

MFSA AML and CFT Strategy

Integrating AML and CFT within our conduct and prudential supervisory activity

Contents

| | |
|--|-----------|
| Foreword | 3 |
| ABBREVIATIONS | 4 |
| STRUCTURE OF THIS DOCUMENT | 5 |
| 1. Role of the MFSA | 6 |
| AML and CFT responsibilities of the MFSA | 6 |
| National institutional framework | 6 |
| 2. Supervisory Principles | 7 |
| 3. Our arrangements | 9 |
| Authorisations | 9 |
| AML/CFT Supervision | 10 |
| Enforcement | 11 |
| 4. Our future work | 12 |
| National AML/CFT Strategy | 12 |
| Coordination and cooperation | 12 |
| TRAINING AND AWARENESS | 12 |
| Cryptocurrency and Blockchain technology | 12 |
| Technology and Compliance | 12 |
| 5. Principles for regulated firms | 13 |
| Introduction | 13 |
| Governance | 13 |
| Firm-wide risk assessment | 13 |
| Policies and Procedures | 14 |
| Customer risk assessment | 14 |
| Customer due diligence | 14 |
| Ongoing monitoring | 14 |
| Communication, training and awareness | 15 |

Foreword



Joseph Cuschieri
Chief Executive Officer

The Maltese financial services industry is a dynamic sector which has grown substantially in recent years and continues to be one of the fastest growing in Europe. Its openness as a European financial services centre, makes it a potential target for financial crime.

As the country's recent National Risk Assessment highlighted, money laundering and terrorist financing represent a threat to the stability, profitability and safety of this industry and of the country as whole. Notably, the sector attracts foreign investment, segments of which carry a higher degree of financial crime risk. Similarly, Malta is establishing itself as one of the world's leading jurisdictions for remote gaming, e-money and digital currencies, sectors which may be more vulnerable to risks of financial crime hence exposing the financial structures that support them to that risk as well.

Malta is at a crucial stage in its evolution. On one hand, its geographical position, economic performance and robust business environment coupled with its innovative approach to new economic sectors represent an unprecedented opportunity. On the other hand, it is crucial that the standards of supervision and governance particularly in the areas of financial crime be strengthened in order to minimise the jurisdictions exposure to reputational risk.

The MFSA is committed to supporting the sector in seizing this opportunity in a safe and controlled manner by establishing a regulatory environment that fosters growth whilst clamping down on money laundering and terrorist financing.

We accept no compromise and complacency. We want Malta to flourish responsibly and establish itself as a top tier financial supervisor with respect to standards of supervision. That is why we made the combatting of money laundering and terrorist financing one of our key strategic priorities for the future. .

The MFSA performs a unique and critical role in the fight against money laundering and terrorist financing. Not only does it cooperate with the FIAU on joint AML/CFT inspections, but it also

plays an independent, proactive role in this endeavour, as part of its continuous conduct and prudential supervisory activity. Weaknesses that facilitate money laundering and terrorist financing are, in fact, often found in governance structures and organisational arrangements other than specific financial crime ones.

In my new role as CEO of this organisation, I have refreshed the impetus and drive behind this commitment. In the future months and years, the MFSA's challenge is to continue to adapt to this fast-growing sector, to keep the pace with the technologies and drivers that fuel it and to lead, providing guidance and direction to its regulated firms.

Working closely with the FIAU we will continue to scrutinise the arrangements which firms plan to establish, at authorisation stage, to supervise their correct implementation and to ascertain that firms are set up for legitimate purposes and have adequate safeguards to prevent themselves from being used for money laundering and terrorist financing.

To achieve this, we will focus our resources on the firms which present the highest money laundering and terrorist financing risk and set clear standards at to what we expect from all firms, guiding them to compliance and safe operation. We will take action, where failures occur. We will also monitor markets, and segments within them, in their entirety, observing their evolution.

It is our objective to keep the industry alive, dynamic and competitive. For this reason, we expect that firms we regulate establish proportionate and efficient financial crime controls. We understand the commercial drivers that firms have and will help them keep avoidable costs to a minimum.

This document explains how anti money laundering and combating terrorist financing fits into our conduct and prudential supervisory framework, how we will continue to evolve our response and action against money laundering and terrorist financing and sets out principles which firms are expected to observe.

Abbreviations

| TERM | MEANING |
|----------------------|---|
| ACR | Annual Compliance Report |
| AML | Anti-Money Laundering |
| BO | Beneficial Owner. |
| BSU | Banking Supervision Unit (MFSA) |
| CBM | Central Bank of Malta |
| CDD | Customer Due Diligence |
| CFT | Combatting the Financing of Terrorism |
| CfR | Commissioner for Revenue |
| EU | European Union |
| FATF | Financial Action Task Force |
| FIAU | Financial Intelligence Analysis Unit (Malta) |
| FT | Financing of Terrorism |
| IPSU | Insurance and Pensions Supervision Unit |
| MBA | Malta Bankers' Association |
| MFSA | Malta Financial Services Authority |
| MDIA | Malta Digital Innovation Authority |
| MGA | Malta Gaming Authority (formerly the Lotteries and Gaming Authority) |
| ML | Money Laundering |
| MLRO | Money Laundering Reporting Officer |
| MONEYVAL | Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism |
| NCC | National Co-ordinating Committee on Combating Money Laundering and Funding of Terrorism |
| NRA | National Risk Assessment |
| PEP | Politically Exposed Person. |
| PF | Proliferation Financing |
| PMLFTR | Prevention of Money Laundering and Funding of Terrorism Regulations |
| PMLA | Prevention of Money Laundering Act (Chapter 373 of the Laws of Malta) |
| SMEs | Small and Medium Sized Enterprises |
| SOF | Source of funds |
| SOW | Source of wealth |
| STR | Suspicious Transaction Report |
| TF | Terrorism financing |
| Working Group | The Working Group established for the purposes of carrying out the NRA |

Structure of this document

The MFSa is responsible for continuously overseeing the correct conduct and financial stability of firms in the financial services industry. This is key to safeguarding the integrity, prosperity, innovation and trust in the Maltese financial services sector. This trust has been undermined by financial crime concerns in recent times, and our National Risk Assessment has highlighted the need for action to be taken to mitigate financial crime risks across all sectors.

In Malta, the FIAU is the government agency responsible for monitoring compliance with the relevant AML/CFT legislative provisions. Our primary remit is, instead, to ensure that regulated firms have in place broader, overarching systems and controls. AML and CFT arrangements are, however, a crucial component of these systems and controls, and one set cannot be considered without the other. We have often found that firms' poor conduct and prudential arrangements are often a symptom of AML and CFT shortfalls, too.

We therefore have an obligation to consider ML and TF risks in authorised firms with our supervisory work, as well as cooperating with the FIAU as part of joint AML/CFT supervision.

This document describes how we fulfil this obligation and is comprised of five sections:

1. First, we set out our role in relation to combating ML and TF. Firms must satisfy us that they have adequate controls in place to mitigate ML and TF risk. We also detail our relationship with other competent national authorities such as the FIAU.
2. We then detail the principles which underpin our AML and CFT supervisory approach. These are further to the MFSa's core values (integrity, trustworthiness, dependability, independence and excellence), and understood within the context of the seven key initiatives of the National AML/CFT Strategy.
3. The next section details how the principles-based approach is reflected across our authorisation, supervision and enforcement activity. In doing so, we implement the National AML/CFT Strategy from a firm's introduction into the sector (authorisation) through to its operation (supervision), using robust enforcement methods.

4. We then set out our approach to future work. We strive to continue to evolve our operations and approach to conduct and prudential supervision, monitoring industry developments (for example, Malta's support for cryptocurrencies and blockchain technology and the inception of technology-based compliance solutions), and future EU regulation.

5. Finally, this document includes certain AML/CFT principles envisaged under Maltese AML/CFT legislation and procedures issued by the FIAU which the MFSa expects firms to uphold.

Chapter 1

Role of the MFSA

AML and CFT responsibilities of the MFSA

Our main responsibility is to maintain continuous oversight of the conduct and financial stability of firms we regulate to safeguard the integrity and stability of Malta's diverse and growing financial services sector.

Weaknesses in regulated firms' conduct and prudential arrangements often pave the way to financial crime risk, making firms more vulnerable targets for criminals seeking to disguise proceeds of crime or to support the financing of terrorism.

We therefore have an obligation to consider ML and TF risks in authorised firms with our supervisory work. The Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR), as further elaborated upon by the Implementing Procedures issued by the FIAU, contain detailed provisions on the measures and procedures to be maintained and applied by authorised firms, including customer due diligence measures, record keeping procedures and reporting procedures, and identify the subject persons to whom such measures and procedures are applicable.

As a regulatory and supervisory authority, we require all authorised firms to establish adequate arrangements to mitigate the risk that they might be used to commit financial crime, and in particular money laundering and/or funding of terrorism.

Authorised firms must satisfy us that they have robust governance, effective processes and adequate internal control mechanisms to manage their ML and TF risk.

Through ensuring that authorised firms satisfy these requirements, we will maintain and enhance Malta's reputation of financial services integrity, excellence, and innovation.

National institutional framework

Our work in relation to AML and CFT integrates with the work of other national competent authorities, and specifically that of:

- the FIAU;
- the police; and
- the CBM

We are independent of these authorities, but we have an obligation to require regulated firms take steps to develop sufficient AML and CFT controls.

As a constituent part of the national institutional framework, we will frequently work with these entities, particularly the FIAU. We are obliged to disclose to the FIAU any facts or information that could be related to ML or the funding of terrorism, discovered or obtained in the course of our supervisory work or in any other manner. In addition, we provide the FIAU with relevant information which we become aware of during the course of our supervisory functions, including where we identify a breach in compliance with the requirements of the PMLA, the PMLFTR or the FIAU's Implementing Procedures.

We carry out on-site and off-site AML/CFT examinations on behalf of and jointly with the FIAU, on subject persons falling under our supervisory competence with the aim of establishing that person's compliance with the requirements of the PMLA, the PMLFTR and the Implementing Procedures issued by the FIAU. We also follow up on supervisory findings together with the FIAU.

Chapter 2

Supervisory Principles

All our AML and CFT supervisory activities are undertaken jointly with or on behalf of the FIAU:

- a. within context of the seven key initiatives of the National AML/CFT Strategy;
- b. in accordance with the MFSA’s core values of integrity, trustworthiness, dependability, independence and excellence;
- c. as part of our supervisory principles that guide our work to help us prioritise our interventions and deliver our operational objectives; and
- d. in accordance with pre-agreed/determined indications/guidance/directions where the supervisory action is undertaken jointly with or on behalf of the FIAU.

These principles also make clear to authorised firms the standards expected of them, and their responsibilities under our supervisory framework. To provide authorised firms with further clarity in relation to their AML and CFT responsibilities, we have set out the following additional guidance for firms on how we apply these key principles to AML and CFT supervision.

| KEY PRINCIPLE | AML/CFT FOCUS |
|--|---|
| <p>Focus on the entire lifecycle.</p> | <p>We expect firms to demonstrate robust AML and CFT arrangements from set up, through to their entire existence in business. We monitor these at all stages of their lifecycle.</p> <p>With this we aim to pre-empt poor conduct so that wrongdoing is minimised.</p> <p>We expect firms to provide evidence of robust AML and CFT arrangements at authorisation stage. In conjunction with the FIAU we assess a firm’s strategies, business models and corporate arrangements to ensure it does not expose the system to ML and TF vulnerabilities. We assess firms’ understanding of ML and TF risk inherent in their business to determine whether robust plans exist for this risk to be adequately monitored and controlled.</p> <p>We continue to monitor firms against this framework throughout their existence in business, as part of our ongoing supervision. AML and CFT are a constituent component of the arrangements we seek to verify firms maintain in place on an ongoing basis. We also assess whether weaknesses and gaps in non AML and CFT arrangements make firms more vulnerable to ML and TF risk.</p> <p>We expect AML and CFT arrangements to be closely and seamlessly integrated with firms’ wider conduct and prudential arrangements.</p> <p>Where concerns exist, we work closely with the FIAU to investigate potential wrongdoing and take enforcement action against failures.</p> |

Culture, governance and accountability. We look at the behavioural drivers which are likely to increase misconduct. These include the objectives and purposes of the firm, the attitude and behaviour, compliance and competence of the senior management, corporate governance, controls, processes and reporting lines.

We recognise that senior management have a responsibility to establish a culture of AML and CFT compliance at their firm by setting a clear 'tone from the top' of appropriate conduct and competence, and also recognise the importance individuals play in preventing, detecting and deterring ML and TF. This recognition is reflected in our authorisations, supervision and enforcement arrangements, taking steps to ensure only individuals possessing the appropriate integrity and capability are appointed to and maintain senior management positions at authorised firms, and that steps are taken when individuals fail to conform to the expected standards.

Our assessment of firm's corporate governance, controls, processes and reporting lines includes the assessment of those with a financial crime nexus.

Risk-based approach. We adopt a risk-based approach to financial supervision focusing our supervisory activities on the potential macro and micro prudential risks and also the conduct and AML/CFT risks associated to the firms we oversee. The aim is to minimise the occurrence of breaches to protect consumer interests and safeguard the integrity and confidence in the financial market.

Our risk-based approach to AML/CFT supervision, implemented together with the fiau means that our focus on firms' AML and CFT arrangements is proportional to the risk that failure to prevent ML and TF risk poses to the safety of our society, the integrity of our financial system, the stability of our economy and malta's reputation as an international financial services centre.

We adopt a principle-based approach to supervision guided by the proportionality principle. The extent of supervision depends on the nature and scope of the business activities and the overall risk profile.

Our adoption of a principles-based approach for AML and CFT supervision encourages firms to adopt a holistic approach to AML and CFT compliance and dissuades firms from regulatory 'box ticking'. It further allows us to respond in an agile way to emerging ML and TF risks, and anticipate and counteract new methods, products and markets being employed by money launders and funders of terrorism.

In carrying out our supervisory role, we analyse the potential macroeconomic and microeconomic risks within the financial services market and focus on those risk areas which pose the greatest risk to the financial market.

Open communication. We engage directly with firms, consumers and investors in order to better understand issues they face and also highlight good and poor practices that we observe. In addition, we aim to be as transparent as possible about our work and our priorities.

We apply the principle of open communication to all our supervisory activity, supporting the FIAU in publicising good practice, helping firms to achieve compliance and analysing and publishing industry trends and lessons learnt.

Integrated. Internally, we work closely together to reach robust decisions, to share knowledge and information and to provide a consistent message throughout the financial services industry. On a global basis, we work closely with a number of international regulators on issues which are common across national borders.

We cooperate on AML and CFT matters with other national competent authorities in accordance with the AML/CFT strategy set out by the NCC and collaborate on supervisory matters with the FIAU.

We work with international regulators and implement EU legislation and Financial Action Task Force (FATF) standards to align our approach to AML and CFT supervision with international practice.

Chapter 3

Our Arrangements

The MFSA’s deep commitment to preventing, detecting and deterring ML and TF is reflected in our authorisation, supervision and enforcement arrangements. These arrangements work together and with the broader national institutional framework to minimise the risk that ML and TF pose to the safety of our society, the integrity of our financial system, and the stability of our economy.

Authorisations

Our authorisations framework is designed to assess that authorised firms and individuals meet the required professional and ethical standards for participation in the financial market and helps them understand that they must continue to meet them for as long as they are authorised.

The assessment of the firms’ and individuals’ commitment and ability to uphold the standards of the MFSA with respect to AML and CFT sits at the heart of our evaluation processes, and our conditions for authorisation:

AUTHORISED FIRMS

| AUTHORISATION CONDITION | AML/CFT FOCUS |
|---|---|
| <p>Our ability to supervise them effectively</p> | <p>An authorised firm must have in place a structured AML and CFT control framework, which must be sufficiently transparent to facilitate review by the MFSA and other relevant competent authorities as needed.</p> <p>The firm’s AML and CFT policies must be clear and up to date. All relevant procedures, processes and systems, as well as the firm’s organisational structure, must be appropriately documented.</p> <p>The firm’s governance bodies, including Board and executive committees, must maintain appropriate records of meetings and material reviewed, to enable the firm to demonstrate the role these bodies play in managing financial crime and CFT risk.</p> <p>The management of the firm must be able to display commitment and ability to cooperate with the MFSA and other relevant competent authorities on supervisory matters.</p> |
| <p>Appropriate resources by the firm both with respect to the organisational structure, operational structure, financial resources and systems to deliver the products and service.</p> | <p>An authorised firm must dedicate appropriate resources to the prevention, detection and deterrence of financial crime and terrorism financing.</p> <p>The firm’s AML and CFT policies, procedures and processes must identify the specific functions, or individuals, responsible for effecting their implementation.</p> <p>The firm must have systems in place designed to manage the AML and CFT risk inherent in the firm’s business.</p> |

| AUTHORISATION CONDITION | AML/CFT FOCUS |
|---|--|
| <p>The firm’s suitability to conduct the business, assessing in the process, the suitability and competence of staff, the appropriateness of the business model and the firm’s controls and governance structure.</p> | <p>An authorised firm’s financial crime framework, including relevant policies, procedures, processes and systems, must be designed to effectively manage the AML and CFT risk inherent in its business.</p> <p>The firm must conduct regular testing of its financial crime framework and controls to determine that it is operating effectively.</p> <p>The firm must be able to demonstrate that its management and staff receive training in AML and CFT and have the capability to manage ML and TF risk in the areas for which they are responsible.</p> <p>The firm’s governance bodies’ self-assessment exercises must incorporate understanding and management of ML and TF risk as a core topic.</p> |

| INDIVIDUALS | |
|--|---|
| <p>Honest people of integrity and hold a sound reputation – we will refuse to approve any individual whereby we are not satisfied of their honesty and integrity</p> | <p>Senior staff of an authorised firm must be able to demonstrate they understand the critical role they play in the prevention, detection and deterrence of ml and tf, and the importance of this role in society, the financial system and the economy.</p> |
| <p>Solvency and financial soundness</p> | <p>The solvency and financial soundness of senior staff of an authorised firm is critical in ensuring additional ml and tf risks are not introduced into the firm’s business.</p> |
| <p>Competence and capability to carry out the proposed role, based on experience and necessary qualifications.</p> | <p>Senior staff of an authorised firm must be able to demonstrate an understanding of aml and cft, and that they are able to carry out their relevant aml and cft responsibilities with the appropriate level of skill, care and diligence.</p> |

AML/CFT SUPERVISION

The supervisory process established together with the FIAU entails a risk-based approach and is structured as follows.

Category One – Ongoing supervision of higher risk firms

Consistent with the risk-based approach to supervision, where a firm is identified as being associated with a higher level of ML and TF risk, it is included within the regime of ongoing supervision. The AML/CFT risk assessment of firms is carried out jointly with the FIAU.

This regime includes major firms with large customer bases, firms which are strategically important within Malta’s financial services industry, firms with higher risk business models or customer bases and firms where systems or control weaknesses relating to AML or CFT are identified.

Ongoing supervision includes regular touchpoints with the firm (including regular supervisory interactions) as well as the regular provision by the firm of management and other relevant information. Where firms undertake remedial or corrective action plans to remedy identified AML/CFT deficiencies, on-going supervision by authorities envisages the conduct of onsite visits.

Category Two – Sampled review of other firms

In addition to ongoing supervision of high risk firms, reviews of other firms are also carried out, to enable all parts of the financial services industry to be covered through the risk-based supervisory cycle.

Firms are selected on a randomised basis and subject to a tailored review of the highest risk areas of a firm's business model. Review of AML and CFT arrangements is a key part of our reviews and our members of staff are trained to identify indicators of AML and CFT weaknesses within broader corporate arrangements.

Category Three – Event-driven reviews of firms

Event-driven supervision consists of as-needed reviews of firms where specific control weaknesses have been identified or breaches have occurred.

Event-driven reviews may be mandated where a category one, two or four review has identified the need for further information on a firm's activities, or in response to information received from other sources, including:

- other regulatory or law enforcement bodies within the National Institutional Framework;
- overseas regulators;
- whistle-blowers;
- self-reporting by firms; and
- publicly available information.

These reviews may result in a regulatory or law enforcement by the MFSa or another body within the National Institutional Framework, and potentially a recommendation that enforcement action be taken against the firm or any individuals involved in the event.

Category Four – Thematic reviews of firms

From time-to-time, thematic reviews are conducted across firms operating within a particular sector of the financial services industry, or in relation to a particular aspect of AML and CFT.

Thematic reviews typically include onsite visits of multiple firms and requests for data.

Consistent with our principle of open communication, and in the interests of promoting a culture of best practice within the financial services industry, we, in conjunction with the FIAU, may make use of the results of thematic reviews to provide guidance to firms.

ENFORCEMENT

Through the MFSa Act, the MFSa is responsible for monitoring the applicability and enforcement of laws that directly or indirectly affect consumers and investors of financial services. The aim of legislation in place is to improve the manner in which firms within the financial services industry operate to the benefit of the general public, businesses and the economy at large.

Enforcement is of prime importance to protect consumers, enhance market stability, enhance market integrity and promote competitiveness in the market. An effective enforcement framework also enhances consumer trust in the market.

Where we identify potential AML and CFT systems and control failings or suspected ML and FT activity to have taken place, we work with other regulatory and law enforcement bodies within the national institutional framework, including the FIAU, to carry out investigations and, where applicable, take enforcement measures.

Enforcement measures taken by the FIAU and MFSa are commensurate with scale and severity of the breach, the extent of cooperation from the firm under investigation, and other relevant factors. Measures may include:

- Financial penalties;
- Sanctions;
- Directives to do or refrain from doing any act, including the imposition of remedial or corrective action plans;
- Restriction, suspension or revocation of an authorisation or license; and
- Criminal proceedings against the firm in question and against any individuals involved in the breach may be taken by the police.

Chapter 4

Our future work

NATIONAL AML/CFT STRATEGY

Malta has defined a national AML and CFT strategy to further mitigate ML and TF risks it is exposed to, which it aims to complete by 2020. The strategy comprises seven key initiatives:

- I. Establish a national coordination mechanism
- II. Strengthen and clarify the supervisory framework
- III. Enhance internal capabilities of FIAU
- IV. Enhance investigation and prosecution capabilities
- V. Establish an effective asset recovery service
- VI. Increase transparency of legal entities and arrangements
- VIII. Build on the existing international cooperation setup

We have a crucial role in enabling this strategy to be completed to the highest standard of excellence. Though initiative II is of the most immediate relevance to us, we will coordinate with other regulatory or legal bodies to assist with the strategy where necessary. This coordination will continue beyond 2020 once the strategy is fully implemented.

COORDINATION AND COOPERATION

To cement Malta's reputation as a financial services hub with outstanding cross-border connections, we are committed to coordinating with international bodies in the fight against financial crime. The EU's Fifth Anti-Money Laundering Directive will be a key focus of ours. The changes brought in by the directive include regulation of virtual currency, enhanced AML/CFT precautions for transactions involving high-risk countries, and improvement of central data systems across the union. Malta's innovative financial sector is well-placed to cope with this new directive, but we will not be complacent; continued coordination with the international community is vital to establishing the MFSA as a dependable and future-proofed financial services regulator.

We will continue to evolve and enhance our investigative approach, to continue to support the FIAU in its critical work in combating ML and TF. We will strengthen our engagement with the FIAU, implementing improved protocols for cooperation with them, which will be vital to remedying the problems raised.

TRAINING AND AWARENESS

We expect firms to have in place a comprehensive AML and CFT training programme, to educate all staff on the topic and their responsibilities within it and to provide staff more closely involved in the management of ML and TF risk with role-specific insight.

We also expect firms to generate awareness on the topic of ML and TF and to promote debate around best practice and industry developments in relation to it.

CRYPTOCURRENCY AND BLOCKCHAIN TECHNOLOGY

Malta has taken unprecedented steps in bringing blockchain and crypto technology into the regulatory fold, as part of the government's drive to embrace innovation in its financial services sector. Whilst this is to be welcomed, blockchain technology and cryptocurrencies do present challenges for the prevention of ML and TF.

Taking steps to ensure that the integrity and stability of our financial sector extends to new cryptocurrencies and blockchain innovations, the MFSA will continually modernise its regulatory approach in line with industry developments. This will include close work with the FIAU, the newly-founded MDIA, and other national authorities – as well as with international bodies such as FATF – to establish Malta as a centre of excellence for cryptocurrencies and blockchain AML and CFT supervision.

TECHNOLOGY AND COMPLIANCE

As Malta positions itself as a hub of financial services innovation, we expect to see many firms taking an innovative, technology-driven approach to regulatory compliance. The use of regulatory technology ('RegTech') such as automation and AI to conduct compliance functions is likely to become widespread in the future.

We aim for our supervisory expertise to remain abreast of the latest RegTech developments and develop our own supervisory technology ('SupTech') to allow Malta to remain at the cutting edge of innovation.

Chapter 5

Principles for regulated firms

INTRODUCTION

We expect regulated firms to adhere, at all times, to the AML/CFT principles (the 'Principles') outlined below in order to maintain their authorisation.

The Implementing Procedures issued by the FIAU set out in further details how these principles are to be implemented within the regulated firms' systems and controls.

Reference to firms' 'staff' is made in the Principles. The term is intended to encompass all individuals who are employed or appointed by a regulated firm and whose actions have a material impact on the firm's operation and conduct (e.g. employees, directors, contractors, etc.) regardless of the nature and duration of the contract.

GOVERNANCE

Firms must have in place robust governance arrangements capable of enabling it to adequately assess, manage and monitor the risk of money laundering and terrorist financing associated with its activities.

Firms must:

- Have in place organisational structures and human and system resources capable of ensuring AML/CFT compliance at all times. Such structures and resources must be (a) commensurate with the nature and size of their business; and (b) such that the firm's AML/CFT policies and procedures can be applied in an effective manner;
- Promote a culture of AML/CFT compliance and have in place a comprehensive framework of systems and controls to enable it;
- Be aware of and manage the potential conflicts of interest which may arise from the firm's commercial objectives and its employees' outside business interests/relationships versus its obligation to counter the risk of the firm being used to further money laundering or terrorist financing;
- Establish and document clearly defined roles and responsibilities in relation to AML / CFT;

- Ensure that all employees demonstrably understand their role in relation to AML/CFT;
- Ensure that firm's implementation of AML/CFT measures is overseen by the Board of Directors (or equivalent function);
- Ensure that AML/CFT considerations are demonstrably incorporated within the firm's strategy;
- Appoint an MLRO and ensure that such function is independent, receives unimpeded access to the Board of Directors (or equivalent function) and is provided with all the necessary resources and access to all the necessary information to perform his role in an effective manner; and
- Establish clear escalation for the reporting unusual customer activities or transactions.

Firm-wide risk assessment

Firms must understand the source, nature and extent of the ML/TF risks they are exposed to by performing a firm-wide ML/TF risk assessment.

In establishing this understanding, firms must have regard to, at least, the risks arising or associated with:

- the customers they service or intend to service;
- the products and services they offer;
- the nature of the transactions they carry out;
- the delivery channels they use to provide such products and services or to execute the transactions they are to carry out; and
- the risk associated with the geographical areas they or their customers may be linked to.

This understanding must be maintained current and take into account internal and external changes (e.g. targeting new markets, implementing new technologies, offering new products/services, changing internal structures, political changes in geographical areas to which the firm is exposed, regulatory

developments etc.) which may increase or decrease the ML/TF risks to which the firm is exposed.

ML/TF risk assessments carried out at supranational, national and sectoral level are all relevant to a firm's understanding of its ML/TF risks as are observations made by the firm's own Compliance, Audit and MLRO functions. These should be taken into account as part of the firm's firm-wide ML/TF risk assessment.

Policies and Procedures

Firms must adopt formal policies setting out their stance on the ML/TF risk they face.

Such policies must be underpinned by procedures describing the processes and controls the firm implements to comply with its ML/TF policies.

Policies and procedures are expected to be commensurate to the nature and size of the firm's business and formally adopted and overseen by the firm's senior management (i.e. Board of Directors or equivalent body).

Such policies and procedures must, inter alia:

- i. set out to which customers it offers/does not offer services and the circumstances under which it makes its services or products available to a (prospective) customer;
- ii. set out the nature, extent and timing of the customer due diligence measures it applies to specific categories of customers.

In particular, policies and procedures must clearly set out:

- Their approach to understanding and assessing the risk associated with prospective customer relationships (i.e. their approach to customer risk assessment, specifying the drivers of risks it will consider, the risk weight associated with them and the model used to compute a final risk score);
- the types of customer due diligence (de minimis, standard, simplified and enhanced) that the firm is required to perform;
- the circumstances under which each of these types of due diligence are applied;
- the documentation deemed acceptable for the purposes of each type of customer due diligence;
- its approach to maintaining current, reviewing and updating customer due diligence information;

- its approach to monitoring on an on-going basis customer transactions and activities;

- iii. set out clear guidance as to when a customer is not to be onboarded or, where applicable, when a customer relationship is to be terminated, as well as under what circumstances situations should be escalated internally to the MLRO.

Firms must monitor, review and, where necessary, update their AML/CFT policies and procedures incorporating, inter alia, Compliance, Audit and MLRO observations as to their effectiveness.

Customer risk assessment

Firms must understand the ML/TF risk inherent in each perspective and actual customer relationship.

A customer ML/TF risk assessment must be performed at onboarding stage to determine whether the customer's ML/TF risk profile is acceptable and to determine the degree of customer due diligence to be applied.

A customer's risk assessment must be reviewed and, if necessary, updated periodically or wherever changes in the customer behaviour, activity or circumstances occur.

Customer Due Diligence

Firms must perform due diligence on perspective customers to understand their (perspective) customers, their circumstances, the networks around them and the nature and purpose their relationship with them.

Customer due diligence information must be maintained current, by reviewing (and, if necessary, updating) it periodically or when the firm becomes aware of events (e.g. unusual activity, changes in personal circumstances, requests for new products/services)

ONGOING MONITORING

Firms must monitor, on an ongoing basis their relationship with their customers. This means:

- establishing robust transaction monitoring systems;
- being otherwise alert to changes in the customer behaviour and activity which may be indicative of money laundering or terrorist financing; and
- analysing (with the support, where required, of the MLRO), anomalous activity potentially indicative of money laundering or terrorist financing.

Communication, Training and Awareness

Firms must communicate AML/CFT standards, policies and procedures to all staff and provide training as to their application in a manner that is proportionate and specific to each member of staff's roles and responsibilities. Such training must provide relevant example of money laundering and terrorist financing might be furthered through of the firm and the individual's day to day activities (i.e. how criminal might exploit the specific products and services that the firm offers to further money laundering or terrorist financing).

In addition to this job-specific training, firms must provide training on industry trends, best practices and insight in relation to ML/TF risk.

Malta Financial Services Authority

Notabile Road, Attard, BKR 3000, Malta.

Tel: +356 2144 1155 Fax: +356 2144 1189

Email: communications@mfsa.com.mt

www.mfsa.com.mt