MFSA
MALTA FINANCIAL SERVICES AUTHORITY

SUPERVISION

PRIORITIES 2024

Contents

Table of Abbreviations

AIFs	Alternative Investment Funds
AML	Anti-Money Laundering
BRA	Business Risk Assessment
CASP	Crypto Asset Service Providers
CDD	Customer Due Diligence
CEO	Chief Executive Officer
CFT	Combatting the Financing of Terrorism
CRA	Customer Risk Assessment
CRD	Capital Requirements Directive
CSA	Common Supervisory Action
CSP(s)	Company Service Provider(s)
CSRD	Corporate Sustainability Reporting Directive
DLT	Distributed Ledger Technology
DORA	Digital Operational Resilience Act
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
ECEP	European Common Enforcement Priorities
EDD	Enhanced Due Diligence
EMIR	European Market Infrastructure Regulation
ESA(s)	European Supervisory Authority(ies)
ESG	Environment, Social and Corporate Governance
ESMA	European Securities and Markets Authority
EU	European Union
FATF	Financial Action Task Force
FCC	Financial Crime Compliance
FIAU	Financial Intelligence Analysis Unit
GRC	Governance, Risk & Compliance
ICT	Information and Communications Technology
IDD	Insurance Distribution Directive
IFR/IFD	Investment Firm Directive and Regulation
IFRS	International Financial Reporting Standards
LSIs	Less-Significant Institutions
MAR	Market Abuse Regulation

MiCA	Markets in Crypto Assets
MiCAR	Markets in Crypto Assets Regulation
MiFIR	Markets in Financial Instruments Regulation
MFSA	Malta Financial Services Authority
MLRO	Money Laundering Reporting Officer
MSE	Malta Stock Exchange
NCA(s)	National Competent Authority(ies)
POG	Product Oversight Governance
SFDR	Sustainable Finance Disclosure Regulation
SI	Significant Institution
SIRC	Supervisory ICT Risk & Cybersecurity
SREP	Supervisory Review and Evaluation Process
TCSPs	Trustees and Company Service Providers
TUBOR	Trusts Ultimate Beneficial Ownership Register
UCITS	Undertakings for the Collective Investment in Transferable Securities
VFA	Virtual Financial Assets
VFASPs	VFA Service Providers

Overview and Update

The setting of the annual supervisory priorities, and the publication of this document, provide an overview of the main supervisory and regulatory priority areas that have been identified for the upcoming calendar year. This exercise is particularly important to guide decision-making related to prioritisation, transparency, and accountability purposes.

The MFSA's supervisory priorities for 2024 have been identified following careful consideration of the market environment, regulatory developments, the European Union Strategic Priorities, the work programs of the European System of Financial Supervision, recommendations of international standard setters, as well as regulatory and supervisory experience. The supervisory priority areas outlined last year remain paramount to this day, hence the MFSA intends to retain its focus on achieving the six supervisory priorities identified last year, namely Resilience of our Supervised Entities, Sustainable Finance, Digital Finance, Governance Risk & Compliance, Financial Crime Compliance and Consumer Protection & Education. In addition, the MFSA has also identified a new priority for 2024 - namely **cross-border supervision**. Furthermore, the MFSA will enhance the supervisory process from a risk-based approach to one which is based on outcomes, which will be measured along a progression of 3 years.

Figure 1 - Supervisory Priorities for 2024

It is important to note that supervisory priorities outlined in this document should not be considered in isolation, but rather as focus areas of a wider array of work which the Authority will be performing in 2024.

The priorities set out in this document may change during the year as the Authority responds to events. Any such changes will be communicated through further interactions, as may be deemed necessary.

Alignment with MFSA Strategy 2023-2025

The priorities established by this document build on the strategic objectives set out in the MFSA Strategic Statement published in February 2023 and which are the following: (i)delivering agile and proactive regulation; (ii) sustaining a resilient, internationally networked financial sector; (iii) promoting good governance and compliance; (iv) embracing innovation; and (v) engaging with the public.

Whilst the strategic statement identifies the high-level areas on which the Authority is focused to deliver its statutory obligations in line with its mission and vision, this document sets out further detail on the main supervisory and regulatory priority areas for the upcoming years.

Key to this drive are the strategic milestones set by the Authority in its ongoing efforts to increase the level of supervisory effectiveness by, *inter alia*, further strengthening its risk-based model, reviewing supervisory policies, processes and procedures, leveraging on cross-border regulatory convergence and supervisory cooperation, and enhancing the system-wide resilience to operational and financial stability risk.

Structure of Document

This document is divided into three main sections. Section I sets out how the MFSA measures its interactions vis a vis the supervisory priorities it identified for 2023.

Section II outlines the shift from a Risk-based Supervisory approach to a more comprehensive Outcomes-Based Supervisory approach that will be rolled-out within the MFSA in a gradual manner. Initially, this process will be involving three of its supervisory functions as a pilot project and is intended to run for the upcoming 3 years which will include a plan for execution and an eventual assessment of achievements.

The last section, Section III, describes the MFSA's focused priorities for 2024 and explains how the Authority's supervision of each sector will address the supervisory priorities identified.

Section I

Update on Supervisory Priorities 2023

Measurement of the MFSA's Interactions with its Supervised Entities

The supervisory engagement that the MFSA undertakes with its supervised entities is an important tool in the measurement of the achievement of our supervisory priorities. Statistical information is maintained with respect to each identified supervisory priority vis-à-vis the interactions carried out by the respective supervisory functions. These statistics help us to gauge our effort and be able to provide a holistic overview of how its supervisory engagements are tackling the pre-determined supervisory priorities.

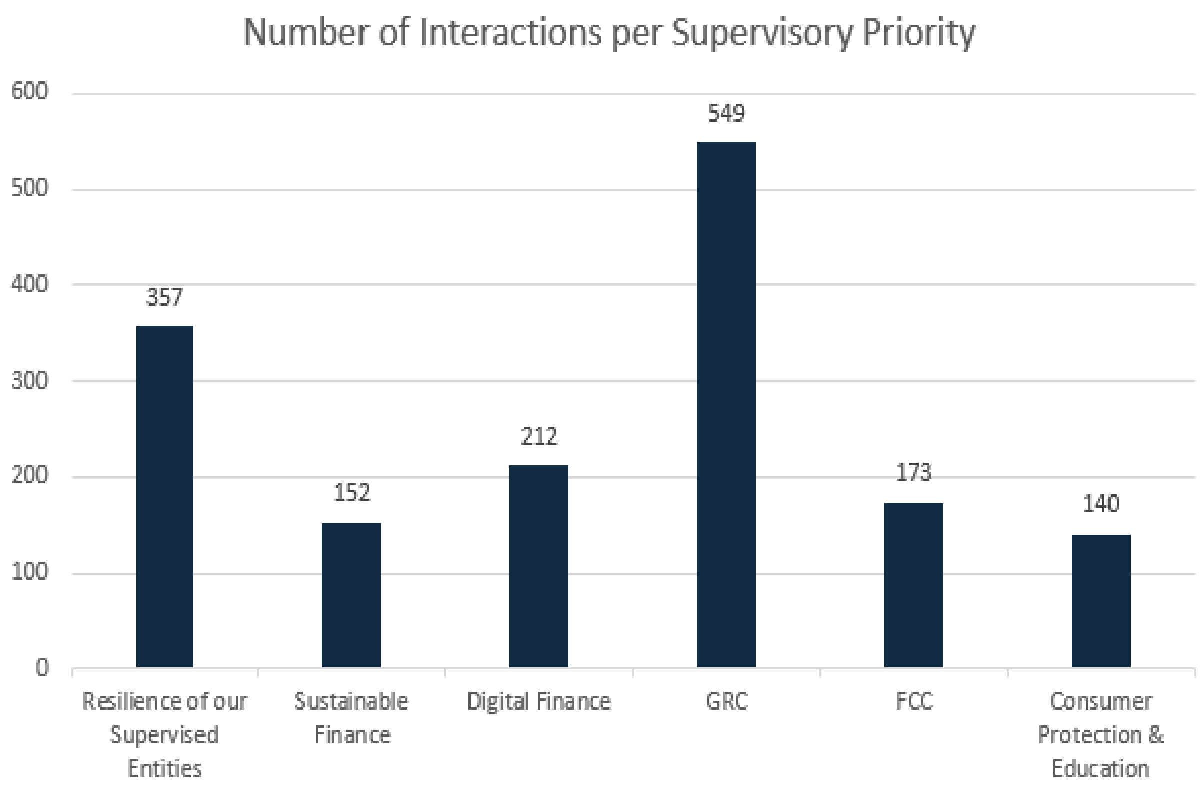


Figure 2 - Graph showing number of interactions conducted per Supervisory Priority

The above diagram, showing data as at 31st December 2023 portrays the number of interactions made by the MFSA utilising a variety of supervisory tools, towards the achievement of 2023 supervisory priorities. The findings of the above interactions were communicated to supervised entities either directly through letters addressed to them or through "Dear CEO Letters" addressed to the industry. During 2023, the focus of the supervisory interactions was specifically centred on the pre-determined Supervisory Priorities with the aim of achieving measurable outcomes with respect to every priority. A number of 'Dear CEO' letters, each having a distinct focus area, were issued to all supervised entities within a particular sector, including those which were not subject to a supervisory interaction with the Authority, in order to highlight any common shortcomings that the Authority would have observed from the interactions and to require all supervised entities in the sector to ensure that measures are in place within their organisations to address these shortcomings, should these also be present. These letters allow the MFSA to fully engage with the industry and bring certain observations to the entire sector's attention.

The findings observed from the interactions are then categorised as per the supervisory priorities identified for the year. This allows for an improved analytical process and enhanced clarity in terms of any internal assessment. From these findings, the MFSA will identify areas of weaknesses and improvement points of each particular sector, extract statistics and conduct effective data analysis which will eventually feed into the outcomes-based supervision for the subsequent years. The diagram below illustrates the supervisory process that will be carried over to the following year.

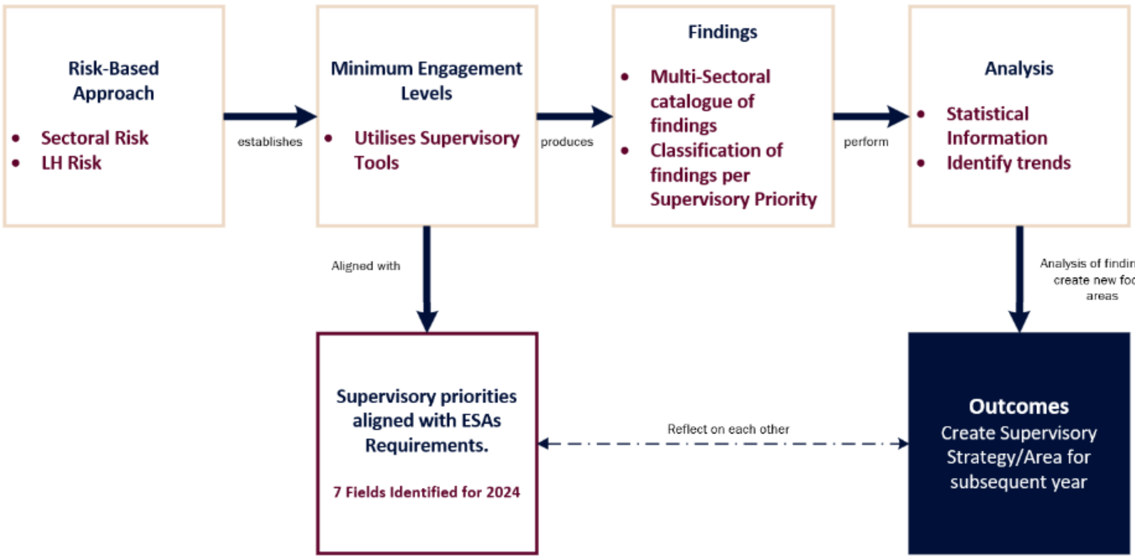


Figure 3 - Outcomes-based transition

The MFSA aims to focus on Outcomes-Based Supervision by maximising the utilisation of established tools to carry out its supervisory interactions. The allocation of such tools is determined through the Risk-Based Approach which identifies a pre-determined yearly number of interactions as Minimum Levels of Engagement. These mainly consist of onsite and offsite Inspections depending on the sector. These tools feed into a multi-sectoral catalogue of findings where the supervisory findings are classified and documented accordingly.

These findings are then analysed for trends and frequency to provide statistical information. From this analysis of findings, the focus areas for an outcomes-based supervisory strategy are established for the subsequent year, and these defined outcomes will form the basis of identification of the next annual supervisory priorities cycle.

Prevalent Findings for 2023

The findings emanating from the supervisory interactions during 2023 also helped to form the basis for the supervisory priorities of 2024.

The findings in the banking sector and financial institutions mainly related to GRC, Resilience of the entities and AML/CFT risk emanating from a governance perspective. With respect to GRC, the findings mostly concerned the governance and improvement of internal controls that are implemented such as the articulation of its risk appetite and how this is followed and implemented throughout the control framework. In general, the findings on GRC were observed when comparing the actual implementation to specific guidelines published by the EBA on governance matters, which include, board composition and oversight, compliance programs, internal audit independence and spread, the risk function and the segregation between these 3 lines of defence. The findings on Financial Institutions were mostly about Safeguarding of clients' funds and the regulatory requirements on separation of own funds. Findings on resilience were mostly on the adequacy and planning of the capital requirements and stress testing.

Similarly in investments and insurance sectors, the most material findings were around aspects of GRC on topics surrounding the effective implementation of policies and procedures established by the licensed entities, adequacy of board composition, the effectiveness of the compliance/risk function and internal audit when analysed against each sector's specific guidelines and regulations.

From an AML/CFT perspective, the major findings emanating from interactions carried out on all the sectors were in general, issues identified with MLRO competency, maintenance of adequate documentation on CDD and EDD, inadequate BRA and CRA carried out, outsourcing and findings on transaction monitoring.

Other findings on digital finance that were identified as part of the operational risk of the supervised entities were related to Access Management, Rights and security monitoring, Classification of loss of data, Change Management, Testing of Business Continuity and robustness of fail-over, inadequate IT audits and insufficient security awareness training.

The major findings emanating from interactions carried out in the Capital Markets in terms of MiFIR and EMIR focused mostly on data quality. The scope of such interactions was generally to discuss with industry the practical issues which investment firms were encountering when it comes to adhering to their reporting obligations.

Regarding supervisory interactions carried out in terms of the MAR, the Authority was pleased to see that investment firms in general were found to be compliant, although enhancement to existing arrangements, systems and procedures was required.

Conduct Supervision has published two Dear CEO letters to the industry. The first was addressed to investment firms and highlighted its expectations in the context of a mystery shopping exercise focussing on client onboarding practices and corresponding investor experience. The most pertinent findings related to the collection of personal information and the suitability and appropriateness self-assessment by clients.

The second Dear CEO letter issued by Conduct Supervision was addressed to the insurance sector and followed thematic work done on the clarity of exclusion clauses in policy wording and POG requirements. The findings from this thematic review revealed that a number of insurance undertakings still had inadequate formal POG arrangements in place or were still in a development stage. Ongoing reviews of insurance products were not carried out as stipulated in the policies and procedures of a number of insurance undertakings. It was also noted that whilst the POG committee minutes capture resolutions and decisions taken by the members, these did not always evidence or contain detail of the discussions and challenges relating to the aspects of the review of the products. In general, insurance undertakings fell short of establishing the criteria and steps adopted in assessing the target market. Furthermore, most insurance undertakings did not carry out product testing or did so with little evidence to show that this task has indeed been undertaken.

The findings in the TCSPs sector were mainly related to GRC and extended to various topics such as the policies and procedures adopted on business continuity plans, internal controls in place, conflicts of interests, record-keeping practices and risk management. Other findings were related to Board of Directors' composition and effectiveness, and the level of detail of minutes kept during board meetings. Findings on the compliance function were also related to the level of documentation kept the entity on compliance checks carried out and the documentation and communication thereof tothe Board of Directors. Lastly, findings were also reported on inaccuracies in the reported beneficial ownership information on the TUBOR in terms of the applicable legislative and regulatory requirements.

With respect to sustainable finance, the main findings were related to conduct supervision, mainly on sustainability preferences. Some of the findings were based on the information to clients about the purpose of sustainability preferences. Proper explanation of critical terminology such as ESG, SFDR and Taxonomy, was not always provided in the necessary detail required. Moreover, some findings related to the collection of information from clients on their sustainability preferences. In certain instances, some entities did not adopt a neutral and unbiased approach to not influence the clients' sustainable preferences. Other findings indicated the lack of attention to organisational requirements where some policies did not outline staff training on sustainability topics and the corresponding record keeping of such training.

Section II

Outcomes-Based Supervision

Introduction

Outcomes-based supervision is the **focus on the intended results** from supervisory practices and deriving an efficient way to achieve them, to maintain the three goals of financial regulation; Consumer Protection, Financial Stability and Market Integrity.

This concept builds on the MFSA's Risk-Based Approach, where the most significant supervised entities, those with the ability to have the greatest impact on financial stability and the consumer, get a higher level of attention under structured supervisory interaction plans guided by the principle of proportionality. The focus is narrowed down on the findings, prioritising the tangible elements from the interactions. The risk-based considerations are an integral part of this process to establish minimum engagement levels and will be a part of the initial phase which will determine the selection of the supervised entities.

The main focus of outcomes-based supervision will be on the results, or outcomes, of such interactions and how the findings can be grouped and analysed to find 'systemic' problems in a particular sector. The MFSA intends to utilise this approach to respond to industry concerns about excessive regulation and to highlight that risk-based supervision would enhance supervisory effectiveness rather than increase burdens.

Setting the Context for Outcomes-Based Supervision

a) In establishing a set of outcomes the quantification of such outcomes will be critical. These should result from **strengthened data quality and data capacity**. Adjusting the Management Information process in terms of the pre-set outcomes is an effective way to harmonise the supervisor's efforts with its objectives.

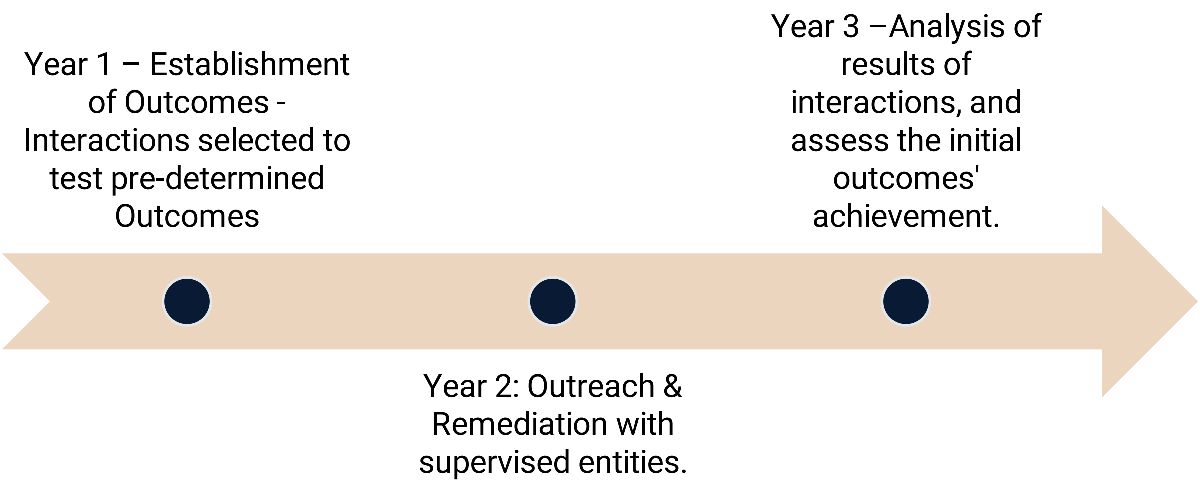
b) The supervisory findings are the most essential part of a supervisory inspection, since they offer an indication as to **what needs to be improved** with respect to the entity. A concrete set of outcomes allows the regulator to act on the results/findings more effectively and promptly.

c) Legitimate outcomes-based supervision requires **optimal transparency** due to the strong emphasis on **tangible outcomes**. A high degree of transparency results in higher levels of accountability.

d) Outcomes-Based Supervision strives to **minimise ambiguity and promote pro-activeness**. Having defined targets helps the MFSA to effectively narrow down on its focus points and promote good practice in the financial services industry.

e) Based on the supervisory findings the MFSA opts to **materialise the focus areas** of current year in order to enhance the industry's improvements in the subsequent year, in a **measurable and effective** way.

Pilot Project & Timelines



In the first year, the desired supervisory outcomes will be identified based on the findings of the Authority's supervisory interactions during the previous year. Supervisory Interactions for the subsequent year are chosen to measure the attainment of those outcomes. In the second year, the MFSA will conduct outreach with supervised entities to remediate the findings. These consist of training, conferences, "Dear CEO" Letters and follow-ups. At the end of the third year, the Findings emanating from these interactions will be used to measure the achievement of those outcomes in the specific sector.

At this stage, the Authority will be conducting a pilot project on three of its supervisory functions namely, FinTech Supervision (which supervise VFASPs and FIs), Supervisory ICT Risk & Cybersecurity, and specifically on TUBOR of Trustees & Corporate Service Providers. The aim is to eventually roll out this Outcomes-Based approach for all the supervisory functions, in order to achieve a harmonised approach.

The following section will delve into the technical details applicable to the abovementioned supervisory functions in order for these to carry out outcomes-based supervision in line with the supervisory priorities that are prevalent in their specific areas.

FinTech Supervision – Outcomes-Based Supervision

The Fintech Supervision Function will be piloting an outcomes-based supervisory approach from 2024 till 2026 for both sectors that fall within its mandate, namely financial institutions and VFASPs. The assessments described hereunder will be applied to both sectors simultaneously against the respective sectors' rules and regulations. Four key supervisory outcomes have been identified on the basis of various previous supervisory engagements and through the feedback gained in terms of reporting and information provided by the supervised entities. Furthermore, these supervisory outcomes are also aligned with the supervisory priorities primarily

Digital Finance, GRC, Cross-border Supervision, Resilience and Consumer Protection that the Authority has established to ensure a consistent approach to supervision. The assessment of such would typically be carried out utilising a variety of supervisory tools using a risk-based approach, including, but not limited to Thematic Reviews, Supervisory Meetings, Supervisory Inspections (onsite and offsite), or other desk-top reviews as necessary.

The four supervisory outcomes which will form the focus of the Outcomes Based Supervisory plan are the following:

1. Adequate arrangements relating to Safeguarding/Safekeeping of Assets;
2. Adequate Governance arrangements and Compliance with Passporting Rules;
3. Strong Business Resilience; and
4. Sufficient MiCA Preparedness.

Outcome 1: Adequate Arrangements relating to Safeguarding/Safekeeping of Assets

Through the supervisory outcome of safeguarding/safekeeping of assets, the Authority will seek to identify any shortcomings that licence holders in these two sectors have in terms of adequate protection of client monies through appropriate segregation of clients' accounts, periodic reconciliation of client assets, correct designation of bank accounts /wallets so as to ensure safeguarding, evaluation of who is controlling the client accounts/wallets and the procedures in place for safeguarding of client assets. This supervisory outcome will support the supervisory priority of Consumer Protection & Education especially since safeguarding/safekeeping is paramount to consumer protection.

Outcome 2: Adequate Governance Arrangements and Compliance with Passporting Rules

The supervisory outcome of **Governance and compliance with Passporting rules** is two-fold and will tackle the supervisory priority of GRC and Cross Border Supervision.

In terms of Governance, the Authority intends to assess the system of rules, practices, and processes by which a supervised entity is directed and controlled. In view of the heavy dependence on technological infrastructures of both FI and VFA Sectors, the Authority will also assess the licence holders' ICT governance in terms of management of ICT platforms, outsourcing arrangements, access rights in terms of data, and the identification of the relevant personnel responsible for certain key decisions, amongst others. This exercise will assess whether the Board of Directors, or selected Directors, have adequate awareness and knowledge of the platforms being used by the licence holders and that any resulting risks are being appropriately mitigated.

Furthermore, the Authority will be taking stock of the activities of supervised entities which are being provided in foreign jurisdictions and assess compliance with the relevant regulatory frameworks. The Authority will also continue to cooperate with various other National Competent Authorities including providing information when requested.

Outcome 3: Strong Business Resilience

The Authority will seek to assess the business resilience of its supervised entities and the Board of Directors' strategic actions to improve the Company's capacity to identify and mitigate risks emanating from economic pressures and/or unplanned changes that could threaten its operations, people, assets, brand, or reputation. Through this outcome, the Authority will assess the efficacy of licence holders to identify and plan for changing market conditions, maintain financial discipline, explore additional/alternative markets to generate further revenue streams, and implement enhancements in systems and internal controls, amongst others. Furthermore, the Authority will engage with licence holders that have been incurring operational losses over recent years and assess if these supervised entities have adequate plans in place to improve their profitability.

Outcome 4: Sufficient MiCA Preparedness

The Authority will assess the readiness and efforts of the current population of VFASPs to become authorised as CASPs under MiCAR. Fintech Supervision will be providing industry guidance as needed. Through this outcome, the Authority will assess the transitional journey in general, and measure progress against plans in particular.

Supervisory ICT Risk & Cybersecurity – Outcomes-Based Supervision

The supervision of ICT Risk & Cybersecurity is cross-sectoral and has an impact on all the supervised entities in various ways. The choice of outcomes selected in this area targets a number of supervisory priorities other than Digital Finance itself. Although specific to ICT risk the outcomes specified hereunder also target the GRC aspect and Resilience albeit from an operational ICT perspective.

The four supervisory outcomes which will form the focus of the Outcomes Based Supervisory plan for Supervisory ICT Risk & Cybersecurity Supervision are the following:

1. Sufficient DORA Preparedness;
2. Implementation of Strong Risk Management and Compliance Functions;
3. Adequate Incident Management Processes; and

4. Satisfactory Status of Third Party Providers.

The assessment of such would typically be carried out through a variety of supervisory tools using a risk-based approach, including, but not limited to ICT Risk Questionnaires, Thematic Reviews, Supervisory Meetings and Supervisory Inspections unless specified otherwise.

<u>Outcome 1: Sufficient DORA Preparedness</u>

Further to the Circular published on 5 September 2023, titled Update and Benchmarking Exercise on Regulation (EU) 2022/2554 on Digital Operational Resilience, the aim of the DORA Preparedness supervisory outcome is to engage with supervised entities on their preparations to comply with Regulation (EU) 2022/2554 and Amending Directive (EU) 2022/2556 (the "DORA Regulation") by 17 January 2025. Through this outcome, the Authority will be assessing Licence Holders' preparations in ensuring legal adherence to DORA before it comes into effect.
The inspection reports emanating from these assessments will continue to reference the relevant DORA provisions for guidance purposes.

<u>Outcome 2: Implementation of Strong Risk Management and Compliance Functions</u>

The Authority will seek to assess the Risk Management and Compliance Function (2^{nd} line of defence) within the supervised entity, in relation to ICT Risk and Cybersecurity. Enabled through the innovative transformation of products and solutions constantly marketed, the Cybersecurity controls that supervised entities have in place should be rigorously checked and tested to ensure that the internal documentation is in line with regulatory and legal obligations and reflected in their implementation. The Authority will be assessing the supervised entity on its ability to translate legal obligations into internal policies & procedures whilst ensuring a satisfactory level of effective control implementation across the organisation. This includes the assessment of controls implemented on its third-party service providers and the inclusion of the necessary

DORA preparedness considerations such maintaining an updated Risk Register which identifies, measures, and maintains ICT and cybersecurity risk.

Outcome 3: Adequate Incident Management Processes

In this outcome, the Authority will assess supervised entities' preparedness against cybersecurity risks that may threaten its confidentiality, integrity, and availability of its ICTs. In its assessment, the Authority seeks to ensure that at least, the entity adequately manages its incident management policies, procedures, tools, and resources including timely detection, reporting, and escalation. It remains of paramount importance that services towards customers remain uninterrupted. Equally critical is the development and testing of comprehensive incident response strategies, including Business Continuity Plans, Crisis Management Procedures, and Recovery Plans. Thus, this outcome will gauge the supervised entity's level of preparedness towards ICT Incidents as required in sector-specific Guidelines, including its plans to adhere to the relevant DORA provisions. The Authority also requires transparent incident reporting. Supervised Entities must therefore provide detailed and timely reports to foster collaborative defence against cyber threats, thus reinforcing the financial sector's integrity. In addition to the typical supervisory tools, the Authority will be introducing a new Cyber Resilience Exercise to assess the above.

Outcome 4: Satisfactory Status of Third-Party Providers

One of the most recurring shortcomings that the SIRC function has noticed in its 2023 engagements relates to the proper interpretation of what constitutes an ICT Outsourcing Arrangement. This is also noticeable from the number of queries addressed to the Authority in this regard. Through this Outcome, the Authority will be assessing the interpretation and implementation of the current applicable Acts, Regulations, Rules and/or sector-specific Guidelines on ICT Outsourcing Arrangements. This will also be analysed from the perspective of a gap analysis of the supervised entities' outsourcing arrangements against DORA provisions, identified corresponding risks, and the state of the necessary negotiations with the service providers that this entails to bring the alignment with the DORA Regulation when it becomes applicable. The aim of this assessment will check, the retention and upkeep of registers of information on ICT Outsourcing Arrangements, the proper conduct of risk assessments stemming from ICT Third-Party Providers, the implementation of proportionate controls and risk management, the implementation of proper oversight and sound governance measures, the proper implementation of information security measures, the proper retention of satisfactory written contractual arrangements, and the proper retention of exit strategies.

Trustees & Corporate Service Providers Supervision – Outcomes-Based Supervision

The importance of the AML/CFT element in this sector, and in particular the focus on availability of accurate and up to date beneficial ownership information, is also amplified through developments occurring at EU level. These include the proposed amendments to the AML Directive and Regulation and the ongoing efforts on the interconnection of EU beneficial ownership registers, as well as the changes made by the FATF to Recommendations 24 and 25 relating to Beneficial Ownership and Transparency of Legal Persons and Legal Arrangements. Preparedness of the sector is therefore key to ensuring that Malta can comply with its international commitments, and the developments in this area.

For this reason, the Authority will continue to ensure that the register contains accurate and up to date information, through supervisory interactions focusing on verification of reported beneficial ownership information of trusts, its desk-top reviews of submissions, as well as enhancements to the TUBOR platform to enable more efficient inputting of data. The Authority will also be involved in the effective transposition and implementation of any changes introduced to the international requirements and standards and will therefore also be engaging in outreach and awareness-raising activities with the industry to ensure as seamless a transition as possible.

These changes will impact the legislative and regulatory frameworks applicable to beneficial ownership registers in Malta, including the TUBOR that is maintained by the MFSA, and which all trustees are required to comply with in this regard.

In this respect the TCSPs Supervision Function enhance its supervisory approach to the verification of reported beneficial ownership information of trusts on TUBOR by also focussing more on an outcomes-based approach in this regard.

The key components relating to beneficial ownership rules relate to availability of beneficial ownership information which is (i) accurate and (ii) up to date. For this reason, the key supervisory outcomes of this workstream, also on the basis of experience from previous supervisory engagements on this subject matter, are the following:

1. Accurately Reported Beneficial Ownership Information of trusts.
2. Timely Reporting and Updating of beneficial ownership information of trusts.

The assessment will primarily be carried out through Supervisory Inspections to verify the reported beneficial ownership information of trusts on TUBOR, against the information and documentation held on file by trustees. This complements the initial consistency high-level desk-based reviews which are carried out by the TCSPs Supervision Function upon every submission of a new trust or updating of beneficial ownership of already reported trusts.

The Authority intends to publish aggregated findings from supervisory interactions and desktop reviews carried out between 2021 and 2023, in order to point out the major shortcomings identified and to clarify its expectations in this regard. Moreover, the Authority also intends to conduct industry outreach to further elaborate on these findings and expectations, with a view to improve the industry's understanding of the applicable requirements, as well as ensuring preparedness for upcoming changes to the legislative framework which will be driven by the imminent changes to the international standards.

Outcome 1 – Accurately Reported Beneficial Ownership Information of Trusts

Since the coming into force of the legislation governing the reporting of trusts beneficial ownership information and the launch of TUBOR the MFSA has issued guidance on various occasions to assist trustees in ensuring that reported beneficial ownership information is accurate, and therefore to clarify the MFSA's expectations in this regard. Nevertheless, the Authority still notes that there are instances where trustees are not reporting beneficial ownership information of trusts to the expected level of accuracy. Therefore the aim is to assess whether, following the issuance of the above-mentioned additional guidance and outreach, supervisory engagements will result in a marked decrease in the number of findings relating to inaccurate reporting of beneficial ownership information.

Outcome 2 – Timely Reporting and Updating of beneficial ownership information of trusts

Another common finding identified both through supervisory interactions as well as through desk-top reviews of submissions of beneficial ownership information relates to lack of timely reporting or lack of timely updating of beneficial ownership information when changes are recorded by the trustee. Whilst the applicable legislative framework clearly sets out that beneficial ownership information of trusts should be reported within 14 days from the trustee being appointed as such, and any changes thereto are also to be reported within the same timeframe, the Authority has nonetheless encountered instances where, for example, trustees misinterpret the trigger for reporting or updating of beneficial ownership information. This results in the data on

TUBOR not being kept up-to date, as required by the applicable legislative framework and international standards, which in turn may lead to instances where other competent authorities having access to such information would not have an accurate picture of the beneficial ownership structure of the trust in question.

In this regard the assessment will also be analysing whether the MFSA's increased efforts on issuance of guidance and outreach activities will also result in a marked progress relating to timely reporting and updating of beneficial ownership information of trusts.

Section III

Focused Supervisory Priorities 2024

Overview of 2024 Work Programme of the Joint Committee of the ESAs

Sustainable Finance

In 2024, the ESA's Joint Committee will provide more guidance on sustainability disclosures under the SFDR and the Taxonomy Regulation. The ESAs are striving to develop draft Implementing Technical Standards on marketing information under Article 13 SFDR. The ESAs will also contribute towards EC's upcoming comprehensive re-assessment of the SFDR and will also carry out activities on climate risk stress testing, such as running a one-off system wide climate risk stress test and develop Guidelines on ESG stress testing.

Moreover, by May 2024, the ESAs will build on the progress reports submitted during 2023 to deliver their final reports to the Commission on various aspects of greenwashing and its related risks as well as on the implementation, supervision and enforcement of sustainable finance policies aimed at preventing greenwashing further to a specific request made by the European Commission to the ESAs in this regard.

Digital Finance

The ESAs Joint Committee will continue its efforts on the EC's Digital Finance Package, focusing on delivering the legal mandates, promoting supervisory convergence, and preparing for its involvement in the oversight activities under the DORA. During 2024, the Joint Committee will strive to deliver DORA-related policy mandates. In parallel, the ESAs will work together on DORA provisions to be ready for the implementation of the framework by 2025: the EU-wide Oversight Framework of ICT Critical Third-Party Providers. The ESAs will also focus on cooperation mechanisms on the development of a framework on EU systemic cyber incident (EU-SCICF) and promoting supervisory convergence. Finally, the ESAs will develop the necessary IT systems to support the direct DORA oversight tasks.

Consumer Protection and Financial Innovation

The ESAs will hold workshops on different topics such as digitalisation, sustainable finance and risks of crypto-assets, to exchange lessons learned and to exchange information among NCAs. The workshops will also identify any relevant initiatives developed at NCAs level such as, factsheets and infographics, that could be shared by the ESAs amongst other NCAs with a view to promote further consumer education and financial literacy. Furthermore, the ESAs may consider identifying key steps that NCAs may put in place to measure the impact of financial education initiatives on consumers.

Risk Assessment

The ESAs will assess key trends and vulnerabilities to financial stability and continue to produce, on top of their respective sectoral risk reports, a cross-sectoral analysis.

EBA - European Supervisory Examination Programme (ESEP)

EBA Identified two priorities of Union-wide relevance with a forward-looking view on developments and trends for the 2023-25 period are:

1) Monitoring and addressing financial stability and sustainability in a context of increased interest rates and;
2) Developing an oversight and supervisory capacity for DORA and MiCAR.

For 2024, the supervisory areas which require consistent focus in the EU and the implementation of respective policy requirements are asset and liability management (ALM), with a special attention on:

1) Liquidity and funding risk;
2) Interest rate risk; and
3) Recovery operationalisation.

Cross Border Supervision

Given the importance of the provision of investment services across the EU under MiFID II, and concerns that emerged in the past on instances of cross-border activities provided in detriment to investors' interests, cross-border activities remain an important item on the agenda of the ESAs especially ESMA. Effective supervision of investment services provided on a cross-border basis is of key importance to ensure that investors in any jurisdiction across the EU are given the adequate level of protection, regardless of the jurisdiction of origin of the entities offering these services. Similarly, passporting rights remain an important aspect within the EU and continue to be monitored for the observance of rules on the freedom to provide services for credit institutions and financial institutions within the EU. In the insurance sector, the IDD has sought to harmonise how insurance is distributed to consumers, yet the insurance distribution market remains diverse and widely fragmented. However, it is still important to ensure that policyholders are given an adequate level of protection irrespective of the jurisdiction where their insurance provider is situated.

Sectoral Supervisory Priorities

The supervisory priorities in focus for 2024 were identified from past interactions carried out by the Authority as well as the supervisory priorities identified by each ESA. Each financial services sector may take a different approach on the implementation of such priorities and may focus on certain priorities rather than others, depending on, for example, market conditions, risk areas, sector specific operating environment etc. This section provides an insight into the Authority's planned work on the Supervisory Priorities per financial sector with the exception of FIs and VFASPs for which an outcomes-based approach will apply as described in a previous section.

		Supervisory Priorities						
		Resilience of our Supervised Entities	Sustainable Finance	Digital Finance	GRC	FCC	Consumer Protection & Education	Cross-Border Supervision
Financial Sectors	Credit Institutions	✓	✓	✓	✓	✓	✓	✓
	Capital Markets	✓	✓	✓	✓			✓
	Insurance & Pensions	✓	✓	✓	✓	✓	✓	✓
	Investments & Securities	✓	✓	✓	✓	✓	✓	✓
	Trustees & Company Service Providers				✓	✓		
	AML/CFT	Cross-Sectoral						
	Conduct	Cross-Sectoral						

Figure 4 - Alignment between sectors and supervisory priorities

Credit Institutions

The Authority will aim to continue steering banks' board members and their general practices towards optimal governance frameworks, taking into account for example, board diversity in line with the requirements in Banking Rule 24 which focuses specifically on the internal governance arrangements and processes that banks must implement to ensure their effective and prudential management. Governance arrangements as well as AML controls including interviews with MLROs are extensively analysed during supervisory interactions with the banks and integrated in SREP.

During 2024, the Authority will assess the replies provided by the LSI banks on the self-assessment questionnaire on the preparedness in relation to ESG risk. The banks would be required to provide a plan on how they plan to mitigate the gaps identified.

Similarly, the SI banks have been subjected to a thematic review by the ECB and in 2024 they are expected to continue to follow-up on any gaps identified.

The resilience of business models of all banks will continue to be monitored. The focus will be on the arrangements put in place by the banks to monitor their credit risk and capital adequacy in accordance with regulatory requirements. The banks' stress testing design and scenarios will also be a focal point and the basis of the P2G calibration framework. Moreover, the potential impact brought about by the revised regulations, namely the CRR3/CRD6 risk weights on bank's business model and implications on capital following the revamp of BR09 will also be considered.

Furthermore, the assessment of the replies received from the LSIs following an ECB IT SREP questionnaire, will be carried out and analysed to gauge best practices, areas of concern as well as to enable the Authority to benchmark vis-à-vis peers.

The Authority will continue to coordinate with other NCAs on cross-border supervision for the purpose of supervising banks having branches and subsidiaries within the Group in other countries. Furthermore, more work has also been done at EU level to harmonise reporting and supervision of branches – including third country branches.

Capital Markets

The Authority will continue to focus on the resilience of applicants when reviewing applications for admissibility to listing of securities on the Malta Stock Exchange as well as disclosures related to sustainability. During 2024, the Authority will continue to provide guidance to ensure compliance on the implementation of changes required arising from the final publication of the Listing Package and MiFIR Refit.

Ongoing market monitoring continues to be important for the Authority to ensure that market participants have effective GRC controls in place which allow them to adapt to a constantly changing environment, whilst preventing and detecting market abuse as required by MAR.

The Authority will also continue working on ESMA's ECEP of the 2023 Annual Financial Reports ('Public Statement') mainly focusing on:

1. Climate-related matters and the importance of issuers and auditors to consider material climate-related risks in line with the IFRS financial statements;
2. The macroeconomic environment - the Authority in line with the Public Statement will continue to emphasise the importance of disclosures related to rising interest rates, liquidity risk, hedge accounting, fair value of investment properties and financial instruments. The priorities in relation to non-financial statements for the 2023 AFRs which will be reported in 2024, includes disclosures on climate-related information, since the enhanced disclosure regime in CSRD is nearing implementation. The MFSA will continue following Sustainable Finance developments, in particular the transposition and the implementation of the CSRD.

Furthermore, the Authority will continue to monitor the implementation of Article 8 of the Taxonomy Regulation and the relevant Delegated Acts by listed entities. The MFSA will also continue to collaborate with the relevant national and international stakeholders to enhance sustainable investments.

Moreover, the Authority will continue to monitor the financial soundness of listed entities and issuers' transparency with the market including updating investors with any material changes in their financial position and material impact on their business. It is the Authority's priority to continue to maintain an open dialogue with listed entities on the challenges ahead.

On digital finance, the Authority will focus on technology enabling systems and market structures. Two areas that are being explored are crowdfunding platforms and DLT market structures seeking exemption under the DLT Pilot Regime. The Authority believes that such novel practices may allow for a better service to all stakeholders involved in the process, lower costs to raise capital, easier access to funds for project owners, and a broader spectrum of investment opportunities for investors. During 2024, the Authority will continue to take an active role in discussions held at ESMA and will focus on the impact of new technologies, automation, artificial intelligence, and machine learning on financial markets. The MFSA is also committed to continue engaging with the use of SupTech tools in order to ensure efficiency in its supervision.

Insurance and Pensions

The Authority will continue to assess the Insurance and Pensions sector for effectiveness of Governance, Risk and Compliance. It will closely monitor the entities via a combination of desk-based reviews and focused compliance inspections especially focusing on the effectiveness of governance arrangements, maturity of the implementation of their Risk Management System and Risk Management Function in particular and will measure against applicable legislation and the Authority's expectations as communicated to the industry. In particular, the Authority will communicate clearer expectations to the market with regards to:

- the role of the compliance officers and the implementation of effective compliance monitoring; and
- the role of independent non-executive directors including their oversight role responsibilities.

As part of its ongoing prudential supervision on AML/CFT monitoring, supervisory interactions will continue to be undertaken either in close collaboration with the Authority's specialised function or through other means delivered by the personnel within the respective function. Nonetheless, the aim is to continue to identify any potential red-flags and weaknesses to combat AML/CFT risk.

The Authority will assess the undertaking's strategy in relation to ESG and sustainable finance at application stage. It will continue to increase supervisory work in the area of ESG via:

- desk-based reviews which include review of various documentation, websites, public disclosures as well as how undertakings are effectively monitoring climate-related risks and ensuring a sustainable business model in this regard; and
- compliance inspections which include further probing as to the how ESG is being integrated within the culture of license holders, whether the Board of Directors and shareholders are setting the right tone at the top, how license holders are aligning themselves with the sustainable finance legislation and objectives, the progress being made in their journey to transition to green.

The Authority will continue to participate actively in working groups and fora on sustainable finance and greenwashing in international fora on insurance and will continue to communicate any new developments in this area with the market, also expressing the Authority's expectations. The Authority will also engage with the market to collate general information on sustainability.

Throughout 2024, the sector will continue to be monitored for resilience by maintaining ongoing reviews of financial returns and monitor financial stresses particularly to those relating to the current economic climate, as well as to monitor closely the financial strength and soundness of shareholders of supervised entities by adopting a risk-based approach. The Authority will also perform desk-based reviews, inspections and supervisory meetings focusing on the areas relating to claims reserving, reinsurance arrangements interconnectedness and contagion risk particularly those stemming from intra-group transactions and arrangements.

The Authority will closely monitor Cross-border business conducted by license holders via the review of financials and other documentation as well as focused compliance inspections. Furthermore, the Authority will continue to review of delegated authority agreements entered into with intermediaries operating in other jurisdictions, requesting information adopting a risk-based approach. The Authority will continue to monitor closely the knowledge and experience of supervised entities writing business in other jurisdictions to identify whether they are able to understand the risks and local specificities of the markets they distribute their products in.

Investments and Securities

In the investment management sector, resilience will be monitored by the Authority by focusing on liquidity risk management, the applicability of liquidity management tools and liquidity stress testing. This will include a determination on the manner by which the rise in interest rates, increase in general product costs, inflation, and delay in project deliverables in the case of venture capital and private equity funds, are assessed to determine any liquidity mismatch between the asset and liability side of a fund. This will be assessed against the ESMA Guidelines on liquidity stress testing in UCITS and AIFs and will be assessed as part of the investment management process streamlined thematics, targeting fund managers and self-managed funds. These thematics will also indirectly delve into the areas of the valuation function and related policies and procedures depending on the nature of the assets within the fund portfolio.

Inspections will also be carried out to assess the robustness of the business models and governance structures of licensed investment services providers, focusing mainly on the adequacy of their operational set-up, safeguarding and segregation of client assets and monies, cash flow and investment restriction monitoring in the area of fund depositaries. Moreover, the Authority will carry out reviews on due diligence service providers in the context of the Notified Professional Investor Fund regime, once the framework is implemented together with the ongoing reviews on the net asset value calculation process of recognised fund administrators.

In view of the importance of capital adequacy, the Authority will continue to monitor the capital of fund managers to ensure that it is sufficient to capture *inter alia* market and operational risks.

The Cross-border presence is evaluated consistently when determining the risk rating of investment services licence holders and the oversight on cross-border operations will continue to be assessed during ongoing interactions.

During 2024 the Authority will continue to assess the adequacy of the governance structures and the effectiveness of control functions, including the compliance, risk management and Anti-Money Laundering through onsite inspections and off-site supervisory engagements of Investment Firms.

Moreover, continued focus on the compliance of Investment Firms with the IFR and IFD, by carrying out desk-based reviews of the financial information and documentation submitted, including the internal capital adequacy risk assessment process, the applicability of Pillar 2 add-ons, the reporting and disclosure requirements and recovery plans which will tie into the new SREP requirements.

In 2024, the Authority will intensify its focus on sustainable finance and evaluating compliance with SFDR, Taxonomy, and relevant delegated acts. The CSA on sustainability risks and disclosures will continue and fund managers will be guided towards more robust and transparent reporting practices. Stakeholder engagement will remain crucial, informing our supervisory practices and realities. Expectations regarding prospectus disclosure, periodic reporting, and broader sustainable finance considerations will be elevated in 2024. Furthermore, the Authority will augment the coverage of sustainable finance in onsite visits, deepening its understanding of how supervised entities integrate sustainability principles into their day-to-day operations.

The Authority will continue to monitor any upcoming developments in the area of digital finance through participation in ESA committees and how such developments could impact the regulatory responsibilities of investment funds and investment firms.

Trustees and Company Service Providers

Throughout 2024 the Authority intends to continue assessing CSPs on their risk management framework. For both trustees and CSPs it also intends to focus on ensuring having in place a robust compliance function, including having effective compliance programs in place and verifying the adequacy of any remedial action required. These assessments will be undertaken with a view to eventually also issue further guidance on its expectations, having taken into consideration any observed trends and lessons learnt.

TCSPs are deemed to be gatekeepers to Malta's financial system, and therefore AML/CFT and Financial Crime considerations play a crucial role in the supervision of TCSPs. For this reason, the Authority will continue to work hand in hand with other competent authorities to ensure a holistic approach to its supervision. The approach of recent years to integrate an AML/CFT element in its engagements with the TCSP industry will be maintained, both through in-depth analysis of proposed MLROs within TCSPs, and also through engagement with MLROs already in office, to ensure that a sound AML function is in place. Through exchange of information about the outcomes of these engagements with other competent authorities, it can be ensured that the TCSP sector has in place adequate systems and controls to appropriately fulfil its gatekeeper role.

Cross-Sectoral Supervisory Priorities

Financial Crime Compliance

Money Laundering, the Financing of Terrorism, Proliferation Financing, Sanctions Evasion, and other financial crimes continue to threaten society and the financial system upon which it heavily depends. Cooperating with other competent authorities to prevent, detect and deter financial crime remains a priority for the MFSA in order to protect the diverse financial sector's integrity and its long-term sustainability.

The MFSA's effectiveness is dependent on the constant development of the local legislative framework. The Authority will prioritise the updating of legislation and regulations and strives to adhere to international standards and will continue to abide by EU-level guidelines and contribute to foreign/domestic policy discussions. Frequent discussions will continue to be held between the MFSA, the FIAU and other competent authorities and bodies in this regard.

The MFSA will prioritise its resources by implementing a risk-based approach and will continue to work very closely with the FIAU. This is of explicit importance in the financial crime compliance context where certain risks may translate into significant harm to the jurisdiction. Hence, the Authority's activities will be driven by, inter alia, the consideration of the recently revised National Risk Assessment as part of its ongoing supervision. The MFSA will continue to identify emerging financial crime risks and function as a key stakeholder in further assessments. Furthermore, the Authority will continue to include an AML element across all the financial sector during its interactions with the supervised entities.

Financial inclusion and the sector's responsible growth is an important element which the MFSA strives to facilitate. The MFSA will prioritise streamlining supervisory efforts to facilitate the sector's growth while continuing to raise compliance standards, supervision, regulation, and enforcement.

Conduct Supervision

Protecting consumers remains a key strategic objective of the MFSA and has been a recurrent theme of focus of the Supervisory Priorities for a number of successive years. In its application, Conduct Supervision is also aligned with the other supervisory priorities and applies each theme from a conduct perspective.

During 2024 the Authority will continue to monitor sustainable finance adherence to the pre- contractual, product and website disclosures which are required in terms of the SFDR and its implementing measures and will focus its supervisory interactions to ensure adherence to the relevant sustainable finance–related requirements. In 2024, the Authority will also be launching new conduct-related returns whereby supervised entities will be required to report additional information relating to their obligations emanating from the **SFDR** and to marketing initiatives having ESG elements. Greenwashing will also be tackled as part of Conduct Supervision' supervisory work, with specific focus on products being marketed as being green.

During 2024, the Authority will continue to look at the processes of banks providing online services to customers with a view to assess the consumer experience in this regard. From an investment services perspective, the Authority will continue to closely monitor the activities of online trading platforms whilst in the context of insurance, the digital aspect of the regulated entities' business will also be looked at during supervisory engagements.

Throughout its supervisory engagements with its regulated entities, the Authority will be also analysing whether consumer-facing practices being adopted by regulated entities in response to the prevailing scenario of increasing inflation and changing economic environment are adequate.

The cross-border activities of supervised entities bring about specific conduct risks and create additional challenges for effective supervision. The Authority collects specific data from its supervised entities relating to their cross-border activity, so that it can monitor such activities more effectively. This includes data relating to, inter alia, the jurisdictions in which the services are provided, the type(s) and number of clients involved, the type(s) of activities and services provided, the instruments involved, and complaints received.

In the context of investment firms, the Authority will continue to request additional information on cross-border activities where it considers necessary via ad-hoc reports or through other supervisory interactions to ensure that these firms' cross-border activities are carried out in compliance with applicable rules.

On insurance undertakings, the Authority will focus on the value for money of products including those that are manufactured by locally authorised insurance undertakings, and which are sold to clients in other Member States on a cross-border basis. This exercise will aim to ensure that the products manufactured by these insurance undertakings provide the cover expected from policyholders vis-à-vis the premium paid.

On credit institutions, the Authority aims to assess the manner in which these calculate the APR for their credit products. This exercise will also cover retail credit institutions which provide such products to customers outside Malta, on a cross-border basis and will serve to ensure that the correct APR is disclosed to clients and potential clients.

Marketing communications issued by local licence holders targeting cross-border clients is also closely monitored and the Authority utilises specific tools in this regard.

In the context of Conduct Supervision, it is important that supervised entities set a tone from the top with respect to the fair and professional treatment of their customers in order to ensure that, they act in the best interests of consumers. Therefore, during its supervisory interactions, the Authority will also assess the effectiveness of the compliance function from a conduct perspective. In this regard, the Authority expects that compliance officers monitor the activities of regulated entities also from a conduct perspective to ensure compliance with the applicable requirements relating to conduct of business.

Finally, the Authority firmly believes that a knowledgeable consumer is an empowered consumer who can take responsible financial decisions thereby increasing trust in the financial system. In this regard, the Authority will be actively reaching out to the society at large with a view to raising awareness about various important topics and issues relating to financial matters, such as Greenwashing, investment in bonds and other securities and online scams. In particular, the intention is for the Authority to increase its initiatives in this regard to reach a wider audience and impart its information in a more effective manner.

Conclusion

This document provides an overview of the focused supervisory priorities set for 2024, as well as a summary of the MFSA's prevalent findings from the supervisory interactions carried out in 2023. The document also provides an overview of the 2024 focus areas being prioritised in the European landscape.

In this document, the MFSA further explains its outcomes-based approach to supervisory engagement and its regulatory and supervisory toolkit. While the document aims to provide visibility on the key areas of supervisory focus for the upcoming calendar year, the priorities outlined in this document should be viewed as forming part of a wider array of activities that the Authority is performing during 2024.

As part of the MFSA's continuing commitment to the highest standards of regulation, particularly in relation to accountability and demonstrating the effectiveness of its supervision, the MFSA is working to identify the key outcomes that the Authority is seeking to achieve with its supervision. These outcomes may relate either to standards that the Authority seeks to achieve in its operations or standards that we expect our supervised entities to deliver. These outcomes will be capable of being evidenced and measured by data that the Authority collects on an ongoing basis in relation to its regulatory tools and activities, and from licensed firms and customers. These measures will be reported on as part of the communications that the Authority publishes from time to time to ensure that it discharges its responsibilities to be transparent and accountable.

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

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