21 January 2025

FinTech Supervision

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Dear Chief Executive Officer,

Re: Thematic Review on (i) Outsourcing and other Third-Party Arrangements and (ii) Safeguarding of Clients' Funds in relation to Financial Institutions

You are receiving this letter as the Chief Executive Officer of a Financial Institution ("Authorised Person") supervised by the Malta Financial Services Authority (the "MFSA" or "Authority").

1. Background and Methodology

Thematic reviews provide benchmarks for Authorised Persons to calibrate their practices against industry standards and regulatory expectations. This tool not only supports continuous improvement for Authorised Persons but also for regulators, enabling both sides to evaluate industry practices, ensure compliance, and identify areas for enhancement to improve overall outcomes.

To this effect, the FinTech Supervision Function ('FS') within the Authority has chosen to conduct two thematic reviews on (i) Outsourcing and Other Third-Party Arrangements and (ii) Safeguarding of Clients' Funds specifically in relation to Financial Institutions licensed under the Financial Institutions Act (Chapter 376 of the Laws of Malta) (hereinafter 'the Act'), with particular regard to the adherence of the Authorised Persons to their respective regulatory obligations and to delineate best practices applicable to the sector.

With reference to the Thematic Review on Outsourcing and Other Third-Party Arrangements, Authorised Persons were required to refer to the EBA Guidelines on Outsourcing Arrangements ('EBA Guidelines'). Financial Institutions licensed under the First Schedule of the Act, specifically under Activity 4 or Activity 10 (i.e. Payment Institutions and/or E-money Institutions) were required to refer to the revised Chapter 3 of the Financial Institutions Rulebook ('FIR/03'), whilst those Institutions licenced under the Act excluding those under Activity 4 or Activity 10 of the same Schedule (i.e. Traditional Institutions which are not a Payment or E-money Institutions) were

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required to follow Banking Rule 14: Outsourcing by Credit Institutions authorised under the Banking Act 1994 ('BR/14'), since they are not in scope of FIR/03. The regulatory framework as detailed above is pursuant to Article 8B(3) of the Act.

The Thematic Review on Safeguarding of Clients' Funds focused on Authorised Persons licenced to provide the services listed under Activity 4 and 10 of the First Schedule of the Act, namely Payment Institutions and/or E-money Institutions. The survey sought to analyse in detail the organisational arrangements which Authorised Persons have in place in order to ensure compliance with the safeguarding of funds requirements emanating inter alia from the Financial Institutions Act (Safeguarding of Funds) Regulations (S.L. 376/04) ('Safeguarding Regulations') and the Financial Institution Rules. Since then, the Authority has published a revised version of FIR/03, which outlines the Authority's expectations regarding this subject. As a result of the Safeguarding of Clients' Funds Thematic, the Authority has already engaged with Authorised Persons individually.

The purpose of this communication is to inform the industry on the main findings of these two Thematic Reviews, as well as to communicate the Authority's expectations and any recommendations related to the two subjects. Therefore, this communication should not be construed as a complete and exhaustive review of all requirements arising from the applicable regulatory framework. It should be read in conjunction with the relevant laws and regulations that may be issued or updated periodically.

2. Findings and General Comments

2.1 Third Party Reliance

(i) Assessment

Outsourcing and Other Third-Party Arrangements

The assessment represents a pivotal step in the process of managing third-party and outsourcing arrangements, as it forms the foundation for all subsequent actions. In this regard, Authorised Persons are expected to conduct a comprehensive and detailed evaluation aligned with the applicable rules and regulations to determine whether an arrangement qualifies as an Outsourcing Arrangement, a critical or important Outsourcing Arrangement, or as a Third-Party Arrangement. Authorised Persons must ensure alignment with the relevant outsourcing framework and, where necessary, seek external legal opinions to support their assessment.

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As outlined in BR/14 Section 1.1 and FIR/03 R-2.8.6, Authorised Persons should establish which agreements fall under the definition of outsourcing as defined under the Act and the applicable legislation. The following steps should be carried out:

(i) The Authorised Person shall determine whether the agreement is considered to be outsourcing. Here reference is to be made to FIR/03 R3-2.8.6 till R3-2.8.8 and Section 1.1 of BR/14;

(ii) Subsequently, an assessment is required to establish whether this is critical or important as per BR/14 Section 1.2 and FIR/03 R3-2.8.9 ; and

(iii) If the agreement is critical or important as per point (ii), the Authorised Person is expected to refer to a list of factors which is to be taken into consideration, as detailed in BR/14 paragraph 15 and FIR/03 R3-2.8.10.

In its review of the replies submitted by the Authorised Persons, the Authority noted instances where the same service provider was classified as both an outsourced arrangement and a third-party service provider, suggesting a lack of clarity in the distinction between these roles. This indicates that assessments to determine the nature of arrangements may either be inadequate or otherwise absent.

It was further observed that in certain instances, internal control functions such as Compliance, Risk, and Internal Audit were not classified as "*critical or important*". This misclassification is not in line with the applicable framework as FIR/03 and BR/14 define "*critical or important*" functions as those that are essential to the performance of core activities or compliance with regulatory obligations. Governance functions, including Compliance, Risk and Internal Audit, are explicitly considered "*critical or important*".

FS further noted instances of significant reliance on intragroup outsourcing arrangements without sufficient evaluation of the associated risks, potential conflicts of interest arising from such arrangements, or compliance with applicable laws and regulatory requirements. While intragroup arrangements may provide additional operational efficiency, these arrangements are still required to adhere to the same regulatory requirements and standards as external outsourcing, therefore they must be subject to the same risk assessments, contractual standards and oversight to ensure compliance and operational resilience.

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Safeguarding of Clients' Funds

Authorised Persons must adhere to the Safeguarding Regulations when determining whether the method utilised complies with the applicable requirements for safeguarding of clients' funds. In addition, compliance with FIR/03 R3-2.9 is also required.

In relation to the deposit safeguarding method with a credit institution, the Authority wishes to emphasize specifically on R3-2.9.4 which specifies that the credit institution chosen shall be authorised in a Member State. It should be noted that the term 'Member State' includes the 27 EU Member States as well as the countries Iceland, Liechtenstein and Norway which together comprise the EEA.

The Authority has observed a significant rise in Authorised Persons safeguarding their clients' funds through the investment method. Previously, it was standard practice for Authorised Persons to safeguard clients' funds by depositing them in a separate account with a credit institution. While the deposit safeguarding method is relatively straightforward, the investment method requires a more comprehensive assessment by the Authorised Person to ensure that the assets are secure, low-risk, and liquid. The assessment should be shared with the Authority upon notification of this safeguarding method.

The Authorised Person should include detailed information about the type of asset and whether in terms of the Safeguarding Regulations, the secure low risk assets are:

i. asset items falling into one of the categories set out in Table 1 of Article 336(1) of the CRR for which the specific risk capital charge is no higher than 1.6% but excluding other qualifying items as defined in Article 336(4) of the CRR; or
ii. units in an undertaking for collective investment in transferable securities (UCITS) which invests solely in assets referred to in sub-paragraph (i) above.

Where the assets are units in an undertaking for collective investment in transferable securities (UCITS) which invests solely in assets referred to in point (i) above, the Authorised Person is to also analyse whether the assets meet both the criteria of secure low risk and liquid in respect of each underlying asset in which the UCITS's fund invests in.

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In terms of the Subsidiary Regulations, the assessment should set out the reasons why these assets are considered to be:

a. **Secure low risk** – The analysis should at least as a minimum explain:

   i. the exposure class to which the assets would be assigned in accordance with Article 112 of the CRR;

   ii. the risk weights that the assets would be assigned to in accordance with the relevant provisions and Articles of the CRR (Articles 114 to 134) and where applicable the credit quality determined by reference to the credit assessments of ECAIs (refer to the ECAIs' mapping under the Standardised Approach as published by the EBA https://www.eba.europa.eu/overview-ecais-mapping-under-standardised-approach) or the credit assessments of Export Credit Agencies; and

   iii. the specific risk capital charge that would apply.

b. **Liquid** – The assessment should explain the reasons for which the assets are considered to be liquid and to support this indicate under which Level between Level 1 and Level 2 (if any) such assets would classify in terms of Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions, if the latter were to apply.

(ii) Concentration

Outsourcing and Other Third-Party Arrangements

The Authority has identified concentration risks stemming from Authorised Persons' reliance on common service providers, particularly in the areas of risk, compliance, and audit. This reliance also raises concerns regarding time commitment, as these roles are often outsourced for only a few hours per week. Consequently, the Authority has reservations about whether such a limited time allocation is sufficient to meet the necessary requirements effectively. Accordingly, the Authority expects that appropriate assessments are conducted when establishing outsourcing arrangements, with particular attention given to evaluating time commitment considerations to ensure successful implementation and ongoing operations in line with the applicable regulatory framework.

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Safeguarding of Clients' Funds

In its analysis of the Thematic Review on the Safeguarding of Clients' Funds, the Authority observed that several Authorised Persons rely on a single safeguarding arrangement. This inherently creates a concentration risk, whereby any issues arising with this arrangement could lead to its termination, and thus potentially hindering the Authorised Person's ability to fulfil safeguarding obligations and resulting in non-compliance. In this context, and in line with R3-2.9.19 (i), the Authority recommends Authorised Persons to establish more than one safeguarding arrangements in order to mitigate this concentration risk.

Moreover, when an Authorised Person opts to utilize the investment method as the primary safeguarding arrangement, a proportionate percentage of clients' funds held is recommended to be deposited with credit institutions to ensure sufficient liquidity for the execution of payment transactions.

2.2 Governance

(i) Oversight and Sound Governance Arrangements

Outsourcing and Third-Party Arrangements

The Authority notes weaknesses pertaining to the governance arrangements put in place by Authorised Persons which result in shortcomings relating to the effective oversight of outsourced critical or important functions.'. It was noted that in some instances, Compliance Officers have oversight of Internal Audit functions. This practice is not aligned with FIR/03 R3-2.7.42 which clearly highlights that oversight responsibilities of Internal Audit functions should rest with a member of the Board of Directors. The Compliance Function, as part of the second line of defense, should not oversee or hold responsibility for the Internal Audit Function, which operates within the third line of defense.

Moreover, in some instances, Ultimate Beneficial Owners ('UBOs') were found to have direct oversight of all outsourcing arrangements. While UBOs have a vested interest in the operations of the Authorised Person, the centralization of oversight is not deemed to be conducive to the sound and prudent management of an Authorised Person.

In some other instances, Internal Audit function was observed to have oversight of IT support service providers. The Authority expects that operational functions, such as

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IT support, should be overseen by the Chief Technology Officer (CTO), or otherwise the Board of Directors. The Internal Audit function should be separate and independent from the other functions and activities of the Authorised Person to ensure an independent review of the adequacy and effectiveness of the Authorised Person's systems, internal control mechanisms and arrangements.

Safeguarding of Clients' Funds

As outlined in R3-2.9.16 of the FIR/03, it is the Authority's expectation that Authorised Persons identify an individual who shall have the following responsibilities:

i. to monitor and, on a regular basis, to assess the adequacy of the Licence Holder's safeguarding policy and procedures;
ii. to ensure compliance with the Licence Holder's safeguarding requirements;
iii. to draw up periodic reports to the Board on compliance by the Licence Holder with its obligations regarding the safeguarding of clients' funds on at least an annual basis and where there are changes to the Licence Holder's safeguarding arrangements.

The Authority notes that the above referenced individual identified is usually the Chief Financial Officer or their equivalent. In order to ensure a strong compliance culture and an effective oversight of the safeguarding arrangements, the Board of Directors is expected to proactively ensure that the policies and internal control mechanisms adopted are such that they adequately minimise the risk of loss of relevant funds through fraud, misuse or negligence, and to further ensure that it has access to such safeguarding accounts.

FIR/03 sets out the expectation that an Authorised Person establishes a reconciliation procedure in accordance with R3-2.9.21 to R3-2.9.24. Reconciliations are expected to be properly documented, dated, and signed for record-keeping purposes, and a function within the Authorised Person's organisation structure should be tasked with carrying out the reconciliations review.

As a best practice, Authorised Persons are recommended to implement the four eyes principle relation to access and control of the safeguarding account/s. Furthermore, the Authority is of the opinion that it is not an adequate governance practice to have UBOs of Authorised Persons signing off on transactions.

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(ii) Conflict of Interest

Outsourcing and Other Third – Party Arrangements

FIR/03 R3-2.8.24 and BR/14 Section 2.4 set out the obligations of Authorised Persons to identify, assess and manage Conflict of Interest (hereinafter 'COI') in relation to Outsourcing Arrangements, and where these arrangements are deemed to create material COI, also in the context of intra-group outsourcing arrangements, the Authorised Person shall take appropriate measures to manage them.

The identification of COI begins during the pre-outsourcing analysis, as outlined in R3-2.8.33 of FIR/03 and Section 2.4 paragraph 24 of BR/14, wherein Authorised Persons must identify and evaluate any COI prior to entering into Outsourcing Arrangements. Furthermore, the Authorised Person is expected to continue monitoring any COI matters that may arise during the duration of the outsourcing arrangement.

In its course of supervisory work, the Authority has met instances where Authorised Persons have proposed Board Member of an Authorised Person engaged through an outsourcing arrangement to provide Compliance or Internal Audit services to the same Authorised Person creates a COI. This arrangement is classified as a critical or important Outsourcing Arrangement. Given the existing involvements and connections, it may compromise the individual's independence of mind, judgement and potentially jeopardize the integrity of decision-making. Please refer to FIR/03 R3-2.7.23 and the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2021/06) for other instances of potential or actual COI.

Authorised Persons should not assume that intra-group Outsourcing Arrangements do not give rise to COI. Therefore, it is expected that arrangements with companies within the same group must meet the same requirements as outsourcing to external third parties. In fact, some Authorised Persons with intra-group Outsourcing Arrangements have acknowledged the presence of COI. Authorised Persons are responsible for assessing the materiality of any COI within intra-group arrangements and, as a result, determining and implementing appropriate mitigating measures. Establishing arm's length conditions is one approach to preventing COI.

It is the Authority's recommendation that COI identified by the Authorised Persons within the Outsourcing and Third-Party arrangements are recorded by the Authorised Person in the COI Register, and that mitigating measures are put in place

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2.4 Quality and Availability of Documents

Outsourcing and Other Third-Party Arrangements: Documents

Outsourcing Policy:

FIR/03 and BR/14 mandate Authorised Persons to establish and maintain an Outsourcing Policy which shall be approved by the Board of Directors. More specifically, FIR/03 R3-2.8.21 and BR/14 Section 2.3 outline the contents of what the Outsourcing Policy should entail. Authorised Persons are expected to review and update the Outsourcing Policy on an ongoing basis to remain aligned with the applicable regulatory framework and to also update the document in response to any significant changes in business operations, internal governance or risk management profiles. Authorised Persons are expected to regularly review their outsourcing policies, ensuring updates are documented, especially when significant changes occur in business operations, risk environments or regulatory framework.

The following are a number of findings which were noted :

(i) Policies were not reviewed on a regular basis;

(ii) a number of Authorised Persons did not have the Outsourcing Policy in place, and this document was introduced due to the thematic exercise;

(iii) Other outsourcing policies indicated the same date for both their introduction and last review or did not contain any review log, implying that no prior updates were conducted as required; and

(iv) Outsourcing Policies were not approved by the Board of Directors. Instead, they were reviewed and approved by other senior management or committees within the Authorised Person. This practice contravenes the requirements set in FIR/03 and BR/14 which include that the Board of Directors holds ultimate responsibility for approving and ensure adequate implementation of the outsourcing policy.

(v) Some policies were drafted in very general terms, lacking specific details on key matters such as definitions of outsourcing and distinctions from third-party service providers and due diligence conducted on prospective outsourcing service providers.

Consequently, these policies were misaligned with the requirements outlined in BR/14 and the new FIR/03, raising concerns about the adequacy of the oversight and compliance measures in place.

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Contractual Agreements

The Authority observed that in some instances, critical or important outsourcing agreements were not in line with the regulatory requirements as per R3-2.8.41 of FIR/03 and paragraph 64 of BR/14. These agreements lacked essential provisions such as the governing law of the agreement, reference to the outsourcing framework, termination and exit strategies and business contingency plans.

It was also noted that in other instances Authorised Persons rely on quotations, letters of engagement or proposals for outsourced services rather than establishing proper outsourcing agreements. This practice fails to meet the requirements of FIR/03 and BR/14, which highlights that formalized agreements should be in place with clearly defined terms and conditions to ensure accountability and regulatory compliance. Additionally, in some cases, outsourcing agreements were not signed and/or dated. It is the Authorised Persons' responsibility to ensure that all outsourcing arrangements are governed by a formal written agreement which is legally binding and enforceable, and which follows the applicable provisions in the Outsourcing framework.

Authorised Persons are reminded on the importance of formalised agreements that are consistent with regulatory standards to ensure proper oversight, risk management, and operational continuity of outsourced services.

Outsourcing register

The Authority noted that although all respondents submitted the Outsourcing Register, a number of Authorised Persons did not have this in place prior to the receipt of the questionnaire, and that this register was drafted following the Authority's communication. Furthermore, from a review carried out on the Outsourcing Registers submitted, it emerged that a large percentage were not aligned with the criteria established by the EBA Guidelines on Outsourcing and did not provide the level of detail as set out in the outsourcing obligations.

There was also a notable disparity in the quality of outsourcing registers submitted. While some License Holders provided registers with a commendable level of detail and formality, others submitted registers that were informal, poorly structured, and lacking in essential information.

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Safeguarding of Clients' Funds: Documents

Acknowledgement Letter

When utilising the deposit method for Safeguarding of Clients' Funds, Authorised Persons must have a Safeguarding Acknowledgement Letter from each credit institution and/or custodian with which it holds safeguarding accounts which confirms that the Safeguarding Account complies with the conditions set out in the Safeguarding Regulations (S.L. 376.04). A general finding emanating from the Thematic Review of the Safeguarding of Clients' Funds was that albeit an Authorised Person would have an Acknowledgement Letter, this would not be aligned with R3-2.9.13 of the FIR/03, which states that this documentation should evidence that:

i. funds/ assets held in the Safeguarding Account are insulated and held solely for and on behalf of and in the interest of clients of the Licence Holder;
ii. clients of the Licence Holder enjoy a right of ownership over the funds held in the safeguarding account; and
iii. no other person, including the Licence Holder and the credit institution or depositary, has any claim or right of action on or against the funds/ assets held in the safeguarding account.

Safeguarding of Clients' Funds Policy and Reconciliation Procedure

As per R3-2.18, Authorised Persons should ensure that the Safeguarding Policy should demonstrate the Authorised Person's compliance with all safeguarding requirements, and include the following information on the:

- methodology for the safeguarding of clients' funds;
- governance arrangements relating to safeguarding arrangements;
- assessment of third parties used in safeguarding; and
- reconciliation process and escalation process in case of discrepancies.

Authorised Persons were instructed to submit a Safeguarding of Clients Funds Policy and Reconciliation Procedure. It was noted that although a large majority of the population submitted such documents, information differed on a great level. Certain Authorised Persons detailed the policy and procedure in great extent, also providing screenshots and real-life explanations, whilst other Authorised Persons submitted policies and procedures which were poorly written and without the level of detail required. It was also noted that a number of Policies submitted did not indicate that

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these were being periodically reviewed and approved by the Board of Directors, as it should be as per R3-2.9.17 of FIR/03. The Policy should include a 'Version Log' which would detail the date of the last review and approval of the Board of Directors. The Authority has also observed that a small number of Authorised Persons prepared the Policy for the first time specifically for the purpose of this Thematic Review.

3. Closing Remarks

Outsourcing and Other-Third Party Arrangements

In recent years, Authorised Persons have increased their reliance on outsourcing arrangements. However, the Authority has observed that reviews conducted in accordance with the applicable outsourcing framework are not always performed, or, when undertaken, lack the thoroughness and detail required to ensure the reliability of the conclusions drawn. As already detailed in this 'Dear CEO letter', the Authority has observed that certain Authorised Persons tend to classify all their arrangements either as important or critical outsourcing arrangements or as other outsourcing arrangements. This expectation is underscored by the fact that several Authorised Persons have not conducted audits of these arrangements over the past two years.

The Authority highlights the critical importance of the assessment process, as it serves as the cornerstone for all subsequent actions in the outsourcing framework. Appropriate due diligence reviews are to be carried out on all prospective Outsourcing or Third-Party providers, prior to entering into any arrangements. Furthermore the applicable legislation highlights further checks which need to be carried out on critical or important outsourcing arrangements. Authorised Persons are required to ensure that exit strategies are set up accordingly, and that the documentation pertaining to outsourcing arrangements are aligned with the assessment carried out. Outsourcing arrangements which are considered to be critical or important need to be aligned with the framework in place, whilst the Outsourcing Policy needs to be kept updated and reviewed on a regular basis. Firms should maintain and periodically test their business continuity plan with regards to any outsourced functions concerning critical or important functions. Their business continuity plan should consider events involving the provision of the outsourced service to an unacceptable level and the insolvency or other failures of the service provider. Authorised Persons are also expected to strengthen their intragroup arrangements and conduct risk assessments to ensure that these arrangements meet the same standards as external outsourcing

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arrangements, including documentation, oversight, reporting and compliance with all regulatory provisions required under FIR/03 and BR/14.

Consequently, Authorised Persons are expected to establish periodic reviews of their outsourcing arrangements to ensure ongoing compliance with FIR/03, BR/14 and applicable regulations. In light of the Thematic Review on Outsourcing and Third-Party Arrangements and the findings outlined in this 'Dear CEO' Letter, the Authority expects Authorised Persons to integrate Outsourcing and Other Third-Party Arrangements within their Internal Audit Plan. Such expectation is also in line with FIR/03 R3-2.8.26 and BR/14 Section 2.5. This includes conducting a thorough assessment to determine whether an arrangement qualifies as a critical or important outsourcing arrangement, other Outsourcing Arrangement, or a third-party arrangement. Additionally, in case of Outsourcing Arrangements (and also taking into consideration whether it is critical or important outsourcing), it should also encompass reviewing relevant documentation, such as the Outsourcing Register, Outsourcing Policy, contracts governing these arrangements, exit strategies, governance structures, and other criteria stipulated in the applicable framework.

Authorised Persons are also expected to refer to the 'Dear CEO Letter' issued by the Authority in relation to its 'Minimum Expectations in Relation to Financial Entities' Preparedness to Regulation (EU) 2022/2554 on Digital Operational Resilience' and the new obligations the Digital Operational Resilience Act will bring for ICT related Third-Party Arrangements, irrespective if these are considered to be Outsourcing Arrangements or Third-Party Arrangements.

Safeguarding of Clients' Funds

The primary objective of the safeguarding of clients' funds obligation is to ensure that clients' funds are used solely for the intended purposes, and that the Authorised Persons establishes the appropriate measures to protect these funds. The safeguarding requirement constitutes both a condition of authorisation and an ongoing obligation that must be consistently fulfilled.

As outlined in this 'Dear CEO Letter', the responsibility rests with the Authorised Person to adhere to the safeguarding obligations. The foundation of this obligations lies with the safeguarding methods the Authorised Person will utilise, and as such the Authority expects that the Authorised Person ensures that the method is compliant with the applicable rules and regulations. Prior to entering into a safeguarding arrangement, Authorised Persons are expected to assess the arrangement and determine whether

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it is compliant with the Safeguarding Regulations and FIR/03, and ensure that the correct systems and controls are in place. Furthermore, it is also imperative that importance is given to the jurisdiction of the third party involved in the arrangement and to diversify the safeguarding arrangements as much as possible, to decrease concentration risk. This diversification expectation is also tied to the risk management framework of safeguarded funds.

As set out in R3-2.9.25, Authorised Persons shall ensure that the safeguarding arrangements are subject to an annual audit, whereby the auditor must hold the necessary skills, knowledge and experience to carry out the said audit. The Authority reserves the right to require an independent third-party auditor to perform the audit. Authorised Persons are expected to refer to R3-2.9.26 of FIR/03 which sets out the criteria which this audit is required to cover.

When entering into safeguarding arrangements with third parties, Authorised Persons are expected to carry out the necessary due diligence checks. The Authority emphasizes the importance of point (iii) of R3-2.9.18 of FIR/03, which pertains to the assessment of third parties involved in safeguarding arrangements and where such information should also be appropriately documented in the Safeguarding Policy. This section specifically addresses the due diligence evaluations that Authorised Persons are required to conduct on the third parties with whom they intend to establish such arrangements. Additionally, R3-2.9.19 of FIR/03 must also be considered and the Authorised Person should ensure that the points listed are taken into consideration. Authorised Persons shall exercise the necessary skill, care, and diligence in the selection, appointment, and periodic review of third parties where funds are placed, as well as the arrangements for holding those funds.

During its analysis, the Authority has also met instances whereby it was not informed on changes carried out to Authorised Persons' safeguarding arrangements. In this context, Authorised Persons are reminded that pursuant to R3-2.9.12 of FIR/03, the Authority is to be notified in advanced of any changes to its safeguarding arrangements, including the safeguarding methodology or third parties involved.

The revised FIR/03, along with other applicable regulations, further delineates the Authority's expectations regarding Safeguarding Requirements. In this context, Authorised Persons are required to allocate the necessary resources and give due importance to the matter, ensuring that no shortcuts are taken.

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Way forward

The Authority shall oversee compliance with the regulatory obligations concerning (i) Outsourcing and Other Third-Party Arrangements and (ii) the Safeguarding of Clients' Funds through its ongoing supervisory framework. This includes engagement with Licence Holders, supervisory meetings, and onsite inspections conducted by FinTech Supervision. Additionally, in accordance with the internal audit requirements set forth in the regulatory framework and referenced in this Dear CEO Letter, the Authority retains the right to request the submission of the internal audit report. The Authority expects Licence Holders to give due consideration to the comments outlined in this Dear CEO Letter.

Yours sincerely,

Malta Financial Services Authority

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