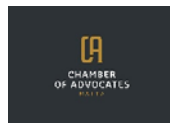


11 May 2020

Raising the Bar for CSPs

Chamber of Advocates Updated Position Paper



CHAMBER OF ADVOCATES

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1. INTRODUCTION

- 1.1 The Chamber of Advocates in a report dated 17 January 2020 set out its position on the consultation document that had been issued by the MFSA entitled “Raising the Bar for Company Service Providers”¹. That document is available on the website of the Chamber. Following the close of the consultation period the MFSA issued its feedback statement on the 9 April 2020, with its final position on the matter and the preferred regulatory architecture for CSPs.
- 1.2 The Chamber must express its utter disappointment at the ultimate outcome and the feedback statement of this consultation. That statement fails to properly consider the submissions made by practitioners in the field and regrettably continues to build on the misconceived notion of considering corporate service provision as a discipline in its own right.
- 1.3 In addition, it has shifted the focus of the original proposal which was to ensure proper and effective AML-CFT measures in the area, into a proposal for equivalent market entry requirements without due consideration of the stark differences that exist in the market. The Chamber must express its dissatisfaction at the manner in which the new regulatory framework has been conceived, it lacks any foundation in principle and completely discards the fact that CSPs are not a homogenous profession and that there are, in fact and in practice significant anomalies between different CSPs that need to be taken into account.
- 1.4 We do find positive, on the other hand that the MFSA has re-considered and abandoned the proposed move towards extending to CSPs the role of providing guidance on, and the submission of, documentation of all prospective applicants for authorisation with the MFSA.

2. GENERAL PRINCIPLES

- 2.1 The Chamber is aware and fully appreciative that the changes in the CSP regulatory framework were, and indeed still are, a major issue in addressing the Moneyval report on Malta and that indeed Malta, as a jurisdiction, needs to address the issues raised in that report fairly, squarely and within a short time.
- 2.2 Regrettably, the MFSA seems to be taking the view that CSP activities are such that can be completely segregated, as if they were a homogenous discipline. The Chamber is of the view that they are not.

¹ MFSA consultative document Ref:17-2019

- 2.3 The Chamber remains of the view that the situation, originally created in 2013, with the enactment of the CSP Act, was merely an attempt at allowing organizations that were not lawyers or accountants, to provide certain services, defined as corporate services, that were until then provided solely by practitioners hailing from the legal and accountancy professions and in so doing distorted the landscape in the provision of those services. The latest feedback statement, rather than removing that distortion compounds it.
- 2.4 Each of the four activities described as CSP activities are, and indeed have been, some more than others, part of the services typically provided by warranted lawyers and accountants in the ordinary exercise of their profession.
- 2.5 The introduction of the CSP Act in 2013 seems to have somewhat distorted the hitherto applicable position. In fact, that Act has simply extended to non-lawyers and accountants the possibility of providing certain corporate services within a light-touch regulatory framework. The services then took on the description of CSP services, thus giving the impression that they are some form of stand-alone group of services that can be performed by anyone.
- 2.6 Clearly, lawyers and accountants, were not subject to the provisions of that Act, not because of an exemption (even though it was in the law expressed as such) but rather in recognition of the ability of each of those professions to have conducted and to continue to conduct the provision of those services as an integral part of the ordinary exercise of their respective professions and within the regulatory infrastructure of the two professions.
- 2.7 It is therefore a misconception to speak of an exemption for the profession – in terms of the provision of services that form an integral part of the services which the profession has the qualifications and training to perform, and has always performed without the need of further regulation or supervision, other than as warranted lawyers.
- 2.8 The Chamber is not, in principle, against the liberalisation of the market for the provision of such services to non-lawyers.
- 2.9 What plainly does not follow however, is that rather than lawyers remaining subject to the regulation of their own profession in providing services which fall squarely, and have historically done so, within the remit of their profession as lawyers, they will now be brought under a regulatory and supervisory regime designed for new-entrants in the market and who are not subject to the same qualifications, training and professional regulation.
- 2.10 The Chamber disagrees in no uncertain terms with this approach, which in the final analysis is both unnecessary; and above all fails to properly address the Moneyval criticism which it purports to address.

3. WHY UNNECESSARY?

- 3.1 Lawyers and other professionals, like notaries and accountants are regulated professions. It is true to say that the legal profession has itself been crying out loud for better and stricter regulation of the profession. Indeed, the Chamber would be the first to acknowledge that the legal profession is in need of regulation that reflects the demands of the profession in the 21st century, and has been the prime mover in this area by proposing legislation to Government that has yet to see the light of day.
- 3.2 That does not however mean that the profession is completely unregulated. Indeed, each profession is separately regulated from a professional perspective, as a profession. From an AML/CFT reporting and compliance perspective the profession is today, and indeed has been for some years, subject to FIAU regulation and supervision.
- 3.3 The solution therefore is to regulate the legal profession in a homogenous manner and then allow the regulator of the profession to address the regulation of what, remain essentially legal services, but what have been termed CSP services.

4. ADDRESSING MONEYVAL

- 4.1 The whole exercise is really an attempt at addressing the concerns raised in the Moneyval report.
- 4.2 The Chamber remains of the view, a view already expressed in our original feedback to the MFSA's consultation document² that the current proposals will not address the deficiencies highlighted in the Moneyval report with respect to the legal profession and that it is only a more comprehensive system of regulation of the profession generally that will address those deficiencies.
- 4.3 The proposal cannot possibly address in a comprehensive manner the criticism levelled in that report, simply by addressing the provision of certain company services. The full text of the assessment in that report goes well beyond the provision of company services.³
- 4.4 **That criticism cannot properly be addressed simply by the change in regulatory structure dealing with what is just one (minor) aspect of the services provided by the legal profession. The criticism does not refer to CSP services but to the lack of**

² See paragraphs 5.6-5.8 of that document

³ See paragraph 4.21 of the Moneyval report

proper regulation of the legal profession with respect to entry into the profession and its on-going monitoring, and not in the provision of CSP services.

- 4.5 The answer, therefore, lies in a more comprehensive regulatory infrastructure for the legal profession, and the enactment of the proposed bill to regulate the legal profession (the “**Bill**”) that provides the basis for a modernised regulatory infrastructure for the profession generally and as a whole.
- 4.6 Indeed, there is a compelling reason for that Bill to become a priority in addressing the issue, the Moneyval report raises as one of the main findings, and classifying it as a matter of *significant risk*, that there is no law to regulate the legal profession in Malta and that we lack any pro-active on-going fitness and properness checks – with the conclusion that the market entry requirements for lawyers in Malta is not adequate.
- 4.7 It would be severely short-sighted to think that the MFSA proposals can actually deal effectively with the findings in the report on the legal profession. In any event, it would also make little, if any, sense to have the legal profession subjected to separate regulation or regulators and which simply addresses one area of when lawyers have to deal with AML/CFT matters, rather than to put in place a cohesive and homogenous regulatory infrastructure that deals with AML/CFT matters in the profession’s practice across the board.
- 4.8 The solution therefore lies in enhancing the regulation of the profession across the board, through the adoption of a comprehensive law that regulates the profession and that will endow the Chamber with the appropriate tools to exercise rule making, supervisory and enforcement powers over the profession that will, as part of its overall function, also have the function to regulate legal professionals in this area.

5. WHY IS THE MATTER NOT ONE OF MARKET ENTRY REQUIREMENTS?

- 5.1 The MFSA feedback statement emphasises the need for authorisation across the board for CSPs, and makes no distinction between lawyers, other professionals and others who deal with CSP activities as a business⁴. This, the statement clarifies, is to address the concerns raised by Moneyval.
- 5.2 The feedback statement also acknowledges that “most respondents expressed concern” about MFSA’s proposal to extend the authorisation requirement across the board. Notwithstanding this acknowledgment this is exactly what the MFSA has proposed to do.

⁴ Except in the context of allowing for lawyers and other professionals a lower level of entry requirements in view of their qualifications and training.

- 5.3 Dealing with the matter by trying to achieve harmonised market entry requirements is, in the Chamber's view, a misnomer and will not deal with the concerns raised by Moneyval at all. Trying to liken or compare a lawyer or law firm who in a financial year possibly sets up, to 2 to 5 companies as part of a transaction or of advice on broader legal issues; to a CSP that would set up hundreds of companies without any context of any particular transaction or other advisory work is simply not comparing like with like. Accordingly, it can never sustain any argument for homogenous market entry requirements. If at all it sustains an argument for differentiation that is advocated by a risk-based approach.
- 5.4 In addition, the argument of homogenous market entry requirements, though it might sound good, is also a very simplistic one. It does not contemplate other vital considerations.
- 5.4.1 For a typical CSP provider the business model is one that depends on numbers and volume. The livelihood and survival of a CSP depends on: (i) the setting up of companies and other legal entities in huge numbers; and (ii) the servicing of those companies and other legal persons, and fees earned through directorship services, registered office provision and other back-office services that would allow a company or other legal entity to operate without the need of its own resources. Its total revenue is indeed generated from the provision of these services.
- 5.4.2 This is in stark contrast to those situations where a lawyer or law firm: (i) sets up a few companies in a year; (ii) does not typically depend on the revenue generated from these services for survival or livelihood; (iii) it really depends on the provision of other services, and where revenue from such activities is marginal; and (iv) where normally the provision of these services are ancillary or complementary to the provision of a broader range of legal services.
- 5.5 These are real distinctions that have been completely overlooked in the MFSA paper and where the incorporation of just one company and one hundred companies are indeed placed in the same category.
- 5.6 The consequent proposals therefore give, or at least try to give, the impression that what we are really looking at is a homogenous market that needs to be subjected to the same entry requirements, without even considering whether the relevant activity is being undertaken as a "business" or not, which is indeed the first requirement under the applicable AML/CFT regulation. Lawyers who do not conduct CSP services as a business should not be considered as falling within a specific CSP regime.

- 5.7 In its own classification and categorisation the MFSA itself considers that a licence would be required where a person provides services “by way of business” however it then fails to determine or define what it means by that term and the paper seems to indicate that the incorporation of even one company could be deemed as falling within the term. Clearly, this cannot be the case, otherwise the term “by way of business” would become completely meaningless. The Chamber on the other hand believes that this is an important qualification that needs to be further amplified and that it should form the basis of the distinctions that need to be made.

6. FUNDAMENTAL DISTINCTIONS

- 6.1 As is inevitable the debate is not one of black or white, and there can be a number of nuances that may need to be addressed to find a properly balanced solution that addresses the concerns raised by Moneyval.
- 6.2 That, however, does not detract from the principle. If at all it is an application and adaptation of the principle that the legal profession ought itself to remain a homogenous profession subject to a regulatory and supervisory framework as a profession, where the activities concerned are legal services that the profession has conducted and continues to conduct in the ordinary course of a legal practice.
- 6.3 The Chamber acknowledges that the principle remains intact only as long as legal professionals provide these services as an integral part of their professional activities. When those activities become themselves the main focus of their practice and where they provide CSP services as a business, the situation changes. This is what led the Chamber to refine its submissions to the MFSA in a subsequent paper earlier this year.
- 6.4 The profession is aware and indeed acknowledges that there are members of the profession who, rather than providing corporate services as a part of the ordinary exercise of their professions, today actually provide CSP services as a focal point of their professional activities, to the extent that they have made the provision of these services the central feature of what they do. It is therefore in this context that an important distinction ought to be made.
- 6.5 There is a difference to be made between professionals:
- 6.5.1 who as part of their professional practice give advice on company law matters and corporate governance; or on transactions involving the setting up of companies; or occasionally act as company secretaries to be able to provide guidance to boards on governance issues; and

- 6.5.2 whose main interest is, the habitual setting up of companies without any involvement in advising or otherwise running any particular transaction, but rather in simply providing corporate vehicles, together with all the other ancillary services such as directorships and corporate services, giving clients a presence in Malta, and running this as a business activity in its own right.
- 6.6 There is little doubt that whilst there is a compelling argument to be made that in the first instance, where a lawyer or law-firm would be acting in the ordinary course of its practice, (where the corporate services are not the main purpose of an engagement, but rather an ancillary part thereof) for regulation within the profession. That argument becomes far less compelling where a lawyer or law-firm, as a habitual feature of their practice fall in the second category. Indeed, the Chamber is aware that a number of practitioners themselves make this distinction already and where they conduct CSP services as a business, in most cases they have set up special purpose vehicles and have registered the same as CSPs.
- 6.7 Those professionals who as part of the ordinary exercise of their profession provide any of these services ought to remain regulated by their professional rules, and indeed to conduct their professions in a manner which is consonant to the rules and the regulatory environment of that profession.
- 6.8 Conversely, those professionals whose main feature of their practice becomes the provision of corporate services and only provide other legal services in support of the provision of corporate services, or where the provision of corporate services is a principal and habitual feature of their professional practice, then the profession accepts that such practitioners may be required to submit themselves to a different regulatory environment which is more specific for CSPs than it is for legal professionals.
- 6.9 There is probably one exception that may merit further analysis. The Chamber believes that the provision of directorships, including arranging for others to act as directors on companies may not effortlessly fall into the parameters of what a lawyer's professional practice entails in the ordinary course of events.
- 6.10 It is true that lawyers, because of their background and training may provide the right profile for directorships and may indeed add value on a board of directors – there is indeed merit in that argument, but that does not mean that acting as a director is an intrinsic part of a legal practice. Indeed, there are cogent contrary arguments to be made.
- 6.11 The situation is however different where company secretarial functions are concerned. This is more in line with the role of the lawyer as an advisor to the board, without however having any decision-making powers or being collectively responsible for board decisions. There is also significant value in having a

lawyer as company secretary, which role can add value in terms of compliance with statutory obligations of the company.

7. SPECIFIC PROPOSALS

- 7.1 This analysis leads the Chamber to reiterate its refined proposals based on the principles above mentioned. Indeed, in its feedback statement the MFSA whilst making reference to the proposals made on this point, discards them without giving any reason for doing so.
- 7.2 It is the Chamber's view that:
- 7.2.1 Lawyers providing the services set out below, are to be deemed to provide those services as an integral part of their professional practices and ought to be and remain regulated fully by the regulator of the legal profession as long as the revenue generated from such activities does not exceed 35% of their total revenue from their professional practice in any one financial year.
- 7.2.2 The services referred to in section 7.2.1 above are the following:
- a. company incorporation/registration and setting up of other legal entities and, or legal arrangements⁵;
 - b. providing registered office to companies;
 - c. company secretarial services;
- 7.2.3 Lawyers providing directorships (but see below in section 8 when this is done in a personal capacity) or arranging for others to act as directors, and lawyers whose revenue from activities mentioned in 7.2.2 above, exceed 35% of their total revenue from all professional activities would be deemed to undertake the provision of such services "by way business" and would be required to register or obtain authorisation as a CSP.
- 7.3 In the context of the above lawyers who fall within the first category can provide the services mentioned as an integral part of their professional activities without any further requirement for a licence or authorisation, other than to be subject to the regulation of their own professional rules.
- 7.4 They will, of course, still be subject to the same AML/CFT regulation for all relevant activities (as defined in the Prevention of Money Laundering and Funding of Terrorism Regulations, S.L. 373.01), including the ones set out above, and will accordingly remain subject to all obligations incumbent upon them by virtue of these regulations, including without limitation the obligation to carry out CDD checks and supervision by the FIAU.

⁵ Even here more information is required as to what will constitute incorporation or registration.

- 7.5 They would not need to set up distinct legal persons to undertake these activities, just like they do not need to do so for other relevant activities that they provide as “subject persons”, and they would indeed be required to report on CSP activities they undertake as a part of their general reporting on all relevant activities conducted, including the submission of the annual Risk Evaluation Questionnaire to the REQ.
- 7.6 Lawyers who fall within the second category would be required to apply for a separate licence and indeed fall within the competence of MFSA as regulator. It is by virtue of the volume of business undertaken in this area that lawyers could be likened to other CSPs and therefore can be fairly required to submit themselves to similar market entry requirements.
- 7.7 The full proposal in this regard would be the following:
- 7.7.1 All lawyers who intend to provide corporate services are to register with the Chamber of Advocates and FIAU;
- 7.7.2 As part of their registration they would need to declare:
- a. whether in the previous financial year their combined revenue from corporate services exceeded 35% of their total revenue – to be confirmed by a duly warranted auditor;
 - b. a forecast of whether in the forthcoming financial year their combined revenue from corporate services is expected to exceed 35% of their combined revenue from the provision of other professional services; and
 - c. the nature of corporate services they provide and whether they will provide directorship services.
- 7.7.3 If either of 7.7.2(a) or 7.7.2(b) above is in excess of the 35% threshold; or if they are not but in 7.7.2(c) they state that they shall provide directorship services; then such professional shall be deemed on the basis of (a) and (b) that he/she provides corporate services as a principal part of his professional practice; and in the case of (c) that it is not a legal service - and that accordingly he/she should be regulated as a CSP and no longer as an integral part of the profession of which he/she forms part.
- 7.7.4 If the threshold is not exceeded then professionals shall remain governed and regulated by their respective professional bodies and regulators including in the provision of corporate services.
- 7.7.5 From a purely AML/CFT perspective, in the provision of corporate services lawyers would be subject to the same reporting and supervisory framework that will remain under the responsibility of the FIAU in conjunction with the regulatory and professional bodies of each profession.
- 7.7.6 Lawyers who do not exceed the threshold may still opt to form a company and obtain a licence/authorisation from the MFSA for the provision of corporate services.

8. INDIVIDUAL DIRECTORS

- 8.1 The last point that the Chamber wishes to raise with respect to MFSA's feedback statement relates to individual directors, whether they are legal professionals or not. This matter seems to have been completely overlooked in the feedback statement, and indeed considers directorships as principally a matter for CSPs, as if individuals cannot provide such services as professional directors.
- 8.2 In effect, the MFSA is suggesting that the *de minimis* threshold is reduced to 5 involvements, but no basis or reasoning has been provided as to why this position was taken.
- 8.3 In addition, the exemptions from the requirement of having a CSP registration (which would mean the requirement to have a company formed) only applies to:
- VFA Agents;
 - Persons who act as director or secretary solely of entities licensed by the Authority;
 - Persons who act as director or secretary solely of entities in which they are beneficial owners; and
 - Persons who act as director or secretary solely of entities in which the government of Malta is a shareholder.
- In a situation where, as a jurisdiction, we need to be placing greater emphasis on good corporate governance, and where finding the right profile of competent non-executive directors of integrity is not always a simple exercise, we find this list of exemptions as too restrictive.
- 8.4 We believe that persons who are not in the business of providing corporate services generally but provide directorships on an **individual and personal basis**, and where they are themselves the individuals who will take responsibility for the directorship, should not automatically fall within the remit of a CSP and should remain unregulated subject to a form of *de minimis* threshold, which is like the one used for directorships in regulated entities.
- 8.5 They should of course register as individuals with the FIAU/MFSA that they provide directorship services.
- 8.6 The *de minimis* threshold would therefore need to take note of certain principles, such as:
- 8.6.1 **For regulated entities** – this should remain subject to the same rules currently applicable;
- 8.7 **For unregulated entities**, including all companies – this should be based on a reasonable time allowance to enable persons

providing such services adequate time to be devoted to the companies of which they are directors.

- 8.8 In their registration they would be required to declare whether they will be providing non-executive directorships on a full-time or on a part time basis.
- (a) **A full-time non-executive director** who has no directorships of regulated entities would be allowed 50 hours per annum for each directorship which would include preparation time and attendance at board meetings. Assuming a working year of 1500 hours – that would enable the individual to act as a director on **30** companies.
 - (b) **A part-time non-executive director** who has no directorships of regulated entities would also be allowed 50 hours per annum for each directorship, assuming 750 hours dedicated to such role, such person would be allowed 15 directorships.⁶
- 8.9 Consideration may also need to be given to an exclusion of directorships of listed entities in the above formula.
- 8.10 In each case of corporate directorships, a CSP authorisation of the corporate would be required.

9. CONCLUSION

In conclusion the Chamber considers the feedback statement as positive only with respect to its re-dimensioning of the role of CSPs and the abandonment by MFSA of extending the role of CSPs. On the whole however, the approach to the overall regulatory architecture fails to make fundamental considerations and distinctions that should indeed be at the heart of the regulatory framework. It is the Chamber's view that this needs to be revisited, if for no reason because it falls short of addressing the concerns raised in the Moneyval report. The only way of addressing those concerns, at least in so far as the legal profession is concerned is through the comprehensive regulation of the legal profession both upon entry and in so far as on-going regulation is concerned. Simply dealing with the legal profession in its provision of CSP services will not deal with those concerns and at the same time create a distortion in the market which will have disproportionate adverse effects on the legal profession.

In this light we therefore urge the MFSA to re-consider its position on the matter.

MAY 2020

⁶ The hours and numbers here are indicative only and are used to illustrate the principle.