

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

**GUIDANCE NOTES ON FITNESS AND
PROPERNESS STANDARDS FOR
AIFMs OF NOTIFIED AIFs**

1 Introduction

- 1.01 Regulation 7 of the Investment Services Act (List of Notified AIFs) Regulations (hereinafter referred to as the ‘Regulations’) requires the AIFM to ensure that the service providers and members of the governing body of the AIF satisfy at the time of notification of the AIF (hereinafter referred to as ‘NAIF’), and on a continuing basis thereafter, the fitness and properness standards expected by the MFSA.
- 1.02 The Investment Services Rules for Investment Services Providers (hereinafter referred to as the ‘Rules’) specify that in assessing whether an individual fulfills the ‘fitness and properness’ standards, the following three criteria should be met:
- (a) integrity, which requires that the service providers or members of the NAIF’s governing body act honestly and in a trustworthy fashion;
 - (b) competence, which requires the service providers or members of the NAIF’s governing body to demonstrate professional expertise and experience; and
 - (c) solvency, which requires proper financial controls and management of liquidity and capital is ensured, where applicable.
- 1.03 These Guidance Notes are not intended to be comprehensive or to replace the provisions of the Regulations and the applicable Investment Services Rules. There are merely indicative of the due diligence process which should be undertaken by the AIFM prior to submitting a notification to the MFSA for the inclusion of an AIF on the list of Notified AIFs.
- 1.04 The MFSA may update or amend these Guidance Notes from time to time as it deems necessary.

2 Who will be subject to the due diligence assessment?

- 2.01 As a general rule, the following will be subject to the due diligence assessment:
- (a) the members of the governing body of the NAIF;
 - (b) MLRO; and
 - (c) the service providers of the NAIF including the administrator, prime broker and the custodian.

3 Which standards of fitness and properness are appropriate?

- 3.01 The MFSA expects the AIFM to assess each individual/service provider and carry out an analysis of the relevant person’s specific competencies and the level of probity appropriate for the performance by such person of their functions.
- 3.02 Where the AIFM deems that due to insufficient information, it is unable to conclude that an individual is fit and proper, it should request additional information to be able to assess the level of fitness and properness as expected by the MFSA.

- 3.03 The AIFM should document and record all due diligence undertaken and retain all documentation and correspondence received in relation to any enquiries carried out. The MFSA reserves the right to carry out spot checks of the records in relation to the due diligence exercise carried out. The AIFM must make these records available to the MFSA upon request.
- 3.04 Regulation 7 of the Regulations together with the applicable Rules provide for a continuing obligation and therefore the due diligence assessment which is carried out by the AIFM prior to inclusion of an AIF in the List of Notified AIFs is one which is not discharged once but on an ongoing basis. For this reason, the AIFM should require an individual/ service provider to report any changes to their status in the case where the changes may impact the due diligence assessment.
- 3.05 The Rules also require that the AIFM update the due diligence assessment on an annual basis and documents the updates carried out. In this regard, the AIFM should request that the individual/service provider confirm whether such individual or service provider is aware of any developments which may impact the due diligence assessment.
- 3.06 The AIFM must retain the records relating to the due diligence assessment.
- 3.07 Where the AIFM becomes aware that a service provider or a member of the governing body of the NAIF is failing to comply on an ongoing basis with the high standards of fitness and properness expected in terms of the Regulations and the Rules, the AIFM must make arrangements for a replacement member of the governing body of the NAIF or the service provider. If no replacement is found, the AIFM must file a request with the MFSA for removal of the NAIF from the List of Notified AIFs.
- 3.08 In carrying out the initial due diligence assessment the AIFM may be guided by the matters outlined in the following sections. The information listed hereunder is by no means exhaustive and an AIFM is encouraged to examine additional factors that may affect the choice of the members of the governing body of the NAIF and the service providers.
- 3.09 In carrying out the due diligence assessment both prior to the notification of the AIF to the MFSA as well as on an ongoing basis, the AIFM shall be guided by and comply with the provisions of the Prevention of Money Laundering and Funding of Terrorism Regulations¹ and the Implementing Procedures.

¹ S.L. 373.01

4 *Standards of 'fitness' required*

4.01 The term 'fitness' shall be understood as referring to the necessary qualifications, experience and competence to carry out the functions assigned.

4.02 The MFSA expects the AIFM to undertake the following checks in relation to the fitness of individuals namely:

➤ General information which includes details of the individual/entity including personal information and title attaching to the function to be fulfilled. The AIFM should request an authenticated copy of an identification document;

➤ *Evidence of qualifications attained:* The AIFM should be satisfied that, where relevant to the function, the individual has recognized qualifications from reputable institutions to carry out the function assigned to him/her. In this regard, the AIFM should request:

[i] information on the academic qualifications of the individual together with supporting documentation where considered necessary. This includes certified true copies of certificates/ university transcripts and records which evidence the qualifications. In the case of doubt, the AIFM 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] memberships of the individual/entity with professional bodies together with supporting documentation where considered necessary. In the case where an individual is registered with a professional body, the AIFM 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 and the College of Notaries in the case of Notaries, the Institute of Management and the Institute of Directors.

[iii] ongoing professional development: the AIFM should enquire as to, and retain records of, any Continuous Professional Development ("CPD") requirements in the fitness assessment.

In the case of a *money laundering reporting officer*, the AIFM 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 AIFM 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 AIFM 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 AIFM 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 AIFM should maintain records of any correspondence exchanged. In the case where the AIFM 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 AIFM could also include in the fitness and properness 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 AIFM 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 AIFM shall require the individual to provide information which includes:

- (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 and company secretary positions held. In particular, the AIFM should seek to obtain information on the entities in which the

individual is currently a director, company secretary and/or main beneficial owner. Furthermore, the AIFM should try and obtain information on the entities of which the individual was previously a director, company secretary and/or main beneficial owner 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 AIFM 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 AIFM should also obtain information whether the individual has been dismissed from any of the position described in paragraph (ii) or asked to resign or agreed to resign rather than being dismissed;
- (v) the AIFM 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 AIFM 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;
- (v) where applicable, information on any prohibition/ restriction or suspension of an approval even though this was restored.

5 *Standards of properness required*

5.01 The AIFM should ascertain that the individual is honest and will act ethically and with integrity. Integrity includes being of good repute and acting honestly and in a trustworthy manner.

5.02 In assessing the propriety of the individual, the AIFM should ensure that where any conflicts of interest have been identified these have been disclosed and mitigated.

5.03 The AIFM should require an individual submit:

- (a) an original Police Conduct Certificate, not more than three months old, from the police authorities or an equivalent certification from the country of residence of the individual;
- (b) an authenticated copy of an identification document (ID Card and / or Passport) of the individual completing the PQ; and
- (c) proof of residential address.

5.04 The AIFM should obtain the following information:

- (a) 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;
- (b) information as to whether the individual was associated or the subject of any criminal or civil investigations or proceedings.

5.05 The AIFM should obtain information on the current shareholdings and business interests which may affect the individual's suitability. Furthermore, the AIFM should enquire whether an individual has been disqualified from acting as a director.

5.06 The AIFM should carry out the necessary searches to confirm whether an individual has been declared bankrupt or whether the individual is party to any lawsuit or has been convicted of any offence which could affect the individual's fitness and propriety assessment. In this regard, offences relating to fraud or theft and offences related to breaches of financial services legislation are likely to affect such assessment.

6 *Solvency*

6.01 Solvency means that the individual in relation to whom the AIFM is carrying out the necessary due diligence assessment has the necessary financial standing. The AIFM should verify this by obtaining relevant and adequate records relating to solvency. Information obtained in this regard may include copies of any relevant audited accounts and statement of wealth, as and where considered appropriate, in addition to adequate banker's references.

7 *Due diligence assessment of service providers*

- 7.01 The AIFM should, as a minimum obtain and address the following information from the service provider when carrying out its due diligence exercise.
- 7.02 The list below is being provided by way of indication and is by no means an exhaustive list of the information which the AIFM must request. The AIFM is expected to further supplement the list below in order to ensure that the due diligence exercise being conducted is robust and complete in all respects.

General information

- 7.03 The AIFM should obtain the following information:
- (i) the latest instruments of incorporation;
 - (ii) a copy of the licence/recognition granted to the service provider by the MFSA or other European regulatory authority. The AIFM should also provide information on the regulated functions which are provided by the parent company where applicable;
 - (iii) where applicable any available external certifications;
 - (iv) annual report and audited financial reports for the past three years;
 - (v) 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;
 - (vi) the latest shareholding structure chart; This information should be further supplemented with information on the parent company where applicable. Furthermore, the AIFM should obtain information on whether the shareholding structure has changed considerably over the past three years and outline the changes;
 - (vii) 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

- 7.04 When carrying out the due diligence assessment of a service provider, the AIFM should collate the following information:
- (i) an organigram of the company together with salient information on the senior management;
 - (ii) 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 and money laundering reporting officer;
 - (iii) 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.

- 7.05 The AIFM should enquire on the training programs available for employees and the CPD initiatives undertaken.
- 7.06 The service provider should provide the AIFM with detailed information on the corporate governance framework which is implemented together with information on the different committees in the organisation.
- 7.07 The service provider should provide the AIFM with detailed information as to the manner in which conflicts of interest are declared, managed and mitigated;
- 7.08 The AIFM should carry out enquiries on the confidentiality policy adopted by the service provider.
- 7.09 The service provider should provide information as to the company's auditors.

Outsourcing and delegation

- 7.10 The AIFM should obtain information on outsourcing and delegation arrangements which the service provider has concluded. This information should cover the functions which are being outsourced.
- 7.11 Furthermore the AIFM 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, to given at any time instructions to the delegate and to withdraw the delegation with immediate effect should the circumstances so require.

Legal and related matters

- 7.12 The AIFM should obtain information relating to:
 - (i) any pending lawsuits initiated against the company;
 - (ii) any pending lawsuits initiated by the company;
 - (iii) 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;
 - (iv) where applicable information on whether the service provider has ever been subject to a suspension of licence;
 - (v) instances where the disputes were referred to arbitration.

Business Contingency and Disaster Recovery Plans

- 7.13 The AIFM should obtain the following:

- (i) a confirmation from the service provider that it has Business Contingency and Disaster Recovery Plans;
- (ii) information as to whether the documents are revised at periodical intervals;
- (iii) information as to whether the Business Contingency and the Disaster Recovery Plans are conducted at periodical intervals and whether such tests are documented;
- (iv) information on whether remedial measures were adopted.

Technology

7.14 The AIFM should enquire:

- (i) what systems and technology is in place and whether they are bespoke or packaged solutions;
- (ii) what is the process for system improvements and enhancements;
- (iii) whether any material IT changes are being planned in the foreseeable future.

8 Annual updates of the due diligence assessment

8.01 The AIFM shall as a minimum verify on an annual basis:

- [a] whether the individual has been subject of 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 judgement 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.

8.02 The AIFM should similarly update the due diligence assessment carried out in relation to the service providers on a yearly basis.