, in order to ensure a consistent approach and avoid conflicts of interest. In this light a number of respondents identified the MFSA as being best placed to carry out this function, given that it already has the necessary infrastructure in place. This notwithstanding, some respondents reiterated their argument that the supervision of 'warranted professionals' should remain with the respective professional body regulating the said profession.

A number of respondents also highlighted that it is crucial that the MFSA is provided with adequate and sufficient resources to be able to adequately perform its functions.

With respect to Option B, some respondents expressed the view that the hybrid model would lead to significant inconsistencies and possibly different interpretations of the regulatory framework. One respondent went as far as stating that this would add a new layer to regulation, increase costs and result in a "dilution of standards".

MFSA position

The MFSA remains of the view that Option A is the preferred way forward. The Authority will therefore remain responsible for authorisation, supervision (in conjunction with and as agents of FIAU) and enforcement with respect to CSPs.

This notwithstanding, given that the option to have SROs, or co-regulatory mechanisms, may be viable in the future, the Authority shall be proposing that the CSP Act grants the Minister, acting on the advice of the Authority, the power to make regulations which cater for SROs and other possible regulatory mechanisms.

3 Way forward: Implementing the Reforms to the Framework

The Authority is cognisant that this document puts forward substantial reforms which are aimed at bringing exempt and non-registered persons within scope of the CSP Act, raising awareness of AML/CFT risks in the sector and generally raising standards for all persons providing CSP services in or from within Malta. In order to implement the requisite changes, the Authority will proceed to implement amendments to the Act, the CSP Regulations and the Rules for CSPs.

1. Amendments to CSP Act

Amendments are required for the Act to cater for the changes put forward in this document. These changes will: [i] bring a number of persons, who are currently exempt from or do not require registration, within scope of the Act and therefore subject to registration; and [ii] generally raise standards for CSPs. Within this context, the Authority understands that the inclusion of a transitory provision within the amended Act is required in order to provide for a stepped implementation. This would allow registered CSPs sufficient time to align themselves with new requirements and existing CSPs who are currently exempt from, or do not require registration, sufficient time to align themselves with the Act and to apply for Authorisation. The Authority is currently assessing the available options with respect to the application of the transitory provisions.

Further to the above, the Authority is also proposing the inclusion of a review clause which will commit the Authority to reassess its position and re-evaluate the effectiveness and efficacy of the framework as promulgated.

2. Revisiting the CSP Regulations

In order to cover the costs of increased supervisory work and application processing, the Authority will be proposing revisions to the applicable registration and supervisory fees for CSPs.

3. Rethinking the Rules for CSPs

As part of the reform, the Authority will be issuing a new 'Company Service Providers Rulebook'. Whilst strengthening existing provisions of the current rules, the new Rulebook will reflect the changes put forward in this document. The Rulebook will be applicable once the transitory period provided for in the Act expires to allow CSPs sufficient time to align themselves therewith.

Any comments or queries in relation to this Feedback Statement should be directed to CSPframework@mfsa.mt.