

9 January 2021

MFSA Consultation on new CSP Rulebook

Chamber of Advocates Feedback and
Position Paper



CHAMBER OF ADVOCATES

CONTENTS

1. INTRODUCTION.....	2
2. GENERAL PRINCIPLES	5
3. ADDRESSING MONEYVAL	10
4. WHY IS THE MATTER NOT ONE OF MARKET ENTRY REQUIREMENTS?.....	13
5. THE UNDER THRESHOLD CLASSES.....	15
6. RISK MANAGEMENT.....	31
7. EXEMPTIONS FOR SPECIFIC CATEGORIES OF PERSONS FROM AUTHORISATION UNDER THE ACT.....	35
8. THE RULEBOOK SHOULD TAKE INTO CONSIDERATION CURRENT COMPANIES ACT REQUIREMENTS.....	40
9. CERTAINTY AND PREDICTABILITY OF APPLICABLE RULES.....	43
10.THE LEGAL PROFESSION	44
11.CONCLUSION.....	50

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. On the 11 May 2020 the Chamber issued an updated position paper with respect to the April Document.

1.2 In that position paper the Chamber expressed its disappointment at the ultimate outcome and the feedback statement of that consultation. That statement dismissed the submissions made by practitioners in the field and regrettably continued to build on the misconceived notion of considering corporate service provision as a discipline, indeed worthy of regulation beyond the existing regulation

¹ MFSA consultative document Ref:17-2019

in the AML/CFT space, which remains a major flaw in the whole design of this regulatory framework.

- 1.3 What has transpired so far in this process is that the focus has been completely shifted from the original proposal which was to ensure proper and effective AML-CFT measures in the area, into a proposal for equivalent market entry requirements and a broad-brush regulatory environment, without due consideration of the stark differences that exist in the market – resulting in a regulatory capture which is unnecessary and, in some instances, counter-productive.

- 1.4 The proposed rulebook is yet another confirmation of how distant and detached the regulator remains from the market, or that the regulator conceives the market as one homogenous market which it is not. The Chamber must express its dissatisfaction at the way 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. There are, in fact and in practice significant anomalies between different CSPs that need to be comprehensively considered.

1.5 As a general matter the Chamber must note that the proposed regulatory framework, generally is unparalleled elsewhere in the European Union and the U.K. We are not aware of any other jurisdiction where, apart from the standard AML/CFT requirements for undertaking relevant activity, any person who (i) forms one or more companies; and/or (ii) sits as a company secretary or director on companies requires any form of *a priori* authorization and is subject to ongoing supervision and regulation to the extent contemplated by the proposed Rule Book. Indeed, if one may consider this a sector in its own right – in other jurisdictions the sector is not separately regulated, even where the services in question are provided by way of business. There exists no parallel regulatory regime anywhere within the EU that would require a person whose business it is to form companies or habitually acts as company secretary or director, to be authorised in the first place and then to be supervised with a host of regulatory requirements and reporting obligations. What is being proposed by the MFSA is full and complete regulation that would see not only persons who provide these services by way of business regulated and supervised, but also those who only provide these services as an ancillary service to their professional practice.

1.6 We shall therefore continue to ask the fundamental question: why has the regulator opted for such a heavy regulatory environment when none of the other the member states of the EU have considered this a sector that requires *ad hoc* regulation, apart of course from compliance with AML/CFT regulation? What are the compelling arguments that would lead towards such a model when the objective could very well be otherwise achieved?

2. GENERAL PRINCIPLES

2.1 The process to raise the bar for company services providers is a laudable objective. It is indeed sad that Malta's reputation has taken a battering for several reasons. Restoring Malta's reputation requires far more than simply increasing regulation for company service providers ("CSPs."). The Chamber is accordingly in agreement with, and indeed whole-heartedly supports, the concerted effort to raise the bar for operators, regulators and enforcement authorities. The sooner the steps are taken to address Malta's reputational deficit the better.

2.2 The subject of debate however is whether the proposed regulatory framework, and in particular the CSP Rulebook will attain the objectives it purportedly sets out to achieve or whether, to the contrary, some of the measures it proposes are inherently counter-productive. In addition, it is not amiss to also consider (i) the cost at which those objectives may be attained and (ii) whether the broad-brush regulatory approach adopted, including in the proposed Rulebook, is the right approach at all.

2.3 In this document the Chamber provides feedback in respect of the proposed CSP Rulebook, though the comments in this document are not limited exclusively to the “Scope of Consultation” requested, that is:

- Class A Under Threshold;
- Risk Management Function;
- Exemptions for Specific Categories of Persons from Authorisation Under the Act.

This document goes beyond commenting only on those matters, as it firmly believes that that the real flaw is in the underlying design of the regulatory framework and that the rulebook is a result of that design, that in effect exacerbates the flaws but does not create them.

- 2.4 Regrettably, the MFSA continues to take the view that CSP activities can be completely segregated, as if they were a homogenous discipline. The Chamber is of the view that they are not.
- 2.5 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, conveniently defined as corporate services, that were until then provided solely by practitioners hailing from the legal and accountancy professions, principally as part of a wider range of services, and in so doing distorted the landscape in the provision of those services. The proposed rulebook, rather than removing that distortion compounds and exacerbates it.
- 2.6 The new law² (the Act²) has already done away with what has been and still is mistakenly considered as an exemption for lawyers and accountants. Clearly, lawyers and

² Company Service Providers (Amendment) Act, 2020 passed by Parliament as Act No.

L of 2020 and published in Government Gazette no 2521 of 13th November 2020.

accountants, were not subject to the provisions of that Act, not because of an exemption (even though it was in the law articulated 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 was therefore then and still is now, 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 and in respect of ‘relevant activity’ as Subject Persons in terms of the Prevention of Money Laundering and Funding of Terrorism Regulations .

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.
- 2.11 Whilst this is intended to be a feedback statement on the proposed CSP rulebook, one can hardly restrict the considerations incisively to a very specific part of the regulatory regime, when the problem lies deep in the underlying design of the whole framework which remains misconceived and misguided.
- 2.12 The proposed CSP Rulebook simply confirms that the whole notion of regulating CSPs in the manner proposed is, frankly, an overkill.

3. ADDRESSING MONEYVAL

- 3.1 The whole exercise of what has come to be termed the CSP sector was originally designed to address the concerns raised in the Moneyval report. This is also very clear in the last consultation document.
- 3.2 The Chamber remains of the view, a view already expressed in our original feedback to the MFSA's consultation document³ 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) a more comprehensive system of regulation of the profession generally that will address those deficiencies; and (b) an effective enforcement of the existing AML/CFT regulatory regime that will achieve the objective.

A more comprehensive system of regulation

- 3.3 The proposal as a whole cannot possibly address in a comprehensive manner the criticism levelled in that report, simply by addressing the provision of certain company

³ See paragraphs 5.6-5.8 of that document

services. The full text of the assessment in that report goes well beyond the provision of company services.⁴

3.4 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 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.

3.5 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 See paragraph 421 of the Moneyval report

- 3.6 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 be endowed 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.

The real issue is AML/CFT

- 3.7 Putting in place a whole regulatory framework such as the one being proposed, with a rulebook which is so taxing even on small operators does not deal with the real issue. **The experience over the past years has highlighted the fact, that the “elephant in the room” is not the regulation of CSPs in the manner proposed in the rulebook, but rather the manner in which CSPs comply with and give effect to AML/CFT obligations and the failure of the regulators and enforcement authorities to address these omissions and shortcomings.**
- 3.8 The whole structure for AML/CFT regulation is already in place and in real terms the answer to the Moneyval report is its effective implementation and enforcement, rather

than the creation of a tight regulatory framework that does not address AML/CFT failures.

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

4.1 The original 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 business. This has now been reflected in the Act.

4.2 Dealing with the matter by trying to achieve harmonised market entry requirements is, in the Chamber's view, a misguided approach and will not deal with the concerns raised by Moneyval at all. What is now being proposed is to cast the regulatory net as wide as possible without distinction and without due consideration to the impact that doing so will have on those whose business is not really that of a CSP – but has only come to fall within scope because of a misconstrued and artificial definition of CSP services.

4.3 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.

4.4 In addition, the argument of homogenous market entry requirements, though possibly sounding good in theory, is also a very simplistic one. It does not contemplate other vital considerations.

4.5 There are real distinctions, which the Chamber has already had occasion to point out in previous submissions, and that have been completely overlooked and where the incorporation of just one company and one hundred companies are effectively placed in the same category.

4.6 The Act and the consequent rulebook therefore simply assume, without any basis in fact, that this is a homogenous market that needs to be subjected to the same entry and on-going requirements. The definition of “by way of business” a matter which the Chamber had

raised as an important issue in our previous paper. The issue that remains is the exact parameters of that definition and its excessive regulatory capture⁵.

- 4.7 Lawyers who do not conduct CSP services as a business should not be considered as falling within a specific CSP regime.

5. THE UNDER THRESHOLD CLASSES

The de minimis exemption should be retained.

- 5.1 The market for company formations, directorships and other services which have been defined, albeit artificially, as if they are a distinct discipline of company services, is composed of:

- 5.1.1 a significant number of CSPs; and
- 5.1.2 a number of exempt persons, including warranted advocates and accountants who, until a couple of months ago, did not require authorisation by the MFSA.

⁵ See below

- 5.2 In the provision of company services, advocates and accountants were bound by their professional rules of conduct and are subject persons for the purposes of the Prevention of Money Laundering and Funding of Terrorism Regulations. In this capacity, they are regulated and supervised by the Financial Intelligence Analysis Unit.
- 5.3 Authorisation is now required in terms of the Act.
- 5.4 Besides the above increase in regulatory capture, the proposed Rulebook also purports to bring within the regulatory net and hence requiring authorisation and subsequent supervision, **Under the Threshold Class A CSP's and Under the Threshold Class B CSP's** which latter category includes 'de minimis' company secretarial and directorship services.
- 5.5 The de minimis threshold is today set at ten secretarial and/or directorship appointments. The current '*de minimis*' exemption is reasonable also in view of the current definition of '**by way of business**'.

By way of Business definition

5.6 By way of business is currently defined as activities provided by a person who either:

a) Holds himself out as providing company services inter alia by soliciting the services on offer to members of the public or

b) Provides company services on a regular and habitual basis; and

c) Is being directly or indirectly in receipt of remuneration or other benefits for the provision of these services.

5.7 The first test is alternative. The latter two tests are cumulative and are very easily satisfied. Doing away with the 'de minimis' exemption will in effect mean that most company secretarial and directorship appointments will be 'captured' by the definition of 'by way of business' and therefore subject to authorisation and ongoing supervision.

5.8 It is the Chamber's view that doing away with the 'de minimis' exemption altogether and subjecting Under the Threshold Class A CSP's and Under Threshold Class B CSP's to the proposed regulation is an overkill and will end

up being counter-productive, for a number of reasons outlined below.

5.9 A debate on the actual number of *de minimis* appointments is welcome and possibly a lowering of the current 10 appointments may be justified. However complete elimination of the *de minimis* threshold will create an unnecessary overload on regulators and an unnecessary regulatory burden on individual *de minimis* operators, without any justification for such regulatory burden.

5.10 Additionally, individual directors who, not being lawyers or accountants and therefore already fall within the ambit of the AML/CFT regulatory framework, take on a couple of directorships will, as of entry into force of the Rulebook become subject persons for the purposes of the Prevention of Money Laundering and Funding of Terrorism Regulations as, by definition, they are now company services providers. That is not currently the case nor is it necessary.

5.11 **The regulatory capture of the rulebook is far broader than one could ever consider as reasonable. That an individual**

director who holds a few directorships will be considered as a CSP by definition, and therefore a subject person for the purposes of the AML/CFT regime, is taking the matter completely overboard – it is unjustified for the purpose of the objective which this regime is stated to be aimed at attaining.

- 5.12 The focus of the regulation should be on **CSPs proper** namely companies whose sole or predominant business is the formation of companies, provision of registered office and company secretary and directorship services – and therefore whose business model is based on the volume of such services they provide rather than the quality of those services. These constitute the major risk to the jurisdiction – their model is dependent on attracting the establishment of companies locally and their on-going servicing – normally companies that have little, if any link, or association with the jurisdiction. Indeed, it is unlikely and uncommon that Maltese entrepreneurs who need to set up or establish a company for *bona fide* commercial reasons would resort to such service providers to set up a company and to manage and service that company. The proposed Rulebook ignores this differentiation completely and takes on a regulatory overload which is unnecessary.

It is here that the “**by way of business**” definition needs to be focused and it is here that the otherwise broad-brush regulatory capture has to provide for exemptions to ensure a proportionate regulatory burden based on an appropriate risk based approach. The current rulebook fails in this respect.

The Soft-Touch regulation proposed for under the threshold categories is disproportionately burdensome and will prove to be counter-productive.

5.13 The so called ‘soft-touch’ regulation for individual CSP’s who take on a couple of secretarial appointments and/or directorships (currently exempt in view of the ‘de minimis exemption’) is disproportionately burdensome and anything but soft touch.

5.14 Besides the compliance and MLRO function, it also entails the following newly added requirements:

- An Own Funds requirement in the form of a guarantee or an irrevocable letter of credit;
- A requirement to ensure arrangements in the event of death, incapacity, sickness, holidays or other absence;

- An extensive insurance requirement (notwithstanding that this may have been taken out by the Company);
- Independent audit of the compliance function;
- Audited Financial Statements;
- A statement of solvency (based on audited Financial Statements) with an accompanying balance sheet.

This overkill is unparalleled in the EU and UK and is totally unnecessary.

5.15 The Chamber would like to ask whether the Authority has 'costed' the above requirements and whether it has considered a cost benefit analysis prior to proposing such a regime for an Under the Threshold Class B CSPs. If the Under the Threshold Class B CSP category is to be regulated then the above 'soft touch' regulatory requirements should be re-visited and an appropriate risk benefit analysis undertaken.

5.16 It is the Chamber's view that the net effect of the above sets a new standard for 'over regulation' if ever there was one. In the case of 'de minimis' services it will have the effect of disincentivising professionals and/or experienced retirees from taking on the role. The recurring financial cost of the above requirements will inevitably raise the fees

of directors, rendering the recruitment of a director prohibitively expensive.

5.17 Alternatively, the above requirements will push directors to take on multiple offices as the retention of a couple of directorships, at current market rates, will no longer remain financially viable. This is counterintuitive as the industry is far better off with directors taking on fewer roles and dedicating the time and efforts to those roles. What the rules should do is seek to attract and retain professional persons and experienced retirees to take on a few manageable directorships. The rules instead purport to do the opposite.

5.18 Another point that the Chamber wishes to raise with respect to this matter relates to individual directors, whether they are legal professionals or not. The rulebook seems to make no distinction and indeed considers directorships as principally a matter for CSPs, as if individuals cannot provide such services as professional directors. This, in the Chamber's view, is misguided.

5.19 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.

5.20 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 *de minimis* threshold.

5.21 If we really want to enhance the standards of corporate governance in Maltese companies, the focus should be on creating a class of professional non-executive directors who are prepared to personally act as directors rather than seeking the protection of the corporate form. Bringing these people within the regulatory fold through on-going supervision and reporting ordinarily directed at corporate CSPs, will completely stultify the objective. Conversely the regulatory focus should be on those whose business is to consistently provide non-resident shareholders with a corporate vehicle in Malta, which has little if any link or association with Malta whether in terms of the

shareholders, the location of its assets or the transaction of its business – and servicing all the needs of such companies through the provisions of directorship services etc. This is where the higher risks reside and therefore the regulatory framework ought to ensure that it is focused incisive intervention that is required and not a broad-brush approach that places anyone providing certain services in the same pot without any distinction of the extent and complexity of the services provided.

The Proposed Rulebook purports to create a parallel regulatory regime encouraging regulatory arbitrage.

5.22 The proposed Rulebook also purports to create a parallel regulatory regime for companies where CSP's (including individual "Under Threshold Class B CSP's) are involved as directors or secretaries and companies where the same offices are taken up by individuals who are not CSP's properly so called. Thus, by way of example, R3- 11.7.1. deals with the obligation of a director who is an individual "Under Threshold Class B CSP" to grant a right of access to the MFSA to all information pertaining to the services being provided to the client as well as the client.

- 5.23 That obligation is not incumbent upon the client but upon the CSP who services the client. If a director is not a CSP, the Client company has no obligation to provide such wide-ranging access, if not within the course of an investigation of sorts where access is otherwise authorised.
- 5.24 The same argument/observation holds for the added regulation in terms of Chapter 4 Title 3, would not be applicable to companies who engage non CSP directors. In attempting to 'regulate' the non- regulated sector via individual directors and secretaries who qualify as CSP's, the Rulebook is in effect encouraging regulatory arbitrage and dis-incentivising non-regulated companies from appointing CSP's as directors or secretaries.
- 5.25 Client companies will inevitably opt for the line of least resistance since, in terms of the Companies Act, 'non-professional' directors and or secretaries could be appointed to the office of director and secretary and the said companies would not be subject to the regulation which comes in the wake of appointing a CSP to the same office.

Gaping loopholes in respect of the more vulnerable corporate sector.

5.26 Experience has shown that the more vulnerable sectors from a reputational perspective are in effect:

- (i) the non-resident owned companies whose assets and business are preponderantly outside of the jurisdiction, and whose presence and links to the jurisdiction are rather slight;
- (ii) The Companies with a governmental stake.

5.27 The proposed Rulebook has left gaping loopholes in respect of the indicated sectors. The former now have an opportunity and incentive for regulatory arbitrage by not appointing professional directors and/or secretaries (see above).

5.28 The latter have inexplicably been 'exempted in terms of the proposed Exemption for Specific Categories of Persons from Authorisation under the Act Para 5:

A Person who only acts as director or secretary of a company, as a partner in a partnership or who acts in a similar position in relation to other legal persons, in which the Government of Malta is the majority shareholder.

5.29 The Chamber fails to see any logic or justification in exempting directors on Government Owned companies. Such persons are PEP's by definition and high risk by nature. Regulatory logic and consistency would suggest that such offices are subject to the same if not more rigour than that expected from directors in non-Government owned companies.

5.30 In essence the Rule Book is creating an unnecessary regulatory burden by extending the scope of regulation to the hitherto exempt de minimis sector (and opting for a regulatory overkill in the process) whilst failing to address the most vulnerable sectors as above explained. The Chamber's suggestions below will address these gaping loopholes.

Under the Threshold Categories should be exempt.

5.31 The Chamber finds no principled basis for the introduction of the second factor (that is the EUR100,000 in the definition of revenue) for the purposes of establishing which persons fall within the Under the Threshold Class A CSP's. The 35% threshold should be sufficient for this

purpose, the test of determining whether an activity is, or is not undertaken by way of business ought to be relative to the overall business and should not be a fixed number. However, in practice this is probably a number which one can live with. The Chamber however strongly recommends that the Under the Threshold Class A CSP's should be exempt from regulation under the Act.

5.32 Company incorporations qualifies as 'relevant activity' in terms of the Prevention of Money Laundering and Funding of Terrorism Regulations and is classified as an occasional transaction. It is subject to FIAU oversight in the ordinary course of business. To the extent that it falls within the Under the Threshold Class A category it should be deemed not to be provided by way of business and/or be exempt, whilst continuing to be subject to FIAU oversight.

5.33 The Chamber also strongly recommends, for the reasons above mentioned, that the *de minimis* exemption for provision of secretarial services and directorships should be retained in lieu of the Under the Threshold Class B CSP's. Provision of secretarial appointments and directorships within the *de minimis* threshold should remain outside the scope of the Rulebook as is currently

the case, and the requirement for the “by way of business” should be revised.

An Alternative approach which meets regulatory objectives without creating counterproductive unnecessary burdens.

5.34 The Chamber takes the view that as a general principle of corporate law and best practice in corporate governance, companies should be directed and managed by a competent board, that acts in the best interest of the company.

5.35 Where directorship and company secretarial services are being provided by way of business it becomes even more essential that any service provider has the right attributes to ensure that companies serviced by such providers will meet this fundamental requirement. It is in this context that the Chamber therefore would favour a system where, subject to the necessary exemptions as stated above:

5.35.1 the office of company secretary is occupied by qualified persons who have shown that they have the necessary knowledge and competence to provide such services, and to have the obligation to guide the board with respect to

their obligations under corporate governance rules and best practice.

5.35.2 the office of director of a company also be occupied by persons who have the knowledge, competence and experience to be able to understand and discharge their obligations as directors under the Companies Act.

5.35.3 In each case this could be addressed by the introduction of a 'fit and proper test' for company secretaries and directors at inception, coupled with an annual declaration by the individual concerned that the circumstances affecting that fit and proper status have not changed, together with a mandatory continuing professional education requirement.

5.36 The above suggestions will in effect raise the bar without creating an unnecessary regulatory burden on the Authority, enabling it to focus its resources on the real CSP sector and not on '*de minimis*' activity which has been artificially construed as a CSP service by the proposed Rule Book.

6. RISK MANAGEMENT.

Risk Management need not be split from the Compliance function.

- 6.1 Risk Management is fundamental to any professional practice, indeed most professional practices, undertake risk management practices without the need of regulatory imposition.
- 6.2 The Chamber can only laud the objective to raise the bar relating to risk management requirements for CSPs. It appears however that the rules on risk management have been drawn up with large CSP operations in mind, with little or no consideration of the smaller niche practices, that probably constitute the majority of CSPs.
- 6.3 The Chamber is therefore of the opinion that proportionality in the implementation of an independent risk management function is critical.
- 6.4 The Rulebook appears to imply that the implementation of an independent risk management function necessarily entails the employment of a risk officer to deal exclusively with risk management and that departure from this rule

requires express derogation. Apart from introducing a requirement which does not take stock of the current labour supply of risk officers, the model which splits risk from compliance is not the only available model of independence. There are a number of regulated sectors where the employment of a dedicated risk officer is not necessary and yet the independence of the risk management function is not compromised.

- 6.5 It is submitted that an adequately resourced 'risk and compliance' function can still fulfil an independent risk management function effectively. Having a risk management function which is independent from operations is critical though independence from compliance is not. To the contrary, there is sometimes merit in combining the two functions within an independent risk and compliance officer and/or team. The insistence on a separate risk officer as a standard arrangement requiring derogation should be revisited. Whilst insisting on strengthened risk management processes, the recruitment of a dedicated risk manager should not be an imperative.

Is the Rulebook introducing any additional or separate BRA and CRA requirement from the ones currently incumbent on CSP's in terms of the FIAU Implementation Measures?

6.6 Some of the Rules relating to Risk Management in terms of Chapter 3 Title 7 also need clarification. In terms of R3-7.1, the CSP is required, inter alia, (i) to undertake an assessment in respect of all the risks associated with its business model (R3-7-1) (ii) to draw up and maintain a Risk Register vis-a-vis its clients.

6.7 In terms of Rule R3-7.6 it is further provided that:

“the Risk Register shall:-

list all the Clients which the CSP has onboarded together with the relevant risk classification/rating of each Client and

Identify the risks inherent to (sic) the business model of each client.”

6.8 The Implementation Measures issued by the FIAU in terms of the Prevention of Money Laundering Regulations already require a CSP to carry out a Business Risk Assessment which is submitted annually together with the REQ and a Customer Risk Assessment. It ought to be clarified whether the proposed Rule Book requirement is referring to the same Business Risk Assessment and

Customer Risk Assessments or whether a new requirement is being contemplated.

- 6.9 If it is the former then there is no need for the rule as the requirement is already covered for AML/CFT purposes; if it is the latter, then there must be some compelling justification as to why this requirement is being doubled on operators.
- 6.10 The clarification is being sought particularly in view of the requirement for the CSP to “identify the risks inherent to (sic) the business model of each client.” A CSP cannot reasonably be expected to carry out a business risk assessment of clients’ business, a duty which is not even incumbent on the client company itself in the non-regulated corporate sector. If that is not the intention it should be clarified.
- 6.11 The CSP should be concerned with its own Business Risk Assessment. The CSP’s Customer Risk Assessment should be concerned with the money laundering risks associated with the business model of its clients but not with all of the risks inherent in the business model of the client. A business risk assessment is a matter for the company and

not the service provider. There is no justification as to why CSP's should be carrying out different risk assessments for different regulators when the regulatory objective remains the same. The Rulebook should therefore clarify that the reference CRAs in the Rulebook are in fact the CRAs carried out in terms of the FIAU implementation measures.

7. EXEMPTIONS FOR SPECIFIC CATEGORIES OF PERSONS FROM AUTHORISATION UNDER THE ACT

7.1 The Chamber's views in respect of the proposed exemptions 1-5 will be addressed in the order in which they appear in the Consultation Document.

7.1.1 **Exemption 2.3.1.** The Chamber is favour of the exemption in respect of a person authorised to act as a trustee or to provide other fiduciary duties in terms of the Trusts and Trustees Act.

7.1.2 **Exemption 2.3.2.** The Chamber is similarly in favour of the exemption in respect of a person registered to act as a VFA agent in terms of the Virtual Assets Act, when providing the activity of a company service provider as part of its activity under the said Act provided that the said activity shall not be or include the service of acting as director of a company, as a partner in a partnership or of

acting in a similar position in relation to any other legal person.

7.1.3 **Exemption 2.3.3.** This exemption contemplates a person who only acts as director or secretary of a company, as a partner in a partnership, or who acts in a similar position in relation to other legal persons, in which such person has an **ownership and controlling interest**. Use of the word only is unnecessarily limiting as is the controlling interest requirement. The reality is that there are in Malta a number of family owned, second, third and fourth generation businesses, with dispersed ownership which would not be captured by this exemption. Likewise, there are several joint venture companies where underlying shareholding can be dispersed to a level which would not endow shareholders a controlling interest. These companies constitute the backbone of the local economy. They are not typically companies which resort to CSP's to occupy the offices of either secretary or director, nor indeed should they be encouraged or constrained to do so. The offices are typically filled in by family members in respect of whom there is no compelling reason to introduce a regulatory regime in the shape of the Under the Threshold Class B category. The rules should make it

clear that where a director or company secretary is appointed because of a direct or an indirect bona fide beneficial interest (and not necessarily a shareholding as organisations are often set up as group structures), there should not be any authorisation requirement and in any event such involvements should not be counted for any purposes in terms of the Rulebook. The same holds for a vast number of joint ventures which are set up locally as special purpose vehicles for ad hoc local ventures where there is not necessarily a controlling interest and the office of director is occupied by a shareholder or beneficial owner. Accordingly, the exemption should be re-drafted to read “a person who acts as director or secretary of a company, or a partner in a partnership, or who acts in a similar position in relation to other legal persons, in which such person has an ownership interest, whether direct or indirect, in excess of 5% per centum.

7.1.4 **Exemption 2.3.4.** This refers to a person who only offers the services of director in relation to another legal person, where such person is licensed, registered or otherwise authorised by the Authority. The Chamber is in principle in favour of this exemption subject to the clarifications made below.

(a) Use of the word only is again unnecessarily restrictive.

The justification for exempting such office from CSP regulation is that such activity is in any case already regulated.

(b) The same logic applies to the director or secretary who sits, for argument's sake on two regulated companies and one unregulated company. Why should the holding of office in respect of one unregulated company, disapply the exemption which would otherwise be applicable in respect of the office relative to regulated companies. It should also be clarified that the exemption applies to offices in respect of listed companies where directorships are vetted by the Listing Authority and officers are subject to the Listing Rules including the Code of Principles of Good Corporate Governance. The exemption should therefore be amended to read as follow:

“A person who offers the services of acting as director or secretary of a company, as a partner in a partnership or of acting in a similar position in relation to any other legal person, where such legal person is licensed, registered or otherwise authorised by the Authority or where such legal

person has financial instruments authorised for admissibility to listing by the Listing Authority.

7.1.5 **Exemption 2.3.5.** As stated above the Chamber is not in favour of the exemption in terms of 2.3.5 in respect of offices in which the Government of Malta is a majority shareholder. Such involvements are high risk by their nature in view of the PEP status and there is no logical justification for exemption.

7.1.6 Chapter 2 para R2-2.3 clarifies that employees or directors of a CSP whose appointments are arranged by that CSP do not require authorisation. However the proposed “Exemptions” then fail to carve out this situation. Hence it is recommended that another exemption be added as follows:

Employees or directors of a CSP (including employees or directors of an authorised trustee or fiduciary which provides company services in terms of its exemption) whose appointment as director or secretary to another company or legal person is arranged by that CSP, are not subject to authorisation or regulation, in terms of the Act, in their own name.

8. THE RULEBOOK SHOULD TAKE INTO CONSIDERATION CURRENT COMPANIES ACT REQUIREMENTS.

- 8.1 Directors are subject to onerous rules in terms of the Companies Act. They are also fiduciaries for the purpose of the application of the fiduciary rules in terms of the Civil Code.
- 8.2 They are, in any event, subject to the possibility of disqualification, a power which for some reason has been very sparingly invoked by the Registrar of Companies. Beyond the 'fit and proper requirement' and a mandatory continuing professional education requirement, there is no compelling need to subject directors to an overbearing parallel regime in terms of a CSP Rule Book. Any new duties incumbent upon directors should be crystallised in terms of the Companies Act or regulations made thereunder in order to avoid regulatory arbitrage.
- 8.3 The observation is being made generally and also in view of Chapter 4, Title 3, R4 3.1. Worse still the rule Book, particularly Chapter 4, Title 3, R4-4.2 introduces a rule which runs counter to the Companies Act itself.

8.4 R4.4.2 provides that Where a CSP in terms of its Authorisation under the Act arranges for another person to act as director or secretary of a company it shall be required to

“..... perform adequate oversight and monitoring on such person and request such person to provide regular reports on activities undertaken. The frequency of such reports should be determined upon the activity undertaken by the client company however such reports need to be prepared at least annually.”

8.5 In terms of law of a director is an officer of the company and a fiduciary who, once appointed acts in the best interests of the company (and its stakeholders.) A director does, and indeed ought not, have a duty towards “an arranger.” Even in the event of appointment by a particular class of shareholders, a director has no particular duties towards a nominating shareholder, let alone an “arranger” of office. Sharing information with an arranger constitutes a breach of directors’ duties. It is critical that the rules proposed by the Rulebook are consonant with the Companies Act.

8.6 The proposed Rulebook particularly Chapter 4, Title 3 R4-3.1 appears to be oblivious of the differentiation in role between a director and company secretary in terms of the Companies Act. The duties of a company secretary in terms of law are indeed onerous. However equating the responsibilities of a company secretary to those of a director in respect of matters which are not within his/her control is taking the matter too far. It is amply clear in terms of Section 136 A that a Company secretary is not tasked with the responsibility for the administration and management of the company or the general supervision of its affairs, he does not actively participate in the deliberations of the Board of directors nor does he have a vote.

Rendering the company secretary responsible or liable in terms of the Rulebook for matters which do not fall within his/her remit in terms of the Companies Act is non-sensical from a regulatory point of view and counter intuitive from a governance point of view as it will simply lead to a situation where independent company secretaries are disincentivised to take on the role.. Yet again this approach is unparalleled elsewhere in the EU and the UK and departs fundamentally from the position in the UK Companies Act, which originally was and remains the principal source of the provisions in the

Maltese Companies Act dealing with the Company Secretary. In any event, the CSP Rulebook is not the place to introduce fundamental changes to the office of the company secretary and any such fundamental changes should be grounded in the Companies Act.

The CSP Rulebook should be in sync with the Companies Act and accordingly the Chamber strongly recommends that reference to the company secretary in Chapter 4, Title 3, R4-3.1 is deleted.

9. CERTAINTY AND PREDICTABILITY OF APPLICABLE RULES.

9.1 An authorised person is entitled to certainty and predictability of applicable Rules. Vague wording such as is proposed in R1-2.5 do not satisfy this test. The proposed Rulebook states that, in complying with R1.21 “CSP’s shall take due account and where applicable comply with any relevant EU legislation as well as any Guidance Notes/Statements/Industry Best Practices which may be issued by local and, or international standard setting bodies.”

9.2 Reference to “Guidance Notes/Statements/Industry Best Practices which may be issued by local and, or international standard setting bodies” is as vague as they come. There is

a plethora of guidance on governance across the European Union and beyond. Should the Authority have in mind any specific guidance or best practice, the Authority should say so and incorporate such rules in the Rulebook or rules of conduct rather than make loose references such as the ones made in R1-2.5. No person should be subject to legal or regulatory sanctions simply for a threshold which a regulator may have had in mind but failed to articulate in regulation properly and accurately. This should be removed.

10. THE LEGAL PROFESSION

- 10.1 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.
- 10.2 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.

10.3 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.

10.4 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.

10.5 There is a difference to be made between professionals:

10.5.1 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

10.5.2 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.

10.6 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.

10.7 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.

10.8 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.

10.9 It is the Chamber's considered view that:

10.9.1 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 – thus qualifying as Under Threshold for the purposes of the Act

10.9.2 The services referred to in section above are the following:

- a. company incorporation/registration and setting up of other legal entities and, or legal arrangements⁶;
- b. providing registered office to companies;
- c. company secretarial services;

10.9.3 Lawyers providing directorships (but see above when this is done in a personal capacity) or arranging for others to act as directors, and lawyers whose revenue from activities mentioned 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.

10.10 In the context of the above lawyers who fall within the first category can provide the services mentioned as an integral

⁶ Even here more information is required as to what will constitute incorporation or registration.

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.

10.11 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.

10.12 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.

10.13 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.

10.14 For the Chamber's full proposal on this matter reference is made to the Chamber's updated position paper in response to the previous consultation.

11. CONCLUSION

Added regulation is not necessarily an elixir for the reputational deficit in the CSP sector or of Malta generally.

The current regulation could have served its purpose had it been applied across the board, appropriately supervised and had adequate enforcement action been taken where necessary. That having been said, the proposed Rulebook has a number of merits. The Chamber would be in favour of a new Rulebook which effectively seeks to raise the bar where the bar needs to be raised and to serve as a safeguard against Malta being unnecessarily exposed to reputational risk.

The Chamber is in favour of a regulatory net which can be managed and supervised effectively, whilst being proportionate to the nature, extent and complexity of the services in question. The current rulebook,

notwithstanding that it expressly states to follow a risk-based and proportionate approach – fails on both counts. It is a model of over-regulation that attempts to regulate an environment beyond the limits of what is necessary, realistically manageable by stretched regulator and desirable to address the deficiencies; that fails to take into account the significant cost to the sector against the benefits that it will create; that places all providers of services in one pot without and differentiation as if providers are a homogenous sector; that has shifted what originally was an AML/CFT issue to a market entry issue – when in all frankness the AML/CFT regulatory framework and now its improved supervision and enforcement would on its own deal with the main issues raised by Moneyval.

The above suggestions are intended to reach the desired objectives in a truly proportionate manner, without compromising enhanced quality and integrity, whilst avoiding over-reaching regulatory capture; regulatory arbitrage and introducing an unnecessarily onerous regime which is unparalleled elsewhere in the European Union and the UK thereby rendering Malta unjustifiably uncompetitive.

Overall, it is the approach to the overall regulatory architecture that 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 even the Act needs to be revisited. 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.

In this light we therefore urge the MFSA to comprehensively reconsider its position on the matter and to adopt the specific recommendations made by the Chamber.

JANUARY 2021