Fintech Law: Malta

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GTG Advocates
By Ian Gauci and Cherise Abela Grech

Introduction

Over the past years, both the Maltese Government and the Malta Financial Services Authority (MFSA) have sought to prioritise the fintech sector and this has attracted a plethora of licensees to the island. Indeed, despite its size, Malta is one of the EU Member States with the highest number of electronic money institutions (EMIs). This is not to infer that the MFSA adopts a lax attitude towards regulated entities, but it is rather testament to the strength and reputation of the Maltese regulator.

Malta offers different types of incentive schemes and support measures, particularly assisting startups and small and medium-sized enterprises (SMEs). Malta Enterprise has an ongoing seed and growth funding scheme called 'Business Start' through which applicants can receive an initial grant of up to €10,000 to help develop their business proposal prior to seeking further funding or third-party equity.

Other support measures offered include Start-Up Finance, through which eligible applicants may benefit up to €1.5 million in support. The Patent Box Deduction scheme on the other hand establishes a fiscal regime for income arising from patents, similar intellectual property (IP) rights and copyrighted software. Companies may also be eligible to benefit from the SME Fund, which is an EU grant scheme designed to help SMEs protect their IP rights.

Malta also offers attractive tax residency for certain levels of employees in particular sectors whereby they can benefit from a flat rate of 15 per cent on income tax on particular income streams provided that certain requirements are met.

Year in review

In 2023, the MFSA identified digital finance and sustainable finances (ESG) among its supervisory priorities. These themes were intended to apply to a number of sectors but most importantly including fintech, investment services, banking, and supervisory ICT risk and cybersecurity. The choice of these priorities reflects the changes that the Maltese legal framework has undergone and continues to undergo in light of EU regulatory changes.

Foremost among these is the coming into effect of the Markets in Crypto Assets Regulation (MiCA). In view of the changes, this will bring to the Maltese Virtual Financial Asset (VFA) homegrown regime, the MFSA had commenced the process to update its rulebooks applicable to VFA service providers and VFA issuers. A parliamentary bill which will amend the VFA Act to bring it in line with MiCA is currently being read in parliament to effect these changes.

The MFSA is also conducting a consultation process on the implementation of the Digital Operational Resilience Act (DORA) and the introduction of local Regulations to this effect. The MFSA shall be the designated competent authority for matters related to these Regulations.

Regulation

i Licensing and marketing

Malta offers a comprehensive regulatory framework applicable to different types of businesses operating in the fintech sector.

Malta enacted an innovative legal framework regulating VFAs in 2018, distributed ledger technologies (DLTs), initial coin offerings and VFA service providers. The legislator also created a mechanism regulating innovative technology arrangements (ITAs), such as smart contracts, and innovative technology service providers (ITSPs).

The regulation of cryptocurrencies came on the back of the regulator's years of experience in licensing financial institutions including payment services providers (PSPs) and EMIs. Over the years the MFSA has also sought to adapt to the emergence of new technologies and the need to introduce requirements and guidelines to cater for the risks and realities faced not only by entities operating in the fintech sector but licensees in general.

Entities authorised by the MFSA are required to comply with the marketing rules established by the authority. Further information on marketing rules is outlined below.

The provision of robo-advice may be deemed a licensable activity, like the provision of traditional investment advice under the Investment Services Act, Chapter 370 of the Laws of Malta (ISA). Although the MFSA has not issued specific rules in relation to robo-advisers, the European Securities and Markets Authority (ESMA) issued guidelines on certain aspects of the Markets in Financial Instruments Directive (MiFID) II suitability requirements, which define the concept of robo-advice and provide further clarity on the information to be provided to clients when making use of robo-advice.

Asset management companies are also licensed under the ISA. This sector has grown exponentially in Malta with Malta's asset management and asset servicing clusters having become renowned for their knowledge, commitment and cost-competitive services.

The Trading Licence Regulations under the Trading Licence Act (Chapter 441 of the Laws of Malta) define the term 'credit reference agency' as 'any undertaking licenced by the Trade Licensing Unit . . . the main business of which is to prepare, assemble and evaluate credit information and related credit and risk management services on legal and natural persons for the purpose of issuing credit scores to be furnished to third parties, provided that a credit reference agency is not precluded from carrying out other related tasks'.

The Central Bank of Malta is the responsible supervisory authority of credit reference agencies solely for the purpose of overseeing and regulating the task of issuing credit scores. In this regard it has issued Directive No. 15 on the Supervision of Credit Reference Agencies, which sets out the requirements to be met by licensed credit reference agencies.

The MFSA's Conduct of Business Rulebook includes specific guidelines on marketing and advertisements issued by authorised service providers. These rules apply to any advertisement or information issued in or from Malta; and any advertisement or information which is circulated, published, broadcast or otherwise received in Malta.

Advertisements and information must be fair, clear and not misleading. Advertisements should also be identifiable as such. The rulebook further sets out rules on the issue and approval of advertisements, and disclosures, warnings or disclaimers that may need to be included. It also sets out rules on information to be included in advertisements, such as pricing claims, disclosures on taxation, references to past and future performance as well as guidance on advertisements broadcast on television and radio or issued on social media.

ii Cross-border issues

Fintech service providers licensed in one EU member state are afforded the important benefit of being able to passport their services throughout the whole EU. This is undoubtedly a very crucial prospect for service providers who seek to offer their services with the utmost ease and with the greatest reach. Thus, among the different types of service providers, PSPs and EMIs are able to passport their services through this fundamental EU principle.

To date, VFA service providers do not benefit from the principle of passporting as the VFA Act is a Malta-grown regime. However, the passporting principle has been enshrined in MiCA, and thus service providers registered under MiCA will now be able to benefit from passporting as well.

An EU or European Economic Area (EEA) financial institution licensed or holding equivalent authorisation in another EU or EEA State as a PSP or EMI may provide the activities for which it has been authorised either through the establishment of a branch or the freedom to provide services, including by engaging an agent.

The requirement of a licence largely depends on the type of activity that a service provider intends to offer. Fintech service providers such as PSPs, EMIs and investment services providers authorised in an EU Member State benefiting from passporting would not need to obtain a separate licence in another Member State to offer services in that Member State.

The VFA Act provides that no person shall provide, or hold itself out as providing, a VFA service in or from within Malta unless such person is in possession of a valid licence granted under the VFA Act by the MFSA. Thus, any person seeking to actively provide VFA services in Malta must first obtain the necessary licence. The same wording is used in the ISA in relation to the provision of investment services.

On the other hand, the Financial Institutions Act (FIA) provides that the provision of licensable activities such as the issue of electronic money and the provision of payment services can only be transacted regularly or habitually, in or from Malta, by a company that is in possession of a licence granted under the Act by the MFSA.

There are no foreign exchange or currency control restrictions or limitations on ownership of companies by foreigners in place.

However, it is also important to bear in mind that the National Foreign Direct Investment Screening Office Act, 2020 sets out a screening mechanism in the case of foreign direct investments made or planned to be made in Malta and to all persons involved in a foreign direct investment, including foreign investors aiming to establish or to maintain lasting and direct links to carry out an economic activity in Malta, including investments which enable effective participation in the management or control of a company carrying out an economic activity.

Digital identity and onboarding

The Identity Card Unit is the responsible authority for the issue of electronic identity cards to Maltese nationals and residents. Its use is currently limited to accessing government services and certain authorities' online portals.

The Financial Intelligence Analysis Unit's (FIAU) Implementing Procedures set out specific rules for the onboarding of clients on a non-face-to-face basis. In particular with regards to the verification process, the FIAU clarifies that documentation can be received in scanned format, and that additional measures may be implemented by service providers in their role as subject persons to verify the client's identity.

The Implementing Procedures also offer specific guidance on the use of video conferencing tools, the use of identity verification software, verification through the use of commercial electronic data providers, the use of e-IDs, and verification of identity platforms.

Digital markets, payment services and funding

The VFA Act regulates the operation of a VFA exchange. Apart from the general licensing and ongoing requirements established by the MFSA for VFA service providers, VFA exchanges are also required to lay down, maintain and implement clear and transparent operating rules. Before admitting a VFA to trading on its platform, the exchange must ensure that the VFA complies with its operating rules and must assess the suitability of that VFA. Apart from having established listing criteria, the VFA exchange cannot deal on its own account on the same exchange on which it operates and it can only engage in matched principal trading if the client has consented to the process. Exchanges are also required to comply with principles of pre- and post-trade transparency in line with the MFSA's rules as well as additional rules on client record-keeping, system resilience and transaction settlement.

Collective investment schemes are regulated under the ISA. The MFSA has further issued specific rules on the different type of funds available in Malta: UCITS, Alternative Investment Funds (AIFs), Professional Investor Funds (PIFs), Notified AIFs and Notified PIFs.

If a collective investment scheme is intended to invest in VFAs, it must be set up as a PIF or a Notified PIF. The MFSA is still in the process of considering whether AIFs and Notified AIFs may also be able to invest in VFAs.

The provision of crowdfunding services is regulated by the Crowdfunding Regulation (EU 2020/1503) and the Crowdfunding Service Providers Act (Chapter 637 of the Laws of Malta). These are further supplemented by the MFSA rules.

Any person seeking to provide crowdfunding services in Malta must be a legal person duly authorised by the MFSA or any European regulatory authority as a crowdfunding services provider.

The EU Crowdfunding Regulation includes within its scope both investment-based crowdfunding as well as lending-based crowdfunding. Specifically in relation to lending-based crowdfunding, the Regulation applies to crowdfunding services that consist of the facilitation of granting of loans, including services such as presenting crowdfunding offers to clients and pricing or assessing the credit risk of crowdfunding projects or project owners. The definition of crowdfunding services is aimed to accommodate different business models enabling a loan agreement between one or more investors and one or more project owners to be concluded through a crowdfunding platform. Loans included within the scope of the Regulation are loans with unconditional obligations to repay an agreed amount of money to the investor, whereby lending-based crowdfunding platforms merely facilitate the conclusion by investors and project owner of loan agreements without the crowdfunding service provider at any moment acting as a creditor of the project owner.

In addition, the Consumer Credit Regulations (Subsidiary Legislation 378.12) implement into Maltese law the provisions of the Consumer Credit Directive (Directive 2008/48/EC), which regulates credit agreements involving a total amount of credit more than €200 or less than €75,000, which are provided to consumers. The text of this Directive has now been amended and is expected to come into effect from November 2026.

There are no particular restrictions applicable to trading loans in the secondary market in Malta.

The assignment of loans is regulated by the Civil Code (Chapter 16 of the Laws of Malta). An assignment of a loan is deemed complete and ownership is acquired by the assignee as soon as the thing is transferred, the price has been agreed upon and the written deed of assignment is made. The assignee may not exercise the rights assigned to them, except against third parties, after due notice of the assignment has been given to the debtor; such notice, however, is not necessary if the debtor has acknowledged the assignment.

However, under Malta's securitisation framework, which is governed by the Securitisation Act (Chapter 484 of the Laws of Malta), some of these requirements are relaxed to facilitate securitisation transactions. Thus, an assignment of rights to a securitisation vehicle pursuant to the Act does not require the assignment to have a price; is complete as soon as the assignment is written; and allows notice to be given to debtors by a simple written notice or by publication of a notice in a daily newspaper. Such an assignment is treated as final, absolute and binding on the assignor, the assignee and all third parties and is not subject to clawback.

The provision of payment services is regulated by the FIA. Any person providing such services regularly or habitually, in or from Malta, must be a company in possession of a licence granted by the MFSA under the Act.

Open banking is the process by which account information service providers (AISPs) and payment initiation service providers (PISPs) offer (or enable other parties to provide) value added services to users by accessing – upon user request - their account data held by credit institutions and other payment account providers. This was a major innovation of the Payment Services Directive (PSD) 2.

PSD2 helped ensure that this topic, which was largely unregulated, was given a stable regulatory framework. It imposed an obligation on banks to facilitate access to payments data for AISPs and PISPs via a secure interface.

The provision of custody services in relation to VFAs qualifies as a VFA service under the VFA Act. A licence issued by the MFSA is thus typically required to provide such service.

The VFA Regulations outline specific requirements on the safeguarding of client funds and assets held in custody. As a primary principle, assets held by a custodian constitute a distinct patrimony from the custodian's assets. Such assets thus cannot be subject to the rights of creditors of the custodian. The Regulations further specify that any VFAs held on behalf of clients may be deposited into an account opened with a third party, provided that such third party holds the necessary licence under the VFA Act to provide such service, or is exempt therefrom, or is constituted in a recognised jurisdiction, provided that the custodian discloses to both its clients and to the MFSA, the arrangements that will be put in place to ensure adequate safekeeping of assets. The custodian may also not use the VFAs held on behalf of clients for its own account or for the account of another person or client unless certain conditions are met.

Cryptocurrencies, initial coin offerings (ICO) and security tokens

The enactment of the VFA Act in 2018 sought to regulate cryptocurrencies that are deemed to be VFAs under the Maltese legal framework.

The term VFA refers to any form of digital medium recordation that is used as a digital medium of exchange, unit of account or store of value, and that is not electronic money, a financial instrument or a virtual token.

To offer legal clarity regarding this distinction, the MFSA created the Financial Instrument Test. The test must be applied to each DLT asset to determine its nature and the respective applicable legal framework based on the token's features.

Once the type of DLT asset is determined, the following legal regime would be applicable:

a. virtual tokens are not regulated by any specific body of law in Malta;
b. financial instruments are defined as set out in the MiFID and thus regulated by financial services legislation;
c. electronic money is regulated in Malta by the FIA; and
d. VFAs are regulated by the VFA Act.

The VFA Act also regulates the provision of VFA services including the custody of VFAs, operating a VFA exchange, providing advice in relation to investment in VFAs and dealing on own account.

As the MiCA Regulation comes fully into force, the VFA Act will be replaced. Under MiCA, 'cryptoasset service providers' (CASPs) are defined as an approved 'legal person or other undertaking whose occupation or business is the provision of one or more cryptoasset services to clients on a professional basis.' In turn, the Regulation defines 'cryptoassets' as 'a digital representation of a value or of a right that is able to be transferred and stored electronically using distributed ledger technology or similar technology'. The list of cryptoasset services is practically identical to the list of VFA services. Prospective CASPs are required to obtain prior authorisation in their home member state before being able to provide such services. A long-standing principle of the EU's freedom of establishment and freedom to provide services, the MiCA Regulation also establishes the 'passporting' mechanism, allowing CASPs to obtain authorisation from a single Member State while still having the possibility to provide services throughout the entire EU. This important advantage will undoubtedly solidify the EU's position as a leading market for the provision of cryptoasset services.

The MFSA has already started updating its internal rules to align its procedures with the implementation of MiCA, with certain provisions becoming applicable from 1 January 2024 while the remaining provisions become applicable from 1 July 2024.

However, the Maltese regulator did not only enact the VFA Act in silo. The VFA framework, as it is more commonly referred to, also included the Malta Digital Innovation Authority (MDIA) Act and the Innovative Technology Arrangements and Services Act (ITASA). The innovative legal framework sought to go beyond the concept of crypto assets and created a certification mechanism for ITAs, such as smart contracts. This certification process is overseen by the MDIA as the responsible authority.

The concept of an ICO under the VFA Act is termed as an Initial Virtual Financial Asset Offering (IVFAO). In all instances, an issuer is first required to understand the legal classification of the cryptoasset in question under the Financial Instrument Test.

Any person wishing to offer a VFA to the public in or from Malta or wishing to apply for the VFA's admission to trading on a DLT exchange, must draw up a white paper in line with the VFA Act and register it with the MFSA at least 10 working days before the date of its circulation in any way whatsoever.

MiCA will repeal and replace the VFA framework, thus overhauling (in principle) the IVFAO process. Under MiCA, there are three types of cryptoassets: asset-referenced tokens, e-money tokens and other types of cryptoassets. MiCA will have its own version of the Financial Instrument Test which will aid in the determination of the classification of each type of cryptoasset. Specifically with regards to issuers of other types of cryptoassets, just like under the VFA framework, issuers will be required to publish a white paper in line with MiCA. Any marketing communication must be fair and not misleading, while clients will have a 14-day period within which to ask for a refund. Issuers are required to be legal persons and clients' funds will also be protected.

If the Financial Instrument Test determines that the cryptoasset in question is a financial instrument, then the VFA Act does not apply. In such cases, if the issuer is conducting an offer to the public, then the issuer must conduct the offer in line with the provisions of the Prospectus Regulation.

Once MiCA comes into force, this will continue to apply as MiCA has clearly stated that cryptoassets qualifying as financial instruments as well as the provision of services in relation to such cryptoassets, falls outside of its scope.

The MFSA is amending its existing security offering regulatory framework to cater more specifically for security token offerings (STOs). This will also trigger changes necessary to local company law to specifically cater for the use of DLT.

Money laundering is criminalised primarily by means of the Prevention of Money Laundering Act (PMLA) and the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR). These are supplemented by the FIAU's Implementing Procedures. VFA service providers and VFA issuers are deemed to be subject persons.

The fifth AML Directive extended the scope of the Directive to cover both crypto wallet providers and crypto exchange service providers. The Directive limited itself to regulating fiat-to-crypto exchanges and not crypto-to-crypto exchanges.

Following a consultation process, the FIAU issued new Implementing Procedures which took into consideration the provisions of the Directive. The Implementing Procedures set out the requirement on subject persons to carry out a Business Risk Assessment to identify the risks their business is exposed to.

Subject persons must also carry out a Customer Risk Assessment to determine risks present in individual business relationships and occasional transactions. The Implementing Procedures also discuss the Risk-Based Approach, the importance of distinguishing business relationships from occasional transactions for AML purposes, conducting ongoing monitoring, source of wealth and source of funds and they outline a number of red flags that may be typically encountered in this sector.

More recently, Regulation (EU) 2023/1113 on information accompanying transfers of funds and certain cryptoassets (the Transfer of Funds Regulation) was approved, thereby giving effect to the Financial Action Task Force's (FATF) recommendations on virtual assets. These new rules aim to prevent, detect and investigate money laundering and terrorist financing where at least one of the CASPs involved in the transfer of cryptoassets is established in the EU. These service providers are required to accompany transfers of cryptoassets with information on the originator and the beneficiary. The information should be submitted in a secure manner and in advance of, or simultaneously or concurrently with, the transfer of cryptoassets. The Regulation will apply from 30 December 2024.

The Maltese Inland Revenue Department issued guidelines for the treatment of VAT for transactions involving DLT, guidelines on the Income Tax Treatment of transactions or arrangements involving DLT Assets, and Guidelines for the purpose of the Duty on Documents and Transfers Act. The guidelines address the various types of DLT Assets that exist, including the treatment of hybrid tokens.

Under the Income Tax Rules, the guidelines provide that any payment carried out in cryptocurrencies is to be treated as payment made or received in other currencies. However, generally, to determine duty on document transfers, this determination is to be made on a case-by-case basis. Charging of VAT depends on whether a specific good or service is identified.

In the case of VFAs, if a public offer is made by an issuer who is not a Maltese legal person, and therefore not an 'issuer' in terms of the VFA Act, such an offer would fall outside scope of the Act. There would thus not be any requirement to register the whitepaper with the MFSA.

Other new business models

There is no special law applicable to self-executing contracts; provided that the contract complies with the legal requirements for the validity of a contract under Maltese civil law, it is permitted. However generic conditions for such contracts would need to be drafted according to consumer law and any applicable *lex specialis*, including financial services legislation. Depending on the type of self-executing contract envisaged, it may also be possible to opt for the voluntary regime for registration and certification of such artefacts offered by the MDIA.

In line with ESMA's applicable guidelines, an investment firms' electronic trading system, which may include trading algorithms, must ensure that the firm complies with the applicable obligations under MiFID and other relevant EU and national laws as well as the rules of the trading platforms to which it sends orders. In particular, the system should be well adapted to the business which takes place through it and is robust enough to ensure continuity and regularity in the performance of its investment services and activities in an automated trading environment.

Such service providers may also avail of the benefits of the MFSA's regulatory sandbox.

As part of its digital strategy, the EU proposed, and as of December 2023, reached a provisional agreement on the world's first comprehensive AI law. The AI Act takes a risk-based approach and categorises AI systems into four risk levels: minimal or no risk, limited risk, high risk and unacceptable risk. High risk AI

systems include essential private and public services such as credit scoring denying citizens the opportunity to obtain a bank loan.

The impact of this new Act on the financial services sector will largely depend on the specific AI applications used by service providers. MEPs also successfully managed to include a mandatory fundamental rights impact assessment, among other requirements, applicable to the insurance and banking sectors. Thus, in light of these regulatory developments, financial institutions should start by mapping the AI systems currently in use and start developing an internal AI governance framework while keeping up to date with updates.

Regarding third-party websites comparing products or providing information about financial products subject to regulation, data protection or competition rules, there is no particular law or regulation governing comparison websites, and there is no particular definition of this activity.

The Commercial Code (Chapter 13 of the Laws of Malta) allows comparative advertising but it is highly regulated and restricted in the interest of consumers.

As the Maltese government has chosen to prioritise the fintech sector, financial institutions are encouraged to explore the benefits offered by newer technologies. While long-standing credit and financial institutions may have been wary of exploring more innovative technological solutions, established players in the local financial services industry have shown an increased interest in embracing such changes to their business models. Insurtech is in fact one area that has seen an element of increased interest and growth over the past few years.

Although the term DeFi is not defined under Maltese law, the MFSA refers to DeFi as a technology which utilises DLT, encompassing the elements of composability, competition and automation, to offer autonomous and decentralised financial services. Service providers intending to use DeFi can avail of the use of the MFSA's regulatory sandbox, which allows them to test their innovation for a specific period of time in the financial services markets under certain prescribed conditions.

Decentralised autonomous organisations (DAOs) on the other hand are captured under the ITASA, which refers to DAOs specifically as a type of ITA. ITASA, through the MDIA as the responsible regulatory authority, offers the possibility to register and certify DAOs under a voluntary regime which is the first of its kind.

Intellectual property and data protection

Fintech business models and related software can be protected in Malta through traditional intellectual property rights, principally through copyright, which arises automatically upon the publication of an eligible work in terms of the Copyright Act (Chapter 415 of the Laws of Malta).

Patent protection for Fintech business models and software tends to not be available in Malta in that the Patents and Designs Act (Chapter 417 of the Laws of Malta) deems 'programs for computers' as not regarded as a patentable invention.

Furthermore, where an invention is made in execution of a commission, or a contract of employment, the right to a patent for that invention shall belong (in the absence of contractual provisions to the contrary) to the person having commissioned the work or to the employer (as applicable).

In the context of employees, the employee would have a right to an equitable remuneration taking into account the employee's salary, the economic value of the invention and any benefit derived from the invention by the employer. In the absence of agreement between the parties, said equitable remuneration would be fixed by the Court.

The data protection rules applicable to client data are those deriving from EU legislation, principally the General Data Protection Regulation (GDPR) (Regulation 2016/679) and those deriving from the local Data Protection Act (Chapter 586 of the Laws of Malta), including the Subsidiary Legislation applicable thereunder; particularly noteworthy are the Processing of Personal Data (Electronic Communications Sector) Regulations (SL 586.01 of the Laws of Malta).

From a data protection law point of view, there are no special rules applicable to the digital profiling of clients. That being said, the generic rules under the GDPR naturally apply. Fintech and AML/countering the financing of terrorism (CFT)-specific legislation do also include rules and obligations regarding client profiling.

Outlook and conclusions

With numerous legislative proposals being discussed and laws expected to come into force, service providers are expected to remain constantly up to date with upcoming developments.

Foremost among these, and as mentioned earlier in this publication, is MiCA which came into force in June 2023 and is expected to be fully in effect by the end of 2024.

Another very significant piece of legislation is DORA, which came into force in January 2023 and will apply as from January 2025. DORA sets uniform requirements for the security of network and information systems of companies and organisations operating in the financial sector as well as critical third parties that provide ICT-related services to them, such as cloud platforms or data analytics services. Ancillary to DORA is the Network and Information Security Directive (NIS2) which aims to establish a higher level of cybersecurity and resilience within EU organisations. The EU has also reached an agreement on the Cyber Resilience Act, which is intended to bolster cybersecurity rules to ensure more secure hardware and software products.

As mentioned earlier in this publication, the EU AI Act is intended to address the risks generated by specific uses of AI through a set of complementary, proportionate and flexible rules. This will be enhanced through the proposed AI liability directive.

The European Commission has also presented proposals for a new Payment Services Directive (PSD3) which will incorporate the electronic money directive, as well as a Payment Services Regulation and a proposal for a Regulation on a framework for financial data access.

Footnotes

[1] Ian Gauci is a managing partner and Cherise Abela Grech is a partner at GTG Advocates.