

Guidance Note on the Methodology to Set Administrative Penalties Imposed on Entities and Individuals

09 May 2022

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Section 1 - Introduction

The Malta Financial Services Authority (hereafter referred to as 'MFSA' or 'the Authority') is publishing a Guidance Note that outlines the principles and processes for calculating the administrative penalty used to sanction entities and individuals (hereunder referred to as 'Person/s'¹) for breaches of regulatory requirements. The publication of this Guidance Note is a further step forward in the transparency of the MFSA's policies and practices to Persons authorised and supervised by the MFSA. Moreover, this Guidance Note should serve as a means for the Authority to ensure that appropriate action is taken against entities and individuals which have carried out financial services activities without having the necessary licence or authorisation by the MFSA.

Persons authorised and supervised by the MFSA should comply with all the relevant regulatory requirements and standards. To foster such compliance, the Authority has a range of enforcement powers emanating from the MFSA Act (Cap. 330 of the Laws of Malta), as well as various other sectorial financial services legislation. In terms of Article 16A of the MFSA Act, as well as provisions within various other sectorial financial services legislation, as the competent authority, the MFSA may impose an administrative penalty on any licence-holder should the Person's conduct or/and prudential objectives, in the opinion of the MFSA, amount to a breach of the regulatory requirements applicable to the licence-holder. While the MFSA is conferred a degree of discretion through the relevant laws in determining the amount of the administrative penalty appropriate in each case, the penalties must be effective, proportionate and dissuasive and must not exceed the limits specified in the respective legislation.

This Guidance Note provides information on the process followed by the MFSA when setting the appropriate level of an administrative penalty. With the aim of ensuring that the amount of an administrative penalty is fair and proportionate, the methodology applied by the MFSA (in determining the amount of an administrative penalty) considers the degree of impact and seriousness of the potential breach², as well as the size and financial strength of the licence-holder.

With respect to the degree of impact and seriousness of a potential breach, this is classified in one of five risk categories: Very Low, Low, Medium, High and Very High. The determination as to which category a potential breach is classified depends on a combination of factors, with the aim of ensuring that the amount of an administrative penalty is proportionate, effective and dissuasive.

During the process of determining the quantum of an administrative penalty, the Authority also looks at the appropriateness of the administrative penalty in order for the penalty not to cause disproportionate financial distress to the licence-holder.

¹ All natural or legal persons authorised by the MFSA to provide financial services or otherwise falling under the regulatory and supervisory function of the MFSA.

² The term 'potential breach' is used when the Authority's decision is still at minded stage and is so used because the entity, at this point, is given an opportunity to send representations with reasons why the proposed regulatory action should not be taken by the MFSA. Thus, an identified breach is considered to be a 'potential breach' unless otherwise demonstrated by the entity and until the Authority reaches a final decision on the breach it identified.

Section 2 - Purpose

The MFSA's penalty-setting methodology is based on the principles of proportionality, discipline and deterrence. Moreover, the Authority's decisions on the imposition of appropriate administrative penalties must deter a Person that has committed a breach from committing further breaches. Such decision should also act as a sufficient deterrent for other Persons from committing similar breaches, as well as to enable the MFSA to continue to meet its long-term operational objectives, that is, to safeguard the integrity and stability of the financial market and protect consumer interests.

The purpose of this Guidance Note is to provide information to Persons authorised and supervised by the MFSA, as well as entities or individuals found to be providing financial services without the necessary licence, authorisation and registration, on the process that is followed by the Authority in the determination of the administrative penalty used to sanction Persons for breaches of regulatory requirements. Essentially, this process should not be regarded as exhaustive as it serves as a guiding principle for the Authority to ensure that the administrative penalty is proportionate, effective and dissuasive. In the event that the Authority considers that the administrative penalty is not dissuasive enough, the Authority may – at its discretion – increase the quantum of the said administrative penalty.

Section 3 - Determining the Appropriate Level of Administrative Penalty in Cases Involving Legal Persons (Entities)

As explained in Section 1 of the Guidance Note, the total amount payable by an entity subject to enforcement action consists of an administrative penalty that reflects the degree of impact and seriousness of the potential breach taking into account any aggravating and mitigating factors. Additionally, in order to ensure proportionality when computing the quantum of the administrative penalty, the Authority also considers the entity's size and financial strength.

These elements are incorporated in a 3-level process, which is explained below:

Level 1 – Setting the base amount of proposed administrative penalty

The base amount of the administrative penalty is determined on the basis of the maximum administrative penalty that may be imposed by the MFSA in terms of the MFSA Act, as well as various other sectorial financial services legislation for the identified potential breach.

Moreover, in order to ensure proportionality when computing the amount of the administrative penalty, the Authority considers the entity's size and financial strength. In doing so, the MFSA takes into account the average revenue generated by the entity over the last three financial years preceding the date when the Authority communicates the proposed regulatory action to the entity.

On the basis of the average revenue generated by the entity in the preceding three financial years, the entity is then classified in the relevant group in terms of the categorisation table shown below:

Licence-Holder Grouping	A	B	C	D	E	F
Proportionality on the basis of average revenue generated by the LH in the last three financial years	Over €3 million	Over €2 million to €3 million	Over €700,000 to €2 million	Over €350,000 to €700,000	Over €50,000 to €350,000	Up to €50,000

In the event that the Authority has no information on the revenue generated by the entity in the preceding three financial years, the Authority shall accept that the average revenue generated by the entity in the last three financial years is equivalent to the figure in lowest group within the categorisation table above (i.e. Category F).

If no information is available on the revenue generated by the entity for a particular financial year from the three previous financial years, the Authority will consider the average of the two available revenue figures.

In the event that the Authority has no information on the revenue generated by the entity for two financial years from the three previous financial years, the Authority will consider the available revenue figure for the purposes of the above-mentioned categorisation.

Level 2 – Risk categorisation of the potential breach

When an entity is found to have potentially committed a breach of the regulatory requirements, the potential breach is classified according to its seriousness and degree of impact. In assessing the seriousness and degree of impact of a potential breach, the Authority considers various factors which reflect the nature of the potential breach. On the basis of these factors, the Authority categorises the potential breach into one of the five categories of risk – Very Low, Low, Medium, High and Very High – depending on the seriousness and potential impact on the entity’s business activities, its reputation and that of the financial services industry in general.

Upon the completion of this risk categorisation process, the Authority has discretion on the overall risk assessment of the circumstances of the case to ensure that the proposed administrative penalty complies with the principles of effectiveness and proportionality, and the intended deterrent effect of the administrative penalty. In this regard, the Authority assesses any mitigating and aggravating circumstances of the case which may increase or decrease respectively the risk rating allocated to the potential breach.

The following is a list of factors which the Authority takes into consideration when determining the risk rating of the potential breach. Among these factors is the seriousness of the effects of the potential breach, including the possible losses of third parties, the repetition and duration of the potential breach:

- a) The gravity of the potential breach;
- b) The degree of openness of the entity in the fulfilment of its obligations under the Act, relative Rules or decisions of the MFSA in this regard;
- c) Any evidence of wilful deceit on the part of the entity, including profits gained or losses avoided by the entity responsible for the potential breach, insofar as it can be determined;
- d) Possible losses of third parties caused by the potential breach, insofar as it can be determined;
- e) The level of cooperation of the entity responsible for the identified breach with the MFSA;
- f) Previous breaches committed by the entity responsible in the last five years and their severity;
- g) Duration of the potential breach; and
- h) Measures taken by the entity responsible for the potential breach to prevent its repetition.

In view that the penalty-setting methodology serves as a guidance to the Authority to calculate an administrative penalty, the MFSA may take into consideration any other factors or circumstances which it may deem relevant in determining a penalty amount which is fair, proportionate and dissuasive.

Level 3 – Application of an entity/potential breach categorisation scoring matrix

Depending on the category within which the entity is classified based on the average revenue for the preceding three years (as explained in Level 1 above), as well as the risk categorisation for each identified potential breach (as explained in Level 2 above), the proposed administrative penalty for each individual potential breach is calculated by means of an Entity/Potential Breach Categorisation Scoring Matrix.

The Entity/Potential Breach Categorisation Scoring Matrix is determined on the basis of maximum administrative penalty that may be imposed by the MFSA in terms of the MFSA Act, as well as various other sectorial financial services legislation. In view of the fact that the maximum administrative penalty that the Authority may impose varies between different sections of sectorial financial services legislation, this Guidance Note provides an example of a Scoring Matrix where the maximum penalty that may be imposed by the MFSA amounts to €150,000 per breach.

Licence-Holder / Potential Breach Categorisation Scoring Matrix (General)							
Amounts in €		Licence-Holder Grouping					
		A	B	C	D	E	F
Potential Breach Categorisation	Very High	150,000	125,000	100,000	75,000	50,000	25,000
	High	125,000	100,000	80,000	60,000	40,000	20,000
	Medium	100,000	90,000	70,000	50,000	30,000	15,000
	Low	80,000	70,000	60,000	40,000	20,000	10,000
	Very Low	50,000	40,000	30,000	20,000	10,000	5,000

Also, guided by the principles of proportionality, fairness and effectiveness, when the circumstances warrant and when the Authority is allowed in terms of financial services legislation, it may increase the resulting amount of the administrative penalty through the application of a daily, weekly or monthly penalty as may be specified in the applicable legislation.

The above-mentioned penalty-setting methodology applies in cases against entities and an alternative penalty-setting methodology is applied in cases against individuals as will be explained further in Section 4 of the Guidance Note.

A case study is presented below to better explain the 3-level process in calculating administrative penalties in cases involving entities.

➤ Case Study 1

Level 1 – Setting the base amount of proposed administrative penalty

In this case study, it is assumed that the Authority may impose administrative penalties of not more than €150,000 per breach on entities.

If a licensed entity generated an average revenue of €4.5million in the past three financial years, in accordance with the Categorisation Table explained further above, the said entity is to be categorised in Group C.

Level 2 – Risk categorisation of the potential breach

For the purpose of the determination of the administrative penalty, the MFSA takes into consideration the breach committed by the licensed entity on the basis of various aggravating and mitigating factors which are rated through a Potential Breach Risk Rating Model as explained further above. In this case study, it is assumed that the potential breach committed by the licensed entity is categorised as 'High'.

Level 3 – Application of an entity/potential breach categorisation scoring matrix

Having considered the following elements: [i] the upper limit of the administrative penalty which may not exceed €150,000 per breach and the categorisation of the licensed entity in Group C (as per level 1); and [ii] the classification of the potential breach committed by the licensed entity as 'High' (as per level 2); after mapping these factors in a Categorisation Scoring Matrix (exhibited further above), the final administrative penalty that the MFSA may decide to impose on the entity would amount to €80,000.

Section 4 - Determining the Appropriate Level of Administrative Penalty in Cases Involving Natural Persons (Individuals)

As explained in Section 1 of the Guidance Note, the total amount payable by an individual subject to enforcement action consists of an administrative penalty that reflects the degree of impact and seriousness of the potential breach, taking into account any aggravating and mitigating factors. Additionally, in order to ensure proportionality when computing the quantum of the administrative penalty, the Authority also considers the income earned by the individual from the relevant entity, as well as the shareholding value of the individual in the relevant entity as may be applicable. The above-mentioned approach is incorporated in processes that cater for three different scenarios, as will be explained further below.

4.1 Scenario 1: Cases where the individual holds both the position of a shareholder as well as any other position which requires the MFSA's prior approval (such as Director, Compliance Officer, MLRO, etc.)

In this scenario, the total amount payable by an individual subject to enforcement action consists of an administrative penalty that reflects the degree of impact and seriousness of the potential breach, taking into account any aggravating and mitigating factors. Additionally, in order to ensure proportionality when computing the quantum of the administrative penalty, the Authority also considers the income earned by the individual, as well as the shareholding value of the individual in the respective entity.

These elements are incorporated in a 3-level process as explained in further detail below:

Level 1 – Setting the base amount of proposed administrative penalty

The base amount of an administrative penalty is determined on the basis of the maximum administrative penalty that may be imposed by the MFSA in terms of the MFSA Act, as well as various other sectorial financial services legislation for the identified potential breach.

Moreover, in order to ensure proportionality when computing the amount of an administrative penalty, the Authority carries out an overall risk assessment of the degree of impact and seriousness of the potential breach by considering a number of aggravating and mitigating factors as listed in Section 3 of the Guidance Note. With respect to the degree of impact and seriousness of a potential breach, this is classified in one of five risk categories: Very Low, Low, Medium, High and Very High.

Finally, in determining the base amount of the proposed administrative penalty, an applicable percentage of the determined maximum administrative penalty is applied in terms of the table shown below:

Potential Breach Risk Rating	Very Low	Low	Medium	High	Very High
Percentage on the maximum administrative penalty	20%	40%	60%	80%	100%

Level 2 – Applicable percentage on base amount (on the basis of income earned)

In this second stage, the Authority takes into account the proportionality aspect on the basis of income derived by the individual from the relevant entity. In this respect, a percentage is applied on Level 1 base amount on the basis of aggregate income earned by the individual from the relevant entity (in the form of employment income, directorship fees or others) in the last three financial years.

The income ranges and respective percentages applied by the MFSA are being presented in the table below:

Income Ranges	Level 2 Administrative Penalty (as a percentage of Level 1)
€0 - €10,000	20%
€10,001 - €20,000	30%
€20,001 - €50,000	40%
€50,001 - €100,000	50%
Over €100,001	60%

Level 3 – Additional percentage on the Level 2 administrative penalty (on the basis of shareholding value)

In the third and final level, the Authority considers the proportionality aspect on the basis of shareholding value of the individual in the relevant entity. In this scenario, an additional percentage on the Level 2 administrative penalty is applied by the Authority on the basis of shareholding value of the individual in terms of information presented in last financial statements of the relevant entity.

The shareholding value ranges and respective percentages applied by the MFSA are being shown in the table below:

Shareholding Value Ranges	Level 3 Administrative Penalty (additional percentage on Level 2)
€ 0	N/A
Up to €10,000	20%
€10,001 - €20,000	30%
€20,001 - €30,000	40%
€30,001 - €40,000	50%
Over €40,001	60%

A case study is provided below to better explain the 3-level process in calculating an administrative penalty in cases where an individual holds both the position of a shareholder as well as any other position which requires the MFSA's prior approval.

➤ Case Study 2

Level 1: Base amount of the proposed administrative penalty

In this case study, it is assumed that the Authority may impose administrative penalties of not more than €150,000 per breach on individuals.

For the purpose of the determination of the administrative penalty, the MFSA takes into consideration the potential breach committed by the individual on the basis of various aggravating and mitigating factors which are rated through a Breach Risk Rating Model as explained further above. In this case study, it is assumed that the potential breach committed by the Individual is categorised as 'Medium'.

Thus, in accordance with the table illustrated further above, the base amount of the proposed administrative penalty would amount to €90,000 (60% of €150,000).

Level 2: Percentage on Level 1 base amount (on the basis of income earned)

If the respective individual derived a total income from the relevant entity in the last three financial years amounts to €80,000 (in the form of employment income, directorship fees or others), the proposed administrative penalty is reduced to €45,000 (50% of €90,000) in accordance with the income and percentage ranges illustrated above.

Level 3: Additional percentage on Level 2 amount (on the basis of shareholding value)

In the event that the respective individual has a value of shareholding in the relevant entity of €50,000 (as per information provided in the last available financial statements), the final proposed administrative penalty is increased to €72,000 (60% of €45,000) in accordance with the shareholding value and percentage ranges illustrated above.

4.2 Scenario 2: Cases where an individual holds a position in the relevant entity which requires the MFSA's prior approval (such as Director, Compliance Officer, MLRO, etc.)

In the second scenario which involves cases where an individual solely holds a position in the relevant entity which requires the MFSA's prior approval, the base amount of the administrative penalty is determined on the basis of the maximum administrative penalty that may be imposed by the MFSA in terms of the MFSA Act, as well as various other sectorial financial services legislation for the identified potential breach.

Moreover, in order to ensure proportionality when computing the amount of the administrative penalty, the Authority carries out an overall risk assessment of the degree of impact and seriousness of the potential breach by considering a number of aggravating and mitigating factors. In this scenario, the Authority also considers the income earned by the individual from the relevant entity.

These elements are incorporated in a two-level process as explained in further detail below:

Level 1 – Setting the base amount of proposed administrative penalty

The base amount of an administrative penalty is determined on the basis of the maximum administrative penalty that may be imposed by the MFSA in terms of the MFSA Act, as well as various other sectorial financial services legislation for the identified potential breach.

Moreover, in order to ensure proportionality when computing the amount of the administrative penalty, the Authority carries out an overall risk assessment of the degree of impact and seriousness of the potential breach by considering a number of aggravating and mitigating factors as listed in Section 3 of this Guidance Note. With respect to the degree of impact and seriousness of a potential breach, this is classified in one of five risk categories: Very Low, Low, Medium, High and Very High.

Finally, in determining the base amount of the proposed administrative penalty, an applicable percentage of the determined maximum administrative penalty shall be applied in terms of the table shown below:

Potential Breach Risk Rating	Very Low	Low	Medium	High	Very High
Percentage on the maximum administrative penalty	20%	40%	60%	80%	100%

Level 2 – Applicable percentage on base amount (on the basis of income earned)

In this second stage, the Authority takes into account the proportionality aspect on the basis of income derived by the individual from the relevant entity. In this respect, a percentage is applied on Level 1 base amount on the basis of aggregate income earned by the individual from the relevant entity in the last three financial years.

The income ranges and respective percentages applied by the MFSA are being presented in the table below:

Income Ranges	Level 2 Administrative Penalty (as a percentage of Level 1)
€0 - €10,000	20%
€10,001 - €20,000	30%
€20,001 - €50,000	40%
€50,001 - €100,000	50%
€100,001 - €150,000	60%
€150,001 - €200,000	70%
€200,001 - €250,000	80%
€250,001 - €300,000	90%
Over €300,001	100%

A case study is presented below to better explain the 2-level process in calculating an administrative penalty in cases where an individual holds a position in the relevant entity which requires the MFSA's prior approval.

➤ Case Study 3

Level 1: Base amount of the proposed administrative penalty

In this case study, it is assumed that the Authority may impose administrative penalties of not more than €150,000 per breach on individuals.

For the purpose of the determination of the administrative penalty, the MFSA takes into consideration the potential breach committed by the individual on the basis of various aggravating and mitigating factors which are rated through a Breach Risk Rating Model as explained further above. In this case study, it is assumed that the potential breach committed by the Individual is categorised as 'High'.

Thus, in accordance with the table illustrated further above, the base amount of the proposed administrative penalty would amount to €120,000 (80% of €150,000).

Level 2: Percentage on Level 1 base amount (on the basis of income earned)

If the respective individual derived a total income from the relevant entity in the last three financial years amounts to €170,000 (in the form of employment income, directorship fees or others), the proposed final administrative penalty is reduced to €84,000 (70% of €120,000) in accordance with the income and percentage ranges illustrated above.

4.3 Scenario 3: Cases where the individual holds the position of a shareholder in the relevant entity

In the third scenario which involves cases where an individual solely holds the position of a shareholder in the relevant entity, the base amount of the administrative penalty is determined on the basis of the maximum administrative penalty that may be imposed by the MFSA in terms of the MFSA Act, as well as various other sectorial financial services legislation for the identified potential breach.

Moreover, in order to ensure proportionality when computing the amount of the administrative penalty, the Authority carries out an overall risk assessment of the degree of impact and seriousness of the potential breach by considering a number of aggravating and mitigating factors. In this scenario, the Authority also considers the shareholding value of the individual in the relevant entity.

These elements are incorporated in a 2-level process as explained in further detail below:

Level 1 – Setting the base amount of proposed administrative penalty

The base amount of an administrative penalty is determined on the basis of the maximum administrative penalty that may be imposed by the MFSA in terms of the MFSA Act, as well as various other sectorial financial services legislation for the identified potential breach.

Moreover, in order to ensure proportionality when computing the amount of the administrative penalty, the Authority carries out an overall risk assessment of the degree of impact and seriousness of the potential breach by considering a number of aggravating and mitigating factors as listed in Section 3 of this Guidance Note. With respect to the degree of impact and seriousness of a potential breach, this is classified in one of five risk categories: Very Low, Low, Medium, High and Very High.

Finally, in determining the base amount of the proposed administrative penalty, an applicable percentage of the determined maximum administrative penalty is applied in terms of the table shown below:

Potential Breach Risk Rating	Very Low	Low	Medium	High	Very High
Percentage on the maximum administrative penalty	20%	40%	60%	80%	100%

Level 2 – Applicable percentage on base amount (on the basis of shareholding value)

In this second stage, the Authority takes into account the proportionality aspect on the basis of the shareholding value of the individual in the relevant entity. In this respect, a percentage is applied on Level 1 base amount on the basis of shareholding value of the individual in the relevant entity in the preceding year as per the latest available financial statements.

The shareholding value ranges and respective percentages applied by the MFSA are being presented in the table below:

Shareholding Ranges	Level 2 Administrative Penalty (as a percentage of Level 1)
€0 - €10,000	20%
€10,001 - €20,000	30%
€20,001 - €50,000	40%
€50,001 - €100,000	50%
€100,001 - €150,000	60%
€150,001 - €200,000	70%
€200,001 - €250,000	80%
€250,001 - €300,000	90%
Over €300,001	100%

A case study is provided below to better explain the 2-level process in calculating an administrative penalty in cases where an individual holds a position of a shareholder in the relevant entity.

➤ **Case Study 4**

Level 1: Base amount of the proposed administrative penalty

In this case study, it is assumed that the Authority may impose administrative penalties of not more than €150,000 per breach on individuals.

For the purpose of the determination of the administrative penalty, the MFSA takes into consideration the potential breach committed by the individual on the basis of various aggravating and mitigating factors which are rated through a Breach Risk Rating Model as explained further above. In this case study, it is assumed that the potential breach committed by the Individual is categorised as 'Very High'.

Thus, in accordance with the table illustrated further above, the base amount of the proposed administrative penalty would amount to €150,000 (100% of €150,000).

Level 2: Percentage on Level 1 base amount (on the basis of shareholding value)

If the respective individual has a value of shareholding in the relevant entity of €350,000, the proposed final administrative penalty will remain €150,000 (100% of €150,000) in accordance with the shareholding value and percentage ranges illustrated above.

Section 5 - Conclusion

The resulting amount of an administrative penalty may be further revised following the consideration of any representations received from the Person, which representations may justify a reconsideration of the quantum of the Authority's proposed administrative penalty.

In conclusion, the information presented in this document should not be regarded as binding and the process followed by the MFSA in determining the amount of an administrative penalty is essentially a guideline for the Authority to ensure that administrative penalties are proportionate, effective and dissuasive.