

**THE NATURE AND ART OF
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**TRUSTEES AND COMPANY SERVICE
PROVIDERS SUPERVISION**

AN INSIGHT INTO THE REFORM OF COMPANY SERVICE
PROVIDERS AND THE AUTHORITY'S EXPECTATIONS



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Table of Abbreviations

Act	Company Service Providers Act, Chapter 529 of the Laws of Malta.
AML/CFT	Anti-money laundering and countering the financing of terrorism
Authority	Malta Financial Services Authority
CSP	Company Service Provider
CSP Amendment Act'	Company Service Providers (Amendment) Act enacted by Parliament as Act L of 2020
CSP Rulebook	Rulebook for Company Service Providers issued on 15 March 2021
DNFBPs	Designated non-financial businesses and professions
EU	European Union
FATF	Financial Action Task Force
FCC	Financial Crime Compliance
FIAU	Financial Intelligence Analysis Unit
MFSA	Malta Financial Services Authority
MLRO	Money Laundering Reporting Officer
ML/FT	Money Laundering and Financing of Terrorism
MONEYVAL	Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
NCC	National Coordinating Committee on Combating Money Laundering and Funding of Terrorism
NRA	National Risk Assessment
Phase 1	From 16 May 2021 to 16 November 2021
Phase 2	From 17 November 2021 to 16 November 2022
PMLFTR	Prevention of Money Laundering and Funding of Terrorism Regulations, Legal Notice 372 of 2017 as amended.
PQ	Personal Questionnaire
TCSPs	Trustees and Company Service Providers

Introduction

Overview of the Authority's Supervisory Work

The MFSA has been responsible for authorisation, and ongoing prudential and conduct supervision of Company Service Providers (“CSPs”) since 2013. It works in tandem with the Financial Intelligence Analysis Unit (“FIAU”) being the national agency responsible for the AML/CFT supervision of this sector.

Drawing on years of experience regulating the sector, in October 2019 the Authority commenced the process to raise the bar for CSPs. The reform of the CSPs’ regime took place through a phased approach which was concluded in November 2022, thus giving those persons who were previously not required to register as CSPs under the Act the time to adjust to the MFSA’s standards of regulation.

The said reform saw more onerous compliance and governance requirements being introduced, resulting in the morphing of the registration process into an authorisation one and in the need to amend the Company Service Providers Act (“Act”) accordingly¹. In addition, the Authority leveraged its years of experience in supervising CSPs in order to close gaps in interpretation and clarify specific aspects of the regulatory framework.

The Authority is reporting on the outcomes of the CSP reform in this document while also setting out its observations on topics that were raised during the CSP Reform and in relation to which clarity on the MFSA’s expectations is considered useful for CSPs.

¹ This took place by virtue of Act L of 2020.

Scope, Purpose and Structure of this Publication

This document is addressed to all those authorised under the Company Service Providers Act. It is also intended to be a reference to those persons considering seeking authorisation under the Act, advisors and industry bodies. It outlines the MFSA's observations and corresponding compliance expectations so that authorised CSPs can take stock of what is expected by the Authority, make improvements to their processes and procedures, and reflect these in practice in their day-to-day operations.

The Authority is also setting out its expectations regarding the standards required to be maintained by authorised CSPs in a bid to help them understand what the Authority expects during its supervisory engagements with CSPs. This document is also relevant to potential applicants as it gives insight into the Authority's expectations both at application stage and on an ongoing basis.

CSPs are urged to consider the observations set out in this document and how best to implement the standards expected by the Authority in practical terms.

Section 1 of this document sets out the process undertaken by the Authority during the reform, from inception to its completion in 2022.

Section 2 of this document sets out the MFSA's observations and corresponding high-level expectations derived from the CSP reform.

Section 1: The Reform of Company Service Providers

1.1 Background

The MFSA has been responsible for the registration (and more recently authorisation)² and supervision of the CSP sector since 2013. As part of Malta's ongoing efforts to improve the compliance culture in the sector and strengthen its ML/TF framework, in October 2019 the Authority set out its objectives and proposals to raise the bar for CSPs. These were presented in a consultation document published by the Authority in 2019³ ("**2019 Consultation**") putting forward proposals relating to the institutional architecture for the supervision of CSPs.

The applicable legislation being the Company Service Providers Act, had been enacted in 2013 by virtue of Act XX of 2013 implementing Article 36 of Directive 2005/60/EC⁴ of 26 October 2005 on the prevention of the use of the financial system for the purposes of money laundering and terrorist financing. The Directive required EU Member States to introduce a licensing or registration framework for certain services (such as providing incorporation of companies and the service of registered office), to mitigate ML/TF risks. In Malta this was implemented by the registration (and subsequently by licensing) of CSPs and by ensuring that the persons owning and running CSPs are fit and proper persons. The introduction of the CSP Act complemented the existing AML/CFT obligations for the sector under the version of the PMLFTR then in force, further strengthening the supervisory framework required

² The MFSA was originally responsible for the registration process of CSPs since 2013. With the enactment of Act L of 2020 amending the CSP Act, the MFSA became responsible for authorisation of CSPs.

³ MFSA (2019, October). *Raising the Bar for Company Service Providers*, Ref 17-2019. Retrieved from https://www.mfsa.mt/wp-content/uploads/2019/10/20191017_CSPconsultation_final-.pdf

⁴ OJ L 309, 25.11.2005. 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. Retrieved from <https://rm.coe.int/moneyval-2019-5-5th-round-mer-malta2/168097396c>

to mitigate the risks of ML/FT to which CSPs are exposed by virtue of their role as gatekeepers.

Understanding the Role of CSPs

CSPs in all jurisdictions are particularly vulnerable to ML/TF risk due to their role as gatekeepers to the financial sector, particularly as one of their roles is that of assisting with the formation of companies or establishment of other legal persons⁵. Legal entities can be useful tools for criminals seeking to obfuscate the ownership of criminally derived assets and through which they can also gain access to the wider financial system. CSPs therefore play a key role to prevent such persons from gaining access to the wider financial sector. This gatekeeper role, if not undertaken appropriately, may result in CSPs being exploited (with or without their knowledge) by criminals to establish themselves as legal entities and process transactions using funds or assets derived from criminal activities.

It is for these reasons that being a CSP attracts AML/CFT requirements in terms of international and EU standards, and CSPs are therefore considered “subject persons” under the PMLFTR⁶.

Engaging with Industry Stakeholders

Throughout the 2019 Consultation the MFSA sought the industry’s view on the ways in which the Authority could strengthen the regulatory framework for CSPs and raise the bar for all those providing CSP services, including those who were providing such services in terms of the exemptions applicable at the time⁷ and those who were

⁵ The significance of this role is recognised in Malta’s 2023 NRA, NCC (2023, December), retrieved from https://www.ncc.gov.mt/wp-content/uploads/2024/01/PublicNRA_Dec2023.pdf vide p. 49 and p. 136,

⁶ As “subject persons” CSPs are inter alia responsible to take appropriate steps, proportionate to the nature and size of their business, to identify and assess the risks of money laundering and funding of terrorism that arise out of their activities or business in terms of Regulation 5(1) of the PLMFTR.

⁷ As will be explained further below, professionals holding a warrant to practice as advocate, notary public, legal procurator and accountant were already “subject persons” under the

registered as CSPs under the CSP Act. As the 2019 Consultation Document explained, the importance of the Authority's proposals was 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 Mutual Evaluation Report adopted in July 2019⁸ following a jurisdictional on-site visit held in Malta between 5-16 November 2018.

In 2018 Malta's ML/TF National Risk Assessment ("**NRA**") had already identified the CSP sector as a sector with a higher risk profile from the ML/TF perspective. In its 2019 Mutual Evaluation Report MONEYVAL identified specific aspects under Recommendation 28 that were increasing Malta's exposure to ML/TF risk specifically related to the CSP regime then in force. The Report explains that the conclusions⁹ under Recommendation 28 were influenced by the fact that the statutory exemptions and *de minimis* ruling (applicable at the time) limited the effectiveness of the regime as not all persons providing CSP services were subject to market entry measures and/or subject to AML/CFT. These concerns were further exacerbated by concerns regarding the adequacy of market entry measures and on-going fitness and properness measures applicable to some professionals.

The feedback received in relation to the 2019 Consultation Document was analysed by the Authority and a Feedback Statement¹⁰ published in April 2020 putting forward the grounds upon which the reform of the CSP sector would be based. Notably one of the main changes announced in the Feedback Statement was that a number of persons who, at that point in time, were providing CSP Services but were exempt from, or did not require registration, would be brought within the scope of the CSP Act and become subject to an authorisation requirement¹¹. These persons included warranted professionals who had been exempt from the provisions of the Act¹² but

applicable law and regulations and therefore subject to scrutiny in terms of AML/CFT by the FIAU.

⁸ MONEYVAL, (2019, July). Retrieved from <https://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/Moneyval-Mutual-Evaluation-Report-Malta-2019.pdf>

⁹ Vide Para 431, p. 200.

¹⁰ MFSA (2020, April). *Raising the Bar for Company Service Providers*, Ref 17-2019. Retrieved from <https://www.mfsa.mt/news-item/raising-the-bar-for-company-service-providers-the-mfsa-publishes-feedback-statement-on-proposed-reforms-to-the-csp-framework/>

¹¹ Vide Section 2.5, p. 8.

¹² Vide Article 3(1A) of the CSP Act.

who had been “subject persons” in terms of the PMLFTR as they carried out “relevant activity” in terms of the PMLFTR. As for individuals who had been operating under the “de minimis” rule and who were not subject to any regulatory requirements until the reform took place, these had to adapt and put in place the necessary systems and governance mechanisms to start complying with the rules applicable to them.

The impact of the reform of the CSP regime is recognised in Malta’s NRA for 2023 which notes that “*the effectiveness of the licensing and authorisation is considered as ‘very high’ (the highest rating for the effectiveness of mitigating measures)*”. The 2023 NRA continues by explaining that this is a result of the fact that through legislative amendments published in 2020, these professionals and individuals operating under the “de minimis” rules have also been captured within the MFSA’s licensing and supervisory remit as they are required to undergo fitness and propriety assessments and are subject to ongoing scrutiny by the MFSA. This reform has contributed significantly to the overall residual risk of the sector being ‘medium-high’¹³.

1.2 CSP Reform – How did it happen?

Following the Authority’s 2019 Consultation on Raising the Bar for CSPs and the publication of its analysis of the feedback received from industry stakeholders, the CSP Act was amended by virtue of the Company Service Providers (Amendment) Act, 2020 enacted by Parliament as Act L of 2020 (“**CSP Amendment Act**”). A dedicated team at the Authority focussed on the implementation of the reform and extensive outreach to the industry explaining the reform and its repercussions for those providing CSP services. A new dedicated application process was developed for those who were already providing CSP services (either as warranted professionals or under the *de minimis* ruling) and who would be applying for authorisation under the CSP Act’s transitory provisions once the CSP Amendment Act came into force. The Authority also published detailed guidance on the application process and the use of the Licence Holder Portal aimed at those individuals who would be utilising this portal for the first time and who were not familiar with the Authority online systems¹⁴.

¹³ *Vide* p. 18 and p. 138.

¹⁴ MFSA (March 2021). *Guidelines on the New CSP Regime Application Process*. Retrieved from <https://www.mfsa.mt/wp-content/uploads/2021/04/Guidelines-to-the-New-CSP-Regime-Application-Process.pdf>

Strengthening the Regulatory Framework and Engaging with CSPs

A particular area of focus involved issuing a new set of rules for CSPs to adequately reflect the reforms¹⁵ and the issues identified by the Authority through its experience of regulating CSPs over several years. The updated CSP Rulebook was issued in March 2021 following a consultation document published in December 2020¹⁶ which triggered extensive consultation with CSPs, warranted professionals, and various industry bodies. This feedback was analysed and the rules were amended or new rules added to take into consideration the concerns raised by the industry.

In its analysis of the feedback received from the industry the Authority took a proactive approach incorporating proportionate and flexible solutions where possible.

One such case involved introducing a rule specifically for those CSPs who would be limiting their CSP operations to qualify as under threshold CSPs, and therefore offering their services on a limited scale. The concern raised during the consultation process on the updated CSP Rules was that an under threshold CSP may be close to the upper end of the threshold specified in the CSP Rulebook, so that taking on any further business would result in the CSP exceeding the threshold (albeit for a brief period) until they decide how to regularise the situation. Rules R4-5.3 and R4-5.4 of the CSP Rulebook were introduced specifically to cater for this eventuality whereby under threshold CSPs would be given a period of three months to regularise their position if they exceed the applicable threshold on a calendar year basis¹⁷.

¹⁵ The Authority had issued Rules for Company Service Providers in March 2014. These can be retrieved from https://www.mfsa.mt/wp-content/uploads/2018/12/CSP-Rules_FINAL-up.pdf

¹⁶ MFSA (December 2020), *Consultation Document on the Updated Company Service Provider Rules, Ref 05-2020*, <https://www.mfsa.mt/publication/consultation-document-on-the-updated-csp-rules/> The draft CSP Rulebook was also published with the Consultation Document.

¹⁷ In such cases there is the obligation on the part of the CSP to notify the Authority that the threshold has been exceeded as soon as s/he becomes aware of this.

The Feedback Statement relating to the changes to the CSP Rulebook published on 12 April 2021¹⁸ explains in more detail how the Authority sought to address the issues raised during the consultation period and provides insight into the Authority's efforts to understand and address the industry's concerns and comments.

In addition to the Feedback Statement clear guidance on the application of the CSP Act was published and included a detailed explanation of the components of the "by way of business" assessment referred to in Article 2 of the CSP Act, this being a key concept in the legislation being determinative of its application¹⁹. The guidance on the application of the CSP Act²⁰ includes practical examples of specific instances which the industry had consistently raised in its feedback to the Consultation. For instance, it explains the treatment of individuals who act as directors and/or company secretary in companies where they are employed to do so under a contract of employment; the position of individuals who hold office as director and/or company secretary in companies which are owned by them or by members of their family; the provision of company incorporation by warranted professionals who provide the service on an incidental basis and so forth.

Once Legal Notice 96 of 2021²¹ was published, thus bringing into force the amendments to the CSP Act as at 16 March 2021, the updated CSP Rulebook was issued by the Authority on 16 March 2021. The Rulebook changes were made to address issues identified during supervisory engagements with CSPs, such as strengthening governance, compliance and risk related provisions in the Rulebook. New provisions were introduced to reflect the Authority's risk-based approach to regulation and the implementation of the proportionality principle. This is reflected for instance by the introduction of three categories of CSPs and the further classification into under threshold and over threshold of Class A and B CSPs

¹⁸ MFSA (April 2021), Feedback Statement to the Consultation Document on the Updated CSP Rules, Ref: 05-2020. Retrieved from: <https://www.mfsa.mt/wp-content/uploads/2021/04/Feedback-Statement-to-the-Consultation-Document-on-the-Updated-CSP-Rules.pdf>

¹⁹ Article 3(1) of the CSP Act states: *"Any person operating in or from Malta who acts, or holds himself out as acting as a company service provider by way of its business, shall apply for authorisation with the Authority in terms of this Act."*

²⁰ MFSA, (March 2021), <https://www.mfsa.mt/wp-content/uploads/2021/03/Guidance-Note-on-the-Application-of-the-Company-Service-Providers-Act.pdf>

²¹ Entitled "Company Service Providers (Amendment) Act 2020 (Act No. L of 2020).

depending on specific criteria. The Rulebook also incorporates high-level principles that underpin the MFSA's expectations at both authorisation and supervision stage.

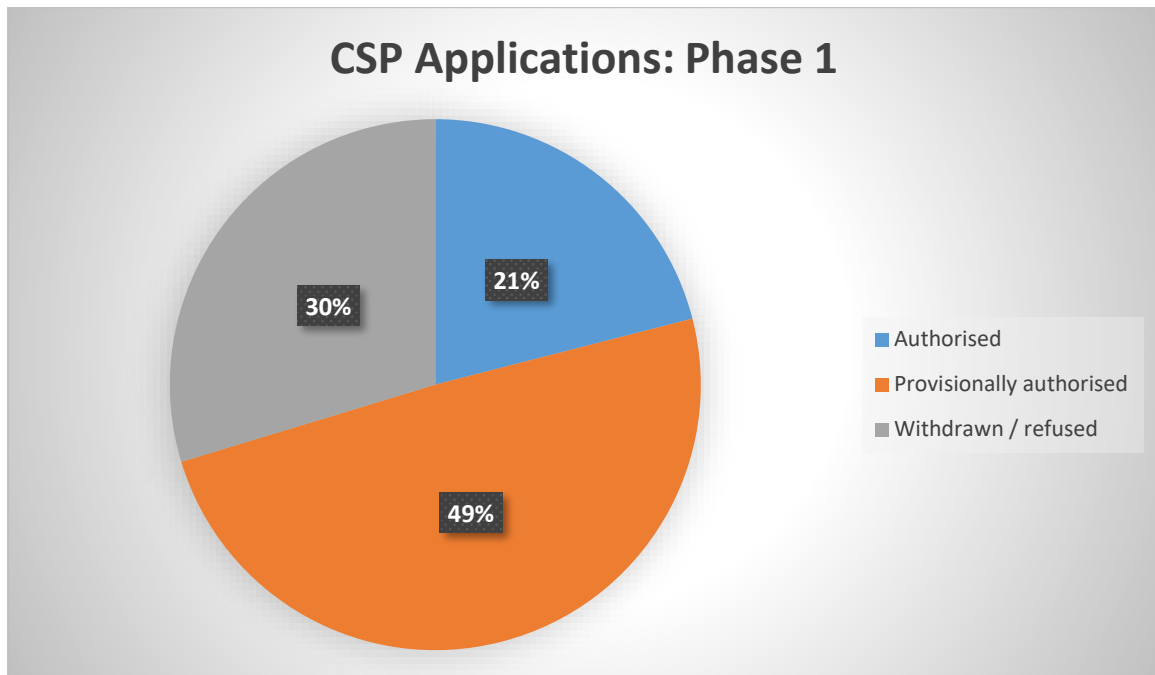
Developing a Process for Applicants already operating as CSPs

For the development of the application process the Authority took into consideration that those applying in terms of the CSP reform's transitory period were, to an extent, an unknown quantity (as a number were not regulated); particularly those operating under the "de minimis" rule were not subject to any form of regulatory requirements nor were they subject persons under the Prevention of Money Laundering and Funding of Terrorism legislation. To address this an application form was designed so as to capture information key to the Authority's understanding of the sector and to inform the processing of applications. This was particularly relevant since the standard CSP application was not intended to cater for those already operating as CSPs. The information requested included the nature and scale of the applicants' existing CSP business and the controls they had in place. The Authority's management information dashboard gave a breakdown of the risks for the population of applicants on a case-by-case basis and specific risk models were created in order to assess the risks posed by their CSP business while taking into account the mitigation measures they had in place. It also gave the Authority a snapshot of the applicants' business models based on the information they themselves had provided to the Authority. This information was particularly helpful given the Authority received a total of 276 applications as at 16 May 2021 which had to be processed within the legal deadlines in the CSP Act being 16 November 2021 and 16 November 2022 as explained below.

Applications processed in terms of the CSP Reform

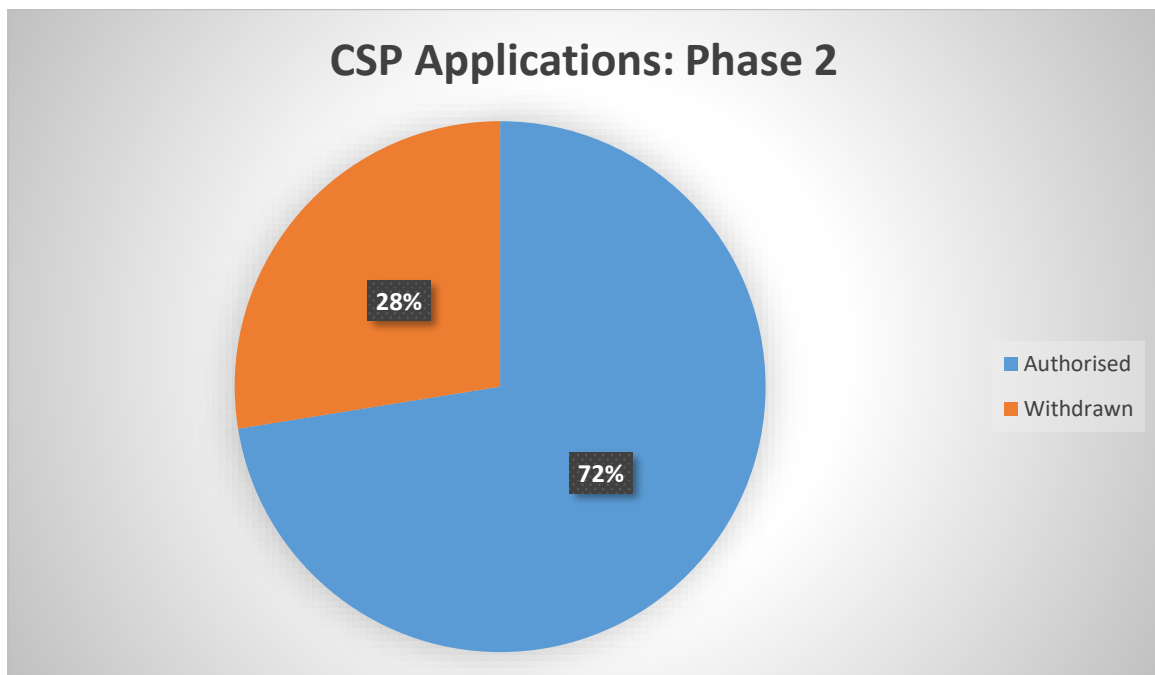
A total of 276 CSPs applied for authorisation under the transitory provisions in the Act. Between 16 May 2021 and 16 November 2021 a total of 58 applicants were authorised to provide CSP services under the Act and 136 applicants were provisionally authorised to provide CSP services under the Act while 82 applications were withdrawn/refused. These figures are depicted in Table 1 below.

Table 1 Breakdown of CSP Applications as at 16 November 2021



During the second phase of the reform process between 17 November 2021 and 16 November 2022, a total of 100 applicants were approved while 38 applications were withdrawn. The former includes those CSPs who decided to consolidate their CSP business in a dedicated entity.

Table 2: Breakdown of CSP Applications at as 16 November 2022



The Process adopted for Assessment of Applicants

Taking account of the size and complexity of the population and with the objective of achieving an early informed understanding of that population a two-phase process was adopted. This permitted an earlier and streamlined application process for smaller entities and individuals; but enabled a more detailed in-depth assessment of the more complex applicants. At the same time there was no interruption to the sector as applicants were permitted to continue to process their CSP business.

During Phase 1 being the period from 16 May 2021 to 16 November 2021, the Authority was legally obliged to authorise (or refuse) those applicants classified as under threshold CSPs and to provisionally authorise those classified as Class C and over threshold Class A and Class B CSPs. The objective of structuring the CSP reform so that some of the CSP applicants would be provisionally authorised at the end of Phase 1, was that of ensuring that all those who had applied under the CSP reform would effectively be regulated as at the legal deadline of 16 November 2021. This recognised that processing all applications within Phase 1 (and therefore a period of 6 months) effectively, and up to the Authority's standard processes, would not be possible; but ensured that measures were taken to mitigate the risk in the sector without causing major disruption.

The fitness and properness assessment and a comprehensive analysis of the business model for all under threshold CSPs thus had to be completed in its entirety by the end of Phase 1 while the focus in the case of the remaining applicants was to satisfactorily conclude the Due Diligence checks on a risk-based approach so the in-depth analysis of the applicants' business model and the remaining aspects of the fitness and properness assessment would be concluded in Phase 2, that is, from 17 November 2021 and 16 November 2022. The TCSPs Authorisation team worked together with the Due Diligence Function to ensure that the Authority's comprehensive due diligence processes were followed and maintained.

Supervisory Engagements with Applicants

As mentioned earlier, the results of the NRA carried out in 2018²² classified the CSP sector as being highly susceptible to ML/FT risk. Adopting a risk-based approach, a

²² Retrieved from

https://finance.gov.mt/en/Library/Documents/Result_of_the_NRA_2018.pdf

number of applicants from various categories and risk profiles were selected during the authorisation process for further supervisory engagement through interviews and onsite inspections.

For these engagements with applicants, the TCSPs Authorisation team also worked closely with the Financial Crime Compliance (“**FCC**”) Function within the MFSA when carrying out MLRO interviews, the MLRO function being one that requires prior authorisation by the MFSA. Externally, it liaised with the FIAU in relation to AML/CFT matters throughout the duration of the CSP Reform, including on the technical aspects of the CSP Reform as well as to identify those CSPs who, through this authorisation would become subject persons in terms of law for the first time. Working collaboratively with the FCC Function and the FIAU was considered extremely important given the AML/CFT Supervision Strategy²³ adopted by the MFSA. Through this strategy the MFSA recognises that its work in relation to AML/CFT integrates with that of the FIAU and other national competent authorities. It also recognises that supervisory functions within the MFSA, including the TCSP Supervision Function, are charged with an element of AML/CFT supervision which supplements and acts as a trigger for the main AML/CFT supervisory activities undertaken by the FIAU and the FCC Function, on behalf of the FIAU.²⁴

Other engagements were carried out jointly between the TCSPs Authorisation team and the TCSPs Onsite Supervision team in relation to both entities and individual applications and the focus of these engagements was to understand the business model, the applicants’ understanding of risk and the mitigation measures in place as well as the knowledge of the CSP regulatory framework, AML/CFT rules and compliance requirements.

²³ Retrieved from https://www.mfsa.mt/wp-content/uploads/2019/02/MFSA-AML_CFT-Strategy.pdf

²⁴ See AML/CFT Supervision Strategy – An Update (2021), p. 6 retrieved from <https://www.mfsa.mt/wp-content/uploads/2021/06/MFSA-AML-CFT-Strategy-An-Update.pdf>

1.2.1 The Authority's Main Challenges during the CSP Reform

Through the reforms of the CSP sector, the Authority achieved the strategic objectives of raising standards for CSPs by upgrading the CSP regulatory framework first introduced in 2013, to establish a more robust, co-ordinated and proportionate risk-based approach, and of addressing key recommendations made by international peer reviews such as MONEYVAL.

During the preparatory phase of implementing the reforms, the Authority faced the challenge of striking a balance between the understandable concerns of the industry and address these concerns in a proactive and effective manner, while at the same time introducing rules which would effectively raise the standards for the entire sector. As explained above this was achieved through extensive consultation with industry bodies representing professionals from various sectors and the analysis of the feedback received to the consultation paper on the changes to the CSP Rulebook.

Effectively communicating with CSPs during COVID-19

It should be mentioned that at the time COVID-19 restrictions were in place so outreach to the industry could only take place through online meetings and methods of communication. Getting the message across to the industry, while complying with COVID-19 restrictions, presented another challenge to the Authority.

Once the date of coming into force of the CSP Amendment Act was published, the Authority launched a web page dedicated to communicating information to the industry and potential applicants²⁵, various circulars were published for the industry's guidance and a dedicated email address was communicated through which industry participants could raise any queries relating to the CSP reform and how they would be affected. Through this mailbox alone a dedicated team of analysts replied to over 1000 queries within a period of 2 months.

Another challenge faced by the Authority was that an effective communications strategy was needed to raise awareness with those individuals or entities not previously regulated and to engage with and acclimatise the professionals new to

²⁵ See MFSA website here <https://www.mfsa.mt/firms/conduct-supervision/company-service-providers/the-new-company-service-providers-regime-in-light-of-act-l-of-2020/>

MFSA regulation. This population was not registered at any Authority therefore the MFSA had no visibility of numbers. With the help of the Authority's Communications Function, the CSP reform was given exposure through various media coverage including print, audio and social media. Webinars were organised at which participants from the industry attended online. Meanwhile the team dedicated to working on the CSP reform prepared a publication of around seventy [Frequently Asked Questions](#) covering many different aspects of the new legislation and rules relevant to both those applying for authorisation under the transitory provisions in the CSP Act, and to existing CSPs who were registered under the CSP Act and would need to adhere to the CSP Rulebook as issued in 2021. These were updated to reflect questions asked by industry participants at the MFSA webinar of 15 April 2021. MFSA officials also participated in various webinars organised by professional bodies and industry stakeholders in order to raise awareness of the new rules and to address any queries regarding the Authority's expectations and the transitory application process.

Adhering to the Legal Deadlines in the CSP Act

The two CSP Act deadlines of the 16 November 2021 and 16 November 2022 also presented considerable challenges to the Authority given that the fit and proper assessment²⁶ had to be carried out in relation to all individual applicants, directors of entities/partners of firms and qualifying shareholders/controllers of applicant entities, compliance officers, MLROs and risk managers (for Class C CSPs). As a result, the number of Personal Questionnaires received was considerable. The workstream was structured to focus upon the full fitness and properness assessment of under threshold applicants so as to be able to decision them by 16 November 2021 (by the end of Phase 1), while also targeting specific aspects of the fitness and properness assessment (such as due diligence) for those applicants classified as over threshold and Class C CSPs who in terms of law would be provisionally authorised or refused authorisation by 16 November 2021. For this process efficiency was critical due to the number of applications received.

An objective of structuring the CSP reform so that some of the CSP applicants would be provisionally authorised at the end of Phase 1, was that of ensuring that all those

²⁶ This assessment is carried out in accordance with the MFSA guidance on the subject which can be accessed here https://www.mfsa.mt/wp-content/uploads/2019/07/20190702_FitnessPropernessGuidance.pdf

who had applied under the CSP reform would effectively be regulated as at the first legal deadline of 16 November 2021. This recognised that processing of all applications within Phase 1, and therefore a period of 6 months, would not be possible, and allowed the sector to keep operating without interruption.

1.2.2 Lessons Learnt

At the beginning of the application process in Phase 1 all 276 applicants had to be classified by the Authorisation team in accordance with the classes of CSPs (established in the CSP Act and CSP Rulebook), so that they would be given a reasonable time to put forward reasons why they did not agree with the classification. A sub-team of analysts considered these requests for re-classification so these cases could be dealt with swiftly and applicants who may not have fully understood the CSP classification could be guided appropriately.

During the classification process in Phase 1 of the CSP reform, the issues of unresponsive applicants' clients and clients with whom the CSP had lost contact were raised by many applicants. Some service providers proposed that because they had lost contact with the ultimate beneficial owner there was no action that needed to be taken by them; while others had formally notified the Malta Business Registry of the termination of the service and/or that their registered office could no longer be used by the client. The Authorisations team guided the former to communicate their position with the Malta Business Registry and, where some contact had been maintained with the client, some service providers managed to terminate their relationship by communicating with the client. **It is important to realise that unresponsive clients present a risk that CSPs should be addressing hence the importance of formulating and implementing an exit strategy to deal with clients who may become unresponsive or with whom contact is eventually lost.**

There were also misconceptions by some applicants who considered that acting as director in 2 companies while also providing company formation services would result in a Class A under threshold classification when, in fact, the combination of CSP services and the holding oneself out as providing CSP services would result in a Class C category. Again, through discussion with the Authorisation team the service providers concerned gained a better understanding of the CSP regulatory framework. The way the reform was structured allowed them to continue their activities as a CSP while making changes to their business model to align themselves to the CSP

Rulebook requirements. Some applicants opted to change their business models to obtain the originally desired Class authorisation while others chose to proceed with the allocated Class. **The importance of CSPs having a good understanding of the CSP regulatory framework cannot be underestimated.**

During this process the Authorisation team **maintained effective and ongoing communication with applicants**, and this helped make the process more efficient and straightforward for all concerned. In doing so, the Authorisation Team adopted a risk-based approach, focusing its resources on those cases that presented a higher risk profile than others as explained below.

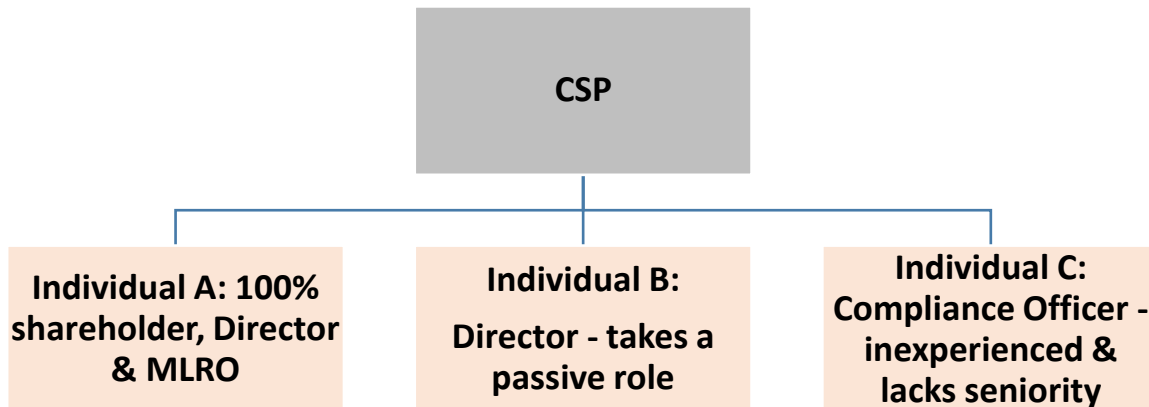
Examples of cases meriting technical expertise and guidance from the Authority

Throughout Phases 1 and 2 the Authorisation team also identified:

- complex and high-profile applications which merited technical expertise and supervisory engagement with the applicants concerned to assess their regulatory history and competence, particularly (but not only) in the area of AML/CFT.
- applicants who did not provide a professional service to clients whether due to the lack of support staff, lack of business continuity measures or similar shortcomings and who, through discussions with the Authority, adapted their business model, undertook training and enhanced their compliance culture so as to reach the Authority's standards and expectations.
- applicants having weak controls and lacking knowledge of the risks that emanate from ML/TF creating a situation where they could be exploited by clients; in these cases, most applicants voluntarily decided to leave the sector.

During the course of the CSP reform the Authority also encountered cases where **one individual exercised a dominant influence over an applicant entity as can be seen from the example below. This raised concerns about the entity's governance and how the dual control principle was being applied.**

Example of dominant individual in a CSP constituted as a company



The Authorisation team was not satisfied that such structures could satisfy the dual control principle which is a fundamental principle in the CSP Rulebook as it requires a CSP to be “effectively directed or managed by at least two individuals” in satisfaction of this principle²⁷. ***Through engagement with the applicants in such cases the Authority managed to guide such entities to re-structure their business so they would be able to comply appropriately with governance standards in the Rulebook.***

Assessing the size, nature and complexity of a CSPs business

The Authorisation team also came across individual applicants whose business had grown to such an extent that it merited re-structuring. When considering an individual’s business model, in terms of Rule R2-2.10 of the CSP Rulebook, the Authority had to consider whether individual CSPs can meet their governance requirements based on the risk presented by the nature, size and complexity of the CSP business. The Authorisation team came across instances where, due to these considerations, through engagement with the Authority, such individual CSPs elected to establish a legal person. Being conscious of the fact that these CSPs would need some time to prepare and submit a new application in the name of a company set up for the purpose, the individuals were authorised as CSPs under specific post-authorisation conditions to ensure that risks would be mitigated accordingly, such as the condition to apply for authorisation as a legal person within a specified time

²⁷ CSP Rulebook, Rule R3-6.6.2.

frame and specific conditions to mitigate risk until the legal person would be authorised as a CSP.

In other cases, the Authority considered that although the volume of business of the individual applicant had not reached a point whereby restructuring of the business would be required, yet it was sufficiently large to merit a post-authorisation condition whereby the individual would be required to provide the Authority with information on the volume of business at specified time periods to enable the Authority to determine whether governance requirements would still be satisfied on an ongoing basis. On the other hand, some applicants decided that the CSP reform would be a good opportunity to consolidate the CSP business into one entity, a special purpose vehicle that would hold and undertake all the CSP business carried out by the individual or firm.

The Authority created a separate workstream for these consolidations by assessing the CSP business submitted by the applicant and the relative Personal Questionnaires, then providing special post-authorisation conditions whereby the CSP business would be transferred to the special purpose vehicle within a specified time frame. The purpose of this workstream was to allow the CSP providers to operate within the transitory provisions envisaged by the CSP Act while the Authority undertook the application process for the new entity. As at 16 November 2022 a total of 18 such consolidations were approved by the Authority.

Authorisation Conditions

The power of the Authority to impose pre-authorisation and post-authorisation conditions was utilised effectively to deal with issues which arose across the board but also to address very specific issues that were uncommon, while allowing applicants the time and flexibility to adjust to the new requirements.

In most cases applicants were given an in-principle approval subject to the satisfaction of certain conditions (such as proof of working capital in accordance with the CSP rules relating to capital requirements). Post-authorisation conditions were imposed on those authorised as CSPs (other than the standard conditions relating to having an operational office, taking appropriate business continuity measures, and segregation of client files and information). The post-authorisation conditions were tailored to address the specific risks identified, such as the requirement for applicants to attend training on the CSP regulatory framework,

AML/CFT or regulatory compliance where it was considered that the applicant and/or officer did not have sufficient training on the subjects. In some cases, individuals were required to obtain qualifications in compliance or AML/CFT (rather than to undertake training) as it was determined that a qualification was warranted based on the proposed role, past experience and the business model including checks and balances in place.

Other post-authorisation conditions utilised by the Authority involved:

- the requirement to engage an external specialist consultant to mentor the appointed Compliance Officer over a period of time, where the individual concerned was deemed to have sufficient knowledge and qualifications, but was considered to lack sufficient experience. In coming to its decision the Authority considered inter alia the size and nature of the CSP business;
- where certain findings were identified during supervisory engagements with applicants, the Authority required the appointment of an external independent person to carry out an audit of the authorised person's client files within a specified timeframe and to provide a plan explaining what remedial action had been taken;
- based on findings from supervisory engagements with applicants, the Compliance Officer was required to carry out a review of the authorised person's processes and procedures and to conduct testing of systems, following which the Compliance Officer was required to provide a report informing the Authority what remedial action had been taken.

In order to provide CSPs with a better understanding of what is expected of them when taking action to satisfy post-authorisation conditions, the Authority issued a [Guidance Note on the Fulfilment of Post-Authorisation Requirements](#). This guidance provides insight on the Authority's expectations for the fulfilment of post-authorisation conditions and requires CSPs to carry out a documented gap analysis between the action taken by them to satisfy the post-authorisation conditions and the action expected of them as per the Authority's guidance. Adopting a risk-based approach, during its supervisory work the Authority is following up on the fulfilment of these conditions to ensure that CSPs adhere to them in the manner expected by it.

Section 2: MFSA's Expectations from the Industry

The Authority has engaged with CSPs since the regulatory framework was first introduced by the Act in 2013 and through publications, supervisory engagements and communications with stakeholders the Authority outlines its expectations from CSPs on an ongoing basis. As a result of the wide-ranging reform of the sector the Authority is taking the opportunity to communicate its expectation both from an authorisation and supervisory perspective to industry participants and to those interested in applying for authorisation as a CSP.

2.1 Knowledge of CSP Rulebook and High-Level Principles

Main Observations

The CSP Rulebook highlights the Authority's expectations of CSPs through the high-level principles which form the basis for the CSP Rules²⁸. Through the CSP Reform the high-level principles were incorporated in the CSP Rulebook issued in March 2021, so that CSPs could have a clear understanding of the principles underpinning the rules.

During the CSP Reform it was clear that some applicants were not familiar with neither these high-level principles nor the CSP Rulebook requirements, and did not

²⁸ The principles are found in Title 2 of the CSP Rulebook. CSPs are urged to be familiar with these high-level principles. These can be summarised as:

- CSPs should act in an ethical manner with due care, skill and diligence, taking into consideration the best interests of their clients and the integrity of Malta's financial system.
- CSPs should act honestly, fairly and professionally and comply with the relevant provisions of the CSP Act, the regulations issued thereunder, and the CSP Rulebook, as well as with other relevant legal and regulatory requirements, including *inter alia* the Prevention of Money Laundering Act, Chapter 373 of the Laws of Malta, as well as any regulations and rules issued thereunder.
- CSPs should co-operate with the MFSA in an open and honest manner and provide the Authority with any information it may require. They are also required to supply the MFSA with such information and returns as the MFSA requires.
- CSPs should also deal openly and in a spirit of cooperation with any other relevant regulatory authority.
- CSPs should co-operate and deal openly with other regulatory authorities.

meet the fitness and properness assessment carried out by the Authority. This is not in line with the Authority's expectations from person applying for authorisation as a CSP and raises concerns about the fitness and properness (from a competence perspective) of such persons.

Expected Practices

- CSPs and those applying for authorisation as CSPs are expected to have a clear understanding of the high-level principles in the CSP Rulebook and to adhere to these on an ongoing basis.
- Applicants should be able to show that they are well versed in and have a thorough understanding of the CSP Rulebook and how these rules will be applied by them in practice.

2.2 Fitness and Properness

Main Observations

Persons who are not fit and proper pose a risk to the proper functioning of the financial sector; by assessing individuals to ensure that they meet and adhere to the fitness and properness requirements, the Authority acts as a gatekeeper to the sector. The Authority conducts a fitness and properness assessment²⁹ to vet *inter alia* individual CSPs, directors (or equivalent) in the case of CSP entities, officers such as Compliance Officers and MLROs, as well as qualifying shareholders and controllers³⁰. When proposing individuals to act in roles that require prior approval by the Authority, the latter expects applicants and CSPs (as the case may be) to carry out their own in-depth assessment of the proposed individual's fitness and properness prior to proposing an individual for the approved position. In particular, CSPs should not propose individuals who are clearly unsuitable for a role, be it due to a lack of competence, lack of time to be able to perform the proposed role in a professional manner, conflicts of interest or any other reason that will undermine their effectiveness or independence.

²⁹ The fitness and properness assessment centres around a person's competence, reputation, time commitment, conflicts of interest and independence of mind.

³⁰ MFSA has issued guidance in this respect which can be accessed here: https://www.mfsa.mt/wp-content/uploads/2019/07/20190702_FitnessPropernessGuidance.pdf

Once a person has been approved in a particular role, the Authority expects that such person is fit and proper on an ongoing basis; it is incumbent on the individual concerned to inform the Authority of any facts or occurrences which impinge, or could potentially do so, upon his fitness and propriety. This should be done as soon as the individual becomes aware of such fact or occurrence in a spirit of openness and co-operation with the Authority.

Expected Practices

- Individuals applying for a position requiring prior approval by the Authority should provide all information and supporting documents required with their Personal Questionnaire, while also being transparent in their communications with the Authority.
- Such individuals should not assume that information that impinges on their fitness and properness, even though it may be in the public domain, is known to the Authority.
- Disclosures to the Authority should be clear, transparent and made in a spirit of co-operation with the Authority.
- it is incumbent on the individual subject to ongoing fitness and properness obligations to inform the Authority of any facts or occurrences which impinge, or could potentially do so, upon their fitness and propriety.³¹

2.3 Compliance Culture and Robust Governance

Main Observations

In the Authority's Strategic Statement published in February 2022³² one of the five pillars of the Authority's strategic objectives is described as promoting good governance and compliance. The Strategic Statement explains the basis for this pillar as follows:

"Governance, risk management and control systems, along with strong compliance frameworks are the mainstays of the industry. A strong compliance culture contributes to efficient regulation by

³¹ See link to the Authority's Guidance on Fitness and Properness Assessment in previous footnote.

³² Strategic Statement (February 2023) p. 23. Retrieved here: <https://www.mfsa.mt/news-item/mfsa-outlines-five-strategic-pillars-in-newly-launched-strategic-statement/>

placing consumer interests at its core, preserving market confidence, and maintaining stability in the financial system.

Given the degree of trust placed in it by society in general, the financial industry is also expected to be a beacon of good corporate governance that not only aims for the highest standards of business conduct but spurs users of the financial system [...] to observe good governance principles and pursue sound management practices”³³

The Authority expects directors of CSP companies (or equivalent officers for other types of legal persons) to be proactive in instilling a compliance culture within the CSP, and for management to embed such culture within all layers of the organisation, thus ensuring that the CSP complies with its regulatory requirements.

The Authority expects CSPs to apply tailor made policies and procedures which are designed to detect risk of failure and to mitigate such risks; staff should have a clear understanding of reporting lines and who is responsible for what within the organisation, and should be trained on a regular basis both in relation to applicable legislation and rules as well as the CSP’s own processes and procedures.

In relation to CSPs established as legal persons the Authority requires a strong governance framework with the directors (or equivalent for other legal persons) taking an active role in the management and direction of the CSP while applying the dual control principle³⁴. The Act makes it clear that a minimum of two directors are required for CSPs established as companies³⁵ (or equivalent for other legal entities), with the CSP Rulebook clearly explaining that having an assessment by two persons reduces the likelihood of major errors occurring in the conduct of the CSP’s operations. Both persons must be fit and proper so as to have the necessary knowledge and experience to be able to manage the CSP and, more importantly, have the necessary personal qualities to be able to effectively apply the four eyes principle in the course of managing the CSP business. Thus, as explained above, where a single individual was found to be particularly dominant in a CSP, this was flagged with the applicant and changes were made to the applicant’s governance structure to satisfy the dual control requirements in the CSP Rulebook.

The requirement of an independent compliance officer for Class A over threshold, Class B over threshold and Class C CSPs is also an important component for good governance. The role is an onerous one as it requires the individual to be responsible for all aspects of compliance, to demonstrate independence of judgement and to

³³ Vide p. 23.

³⁴ CSP Rulebook, Rule R3-6.6.2.

³⁵ Article 5(1)(c)(iii).

exercise day to day control over the CSP in terms of the CSP Act.³⁶ Also worthy of mention is that compliance officers and MLROs should have investigative skills and an analytic approach to complement their academic qualifications³⁷ and experience. These officers must have sufficient seniority to be able to take sensible and effective action even if this involves taking unpopular decisions and challenging directors and/or shareholders.

Expected Practices

- A strong compliance culture is to be embedded within all layers of the CSP.
- CSPs are expected to have a robust governance framework.
- The dual control principle is to be embedded within CSPs' processes and procedures.
- Staff is to be appropriately trained so they know what the processes and procedures entail and can apply them effectively in practice.
- The role of the compliance officer is to be undertaken by an individual who can be effectively responsible for all aspects of compliance, is able to demonstrate independence of judgement and exercise day to day control over all aspects of compliance by the CSP.
- Compliance Officers and MLROs must have sufficient seniority to be able to take sensible and effective action even if this involves taking unpopular decisions and challenging directors.

³⁶ See further CSP Rulebook in particular Title 6, R2-6.1.

³⁷ This was discussed by Chief Officer Supervision at an event organised by the Malta Chapter of ACAMS. See Circular (May 2022) accessed here: <https://www.mfsa.mt/wp-content/uploads/2022/05/Investigative-Skills-Needed-by-Compliance-Officers-and-MLROs-%E2%80%93-MFSA-Chief-Officer.pdf>

During the event Dr Buttigieg also stressed that the Compliance Officer and MLRO roles meant they would need to stand up to the senior management including the chief executive officers when necessary. *"Compliance officers and MLROs must be willing and empowered to take timely and effective action, to intrude on decision-making, to question common wisdom, and to take unpopular decisions,"*

2.4 Communication and Regulatory Reporting

Main Observations

"We will place transparency, risk awareness and two-way communication at the centre of our push for continuous improvement in standards."³⁸

During engagement with applicants and authorised persons the Authority requires discussions to be open and to be undertaken in a spirit of co-operation. Comprehensive and clear information should be provided in communications relating to applications, when requests are made to the Authority and throughout supervisory engagements. As was amply clear during the CSP reform process the importance of effective communication and co-operation between the Authority and the applicant is crucial and leads to timely processing of applications.

Applicants seeking CSP authorisation are to follow the Authorisation process as explained on the MFSA website³⁹ and (particularly when providing a statement of intent and subsequently an application for authorisation) should provide the Authority with comprehensive information. In some cases applications are provided with outstanding information, or a lack of clear and relevant explanations, thus preventing the Authority from building an understanding of the business model and/or the processes and procedures in place; this results in the application processing being stalled due to the lack of information provided by the applicant and extends the timeframe for processing of the application as the Authority has to request information or clarifications which should have been provided by the applicant in the first place. The Authority has endeavoured to explain its commitment towards efficient and timely processing of authorisation requests and what it expects from applicants in the [MFSA's Authorisation Process Service Charter](#)⁴⁰.

Applicants are expected to communicate to the Authority what processes are in place and indicate what preparatory steps have been taken to comply with the CSP Rulebook at application stage. Applicants who have not taken any preparatory steps to put the necessary processes and procedures in place to comply with the CSP Rulebook or do not have a clear understanding of the processes required do not provide the Authority with comfort that they have the necessary compliance culture

³⁸ MFSA Strategic Statement (February 2023) p. 23.

³⁹ See <https://www.mfsa.mt/our-work/authorisations/>

⁴⁰ MFSA, (June 2021), Authorisation Process – Service Charter, see <https://www.mfsa.mt/wp-content/uploads/2021/06/MFSA-Authorisation-Process-Service-Charter.pdf>

and can adhere to the Authority's expectations. This is a legal requirement on which the Authority must be satisfied before granting an authorisation.

In coming to its decision to authorise or refuse an application, the Authority is also required to have regard to the protection of the reputation of Malta while taking into account Malta's international commitments.

For authorised CSPs it is necessary that record keeping processes are in place which allow timely access to records and extraction of data and/or information when this is requested by the Authority (and any other relevant authorities), and to complete regulatory reporting requirements and submit regulatory reporting within the prescribed deadlines. This includes documenting decision making (applicable to individual CSPs who are required to record decisions in writing⁴¹ and to entities who are required to document decisions at management level).

Late submission of regulatory reporting by authorised persons is an indicator that these persons may not have appropriate processes to comply with the applicable rules. The Authority takes such factors into consideration in the course of its risk-based approach to supervision.

Where there are factors which an authorised person wishes the Authority to take into consideration in case of late submission of regulatory reporting, the authorised person should inform the Authority prior to the deadline for submission of document/s of the factors that prevented timely reporting. The Authority comes across cases where authorised persons do not submit their regulatory returns on time; and it is only when reminded that the deadline has elapsed, that the authorised persons explain the issues that led to the late submission. To note that sub-section 3.2 of the Guidance Note on the Methodology to set Administrative Penalties relating to Non-Material Breaches⁴² explains that

"As a general rule, the MFSA will not be granting case-by-case extensions relating to filing deadlines which are explicitly stipulated by law, rules or regulations. The MFSA may however, on a discretionary basis, grant extensions to filing deadlines in very exceptional cases which affect a particular sector or the financial services industry in general."

⁴¹ R3-6.1 of the CSP Rulebook: "... In the case of authorised individuals, said individuals are required to document all decisions taken."

⁴² MFSA (December 2022) *Guidance Note on the Methodology to set Administrative Penalties relating to Non-material Breaches*. Retrieved from: <https://www.mfsa.mt/news-item/mfsa-issues-policy-and-guidance-note-on-regulatory-reporting-breaches/>

The Authority also published a [Policy Document on Non-Material Enforcement Action](#) which was accompanied by the above-mentioned guidance to the financial services industry on the methodology to set administrative penalties relating to non-material breaches⁴³. The aim of these documents amongst other matters is to make it clear that the Authority expects regulatory reporting to be submitted within the deadlines set out in the applicable legislation, rulebooks or the deadlines from time to time stipulated by the MFSA; failing which it will take enforcement action⁴⁴. Through the Guidance, it is also made amply clear that the Authority is under no obligation to issue reminders before or after the expiration of regulatory deadlines.⁴⁵ Of course where in doubt as to the method of submission or to whom the submission should be made, the authorised person should communicate with the Authority in good time and prior to the deadline expiring so the MFSA can provide guidance as required.

The Guidance also emphasises the importance of authorised persons providing all requested and relevant information in their regulatory reporting; this should be comprehensive, complete and the information should be of good quality. The Guidance goes on to explain that where the MFSA deems a submission to be incomplete or of poor quality, it reserves the discretion to take regulatory action in terms of the applicable laws, rules and regulations.

In relation to data held by CSPs, authorised persons are reminded of the importance of safeguarding client and other data held with systems and controls that mitigate the risks posed by ICT and cybersecurity arrangements; and by having adequate and proportionate business continuity measures and disaster planning in place. All CSPs are expected to ensure that risks posed by increased dependence on ICT and cybersecurity arrangements⁴⁶ (such as outsourcing of certain services and enterprise mobility) are identified and mitigated.

⁴³ MFSA (December 2022) *Policy Document on Non-material Enforcement Action*. Accessed from: <https://www.mfsa.mt/news-item/mfsa-issues-policy-and-guidance-note-on-regulatory-reporting-breaches/>

⁴⁴ Section 3, Sub-section 3.2 entitled *Failure to Submit Regulatory Reporting to the MFSA in a Timely Manner*.

⁴⁵ Section 3, Sub-section 3.1 entitled *Timely and Complete Submissions*.

⁴⁶ See MFSA guidance on the subject of technology arrangements and risk management entitled *Guidance on Technology Arrangements, ICT and Security Risk Management and Outsourcing Arrangements* (December 2020) here: <https://www.mfsa.mt/wp-content/uploads/2020/12/Guidance-on-Technology-Arrangements-ICT-and-Security-Risk-Management-and-Outsourcing-Arrangements.pdf>

Expected Practices

- Communication should be transparent and held in a spirit of co-operation. The Authority values comprehensive and clear information which is of good quality.
- Regulatory reporting is to be submitted within the deadlines set out in the applicable legislation, rulebooks or the deadlines stipulated from time to time by the MFSA.
- Authorised persons are reminded of the importance of safeguarding client and other data held with systems and controls that mitigate the risks posed by ICT and cybersecurity arrangements in accordance with MFSA published guidance.

2.5 Conflicts of Interest and Risk

Main Observations

In pursuance of the obligation to act in an ethical manner with due care, skill and diligence, taking into consideration the best interests of their clients, CSPs are expected to identify any actual and potential conflicts of interest in a policy that is effective and proportionate to the size of the CSP. The policy should prevent conflicts of interest from adversely affecting the interests of clients.

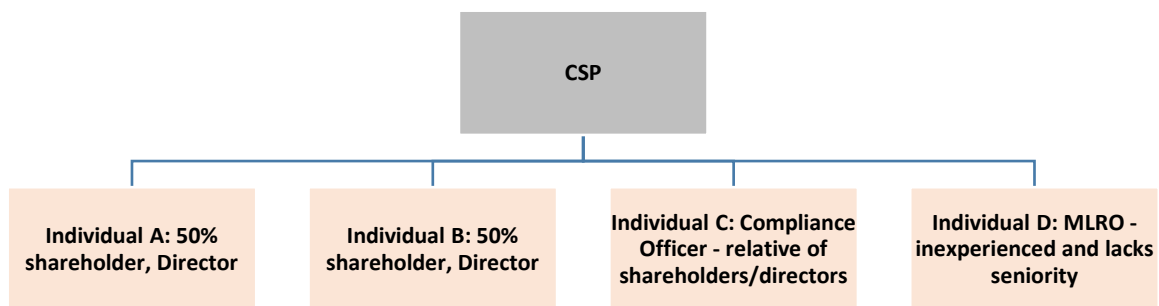
Linked to this, the CSP is responsible to ensure that staff performing multiple functions are not, as a result, prevented from discharging their roles honestly and professionally.

As part of the fitness and properness assessment the Authority considers independence of mind. As this can be affected by conflict of interest, a person applying to hold an approved position will not be considered suitable if there exists a conflict of interest which poses a material risk which is not possible to prevent, adequately mitigate or manage. This is not only relevant in the case of directors (or equivalent) of CSP entities but also in the context of the MLRO and Compliance Officer, where account is to be taken of any other regulatory requirements that may be applicable under other applicable frameworks.

The Authority in its assessment will consider whether the individual in their proposed role, would be able to make their own sound, objective and independent decisions and judgments. The Authorisation team within the TCSPs Supervision Function comes across various cases where the structure of the CSP is organised in a way that does

not take into consideration conflicts of interest and the impact this could have on the officers' independence of mind.

An example of this can be seen below:



Finally, the Authority expects authorised persons to consider risk and how it will impact them⁴⁷. While ML/TF and overall financial crime risk is a serious risk for CSPs, the reality is that CSPs are exposed to other risks, whether in the form of cyber security threats, business continuity or client related risks (such as unresponsive clients). CSPs are expected to consider the risks they face, the likelihood that these risks will materialise, their impact and what mitigation measures can be applied. This exercise is expected to be carried out by all CSPs based on the nature, size and scale of their business. The Authority expects to see the rationale behind this exercise documented and the risk assessment reviewed on a regular basis.

Expected Practices

- Those seeking to be approved to hold an approved position within a CSP should have a clear understanding of what constitutes a conflict of interest, especially where an individual intends to hold the role of director.

CSPs are expected to identify any conflicts of interest in a policy that is effective and proportionate to the size of the CSP.

⁴⁷ CSP Rulebook R3-7.1.

Section 3: Concluding Remarks

Supervision of CSPs has evolved over time based on the lessons learnt and an enhanced understanding of issues of Compliance and risks of ML/FT. For these reasons, outcomes focused supervision is pursued so CSPs operate in compliance with the laws and rules, are resilient as a result of risk mitigation and controls, and are efficient and trustworthy because they operate in the best interests of their clients.

Supervision is data driven and applies the principles of risk-based supervision as explained below. Through risk analysis it is decided where best to deploy resources, and how intensively the Supervision team within the TCSPs Supervision Function needs to supervise different CSPs.

The TCSPs Supervision Function, mainly through the efforts of the Offsite team within the Function, analyses the data received from CSPs in their annual reporting (this includes but is not limited to annual compliance returns and audited financial statements⁴⁸). This data forms the basis for the next step which is to collate all relevant data available to the Authority and allocate risk scores to authorised CSPs. All data is analysed to make sure that the risk scoring properly reflects the different authorised persons' risk scoring. The Authority will therefore take into consideration findings arising from supervisory engagement with CSPs, or findings flagged by other regulatory authorities amongst other matters.

While the industry increasingly makes use of technology for its operations, compliance and for offering services to clients, the Authority is also increasingly making use of technology to supervise CSPs more effectively and efficiently. The Authority is already using data visualisation tools which enable it to monitor risks on a regular basis and it is expected that the use of these tools will increase over time.

The use of technology to supervise CSPs such as automated data collection, validation and analytics will enable the Authority to make better use of resources while collecting data and identifying trends in a timelier manner. These trends will provide more insight to the Supervision team within the TCSP Supervision Function, who will be able to identify and track risks as they emerge through the use of this technology, and to react promptly. One of the Authority's corporate priorities is that of collecting data from the

⁴⁸ For a list of regulatory reporting requirements and the deadlines for submission please refer to Annex 3 of the CSP Rulebook found here <https://www.mfsa.mt/firms/conduct-supervision/company-service-providers/the-new-company-service-providers-regime-in-light-of-act-l-of-2020/>

industry which will lead to deep insights.⁴⁹ It is consequently ever more important that CSPs provide complete, = correct and up to date information to the Authority as regulation will be ever more reliant on such data.

The Authority will of course continue its supervisory work Using also other tools available such as thematic reviews. These reviews form a significant part of the TCSPs Supervision team's work as through them understanding of specific topics is obtained, such as conduct practices, emerging issues and potentially anomalous models. The process enables the Supervision team to investigate key risks and work on particular concerns.

CSPs authorised on 16 November 2021 – The Authority's Role and its Expectations.

The Authority recognises that those CSPs authorised following the CSP Reform may not be accustomed to the Authority's supervisory methods and expectations. That being said, the Authority also recognises that it has provided the foundations for educating the industry as to the regulatory framework and the Authority's expectations, through various consultations, outreach initiatives, publication of guidance notes, circulars and through supporting training initiatives by other regulatory authorities and industry bodies.

For those newly authorised CSPs who will be subject to an onsite inspection in the near future the Authority will expect these CSPs to convince it that the measures in place are adequate from a governance, compliance and risk perspective. The Authority is not convinced by a mere 'tick the box' approach by authorised persons but expects them to analyse and evaluate what is required of them, also in the light of the previously mentioned high level principles in the CSP Rulebook, and to document the process and the rationale for adopting it.

The aim of the Authority during the first onsite inspection is to analyse the business model of the CSPs concerned and identify any deficiencies with a view to providing granular guidance based on the business model of the CSPs concerned. Thus, guiding the authorised persons in the right direction to rectify any deficiencies or matters that can be improved is at the forefront of the MFSA's motivations.

Conclusion

Throughout this document the Authority has sought to give a detailed and comprehensive explanation of the CSP Reform from the initial consultations to the implementation of the reform and the successful processing of CSP applications between May 2021 and November 2022.

⁴⁹ See p. 13 of the MFSA's Strategic Statement published in February 2023.

By giving this insight into the Authority's operations the industry is being guided as to what the Authority expects from all CSPs (and therefore not just the newly authorised CSPs but also those who were registered under the CSP Act prior to the legislative reform changes). With the increase in the regulated CSP population resulting from the changes to the legislative framework in 2021, it is necessary that CSPs are transparent with the Authority, communicate with it proactively and are risk aware.

In line with the Authority's Supervisory Priorities the main themes⁵⁰ that have emerged as central to the authorisation process and supervision of CSPs in this document can be summarised as follows:

- It is critical that CSPs are aware not only of the ML/TF risks they are exposed to but of all the different risks their operations are vulnerable to, and that they assess such risks on an ongoing basis, while also ensuring that they have robust measures in place to ensure compliance with their different responsibilities.
- It is important that CSPs understand that having an effective governance structure in place allows them to operate efficiently and in compliance with the regulatory framework.
- Linked to the preceding point, it is critical that CSPs set the tone from the top when it comes to compliance with the regulatory framework and ensure that a compliance culture is embedded throughout all areas of operation.
- Independence of mind is a key characteristic for individuals holding authorised positions to ensure that they act in the best interest of clients and safeguard the integrity of the financial system in general.
- Conflicts of interest should be properly understood and addressed by CSPs by inter alia putting mitigation measures in place.

Contacts

In case of queries with respect to the above, please do not hesitate to contact the Authority on tcsp supervision@mfsa.mt.

⁵⁰ See further the MFSA's Supervisory Priorities 2022 document which can be accessed here <https://www.mfsa.mt/wp-content/uploads/2021/12/MFSA-Supervision-Priorities-2022.pdf>

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