MFSA MALTA FINANCIAL SERVICES AUTHORITY

Feedback Document

Feedback Statement on the Consultation on Chapter 3 of the Financial Institutions Rulebook (FIR/03)

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Contents

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1 Introduction

On 21 May 2024, the Malta Financial Services Authority ('MFSA' or 'the Authority') published a Consultation Document on the revised Chapter 3 of the Financial Institutions Rulebook ('FIR/03') as part of its efforts to ensure a sound and robust regulatory framework for payment institutions and e-money institutions.

The Consultation sought stakeholder feedback on the proposed FIR/03 which contained a comprehensive set of rules which are intended to be applicable to payment institutions and e-money institutions authorised by the MFSA on an ongoing basis.

A total of 12 stakeholders, comprising both individuals and organisations, responded to the consultation, providing their feedback on the proposed rules.

The Authority wishes to thank respondents for their valid and detailed feedback, all of which was noted and carefully considered. In this regard, the Authority has made various changes to the proposed draft of FIR/03, which are outlined in this Feedback Statement, and which seek to:

- eliminate any overlap between FIR/03 and the provisions of the Financial Institutions Act ('the Act');
- provide further clarification vis-à-vis certain requirements; and
- enable Licence Holders to effectively comply with the new rules.

This Feedback Statement sets out the key points of contributions received, the MFSA's response to such contributions and the changes made to the draft FIR/03 as a result thereof.

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2 Feedback Received and MFSA Position

2.1 Main comments and changes to Title 1

2.1.1 Rule relating to the applicability of Title 3 of FIR/03 to other institutions

Based on feedback received, the Authority has deleted R3-1.1.2 which extended the requirements of Title 3 to other Licence Holders. The MFSA notes that such requirements emanate directly from the Act as well as CBM Directives and hence do not need to be replicated in the FIR/03.

2.1.2 Rule relating to other legislation which may be applicable to Licence Holders

One respondent noted that the list of other laws found in R3-1.1.5 should comprise only laws which are directly applicable to Licence Holders. Nevertheless, the Authority notes that while not all legislation listed in R3-1.1.5 may be directly applicable to Licence Holders, the list in R3-1.1.5 serves to raise awareness on other legislation which may be applicable to Licence Holders.

2.1.3 Definitions

Based on feedback received, the Authority has added definitions for the terms 'Independent Non-Executive Director' and 'Average daily outstanding electronic money'. Definitions which are found in the Act have been cross-referenced directly.

2.1.4 Submission of documents

Based on the feedback of various respondents, the Authority has added a R3-1.3.5 clarifying the submission of documents which are signed with a valid e-signature.

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2.2 Main comments and changes to Title 2

2.2.1 Rules relating to notifications and prior approvals

With reference to R3-2.2.1, certain notification requirements have been elaborated in order to provide further clarity on when a notification is required. Furthermore, the list of notification requirements has been made exhaustive.

R3-2.3.1 on instances where the prior approval of the Authority must be sought has also been made exhaustive. The proposed change in name or address of a Licence Holder will now also require prior approval of the MFSA.

2.2.2 Rules relating to the approval and departure process for appointed persons

Based on the feedback received, this section has undergone minor amendments. Various stakeholders commented on the inclusion of R3-2.4.10 (iii) relating to the submission of a Compliance Report by an outgoing Compliance Officer. Respondents noted that such requirement is considered too onerous and may be challenging for the Licence Holder to comply with. On the basis of feedback received, the requirement has been replaced with a rule providing the Authority with the discretion to request exit interviews with outgoing Appointed Persons.

2.2.3 Rules on passporting, agents and distributors

Based on the feedback of one respondent, R3-2.6.8 has been updated to clarify that passporting activities may commence once a passporting notification is reflected in the Authority's register, in line with Article 8A of the Act. The notification requirement in R3-2.6.8 has also been updated to clarify that such notification should be made by the Licence Holder immediately upon becoming aware of any changes.

2.2.4 Consolidated Supervision

R3-2.7 has been deleted given that such requirement emerges directly from the Act.

2.2.5 Requirements relating to sound and prudent management

With reference to R3-2.8.1 (*now R3-2.7.1*), various respondents noted that the listed publications constitute principles and guidelines which should note be applied directly to

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Licence Holders. In this respect, the Authority notes that it was not the intention for such publications to be directly applicable, but rather, for them to guide Licence Holders in their compliance with the governance requirements. The wording of the rule has been updated accordingly.

R3-2.8.8 (*now R3-2.7.8*) has been updated to clarify that this rule is without prejudice to R3-2.8.2 (*now R3-2.7.2*). Based on the feedback of several respondents, the term 'Independent Non-Executive Director' has been defined.

One respondent noted that the requirement of R3-2.8.23 may not be applicable in the context of payment services and the issuance of electronic money, due to the fact that funds are safeguarded, and the Licence Holder does not have discretion to utilise such funds. The rule has therefore been deleted.

With reference to the rules relating to compliance, R3-2.8.34 (*now R3-2.7.34*) has been amended to also include an obligation for the compliance function to provide prompt feedback to the Authority's requests. Various respondents noted that the temporary derogation provided for in R3-2.8.36 (*now R3-2.7.34*) would impinge on the independence of the compliance function and this rule has therefore been removed. Finally, on the basis of feedback received, the rules relating to the Annual Compliance Report have been updated to remove the requirement for an AML/CFT confirmation from the MLRO. The Annual Compliance Report will now focus solely on the Licence Holder's compliance monitoring plan and any regulatory breaches identified through the execution of such plan.

With respect to the internal audit function, a new rule (R3-2.7.41) has been added to clarify that the internal audit function may be outsourced. In such cases, the Licence Holder shall designate a director who shall remain responsible for oversight of the internal audit function.

2.2.6 Outsourcing requirements

In general, many respondents noted that the requirements emerging from the Digital Operational Resilience Act ('DORA Regulation'), which are set to become applicable in January 2025, may overlap with the rules on outsourcing. Respondents noted that there may be an overlap between the FIR/03 outsourcing requirements and the DORA Regulation, given that FIR/03 on the one hand imposes requirements in relation to 'outsourcing service providers', while the DORA Regulation imposes requirements in

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relation to 'ICT third party providers'. The Authority recognises this but also notes that (i) not all instances of outsourcing would fall within scope of the DORA Regulation and (ii) the requirements on outsourcing go beyond the requirements of the DORA Regulation which are focused on digital operational resilience and the managing of third-party ICT risk. As such, R3-2.8.2 has been added to clarify that the outsourcing rules are without prejudice to the requirements of the DORA Regulation, and the latter would take precedence in case of conflict. As a result of this consideration, reference to the MFSA Guidance on Technology Arrangements, ICT and Security Risk Management and Outsourcing Arrangements has been removed from FIR/03.

Other changes to the outsourcing rules include an update to R3-2.9.4 (*now R3-2.8.5*) to further clarify instances where the Authority may take measures in relation to outsourcing arrangements. As a result of this change, R3-2.9.13 was deleted.

2.2.7 Rules relating to safeguarding of client funds

On the basis of feedback received, the rules in this section have been amended to remove any provisions which emerge directly from the Financial Institutions Act (Safeguarding of Funds) Regulations in order to avoid any overlap or contradictory requirements. This has been clarified through the addition of a new R3-2.9.2

With reference to the proviso of R3-2.10.3 (*now R3-2.9.3*), various stakeholders noted significant operational difficulties to comply with the rule. On the basis of the feedback received, the rule has been amended to require that Licence Holders transfer funds other than client funds which are required to be safeguarded out of the safeguarding account as frequently as practicable throughout the day.

With regard to R3-2.10.5 (*now R3-2.9.4*), one respondent requested that the Authority allow for funds to be safeguarded with branches of third-country credit institutions established in other Member States. The Authority has chosen not to onboard this feedback given that the framework for branches of third country credit institutions in the EU is not harmonised amongst the Member States. As such, the MFSA will only allow for safeguarding with third country branches where such branches are established in Malta.

One respondent requested clarification on the term 'delegation' in the context of R3-2.10.6 (now *R3-2.9.5*). The Authority has re-drafted this rule to further clarify its expectations. R3-2.10.10 (*now R3-2.9.8*) has also been amended to clarify the Authority's expectation that

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an insurance company or credit institution issuing an insurance policy or a comparable guarantee for the purpose of safeguarding is required to be authorised in the EU.

On the topic of safeguarding accounts, various respondents noted the difficulty in requiring a specific title for the safeguarding account. As such this requirement has been retained on a best endeavors basis.

Several respondents requested clarification on the notification requirement in R3-2.10.15 (*now R3-2.9.12*) and when this would be triggered. The Authority considers safeguarding requirements of the highest importance in the context of payment institutions and e-money institutions. As such, the rule has been updated to clarify that such notifications are expected prior to any changes to the safeguarding arrangements being affected.

With reference to R3-2.10.16 (*now R3-2.9.13*), several respondents noted that they are sometimes not able to obtain a safeguarding acknowledgment letter from the institution with which they safeguard, due to inter alia jurisdictional differences or the fact that credit institutions have standard templates in place for such letters. The Authority recognises that it may not always be possible to obtain a safeguarding acknowledgment letter from an institution. For this reason, where Licence Holders are not able to obtain such a letter, they shall now be required to evidence to the Authority that the safeguarding account is held in accordance with the regulatory requirements.

One respondent requested clarification on the expectations vis-à-vis the periodic reports on compliance with the Licence Holder's safeguarding requirements. R3-2.10.19 (*now R3-2.9.16*) has been updated to clarify that such reports should be made to the Board on at least an annual basis, or where there are changes to the Licence Holder's safeguarding arrangements. Finally, the audit requirement in R3-2.10.28 (*now R3-2.9.25*), has been updated to require such audit to be undertaken on an annual basis, based on feedback received. One respondent requested clarification on whether any specific audit standard should be used. At this stage, the Authority does not consider it necessary to prescribe a specific standard in connection to the audit of safeguarding arrangements.

2.2.8 ICT and Cybersecurity Risk

Pursuant to the considerations outlined under section 2.2.6 of this Feedback Statement, the rule in this section has been updated to refer to the DORA Regulation.

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2.2.9 Prudential Requirements

With regard to R3-2.12.2 (*now R3-2.11.11*), one respondent noted that this is a new requirement on the type of capital to be held by Licence Holders, and additional timeframes should be applied to allow Licence Holders time to transition accordingly. The Authority however notes that this requirement emerges directly from the Act (the definition of 'own funds' refers) and as such, no additional transitory period is being considered for this requirement.

2.2.10 Accounting and Statutory Audit Requirements

R3-2.13.1 to R3-2.13.5 have been removed due to their overlap with the provisions of the Act. They have now been replaced with R3-2.12.1.

2.2.11 Reporting Requirements

With regard to the Audited Financial Statements and FI Return, one respondent provided various comments on the structure of such documentation, including the scope of the auditor's confirmation vis-à-vis the FI Return. The Authority has taken note of these comments and has sought to adjust the contents of the audit report. One respondent noted a preference for the FI Return Representations Sheet to be initialised by the Auditor rather than signed. The Authority considers that it is standard practice in other sectors for the auditor to sign the Representation Sheet to regulatory returns and has therefore retained the requirement.

2.3 Main comments and changes to Title 3

2.3.1 Service-Specific Requirements

One respondent noted a discrepancy between R3-3.3.5 and R3-3.3.6. The two rules have now been joined together in R3-3.3.5. R3-3.4.2 relating to the Payment Accounts Directive has been removed due to its inclusion in the initial list in Title 1. Furthermore, R3-3.3.9 has been added in view of the applicability of the Markets in Crypto-Assets Regulation ('MiCA') to electronic money tokens as of 30 June 2024. The terms 'MiCA Regulation' and 'electronic money tokens' have been defined accordingly.

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4 Other Matters

In providing their feedback to the consultation, various respondents sought clarification on various requirements which had previously been included in the regulatory framework. The Authority does not consider that such clarifications require the introduction of further rules, and so, the MFSA will strive to supplement the FIR/03 with further regulatory guidance in due course.

5 Way Forward

A circular informing market participants on the applicability of the new FIR/03 will be issued alongside this Feedback Statement. The circular shall include information on any transitory periods to be applied in this context.

Any queries or requests for clarifications with respect to the above should be sent via e-mail to fintechpolicy@mfsa.mt.

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