

SUPERVISION
PRIORITIES 2021

Contents

Contents.....	1
Foreword	2
Table of Abbreviations.....	4
Introduction.....	5
An Update on the 2020 Supervisory Priorities.....	8
Introduction	9
Cross-Sectoral Priorities.....	9
Banking.....	11
Insurance and Pensions.....	12
Securities and Markets.....	13
Trustees and Company Service Providers.....	16
Virtual Financial Assets	16
Resolution.....	17
Supervisory Priorities - 2021	18
Introduction	19
Cross-Sectoral Priorities.....	19
Banking.....	21
Insurance and Pensions.....	22
Securities and Markets.....	23
Trustees and Company Service Providers.....	25
Virtual Financial Assets	26
Resolution.....	26
Other Key Initiatives	27
Introduction	28
The MFSA’s Supervisory Plan	28
Brexit.....	28
Sustainable Finance.....	30
Outreach and Consumer Education.....	30
Conclusion.....	31

Foreword



Christopher P. Buttigieg

Chief Officer Supervision
Chief Executive Officer ad interim

Today, I am pleased to launch the Authority's Supervisory Priorities for 2021. This document provides updates on the areas of focus which had been identified for 2020 and sets out the priorities for the upcoming year. These have been identified following careful consideration of the market environment, regulatory developments, the Union Strategic Supervisory Priorities, the ESA's supervisory programmes, recommendations of international standard setters and past supervisory experience. It is important to note that the priorities do not encompass the entire spectrum of work performed by the MFSA but document the themes on which supervisory focus is to be expected.

The past few months have been eventful for the Authority. Notwithstanding the challenges faced, a considerable amount of work has been carried out in the course of 2020. Supervision has been strengthened, in line with MONEYVAL recommendations, and the Authority has carried out 386 inspections, a significant increase from 2018 and 2019 figures. In this respect, I would like to take this opportunity to thank the MFSA staff for their unwavering dedication and commitment. Their efforts are key to any initiative the Authority undertakes.

Five cross-sectoral priorities have been identified for 2021, namely: [i] Corporate Governance and Culture; [ii] Financial Crime Compliance; [iii] the impact of COVID-19; [iv] ICT Risk and Cybersecurity ; and [v] FinTech and Innovation. These are complementary to the investor protection, market integrity and financial soundness objectives underpinning financial regulation, which remain at the forefront of the Authority's agenda. Building on the cross-sectoral priorities, sector-specific areas of focus have also been identified. The document also highlights the MFSA's risk-based approach to supervision, which seeks to ensure efficacy and effectiveness of supervisory efforts, together with select key initiatives which may possibly have an impact on stakeholders. The Authority will be monitoring the priorities set as it may, as was the case with the COVID-19 pandemic, respond to extraneous unforeseeable events.

Further to the aforementioned priorities, the Authority will be focusing on:

- i. **Continuity:** During 2021, the MFSA will continue with the implementation of its Strategic Plan 2019–2021 and will be setting the tone for the next strategic period (2022–2024). The Authority’s investment, particularly in technology and the development of its workforce, will continue. The Authority will continue building its relations with other competent authorities at a national, European and international level and cooperating effectively to achieve high levels of supervision in this regard.
- ii. **Stability:** In its journey of transformation and growth, the Authority has experienced significant changes over the recent years. The MFSA shall now focus on the normalisation of the experienced changes and on bringing stability for the longer-term benefit of the financial services sector.
- iii. **Growth:** Whilst the Authority’s primary objective is that of regulating, monitoring, and supervising financial services in Malta, the MFSA shall also prioritise the sector’s sustainable growth through initiatives such as the Capital Markets Strategy, Asset Management Strategy, FinTech Strategy and the review of the Virtual Financial Assets Framework in line with the European Commission proposed Markets in Crypto-assets regulation.

We remain positive and look forward to the continued engagement with our stakeholders, through the various channels of communication and publications such as this one.

Table of Abbreviations

AML	Anti-Money Laundering
BRRD2	the new European Bank Recovery and Resolution Directive
CFT	Combatting the Financing of Terrorism
CI	Credit Institution
CSA	Common Supervisory Action
CSP	Company Service Provider
EMIR	European Market Infrastructure Regulation
ESAs	European Supervisory Authorities
ESMA	European Securities and Markets Authority
ESEF	European Single Electronic Format
ESG	Environment, Social and Corporate Governance
FCC	Financial Crime Compliance
FI	Financial Institution
FIAU	Financial Intelligence Analysis Unit
ICAAP	Internal Capital Adequacy Assessment Process
ICT	Information and Communications Technology
IFD	Investment Firms Directive
IFR	Investment Firms Regulation
ILAAP	Internal Liquidity Adequacy Assessment Process
LSI	Less Significant Institutions
MiCA	Markets in Crypto Assets
MFSA	Malta Financial Services Authority
MREL	Minimum Requirement of own funds and Eligible Liabilities
POG	Product Oversight and Governance
PSD	Payment Services Directive
SFTR	Securities Financing Transactions Regulation
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRP	Supervisory Review Process
TCSPs	Trustees and Company Service Providers
TII	Tied Insurance Intermediary
TUBOR	Trusts Ultimate Beneficial Ownership Register
VFA	Virtual Financial Assets

Introduction

MFSA Supervisory Priorities

By virtue of this document, the Malta Financial Services Authority is setting out its supervisory priorities for 2021 and providing updates on certain [areas of focus which had been identified for 2020](#). The Authority will be monitoring the priorities set as it may, as was the case with the COVID-19 pandemic, respond to extraneous unforeseeable events. It is important to note that supervisory priorities do not encompass the entire spectrum of work performed by regulators but are rather a documentation of themes on which supervisory focus is to be expected. This exercise is particularly important for the purposes of resource and budget allocation.

The MFSA's supervisory priorities for 2021 have been identified following careful consideration of the market environment, regulatory developments, the Union Strategic Supervisory Priorities, the ESA's supervisory programmes, recommendations of international standard setters and past supervisory experience. They are also in line with the [MFSA Strategic Plan 2019-2021](#).

A Risk-Based Approach to Supervision

The MFSA adopts [a risk-based approach to supervision](#) which considers the potential macro and micro-prudential, conduct and financial crime risks associated with regulated entities. Risk-based supervision involves applying resources where they will have the biggest impact with a focus on outputs. Regulators have finite resources that must be deployed where they can make the greatest difference. Adopting a risk-based approach therefore allows the MFSA to allocate resources on: [i] firms which are most significant; and [ii] risks that pose the greatest threat to consumers and financial market stability without ignoring less significant or lower risk firms.

Therefore, firms with the potential of having the greatest adverse impact on consumers of financial services, market integrity and financial stability will receive a high level of supervision under structured engagement plans, leading to early intervention measures necessary to mitigate potential risks. Conversely, those firms having the lowest potential adverse impact will be supervised through thematic assessments, with targeted enforcement action being taken against firms across all impact categories, whose poor behaviour puts the achievement of the MFSA's statutory objectives and the stability of Maltese financial markets at risk. The Authority also intervenes where standards of governance or internal controls fall below the minimum levels required under EU legislative frameworks.

The Authority's risk-based supervisory approach is based on three main principles being supervisory judgement-based, forward-looking, and focused on key risks.



To facilitate the process, the MFSA’s supervisory functions make use of tailor-made risk assessment systems. Apart from including a mix of variables to capture prudential and conduct risks, these models also incorporate the ML/FT CASPAR¹ risk scores provided by the FIAU, for those subject persons who are regulated and supervised by the MFSA. These scores have been integrated within the risk assessment models on the basis of a weighting reflecting the vulnerability of the different sectors under MFSA supervision to ML/FT. The MFSA contributes to the ML/FT CASPAR risk scores through the ongoing submission of data to the FIAU, both through the provision of prudential information as well as when acting as an agent of the FIAU.

The Authority is currently working to develop one holistic entity level risk ranking methodology that stratifies firms into a five-point scale to determine the level of risk associated with each firm. This model will allow the MFSA to score firms both upon their authorisation as well as on an ongoing basis in line with the Authority’s supervisory work. This will allow further consistency across supervisory functions.

The extent and frequency of supervisory work, both from a supervisory engagement and supervisory review perspective, is guided by the risk-based supervisory framework. The MFSA will engage with firms at a level that corresponds to their risk grading category: the higher the risk, the higher the level of engagement and the depth of the reviews. The number of resources allocated to the supervision of a firm also depends on the level of risk posed by that firm. A high-risk firm requires more staff to be focused thereon than a firm with a lower risk profile. Resource allocation is also dependent on supervisory priorities, budgetary constraints and/or new demands.

The MFSA has also developed an individual risk calculator to support its risk-based approach to supervision. This allows for the risk scoring of individuals based on probity checks undertaken by the Due Diligence team and competence checks undertaken by the Authorisations teams. The risk scoring helps determine the risk an applicant offers during onboarding whilst defining the frequency of ongoing due diligence pertaining to individuals.

¹ CASPAR is a risk-scoring system which gathers information from multiple sources. It incorporates an integrated, tailor-made risk engine which translates the information gathered from various sources into risk indicators. It provides inherent risk and control effectiveness scores which result in the overall residual risk of each subject person. Throughout the year, re-evaluation of the risk is done in response to new information received.

The Authority recognises that focusing its supervisory efforts on firms and/or areas which are determined to pose the highest risk is crucial. The adoption of a risk-based approach to supervision provides the MFSA with a framework for proactively assessing and addressing risks.

The MFSA's Supervisory Priorities outlined in this document should be read and understood keeping the above principles and approach to supervision in mind.

Structure of Document

This document is sub-divided into three main sections: Section I providing an update on the priorities which had been set for 2020; Section II identifying the focus areas for 2021; and Section III detailing select key initiatives for the upcoming year.

Section I



An Update on the 2020 Supervisory Priorities

Introduction

This Section provides the user of this document with an update on the priorities which had been outlined for 2020, particularly the work conducted by the Authority over the past months.

Cross-Sectoral Priorities

Six cross-sectoral themes had been identified as priorities for 2020 as follows: [i] Governance and Culture; [ii] Financial Crime Compliance; [iii] Retail Investor Protection; [iv] Cross-border operations; [v] Cybersecurity; and [vi] Financial Soundness.

i. Governance and Culture

Good governance ensures that entities operate transparently, efficiently, and effectively, and fosters mutual trust with stakeholders and the general public. During 2020, the Authority has undertaken considerable work in assessing regulated entities' corporate governance culture and standards. Whilst an initiative to revamp the Corporate Governance Framework has been issued for [consultation](#), several supervisory interactions² and reviews on this theme, have been conducted. The Authority has also established a Due Diligence Function which focuses on probity, intelligence gathering, due diligence and ongoing monitoring of fitness and properness of approved persons both at authorisation stage and on an ongoing basis.

ii. Financial Crime Compliance

The Financial Crime Compliance function performs two key roles. As an agent of the Financial Intelligence Analysis Unit (FIAU), the MFSA acts on behalf of and jointly with the FIAU in conducting AML/CFT supervision of the MFSA's authorised entities. This model is replicated with the Sanctions Monitoring Board with whom the MFSA collaborates to ensure that licence holders comply with applicable global sanctions legislation and regulation. Increased efficiency and effectiveness in detecting, reporting and ultimately curbing financial crime was set as an MFSA priority for 2020. Having established a dedicated FCC function in 2019, the Authority now has a central source of AML/CFT expertise, and an FIAU contact point, which prudential and conduct supervisors can liaise with. The other key role that the FCC function performs is with prudential supervision for AML/CFT.

² The term Supervisory Interactions refers to onsite supervisory inspections and meetings. The vast majority of 2020 onsite supervisory interactions have been carried out remotely due to the COVID-19 pandemic.

In line with the [MFSA AML and CFT Strategy](#), the Authority has integrated AML and CFT into the whole spectrum of its supervisory work. In this respect, the Supervisory Directorate has *inter alia*: [i] introduced procedures whereby the FCC function provides input, to the various sectoral functions, from an AML/CFT point of view, with respect to applications for authorisation; [ii] introduced an AML/CFT element to all its supervisory interactions; [iii] updated its risk rating systems to include AML/CFT metrics; and [iv] provided its officials with enhanced training on anti-financial crime.

iii. Retail Investor Protection

The protection of consumers of financial services was set as a key strategic objective for 2020. In this respect the Authority's Conduct Supervision function has *inter alia*: [i] carried out *ex-post* reviews of promotional material issued by MiFID firms; insurance undertakings and insurance intermediaries to ensure that these are fair, clear, not misleading and include all necessary information in line with Chapter 1 of the Conduct of Business Rulebook; [ii] carried out onsite inspections to assess whether regulated entities have product oversight and governance arrangements in place; and [iii] carried out reviews to ensure that disclosures are being made in line with the requirements set out in the respective regulatory frameworks. Going forward, the Authority will ensure that there is continued focus on retail investor protection so that the interests of consumers of financial services are protected and are placed at the centre of licensed entities' operations.

The Conduct Supervision function has also carried out a cross-sectoral thematic review to assess the product and oversight governance arrangements which insurance undertakings and intermediaries, credit and financial institutions, as well as investment firms are required to have in place. This took the form of a questionnaire sent to the entities which were subject to such a review and was followed up with several supervisory interactions to a sample number of such entities. These were pursued bilaterally with the entities inspected. A circular highlighting the Authority's expectations in this area will be published in the coming weeks.

iv. Cross-Border Operations

In line with the priorities set for 2020, the Authority has increased its supervisory focus on business models that rely heavily on cross-border orders, transactions, and activities in their operations. In this respect, authorised persons which service clients on a cross-border basis featured in the sample of entities which were subject to a supervisory interaction during the past year. Furthermore, the Authority has regularly engaged with other jurisdictions with regard to cross-border activity.

v. Cybersecurity

The fast-paced advances in technology and the ever-increasing reliance on Information and Communications Technology, have seen good ICT governance and effective cybersecurity frameworks becoming key for effective supervision. The MFSA has established an ICT Risk and

Cybersecurity function which houses a number of technical specialists in the field. The function is cross-sectoral in nature and provides support to the Authority's sectoral supervisory functions with respect to matters falling within its remit, both concerning applications for authorisation and ongoing supervisory work, including supervisory interactions and reviews. The function has also published [Guidance on Technology Arrangements, ICT and Security Risk Management, and Outsourcing Arrangements.](#)

vi. Financial Soundness

Throughout 2020, the Authority has performed ongoing monitoring of prudential requirements relating to capital adequacy, business model profitability, liquidity, and general financial soundness of regulated entities. Based on a risk-based approach, the Authority has also applied more intrusive supervision in sectors and on entities that were identified as being exposed to greater risk.

Banking



Supervisory Priorities for the Banking Sector - 2020

Credit Institutions

Throughout 2020, the Authority has continued its efforts to assess credit risk, particularly vis-à-vis non-performing loans, and the assessment of credit underwriting criteria. Given the changes in economic climate, and the fact that any unrecognised credit risk may undermine balance sheet stability, the Authority will be strengthening its approach in this respect in 2021.

Business model and profitability risk were also identified as a focus area for 2020. In this respect, the Authority has analysed several credit institutions' business models, both thematically and as part of the SREP. This is considered as a first, yet important, step in assessing the financial soundness of Maltese credit institutions in view of their sustainability and the risk that they may pose to financial stability in general. Looking ahead, this assessment will facilitate supervisory work as it will allow the Authority to focus on the specific risks each credit institution is exposed to.

The Authority has also continued monitoring the capital and liquidity of credit institutions giving particular attention to capital planning and stress testing. The Authority plans to continue building on the progress achieved in this respect during 2021.

Work was also undertaken to improve banks' ICAAP and ILAAP documents as well as their governance arrangements.

The Authority followed up on mystery shopping exercises conducted in 2018 and 2019 focusing on certain aspects of the Payment Account Directive.

Financial Institutions

The MFSA has sought to ensure good governance practices amongst financial institutions. The banking supervision function has developed an automated tool which assesses and scores financial institutions' organisational structures. Where deficiencies were identified, remedial action was taken through supervisory interactions and reviews.

The Authority has also assessed business models through deep dives to ensure firms' viability and sustainability. Furthermore, on an ongoing basis, financial institutions' regulatory compliance with PSD II was assessed and non-adherence was tackled immediately.

With respect to IT risk, a number of reviews were jointly carried out by the Banking Supervision function and the Supervisory ICT Risk and Cybersecurity function.

Insurance and Pensions

Supervisory Priorities for the Insurance and Pensions Sector - 2020

Through a combination of supervisory interaction and reviews, during 2020 the MFSA has been assessing the effectiveness of [i] the compliance activities, internal controls and monitoring undertaken by principals in relation to tied insurance intermediaries, agents, managing general agents, delegated authority and other arrangements; and [ii] the compliance function of (re)insurance undertakings which is outsourced to insurance management companies.

Supervisory interactions were also carried out to assess the compliance activities of retirement scheme administrators including discussions with MLROs regarding AML/CFT. The Authority had also planned to carry out a workshop for compliance officers of retirement scheme administrators to set out the MFSA's expectations. The Authority has developed the workshop programme and will be holding this event in 2021.

A number of supervisory interactions and reviews have been carried out to assess the effectiveness of the governance structures and internal controls implemented by intermediaries. These mainly focused on AML/CFT.

The Authority had planned to conduct mystery shopping exercises on how insurance distributors (brokers), assess, specify, and communicate the demands and needs of the

customer before the conclusion of a contract of insurance. Given the COVID-19 pandemic, this was not possible.

In the light of the outbreak of the pandemic, the Authority engaged with insurance undertakings who have included a COVID-19 exclusion from cover in their products, with a view to ensure that such undertakings have assessed whether their products still provide 'value for money' for their clients notwithstanding this decrease in cover, as required in terms of their product oversight and governance obligations.

The Authority had also planned to conduct research into consumers' **attitudes and** behaviour relating to home insurance to enhance understanding of the practices related to this specific product. A report relating to this research is expected to be published in early 2021.

Securities and Markets

Supervisory Priorities for the Securities and Markets Sector - 2020

Capital Markets and Market Infrastructures

The implementation of the Capital Markets Strategy is ongoing, work on most of the five pillars has commenced and tangible progress has been achieved in this respect. Several applications for admissibility to Listing, including the review and scrutiny of prospectuses, have been processed over the course of the year.

In 2020, the Securities and Markets Supervision function carried out a number of initiatives regarding financial and non-financial information. By virtue of enhanced selection methods, leading to several examinations, the Authority required corrective action in future financial statements. Examinations were also carried out on non-financial information, whereby specific guidance and recommendations were provided accordingly. Moreover, to promote increased transparency in the market, the Securities and Markets Supervision function directly engaged with the Listed Entities *inter alia* in relation to public disclosures on the impact of the COVID-19 pandemic.

Additionally, the implementation of ESEF is on track. The Authority has continued its engagement with the relevant stakeholders, including its participation in local and EU working groups. In this regard, the relevant updates are made publicly available, including by way of a circular. ESEF is applicable to Listed Entities' annual financial reports containing financial statements for financial years beginning on or after 1 January 2020.

The Securities and Markets Supervision function has continued to work on enhancing its efforts to detect and prevent financial market abuse, and has carried several supervisory interactions with issuers and investment firms to assess their level of compliance to the requirements of the Market Abuse Regulation. This engagement follows a number of compliance meetings which the Securities and Markets Supervision function has held with issuers and investment firms. The findings of these compliance meetings have been published in two separate circulars to the industry.

With respect to EMIR and the reporting requirements contained therein, the Securities and Markets Supervision function engaged in extensive bilateral communication with several counterparties, to address issues regarding data quality, and shortcomings identified in the reports which are submitted by counterparties concerning their derivative transactions.

Work relating to the implementation of the SFTR is also on track. The reporting obligation under this regulation has, for the majority of counterparties, become applicable in 2020. Non-financial counterparties will become subject to the reporting obligation in January 2021.

Funds and Service Providers

In 2019, the Authority carried out a thorough thematic review on liquidity management practices of asset managers. Given that during 2020, ESMA launched a CSA on liquidity as well as due to the outbreak of COVID-19, the Securities and Markets Supervision function carried out: [a] additional supervisory interactions; [b] supervisory reviews; and [c] ongoing engagement with domestic funds to ensure that liquidity risk management rules applicable to UCITS and retail AIFs are adhered to on an ongoing basis. The manner by which any liquidity mismatches between the liquidity portfolio of the fund and the redemption activity were also addressed. The MFSA will be submitting the full results of the CSA to ESMA by 31 December 2020 and will be updating the industry of common findings identified as well as best practices to be adopted.

The Securities and Markets Supervision function has also undertaken an internal information gathering exercise on the fees charged by collective investment schemes, to verify whether investors are charged any undue costs in terms of the ESMA Guidelines on performance fees in UCITS and certain types of AIFs, as well as the Supervisory Briefing on the Supervision of Costs in UCITS and AIFs. This data analysis will be used as a basis to determine additional supervisory engagement on fees and costs charged by funds targeting retail investors during 2021.

The function has also carried out supervisory interactions covering the areas of governance, risk, compliance, as well as the internal controls employed by licence holders to mitigate AML/ CFT risk. In view of the COVID-19 developments, the function has also carried out reviews on the functionality of the business continuity arrangements employed and disaster recovery plans implemented by licence holders. Besides, the Securities and Markets

Supervision function has also undertaken preliminary supervisory work on the outsourcing and delegation of critical functions, in particular to determine the adequacy of the oversight arrangements employed by licence holders and to ensure that authorised AIFMs and UCITS management companies maintain sufficient local substance, and to determine how the delegation arrangements allowed in terms of articles 13 and 30 of the UCITS Directive and article 20 of the AIFMD and articles 75-82 of the AIFMR are being adhered to. Moreover, the Securities and Markets Supervision function has also been working on improved cooperation mechanisms with host national competent authorities of service providers establishing branches outside Malta.

Investment Firms

Throughout 2020, the MFSA has kept monitoring the implementation of the national product intervention measures in relation to contracts for differences and binary options, as well as the disclosures regarding risk warnings to ensure that these are in line with the requirements set out in the Conduct of Business Rulebook. The Conduct Supervision function has also followed-up on work in relation to the classification of clients as elective professional investors.

In 2019, ESMA launched a CSA, focusing on the assessment of the MiFID II Appropriateness requirements as carried out by investment firms. In this regard, the Conduct Supervision function carried out a series of focused supervisory interactions in order to assess the application of the MiFID II Appropriateness requirements as adopted by the selected investment firms – follow-ups on this exercise were performed during 2020. Furthermore, in 2020, in line with the ESMA CSA, Conduct Supervision performed several deep dives in order to assess the application of the MiFID II suitability assessments.

The Conduct Supervision and Securities and Markets Supervision functions acting jointly liaised with a substantial number of investment firms in order to assess the impact which the COVID-19 pandemic had on their clients and the manner in which such firms have acted to mitigate this impact. In this respect, the Conduct Supervision function focused specifically on the impact on consumers amid COVID-19.

Preliminary work has also been undertaken on the Implementation of the Investment Firm Regulatory Package i.e. the Investment Firm Directive and the Investment Firm Regulation. An impact assessment has been drawn up and will continue to be actioned throughout 2021.

Trustees and Company Service Providers

Supervisory Priorities for the TCSP Sector - 2020

In line with the priorities set for 2020, the MFSA has throughout the year continued to verify the accuracy of the data reported in the TUBOR conducting several supervisory interactions specifically on this matter. With respect to the monitoring of business models and the level of risk acceptance, apart from both matters being assessed pre-authorisation, at application stage, the Authority also conducted a number of interactions with a focus on business and client risk assessment, in recognition of the high AML/CFT risk impacting this sector. Several supervisory interactions assessing corporate governance structures were also carried out in view of the weaknesses identified in this area within the TCSP sector.

Following a consultation exercise, initiated in 2019, the Authority also issued feedback on its proposals to raise standards for CSPs. The Authority is currently in the process of revising its rulebook for CSPs to [i] strengthen a number of rules, particularly those concerning governance and compliance; and [ii] reflect the changes to the framework which will be taking effect once [Act L of 2020 – the Company Services Providers \(Amendment\) Act, 2020](#) is brought into force.

Virtual Financial Assets

Supervisory Priorities for the VFA Sector - 2020

Given that the VFA Act only came into force on 1 November 2018, with the first operators being authorised in 2019, the MFSA's priority for 2020 was to monitor the operations of persons authorised under the Act. In this respect, the Authority has developed an internal risk rating model for VFA agents and conducted several supervisory interactions. VFA agents have submitted their annual returns to the Authority for its scrutiny. The Authority has also developed a risk rating model and conducted supervisory interactions with a number of VFA Service Providers operating under the transitory period.

Resolution

An Update on Work Conducted in 2020

The Resolution function continued to effectively collaborate with the Single Resolution Board (SRB) through its direct participation in the Internal Resolution Teams responsible for the resolution planning process of Significant Institutions. In 2020 the function completed the first iteration of the resolution plans for all credit institutions. These plans are updated annually and require collaboration and engagement with the industry and with the Single Resolution Board (SRB), the latter overseeing the resolution planning for LSIs. This also entailed the setting of a Minimum Requirement of Own Funds and Eligible Liabilities (MREL) for these entities.

In 2020 the MREL setting has been aligned with the 2020 SRB MREL Policy amid the new regulatory framework of the EU Banking Package. The latest MREL policy introduces a series of new features to strengthen the MREL approach and the entities' resolvability within the Banking Union. The application of this policy shall be accompanied by the transposition of the new European Bank Recovery and Resolution Directive (BRRD2).

Section II



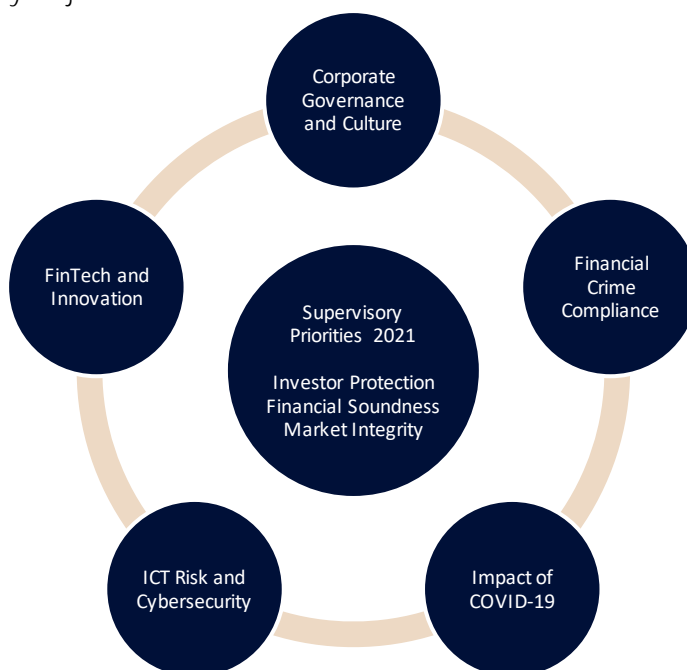
Supervisory Priorities - 2021

Introduction

This Section sets out the MFSA’s supervisory priorities for 2021. The sector-specific areas of focus build on those having a cross-sectoral nature and should therefore be considered as complementary thereto.

Cross-Sectoral Priorities

Financial regulation has three overarching high-level objectives which are constant – safeguarding the stability of the financial system, the protection of investors, and ensuring the integrity of financial markets. Notwithstanding the supervisory priorities which will be set out, the objectives of financial regulation will always remain at the forefront of the MFSA’s agenda. In this respect, the Authority considers that the five supervisory priorities for 2021, namely: [i] Corporate Governance and Culture; [ii] Financial Crime Compliance; [iii] the impact of COVID-19; [iv] ICT Risk and Cybersecurity ; and [v] FinTech and Innovation, as being complementary to these three primary objectives.



i. Corporate Governance and Culture

Supervisory work carried out in 2020 has led to the identification of areas where further improvement on the part of authorised entities may be required. This cross-sectoral area of focus shall therefore be retained as a priority for 2021. Whilst the MFSA shall be communicating its expectations in this respect, as part of the project which will lead to the development of a new Corporate Governance Code for regulated entities, supervisory

interactions assessing firms' governance standards and the effectiveness of their internal controls, including their compliance function, will continue. The Authority is cognisant of the ever-increasing importance of ESG considerations when it comes to company culture and work shall also be undertaken in this respect.

ii. Financial Crime Compliance

Given that the fight against financial crime is key to safeguarding the integrity, prosperity, innovation and trust in the Maltese financial services sector, financial crime compliance shall be retained as a cross-sectoral priority for 2021. Apart from continuing its positive collaboration with the FIAU, the Authority shall continue building on work performed in 2020 in monitoring the compliance of regulated persons with AML/CFT obligations. Furthermore, the FCC function will issue periodic publications to update the industry of developments concerning AML/CFT and the current status of the AML regime within the industry itself.

iii. The impact of COVID-19 – **MFSA's ongoing Supervisory Approach**

The repercussions of COVID-19 have affected all sectors of the economy. Financial services being no exception. To date, the MFSA has: [i] [adapted its work practices and approach to supervision](#), availing itself of technology and shifting some of its supervisory work online in conformity with international best practices; [ii] provided stakeholders with regular updates on developments at European level; [iii] set out its expectations on firms' conduct throughout the pandemic's duration; [iv] provided for regulatory relief and the extension of various deadlines; and [v] provided guidance to stakeholders, including consumers. Throughout 2021, the Authority will continue monitoring the impact of COVID-19 on the financial services sector, particularly the post-COVID viability of regulated entities' business models, including their capacity to cope with the operational consequences it will have, alongside the impact on consumers of financial services.

iv. ICT Risk and Cybersecurity

Building on work carried out in 2020, the MFSA shall retain ICT Risk and Cybersecurity as an area of focus for 2021. In this light, the Authority's newly set up ICT Risk and Cybersecurity function shall continue to support the sectoral supervisory functions to ensure that regulated entities have an adequate cybersecurity programme in place designed to enhance resilience to cyber-attacks and mitigate the risks associated with such threats. The function will also be designing an ICT and Cybersecurity Risk model for supervision and carrying out education and awareness sessions for stakeholders. Moreover, the function also plans to conduct thematic desk-based reviews on a sectoral basis on ICT Risk and Cybersecurity matters, including outsourcing to cloud services providers.

v. FinTech and Innovation

In line with the [FinTech Strategy](#), the MFSA is seeking to foster an environment for FinTech start-ups and scale-ups, technology firms and established financial services providers to develop viable FinTech solutions. Such solutions drive innovation and enhance access to financial products, increase competition whilst promoting market integrity, deliver better customer experiences, and ultimately, contribute to the long-term success of the Maltese financial services sector. In this respect, the Authority has, this year, launched its FinTech Regulatory Sandbox thereby making it possible for operators to apply to test their innovations therein, for a specified period of time and under certain prescribed conditions. The Authority plans to maintain this momentum through the continued implementation of its strategy.

Banking

Supervisory Priorities for 2021 - Banking

Building on work conducted in 2020 and in line with the cross-sectoral priorities for 2021, the Authority will retain the assessment of Governance of credit and financial institutions, as a sector-specific priority for the banking sector. The Authority plans to develop and implement a broader communication channel and training strategy to support the development of boards, particularly for Non-Executive Directors. Specifically, in relation to LSIs, the MFSA shall be assessing the number of and the remuneration afforded to these directors, their quality and understanding of their role, and their effectiveness. The Banking Supervision team will also hold discussions with authorised entities to assess how boards are approaching succession planning. The MFSA will follow up on SREP mitigation actions taken as part of the SREPs on banks and seek continuous improvement in compliance cultures for banks and financial institutions. Where appropriate, the Authority will also take enforcement action.

Given the change in economic climate, particularly due to COVID-19, focus on business model viability, will also be retained in relation to both CIs and FIs, specifically in relation to post-COVID viability and whether firms have appropriately costed their compliance costs in business plans. The impact of climate change (or regulatory change in response to climate change) on entities' business models will also be assessed.

The analysis and quantification of credit risk, together with an assessment of asset quality and credit institutions' preparedness for the balance sheet and operational challenges associated with higher credit risk will be conducted. The MFSA's Banking Supervision function will be conducting onsite inspections to examine the quality of banks' controls over the recognition of impaired exposures, board reporting on credit risk and the operational preparations undertaken for an increase in credit risk profiles.

Further to the above, supervisory efforts will also focus on capital and funding trajectories.

From a conduct of business point of view, the Authority plans to launch Conduct of Business Rules for the banking sector in the upcoming year. Furthermore, the Conduct Supervision team plans to conduct checks, through supervisory interactions, on the creditworthiness assessments carried out when facilities are granted and whether these are sufficient, or otherwise.

Insurance and Pensions

Supervisory Priorities for 2021 – Insurance and Pensions

The Authority shall continue to give importance to the assessment of business models that rely heavily on cross-border operations. Close collaboration with regulators in host Member States will be maintained for effective cross-border supervision of these regulated entities.

The MFSA shall also continue monitoring prudential requirements relating to capital adequacy, business model profitability, liquidity, data quality, and general financial soundness of regulated entities through the SRP. Complementing this area of focus, the Authority shall also be conducting a thematic review on reserving.

The Insurance and Pensions Supervision function will also be conducting supervisory meetings with senior officers of licensed entities to discuss specific risk areas. The Authority shall be holding senior officers more accountable where it comes to the management and mitigation of such risks. The function shall also be carrying out supervisory interactions, particularly on outsourcing - including Managing General Agents arrangements.

From a conduct of business perspective, the Authority shall be focusing on: [i] the distribution activity of insurance brokers, particularly as to whether they carry out fair analysis, demands and needs testing and the placing of business with undertakings; [ii] the timeliness of claims handling by insurance undertakings; as well as [iii] bancassurance (banks acting as TIs), mainly to assess how the approved persons in the different branches are being monitored to ensure that these approved persons abide by the applicable regulatory requirements when distributing insurance products.

Building on work carried out during the past year, the Conduct Supervision function shall also be assessing the POG and its application in practice with regard to the target market assessment, product testing and product monitoring and review phase for insurance-based investment products and ancillary products.

Securities and Markets

Supervisory Priorities for 2021 – Securities and Markets

Capital Markets and Market Infrastructures

The implementation of the MFSA's Capital Markets Strategy, focusing on five main pillars – [i] revisiting the risk appetite of the Authority; [ii] revisions required to the regulatory framework; [iii] strengthening the sponsors regime; [iv] building on supervisory capacity; and [v] investor education – will remain a key priority for 2021 and will guide the Authority's work on capital markets.

The Securities and Markets Supervision function will continue with the supervision and enforcement of financial and non-financial information, as well as with market oversight in relation to EMIR, Market abuse and SFTR carrying out several supervisory interactions and transaction reviews, as necessary. Moreover, the Securities and Markets Supervision function will continue to monitor the impact of the COVID-19 pandemic and specifically promote the use of public disclosures by Listed Entities, where applicable, in order to ensure transparency.

The team shall also be focusing on the implementation of the Securitisation Regulation and ESEF Regulation and the transposition of the Covered Bonds Directive.

Data is key to securities markets regulation and a vital component of competent authorities' data-driven approach to supervision. Data quality is crucial for all stakeholders as reliable and timely data is required to detect and deter market abuse, for transparency calculations and to identify any build-up of systemic and counterparty risk. Throughout 2021 the MFSA will focus its efforts on improving data quality. Entities falling within the scope of reporting data in terms of MiFID II, EMIR, SFTR, and CSDR, amongst others, will be required to report details accurately and up to the standards required by European bodies.

The Securities and Markets Supervision function will be actively participating in the regulatory review of legal texts which will be impacting the market infrastructures' space, such as MiFID II and the CSDR.

Funds and Service Providers

The Securities and Markets Supervision function will build on the work carried out in 2020 and will continue conducting thematic supervisory interactions on outsourcing of key functions. The interactions will focus on those functions which asset managers and collective investment schemes have outsourced, specifically the due diligence conducted on service providers, both

at the point of engagement and on an ongoing basis, as well as the monitoring which the licensed entity is performing on the services being provided. Moreover, the function will also be conducting reviews on the adequacy of the fees and costs charged by funds in terms of the investment strategy of the fund as well as compared to industry benchmarks, including performance and management fees. Additional focus will also be made to the disclosure mechanisms and explanations of such fees to retail investors, in particular to determine whether investors are fully understanding the respective disclosures.

Follow-up work will also be conducted on liquidity management by UCITS funds, in particular considering the findings identified in the CSA exercise. Moreover, additional emphasis will be made on the operations of the existing depositaries of collective investment schemes licensed in Malta, focusing particularly on the cash flow and investment restriction monitoring.

The Securities and Markets Supervision function will also be incorporating a review of the work being carried out by AIFMs insofar as Notified AIFs are concerned. Moreover, additional procedures will be introduced to improve the cross-border collaboration of the MFSA with other National Competent Authorities, in particular for Fund Managers making use of the management passport.

In addition to specific initiatives published in the recent months, such as the [restructuring of the MFSA Loan Funds Regime](#), the MFSA will also be publishing a wider strategy for the asset management sector in 2021. The Authority is also considering possible updates to the regulatory framework vis-à-vis the supervision of ESG Funds.

Investment Firms

One of the ongoing focuses of the Securities and Markets Supervision function will be the implementation of the Investment Firm Regulatory Package including revisions to the regulatory framework and the Investment Services Rules applicable to Investment Services Providers, and industry engagement to raise awareness thereon. Moreover, the Securities and Markets Supervision function will be also implementing the revised Capital Requirements Directive Package – CRD V and CRR II, in view that some Class 1 Investment Firms may still be supervised under the CRD package.

Building on work conducted in 2020, and in line with the cross-sectoral priorities for 2021, the Securities and Markets Supervision function and the Conduct Supervision function will retain the assessment of Governance and the three lines of defence of Investment Firms, as a sector-specific priority for the securities sector. Apart from focusing on Governance models, MFSA will also be focusing on the effectiveness of control functions, such as the Compliance function.

Thematic supervisory interactions on **safeguarding of clients' assets and monies** will be undertaken to review the safekeeping arrangements adopted by investment firms which are holding and controlling clients' assets and monies. Thematic engagement on outsourcing will likewise be conducted, focusing on outsourced functions of investment firms, particularly the initial and ongoing due diligence on service providers and firms' monitoring of the services provided.

From a conduct of business point of view, the MFSA plans to follow up on supervisory work which is currently being undertaken vis-à-vis the MIFID II suitability assessments, utilising a data-driven methodology to inform its risk-based supervisory approach. Furthermore, the Conduct Supervision function will also be examining the selling processes of a sample number of investment firms with respect to the distribution aspect of locally issued financial instruments to the general public, focussing particularly on high-risk customers groups also supported with a data-driven approach. The Authority shall also be continuing its current work on the application of MIFID II Product Governance requirements which remains a key priority at European level.

Furthermore, building on the cross-sectoral priority which had been set for 2020, further supervisory work on cross-border investment services will be conducted.

Trustees and Company Service Providers



Supervisory Priorities for 2021 - TCSPs

Work on verifying the accuracy of data reported in the TUBOR will continue throughout 2021, together with the monitoring of business models and the level of risk acceptance. In line with the cross-sectoral priority on 'Corporate Governance and Culture', the Authority shall continue with its assessment of governance structures of TCSPs as one of the supervisory areas of focus.

Furthermore, 2021 will see the implementation of the reform to the CSP framework which is currently being undertaken. A revamp of the rules for Trustees and other fiduciaries is also being undertaken by the TCSP team.

Virtual Financial Assets

Supervisory Priorities for 2021 - VFA Sector

The Authority plans to continue with the work it conducted in 2020 supervising both VFA Agents and VFA service providers on a risk-based approach. Furthermore, the MFSA is and shall continue monitoring developments at European Union level, particularly concerning the [Digital Finance Package and the legislative proposal on crypto assets \(MiCA\)](#).

Resolution

2021 Initiatives

Bank's resolvability assessments and compliance with MREL requirements will continue to be prioritised in 2021. A resolution framework for investment firms that falls under the scope of the BRRD2 shall also be developed.

Policies and procedures to enhance the resolution framework on a technical and legal level will be developed, especially in the light of the updated European legislation. The implementation of these policies would ensure an effective and orderly resolution of credit institutions.

In 2021, Resolution will provide support in a reform project leading to the adoption of an administrative bank insolvency regime. The MFSA, as the National Resolution Authority, would have the power to implement the orderly closure and liquidation of an ailing bank. This shall be accompanied by the preparation of a legal framework allowing a shift in the responsibility for decisions on bank liquidation, post-licence revocation, from the MFSA's supervisory function to the Resolution function.

Section III



Other Key Initiatives

Introduction

This Section outlines other key initiatives for 2021 and aims to give visibility of those areas which may possibly impact stakeholders.

The MFSA's Supervisory Plan

The MFSA is currently working on establishing a Supervision Plan which will set out its supervisory strategy, underlying pillars, and enablers for the next three years. Through this Plan, the MFSA shall communicate its high-level strategic supervisory direction, and expected changes, concerning how supervision and related work are carried out.

Once published, the Plan is expected to include how the MFSA will be [i] continuing to build a holistic and integrated supervisory approach which will seek to move away from compliance-type of supervision and to focus more on the outcomes and objectives of financial supervision, [ii] fostering the right supervisory culture, knowledge and experience to carry out more effective and efficient supervision, [iii] enhancing engagement with stakeholders, and [iv] enabling jurisdiction positioning through defined focus areas.

The Plan will set the scene for the years to come and certain work that will be initiated during the stated three-year period will span over to the following period. Setting a term to a strategy such as this one helps stakeholders know what to expect and by when, hence increasing accountability and transparency. The year-on-year supervision priorities will continue to be published and should be seen under the light of the longer-term Plan.

Brexit

The withdrawal agreement between the UK and the EU27, which entered into force on 1 February 2020, ensured an orderly withdrawal supported by a transition period until 31 December 2020.

During this transition period, the UK continued to apply Union law without being represented in the EU institutions. This gave more time for citizens, consumers, and businesses to adapt.

At the time of writing, the EU and the UK are currently negotiating an agreement to seal a future partnership which needs to be in place from 1 January 2021. With the outcome of these political negotiations still unclear at the time of the publication of this document, the impact of Brexit in 2021 cannot be precisely formulated.

The EU is preparing for any consequences should the transition period end without a formal, ratified agreement for this future partnership. However, even if the EU and the UK conclude a partnership agreement, it would create a relationship which will be very different from the current one. The end of the transition period will inevitably create some barriers to trade and cross-border exchanges that do not exist today.

During 2020, and building on work done in the previous years, the MFSA has continued its dialogue with stakeholders to ensure that all necessary actions for readiness are taken by the end of 2020. As part of its supervision, it followed the contingency plans of the entities under its supervision and monitored their readiness taking into account the guidance and public communications issued by the European Commission and the ESAs.

Maltese licence holders were encouraged to finalise and implement their preparatory measures by 31 December 2020 at the latest and be ready for the change that will happen in all scenarios, including wherein their area of work, there is no equivalence decision taken by the EU or the UK.

UK entities passporting in Malta were informed that upon the expiry of the transition period, the MFSA does not intend to grant additional temporary permission for the provision of services to Maltese clients and therefore they should ensure that they have obtained the necessary authorisation from an EU competent authority and have effectively established themselves before the end of the transition period.

Maltese licence holders passporting in the UK were reminded that should they wish to continue servicing UK clients; they should reach out to the UK authorities in a timely manner and seek an appropriate authorisation.

In addition, the MFSA actively encouraged licensed entities to continue providing timely and accurate information about the potential impact of Brexit on services and 'business as usual'. Local clients (customers, policyholders, investors) were informed of the MFSA's position with respect to UK entities servicing Maltese clients and were made aware of the need to ensure that any UK entity providing them with a licensable service, is authorised to do so. It is not excluded that in 2021, MFSA may need to conduct supervisory work in relation to Brexit.

The MFSA is now closely monitoring developments in preparation for the end of the transition period. In 2021, the MFSA's focus will be to ensure that the immediate risks and issues are managed properly. The preparation by the industry has been ongoing for a long time. The contingency plans that were drawn up for the risk of the UK's withdrawal from the Union without a withdrawal agreement – a scenario which did not materialise – will still be very relevant for the changes at the end of the transition period – particularly the termination of passporting rights to and from the UK. The MoUs to which the MFSA is party will enable continued dialogue with UK regulators on matters of supervision and regulation.

Nevertheless, it is not excluded that some market volatility and disruption to financial services could arise from the UK's exit from the single market at the end of the transition period. The MFSA is continuing its engagement with the industry to mitigate the risks posed to the economy, consumers, the financial system, and the regulatory environment.

Sustainable Finance

At the international level, the sustainable finance agenda is progressing swiftly. Given the vastness of the matter and the in-depth analyses and expertise required, a number of supervisory challenges arise. The past year has been crucial for the MFSA in laying the groundwork, in particular by assessing the requirements emanating from EU Regulations. Going forward, the Authority shall continue monitoring developments in this field and shall work closely with market players to prepare for any upcoming regulatory changes. The MFSA shall be focusing on creating a policy framework that provides a clear trajectory for sustainable finance.

Outreach and Consumer Education

In line with the Authority's [Vision 2021](#) and the [Strategic Plan 2019-2021](#), the Authority is reiterating its commitment to outreach by engaging directly with firms, consumers and investors to better understand issues they face, highlight any common issues observed through supervisory experience and to set out expectations. Furthermore, in line with its statutory function "*to provide and foster further training, knowledge and education on all matters relating to financial services*"³ the Authority shall also continue carrying out consumer education campaigns to raise awareness on financial services.

³ MFSA Act, Article 4(1)(gA)

Conclusion

This document provides an update on the MFSA's supervisory priorities for 2020 and an overview of those set for 2021, both sectoral and cross-sectoral. In doing so, it sets out the themes which the Authority will be focusing on during the upcoming year. It also highlights the risk-based approach to supervision adopted by the Authority to ensure the efficacy and effectiveness of its supervisory efforts. The document further highlights other MFSA key initiatives for 2021, providing visibility on those areas which the MFSA believes may impact stakeholders. It is reiterated that the priorities outlined in this document should not be considered in isolation, but rather as focus areas of a wider array of supervisory work which the Authority will be performing during the coming year.

Regulated entities are expected to discuss the contents of this document within their Board of Directors, or equivalent administrative body, and examine the implications on their business activities.

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