

**FITNESS AND PROPERNESS
STANDARDS FOR DUE DILIGENCE
SERVICE PROVIDERS OF NOTIFIED
PIFs**

GUIDANCE NOTE

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REVISIONS LOG



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Section 1 Introduction

- 1.01 Regulation 18 of the Investment Services Act (List of Notified CISs) Regulations (hereinafter referred to as the 'Regulations') requires the governing body of the NPIF to appoint a service provider to carry out the necessary due diligence process to ensure that the governing body, functionaries, the manager and any additional service provider the NPIF may appoint, satisfy at the time of notification and on an ongoing basis the high standards of fitness and properness specified by the MFSA.
- 1.02 The Investment Services Rules for Notified Professional Investor Funds (hereinafter referred to as the 'Rules') specify that the appointed service provider shall carry out a due diligence exercise to ensure that other service providers and functionaries, the governing body, founder shareholders, and MLRO of the NPIF, satisfy at the time of notification and on an ongoing basis, the fitness and properness standards expected by the MFSA.
- 1.03 In assessing whether such persons (other service providers and functionaries, the governing body, founder shareholders and MLRO of the NPIF) fulfil the 'fitness and properness' standards, the appointed service provider shall undertake the "fit and proper" test in order to ensure that they meet the following four criteria:
- a) Competence - which requires such persons to have sufficient knowledge, skills and experience to fulfil the proposed role/s. The term competence covers both practical and professional experience gained through previous occupations and academic knowledge through education and training.
 - b) Reputation - which means that such individuals are of good repute to ensure the sound and prudent management of the Entity.
 - c) Conflicts of Interest and independence of mind - which imply that such individuals are able to make sound, objective and independent decisions.
 - d) Time Commitment - which means that such individuals must be able to commit sufficient time to performing their functions.
- 1.04 Pursuant to the Rules, the appointed service provider shall keep records of all evidence of, and correspondence regarding, the due diligence process carried out. The relevant records and documentation are to be updated on a regular basis and at least annually and are to be made available to the MFSA upon request. The MFSA is to be notified of any change in circumstances as soon as they become known to the service provider.
- 1.05 Pursuant to the Rules, the relevant due diligence records and documents are to be retained at the principal office of the NPIF.
- 1.07 Pursuant to the rules, the MFSA may carry out checks, including on the appointed service provider, on the due diligence services carried out as well as on the compliance with the provisions of the Regulations and the Investment Services Rules, and give all the necessary directions it deems fit in the circumstances. Any adverse findings by the MFSA may lead, inter alia, to regulatory action both towards the NPIF and the service providers, as well as the removal of the NPIF from the List of Notified PIFs.

- 1.08 This Guidance Note should not be deemed to override the applicable laws, regulations, or rules, neither should it be considered or construed as advice or any other form of commitment on the part of the MFSA. It is merely indicative of the due diligence process which should be undertaken by the Service Provider appointed in terms of Regulation 18.
- 1.09 The MFSA may update or amend this Guidance Note from time to time, as necessary.

Section 2 Scope and Application

- 2.01 This Guidance Note shall apply to Service Providers appointed by NPIFs in terms of Regulation 18.
- 2.02 As a general rule, the following persons will be subject to the due diligence assessment:
- (a) the members of the governing body of the NPIF;
 - (b) the MLRO of the NPIF;
 - (c) the service providers and functionaries of the NPIF; and
 - (d) the founder shareholders of the NPIF.

Section 3 High Level Principles

- 3.01 The Authority expects the due diligence service provider to carry out a due diligence assessment on the persons listed in 2.02, not only prior to notification, but also on an ongoing basis. The service provider should be considered as a first line of defence and gatekeeper to the financial system.
- 3.02 The onus of proving that a person is fit and proper lies with the due diligence service provider and, ultimately, on the entity proposing such individuals for appointment and responsible for the appointment of the due diligence service provider itself.
- 3.03 Fitness and propriety tests are crucial in preventing persons who are not fit and proper from entering the system or from continuing in their role, given the risk they pose to the proper functioning of the financial sector. In this respect, the due diligence service provider acts as a gatekeeper to the financial services sector.
- 3.04 The principle of proportionality shall be applied throughout the fitness and propriety assessment commensurate to the size of the entity and the nature, scale, and complexity of its activities, as well as the particular role to be filled.

- 3.05 Notwithstanding 3.04, the application of the proportionality principle cannot lead to the lowering of standards.
- 3.06 The fitness and propriety assessment feeds into the supervision of the governance of an entity, specifically with regard to the composition and functioning of the management body.
- 3.07 A fitness and propriety assessment may lead to a decision which needs to be followed up and complemented through a supervisory intervention.
- 3.08 In carrying out the due diligence assessment, both prior to the notification of the NPIF to the MFSA as well as on an ongoing basis, the due diligence service provider shall be guided by and comply with the provisions of the Prevention of Money Laundering and Funding of Terrorism Regulations and the Implementing Procedures.

Section 4 Assessment Criteria

- 4.01 The term 'fitness and propriety' shall be understood as referring to the necessary competence, qualifications, experience, integrity, financial standing, independence of mind and time commitment to carry out the functions assigned.
- 4.02 The four assessment criteria that should be always taken in consideration by the due diligence service provider, when conducting fitness and propriety tests, are the following:
- (a) Competence
 - (b) Reputation
 - i) Integrity
 - ii) Solvency
 - (c) Conflict of Interest and Independence of Mind; and
 - (d) Time commitment.

Competence

- 4.03 To be deemed competent, a person shall demonstrate and provide reasonable assurance of having an appropriate level of knowledge, professional expertise, and experience.

- 4.04 Competence is assessed with reference to both practical and professional experience gained through previous occupations and academic knowledge through formal education and training. Persons should be equipped with the skills, knowledge, and professional experience necessary to perform their duties. The level of knowledge varies according to the level of responsibility and the type of regulated activity to be carried out.
- 4.05 The person must *inter alia* be able to demonstrate:
- (a) Adequate professional or other qualifications and capabilities appropriate to the proposed appointment;
 - (b) Appropriate skills and competence, whether through training or experience gained in an employment context;
 - (c) Sound knowledge of the financial services sector as a whole, that in which they aim to operate, as well as the specific responsibilities that will be undertaken;
 - (d) The capability of identifying the risks relating to the sector which are relevant for the proposed appointment; and
 - (e) A clear and comprehensive understanding of the regulatory and legal framework, including that relating to AML/CFT.
- 4.06 The due diligence service provider shall carry out a series of verifications to assess the competence of a person, which may eventually entail confirming the veracity of the qualifications disclosed by it, liaising directly with the respective universities or educational bodies.
- 4.07 When assessing the competence of a person, the due diligence service provider shall *inter alia* take into account:
- (a) Theoretical experience; and
 - (b) Practical experience.
- 4.08 The competence assessment of collective bodies shall always be aimed to demonstrate that, both collectively and individually, they are sufficiently competent to perform their role.

Reputation

- 4.09 The due diligence service provider shall receive reasonable assurance that the person assessed is of good repute and that they intend to act in an honest, ethical and trustworthy manner. A person shall be considered to be of good repute unless there is evidence to suggest otherwise or reasonable doubt about its good repute.
- 4.10 AML/CFT considerations are an important aspect when assessing a person's reputation. Therefore, the due diligence service provider shall *inter alia* take into account any AML/CFT concerns with respect to such person.

- 4.11 The principle of proportionality cannot apply to the reputation requirement nor to its assessment.
- 4.12 The assessment of reputation shall be based on an assessment of:
- (a) Integrity; and
 - (b) Solvency.

Reputation - Integrity

- 4.13 When carrying out the assessment of the integrity of a person, the due diligence service provider shall take a holistic approach and shall *inter alia* consider the following matters:
- (a) Whether the person was found to be of poor reputation, character, reliability, or to be dishonest;
 - (b) Whether the person was found guilty by a court or other competent authority with respect to matters which may impinge on their honesty, integrity and reputability;
 - (c) Whether the person was convicted of a criminal offence or disqualified by any professional or regulatory body;
 - (d) Whether the person has been subject to any civil suit;
 - (e) Whether the person has a tainted regulatory performance record with the Authority or any other competent authority in Malta or overseas;
 - (f) Whether the person has been publicly criticized with respect to matters relating to the financial services sector; and
 - (g) Whether the person had been made to resign from any past employment or had been dismissed therefrom.
- 4.14 In carrying out its assessment of the integrity of a person, the due diligence service provider shall require the person to submit documentation which will include, *inter alia*, an original Police Conduct Certificate, from the police authorities or an equivalent certification from the country of residence of the individual. The due diligence service provider shall also require information on whether the individual has been found in breach of regulations or convicted of any offence, criminal or otherwise by any tribunal or court.
- 4.15 In case a person is subject, or has been subject to legal proceedings, criminal or administrative, the due diligence service provider shall *inter alia* consider:
- (a) The nature of the charges or accusations;
 - (b) The phase of proceedings reached;
 - (c) The expected penalty if a conviction ensues;
 - (d) The time that has passed and the appointee's conduct since the alleged wrongdoing;
 - (e) Details of the person's involvement – this is particularly relevant where action was taken against a legal person within which the person undergoing the fitness and properness assessment was involved in;
 - (f) Any understanding of and/or insight into the person's conduct gained by the entity over time; and

- (g) Any mitigation or aggravating factors (e.g. whether the person held a position of trust).

Reputation - Solvency

- 4.16 'Solvency' refers to the financial standing of the person upon whom the due diligence assessment is being carried out. The service provider should verify the person's financial standing by obtaining relevant and adequate records relating to solvency. Information obtained in this regard may include copies of any relevant audited accounts and statements of wealth, as and where considered appropriate, in addition to adequate banker's references.
- 4.17 In the case of a legal person, the service provider shall ensure that proper financial controls are in place and management of liquidity will be always applied.
- 4.18 A person shall not be deemed fit and proper with reference to solvency, if that person:
 - (a) Is currently subject to bankruptcy proceedings;
 - (b) Has failed to meet any judgement debt; or
 - (c) Is unable to meet any applicable financial or capital requirements.

Conflicts of Interest and Independence of Mind

- 4.19 Persons, in their proposed roles, should be able to make their own sound, objective and independent decisions and judgments. Independence of mind can be affected by conflicts of interest. There is a conflict of interest if the attainment of the interests of a member may adversely affect the interests of the supervised entity.
- 4.20 A person shall not be considered suitable if there exists a conflict of interest which poses a material risk which is not possible to prevent, adequately mitigate or manage.
- 4.21 The due diligence service provider shall request a declaration from the person/entity under assessment, providing an overview of any conflict of interest that it might have, together with the actions taken to mitigate such conflict.
- 4.22 On the basis of the information provided, the due diligence service provider shall assess the materiality of the conflict of interest and the adequacy of the measures adopted by the entity.
- 4.23 The due diligence service provider shall assess whether, in case of an ongoing conflict of interest, the actions taken by the entity are sufficient and efficient to manage such a conflict. If the measures taken by the entity or the imposition of a condition are not sufficient to adequately manage the risk posed by the conflict of interest, such an entity is not considered suitable.

Time Commitment

- 4.24 'Time commitment' refers to the time persons are requested to commit in their proposed role, in order to perform their function/s efficiently and effectively.
- 4.25 The time a person can dedicate to his or her functions can be affected by several factors, including:
- (a) The number of commitments held;
 - (b) The size and situation of the entities where the commitments are held and the nature, scale and complexity of the activities;
 - (c) The place or country where the entities are based; and
 - (d) Other professional or personal commitments and circumstances.
- 4.26 The due diligence service provider, in assessing the time commitment criterium, shall refer both to quantitative and qualitative aspects.
- 4.27 The quantitative assessment of time commitment involves an assessment of the number of commitments held by the person. The involvement in multiple roles is an important factor which may affect time commitment.
- 4.28 Qualitative factors that determine the amount of time a person can dedicate to his/her function include:
- (a) The size and circumstances of the entity with whom the position is held;
 - (b) The nature, scale and complexity of the activities of the respective entities;
 - (c) The place or country where the entities are based;
 - (d) The travel time required for the role;
 - (e) The number of meetings scheduled for the management body;
 - (f) The time needed for induction and training; and
 - (g) The responsibility to be borne by the person.

Section 5 Supplementary Guidance for when the due diligence assessment is being undertaken on a natural person

- 5.01 The guidance provided in this section is indicative and should not be considered exhaustive. The due diligence service provider is expected to further supplement this, as necessary, to ensure that the due diligence exercise being conducted is robust and complete in all respects.
- 5.02 The MFSA expects the due diligence service provider to *inter alia* undertake checks in relation to the following:
- **General information** - details of the individual/entity including personal information and title attaching to the function to be fulfilled. The service provider should request an authenticated copy of an identification

documentation and proof of residential address;

- **Qualifications attained** - the service provider should be satisfied that the individual is adequately qualified to carry out the function assigned to him. The service provider shall assess whether the person has recognized qualifications from reputable institutions and should request:

- [i] information on the academic qualifications of the individual together with supporting documentation if considered necessary. This includes certified true copies of certificates/ university transcripts and records which evidence the qualifications. In case of doubt, the service provider shall contact, directly, the university/college/institute from where the degrees/diplomas/courses have been obtained for any additional confirmations in relation to any qualifications;

- [ii] membership of the individual/entity with professional bodies together with supporting documentation if considered necessary. In the case where an individual is registered with a professional body, the due diligence service provider should require a certified true copy of the warrant/certification awarded from the professional body together with the latest renewal status. Examples of professional bodies include the Accountancy Board, the Malta Institute of Accountants in the case of accountants, the Chamber of Advocates in the case of lawyers, the College of Notaries in the case of Notaries, the Institute of Management, and the Institute of Directors.

- [iii] ongoing professional development. The service provider should enquire as to, and retain records of, any Continuous Professional Development ("CPD") requirements.

In the case of a Money Laundering Reporting Officer, the due diligence service provider should ascertain and record that the individual is well versed in, and has a sound knowledge of, the local regulatory framework applicable to collective investment schemes as well as the Prevention of Money Laundering Act, the Prevention of Money Laundering and Financing of Terrorism Regulations and the Implementing Measures thereunder. The service provider should also document the training which the individual has undertaken in order to fulfill the role of Money Laundering Reporting Officer.

- **Employment history and references** - the due diligence service provider should try and obtain information in relation to the full employment history of the individual and, where it is the case, identify any employment gaps and obtain an explanation in this regard. The due diligence service provider should request references from former employers including the reasons for the termination of the employment since these could impact the fitness and properness assessment. The service provider should maintain records of any

correspondence exchanged. In the case where the service provider does not manage to obtain any references from former employers and is satisfied that the individual concerned satisfies the 'fitness' test, it should document the manner in which it came to this conclusion. The service provider could also include in the fitness and propriety assessment any additional information about the areas of expertise which demonstrates the individual's competence to occupy the position or role to be assigned to him/her.

Where the due diligence service provider requires professional references, it should ask for the details of the referee (including e-mail and postal address, contact number and position held with the respective entity). The professional reference letters should be provided:

- (a) in original form and on official letterheads or otherwise supported by official identification document;
- (b) in English or in any other language provided it is translated;
- (c) outlining the relation held with the applicant.

If the professional reference letter is being provided as part of the competency assessment:

- (a) it should ideally be issued by persons who themselves are involved in the provision of the proposed activity to be undertaken by the applicant;
- (b) besides including reference to the relation held with the applicant, the letter should also include the basis on which such a confirmation with regards to the competency confirmation is being provided.

➤ **Affiliations and directorships held** - the due diligence service provider shall require the individual to provide information, including:

- (i) information on whether the individual is affiliated in any manner with a corporate services provider as defined in the Company Service Providers Act or any other professional or regulated entity;
- (ii) all directorships, shareholdings, company secretary positions, and business interests held. The service provider should seek to obtain information on the entities in which the individual currently has an interest in. Furthermore, the service provider should try and obtain information on the entities of which the individual was previously a director, shareholder, company secretary and/or held a business interest in, at any time during the last ten years;
- (iii) information on whether the individual has already undergone a due diligence assessment by the Authority or any other regulatory authority in relation to other directorships held:

Provided that the service provider should not rely on the fact that the individual has already undergone a due diligence assessment but should carry out the assessment itself;

- (iv) the service provider should also obtain information whether the individual has been dismissed from any of the positions described in paragraph (ii) or asked to resign or agreed to resign rather than being dismissed;
- (v) the due diligence service provider should obtain information whether the individual has ever resigned whilst under investigation or whether the individual has ever been censured, disciplined, or publicly criticized by any employer or regulatory authority in relation to any posts described in paragraphs (i) to (iii).

➤ **Regulatory status** - including current and previous financial services regulatory approvals. Where applicable, the service provider should collate the following information:

- (i) information on any current financial services regulatory approvals;
- (ii) information on any previous financial services regulatory approvals including details where such approvals were surrendered or have ceased;
- (iii) where possible, information on any refusals from any regulatory authority including the reasons;
- (iv) where possible, information on instances where the individual submitted an application for approval and this application was subsequently withdrawn, including reasons for such withdrawal; and
- (v) where applicable, information on any prohibition/restriction or suspension of an approval even though this was restored.

➤ **Proof of good conduct** – The due diligence service provider should require the person to submit:

- (i) an original Police Conduct Certificate, not more than three months old, from the police authorities or an equivalent certification from the country of residence;
- (ii) information as to whether the individual has been found in breach of regulations or convicted of any offence, criminal or otherwise by any tribunal or court;
- (iii) information as to whether the individual was associated or the

subject of any criminal or civil investigations or proceedings.

The service provider should also obtain information as to whether the person has ever been found guilty of any offence in relation to fraud, theft, or breaches of financial services legislation.

- **Financial Status** – the service provider should carry out the necessary searches to confirm whether a person has been declared bankrupt or is party to any lawsuit or has been convicted of any offence which could affect his financial status.

Section 6 Supplementary Guidance for when the due diligence assessment is being undertaken on a legal person

6.01 The due diligence service provider should, as a minimum, obtain and address the following information from the service provider when carrying out its due diligence exercise. The list of information which the due diligence service provider must request, provided in this section, is merely indicative and by no means exhaustive. The due diligence service provider is expected to further supplement this, as necessary, to ensure that the due diligence exercise being conducted is robust and complete in all respects.

General Information

6.02 The due diligence service provider should obtain the following information:

- (a) the latest instruments of incorporation;
- (b) a copy of the licence/recognition granted to the service provider by the MFSA or other regulatory authority. The due diligence service provider should also request information on the regulated functions which are provided by the parent company where applicable;
- (c) where applicable any available external certifications;
- (d) annual report and audited financial reports for the past three years;
- (e) information on the capital structure of the company including, where applicable, the manner in which the financial resources requirement prescribed in the local Investment Services Rules or EU legislation are fulfilled;
- (f) the latest shareholding structure chart - this information should be further supplemented with information on the parent company where applicable. Furthermore, the due diligence service provider should obtain information on whether the shareholding structure has changed considerably over the past three years and outline the changes; and
- (g) details on the insurance cover held by the company as well as any information relating to material claims to the policy in relation to the business.

Information on management and personnel

- 6.03 When carrying out the due diligence assessment of a service provider, the due diligence service provider should collate the following information:
- (a) an organigram of the company together with salient information on the senior management;
 - (b) information on manner in which the service provider carries out the compliance function and the money laundering reporting function including the officials designated as compliance officer (if present) and money laundering reporting officer;
 - (c) information on the internal control function and the manner in which this is hierarchically separate from the other functions carried out by the service provider.

The above information should be further supplemented with information on the staff of the service providers as classified in senior, middle and junior management staff.

- 6.04 The due diligence service provider should enquire on the training programs available for employees and the CPD initiatives undertaken.
- 6.05 The service provider should provide the due diligence service provider with detailed information on the corporate governance framework which is implemented together with information on the different committees in the organisation.
- 6.06 The service provider should provide the due diligence service provider with detailed information as to the way conflicts of interest are declared, managed and mitigated.
- 6.07 The due diligence service provider should carry out enquiries on the confidentiality policy adopted by the service provider.
- 6.08 The service provider should provide information as to the company's auditors.

Outsourcing and delegation

- 6.09 The due diligence service provider should obtain information on outsourcing and delegation arrangements which the service provider has concluded. This information should cover the functions which are being outsourced.
- 6.10 Furthermore, the due diligence service provider should be able to ascertain through the information which is being provided that the service provider is in a position to justify the delegation structure and the manner in which the service provider can still monitor effectively any delegated activity, give instructions to the delegate at any time and to withdraw the delegation with immediate effect should the circumstances so require.

Legal and related matters

- 6.11 The due diligence service provider should obtain information relating to:
- (a) any pending lawsuits initiated against the company;
 - (b) any pending lawsuits initiated by the company;
 - (c) any warnings issued by the MFSA or where applicable any other European regulatory authority relating to breaches of legislation including information on any sanctions or fines which were incurred by the service provider;
 - (d) where applicable information on whether the service provider has ever been subject to a suspension of licence;
 - (e) instances where the disputes were referred to arbitration.

Business Contingency and Disaster Recovery Plans

- 6.12 The due diligence service provider should obtain the following:
- (a) a confirmation from the service provider that it has Business Contingency and Disaster Recovery Plans;
 - (b) information as to whether the documents are revised at periodical intervals;
 - (c) information as to whether the Business Contingency and the Disaster Recovery Plans are conducted at periodical intervals and whether such tests are documented;
 - (d) information on whether remedial measures were adopted.

Technology

- 6.13 The due diligence service provider should enquire:
- (a) what systems and technology are in place and whether they are bespoke or packaged solutions;
 - (b) what is the process for system improvements and enhancements; and
 - (c) whether any material IT changes are being planned in the foreseeable future.

Section 7 Ongoing due diligence

- 7.01 After the inclusion of the NPIF in the List of Notified PIFs, the appointed service provider shall carry out the necessary due diligence exercise to ensure that the other service providers and functionaries, the manager, the governing body, founder shareholders and MLRO of the NPIF satisfy the fitness and properness standards expected by the MFSA on an ongoing basis.
- 7.02 As a minimum, the service provider shall verify on an annual basis:
- a) whether the individual/entity has been subject to any conviction or whether the individual/entity has been subject to any civil lawsuit during the past

- year;
- b) whether the individual/entity has been subject to any judgment or decision of any court of law or tribunal or regulatory authority;
 - c) whether there have been any other material developments during the past year which could affect the fitness and properness of the individual/entity;
 - d) whether there have been any new directorships, business interests or regulatory authorisations.

7.03

The service provider shall immediately inform the Authority in case any of the above-mentioned circumstances has occurred and shall notify the Authority of any change in other relevant circumstances as it becomes known to it.

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