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The Central Bank of Malta’s latest forecast points to gross domestic product growth recovering to 1.2% this year, followed by 1.8% in 2011 Michael Bonello, Page 7

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The Central Bank of Malta gives an assessment of the country’s economy.

Malta has acquired a reputation as an attractive fund domicile that has drawn in custom from beyond its EU neighbours.

Malta raised its game before it joined the EU in 2004 and now ranks 13th in the world for financial market sophistication. Today it is attracting financial companies from all over the world.

Malta has one of the soundest banking systems in the world, a testament to the reliable, old-fashioned principles adhered to by its leading credit institutions licence holders.

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MARCHING FORWARD WITH CONFIDENCE

Tonio Fenech

The Maltese economy has survived testing times. Tonio Fenech, Malta’s minister of finance, the economy and investment, explains how the country is well placed within Europe to sustain growth in the coming year.

Despite being one of the smallest countries within the EU, Malta’s open but diverse economy – based upon financial and other related services, tourism and higher value-added manufacturing activity – has proved not only to be a success in the good times but an anchor of stability in the more recent difficult times. Although dependent on the major European economies, with EU countries accounting for two-thirds of our exports and also providing the lion’s share of our tourists, the level of recession in Malta in 2009 was half the European average – the country’s economic growth was -2.2%. But while it would have been unrealistic to expect that we could escape the impact of the international recession, not all sectors were affected to the same extent, and a few, such as financial services, continued to grow, attracting international business and investment throughout 2009.

The damage could have been much greater. However, the measures we took to shore up our hardest hit industries of tourism and manufacturing proved successful in containing the extent of the slowdown, safeguarding jobs and encouraging further investment. Our 2010 budget reinforces these efforts, introducing targeted initiatives to boost investment throughout industry sectors and encourage job creation. We are now beginning to see improvements in our economic performance across all sectors. And, while we ended the year with negative growth of 1.9%, initial indications for the first months of 2010 are maintaining a positive trend.

It is clear from recent economic indicators that Malta is emerging as one of the least affected countries by recession in the EU, and one of the reasons for this is the sustained growth in our financial services sector. The finance industry has become one of Malta’s most important economic generators, registering year-on-year growth of 30% between 2007 and 2008. In 2009 this sector grew by 22%.

Malta’s resilience in the face of the international financial crisis served us well, as our banks came through the financial crisis relatively unscathed, and our banking system was lauded internationally for its conservative approach based on sound fundamental banking business. Indeed, an article in the February 2009 issue of The Banker highlighted the reasons for this success – essentially that Malta’s closely monitored yet flexible regulatory framework offers the ideal environment for financial services operators to conduct their business with confidence.

Determination for Success

Going forward, we are determined to continue building on this success in 2010 and the years to come. Our formula, combining stringent supervision with flexibility, innovation and a proactive approach in updating and modifying legislation to meet the needs of the industry, has proved successful, ensuring that we are ideally positioned to attract business such as international banking, captive insurance, investment funds and trust and fiduciary activity. Indeed, in 2009 about 100 new investment funds were registered, an increase of almost 25%. This acceleration is expected to continue through 2010, as more fund managers discover the advantages of setting up or re-domiciling to Malta. Furthermore, as we expand our international network of double taxation treaties and agreements, we are seeing an influx of financial institutions such as international banks and insurance companies seeking the advantages of EU passporting rights combined with the access to new markets that Malta offers.

Malta is a well diversified centre, with strong banking, insurance, investment funds and wealth management sectors, all of which are underpinned by universally praised EU-harmonised legislation and regulation, a highly advantageous EU and Organisation for Economic Co-operation and Development-approved tax regime, an accessible and flexible single regulator and a pool of highly trained, experienced professional services providers. Our commitment to the industry will continue to guide us as we go forward, and we are confident that Malta will continue to flourish as a global financial centre serving global business.
A SAFE HARBOUR

Introduction

Malta ranks 13th in the world for financial market sophistication, according to a World Economic Forum survey. It raised its game considerably before it joined the EU in 2004, and now enjoys the presence of many international banks, insurers and fund managers operating within an EU-compliant regulatory regime.

Writer Michael Imeson

The world is full of cities and smaller nations staking a claim to be the next big thing in finance. They know they haven’t got a hope of toppling London, New York, Singapore, Hong Kong and other locations from the top of the first division of international financial centres – or of even getting into the first division. But many of them make a good case for being taken seriously as emerging regional financial centres and upsetting the order of things further down the table.

Malta is among those challengers as the smallest EU member. But in financial centre terms, it punches well above its weight – and seems to deserve the use of that well-worn cliché, as various surveys attest.

The World Economic Forum’s Global Competitiveness Report 2009/10 ranks Malta 52nd among 133 economies. For financial market sophistication it ranks 13th, up from 34th in the previous year. Malta is in 15th place for strength of regulation of securities exchanges, 13th for soundness of the banking system, and 12th for strength of auditing and reporting standards.

The European Commission’s Internal Market Scoreboard, published last year, ranked Malta and Denmark in joint first position for implementing internal market directives, demonstrating not only Malta’s efficiency in transposing European rules into domestic law, but also that its economy has rapidly integrated into the EU in the six years since it joined.

The country is also one of the top five EU performers in terms of foreign direct investment inflows as a proportion of gross domestic product (GDP). In addition, it is among 40 countries that were praised by the Organisation for Economic Co-operation and Development (OECD) for “substantially implementing” internationally agreed tax standards – a major achievement for Malta which has long fought for this recognition and which immediately placed it on the OECD’s ‘white list’ of countries complying with tax co-operation and exchange of information.

Malta made huge efforts to raise its game in the 1990s as it introduced reforms in preparation to join the EU. By the time it joined the EU in 2004 it had created a sound legislative and regulatory framework compliant with EU economic and financial practices, and it adopted the euro in 2008.

But how big, exactly, is Malta’s financial sector? No matter how good a financial centre looks on paper, unless it has enough critical mass it is never going to make much of an impression on the international scene. The truth is, it is small. But it is making a fair amount of noise in the Mediterranean, marketing itself as ‘a stepping stone between Europe and north Africa’.

GROWTH TARGET

Finance and related administrative services account for about 12% of Malta’s GDP, and employs between 6000 and 7000 people. The government’s ambition is for the financial sector to account for 25% of GDP by 2015.

A former British colony, the country has 24 banks, 15 other financial institutions providing banking services but not licensed to take deposits, about 40 insurance companies, 401 funds, 81 fund managers and 13 fund administrators. The quality of the country’s system of financial regulation, and the accessibility and flexibility of the Malta Financial Services Authority (MFSA), are often cited as reasons for locating there.

When presenting to potential foreign investors, finance minister Tonio Fenech quotes Ernst & Young’s 2009 European Attractiveness Survey, which measures outsiders’ most significant perceptions of Malta. Top of the perceptions list comes the quality of the workforce, especially its productivity and the fact that English is the joint official language with Maltese. Other positive attributes mentioned in the survey are Malta’s membership of the eurozone, quality of life, telecommunications network, political system, corporate tax rate, geographical position, legislative environment and labour law flexibility.

FinanceMalta, a public-private partnership that promotes the country to foreign firms, has been working flat out since it was created in 2007. “Our target market includes financial and credit institutions, funds, insurance companies and family offices,” explains Kenneth Farrugia, its chairman. He is also chief officer for Valletta Fund Services, the fund administration division of Bank of Valletta, one of Malta’s two biggest banks.

FinanceMalta’s modus operandi includes influencing ‘gatekeepers’ – accountants, law firms, consultancies – to offer Malta as an option to clients looking for an international jurisdiction to place their business. But how can Malta compete against all the other financial centres, many of which may be physically small but already have sizeable financial sectors and giant reputations?

“Well, as they say, small is beautiful and it makes you nimble as well,” says Mr Farrugia. “That’s one of the unique success factors for the financial services industry in Malta because being small enables us to react very quickly. To cite one example, in the EU Internal Market Scoreboard, Malta ranked first with Denmark for transposing EU directives into national legislation. I think that is reflective of what happens in the local financial services industry, whereby we react very
quickly to developments taking place, both within and outside Europe.

“The banking industry has continued to grow at a satisfactory pace. We have a good number of banks here, both those that have decided to promote their services to the Maltese market, as well as international banks that are using Malta as a platform from which to conduct specialised banking services.

“The funds industry is in a state of evolution. We first started attracting domestic funds to the market, predominantly led by the banking institutions in Malta. After that, in the early 2000s, we saw international fund-management organisations setting up funds here. And in the past 24 months, we’ve witnessed international fund administrators and fund management organisations setting up their operations in Malta. This is giving shape and form to the industry, which is driven by a number of factors; the fact that Malta is highly cost-competitive, the presence of multi-skilled and multilingual personnel, and the can-do mindset.”

Mr Farrugia says that the recession affected tourism and manufacturing, two pillars of the economy, but the financial sector proved resilient. “The MFSA’s annual report revealed that banking assets, at the end of 2008, grew by 10% that year to €42bn. If you look at the funds industry, we’ve had a record year insofar as the number of new funds registered in Malta. Likewise, insurance companies continued setting up here.”

In some quarters Malta still struggles to shake off its former status as a purely tax-driven offshore financial centre, which it ceased to be as a condition of joining the EU. This is something that rankles Mr Farrugia. “Going back through our history, the finance industry commenced in the mid-1980s with an offshore framework which was predominately tax-driven,” says Mr Farrugia.

“They then in the change in government brought with it a change in strategy which predominately revolved around EU membership, which took place in 2004. In the intervening period, we updated our legal and regulatory framework to ensure that we shed our offshore framework, our offshore regime, our offshore label, in favour of an onshore one. The legacy of Malta’s positioning as an offshore jurisdiction does not go away very quickly but, the recent reviews conducted by international organisations of Malta’s fiscal framework, our legal and regulatory framework are clear attestations of the onshore regime that Malta has in place.”

**EXPATRIATE VIEWS**

HSBC Bank Malta has been on the island since 1999, serving both local and international markets. Chris Bond, its head of global banking and markets, has only been located in Malta since last October, having previously worked for the bank in New York, and before that Bermuda. As a recent arrival, what does he think of his new home and place of business?

“I would describe the banking sector in Malta as strong, stable, well-capitalised, extremely liquid and extremely well-regulated by a firm but flexible and very accessible regulator,” he says. “The domestic market is driven by HSBC and Bank of Valletta. Between us we share 90% of the domestic market but...”
there are some 20 other banks here on the island, subsidiary banks of Portuguese, of Dutch, of Austrian, of German banks, all playing to their respective niches.”

HSBC has a strong retail deposit base in the country and does not rely on wholesale funding. Its loans-to-deposit ratio is at the 70% to 80% level. “Speaking on behalf of the whole banking sector, another thing that characterises it is the fact that we all have effective risk management policies,” adds Mr Bond. “We have prudent lending policies. We have conservative investment policies. And those things have combined to ensure that we’ve sailed through these financial storms relatively well. HSBC has certainly contributed towards Malta’s financial stability.”

Perhaps the last word should go to the International Monetary Fund (IMF). Following an Article IV consultation with Malta last year, which analysed the country’s economy and financial system, the IMF delivered a largely complimentary verdict. It outlined the various difficulties that Malta faced as a result of the global economic downturn, and noted that inflation had remained the highest in the euro area since October 2008. It added that “past efforts at fiscal consolidation and export diversification toward high-value-added services activities in the run-up to euro adoption had increased the resilience of the Maltese economy”.

The IMF also said that the fiscal stance was “appropriately accommodative” and that “the full play of automatic stabilisers, combined with a limited stimulus package focusing on infrastructure investment, should provide an adequate counter-cyclical response to the slowdown”. It stated that being in the eurozone “provides a clear opportunity for Malta in terms of trade and financial integration”, but at the same time “it highlights the urgency of improving inter- nal flexibility to remain competitive, especially given persistent inflation”.

CAUTION PAYS

The IMF also spoke well of Malta’s banking system. “Banks have so far withstood the global financial turmoil relatively well, as they were protected by their limited exposure to structured products, a traditional retail funding model, and conservative lending policies,” noted the IMF executive directors. “Credit has proved resilient, and no government intervention to shore up capital or liquidity has been necessary. Nonetheless, some institutions suffered large valuation losses on their security portfolio, and credit concentration in the construction and real estate sectors remains a concern, especially as property prices have fallen noticeably.”

Although there are many reasons why foreign banks locate in Malta, there is no denying that the favourable tax regime is one of the key reasons, as the IMF report notes: “Out of 23 banks [now 24], 13 are locally incorporated subsidiaries of foreign institutions and three are foreign branches. Only seven banks, dubbed domestically oriented banks – accounting for 30% of total assets – play a role in domestic intermediation. Most of the remaining 16 internationally oriented banks, settled in Malta for tax optimisation purposes, use funding from their overseas banking groups to finance assets outside Malta... Malta’s favourable tax regime and extensive double-taxation treaties explain in part the presence of IBIs [internationally oriented banking institutions]. Under the full imputation system, foreign shareholders receive full credit for tax paid in Malta on distributed profits.”

So there it is, direct from the IMF. Tax is an important pull for foreign firms in Malta. But the IMF is not critical of the country’s tax regime, which is fully compliant with its EU membership and OECD standards. Malta’s international financial centre model therefore combines a favourable tax regime with many other local attributes such as a motivated workforce and business-friendly laws and rules – all wrapped up in the EU’s trademark blue and yellow colours, to present a winning package.

**MAIN ECONOMIC INDICATORS**

- **Registered unemployed (as at December 2009)**: 7,680
- **Labour supply (as at Q3 2009)**: 174,553
- **Financial intermediation (2008)**: 5637
- **Persons employed in financial intermediation (as at Q3 2009)**: 5524
- **Average gross annual salary for employees in financial intermediation (as at Q3 2009)**: 19,740
- **GDP (2008)**: €5.7bn
- **Inflation rate (2009)**: 2.09%
- **Merchandise exports (2009 provisional)**: €1628.5m
- **Goods and services exports (2008)**: €4.7m
- **Merchandise imports (2009 provisional)**: €2767.9m
- **Goods and services imports (2008)**: €4.8m
- **Internet users (2009)**: 180,985

Source: FinanceMalta
Why was Malta in general, and its finance sector in particular, not as badly affected by the financial crisis and recession as other European countries?

In the first place, membership of the euro area has strengthened the capacity of Malta’s economy to withstand external shocks, and we have not had to face the risks that are inherent in the management of a small national currency.

Moreover, the threat posed by the financial crisis was mitigated by the strength of the banking system. There were no toxic assets in the banks’ portfolios; their lending policies were prudent and funding was based mainly on retail deposits. Capital and liquidity ratios remained well above the regulatory minimum throughout the crisis. This helped to retain investor confidence in the banking system.

Another factor which sheltered Malta from a more severe recession was the ongoing diversification of the economy towards high value-added services, which have proved resilient to the downturn.

However, certain sectors of the economy which are significantly exposed to the international economy, such as manufacturing and tourism, did sustain a notable decline. To combat the negative effect of the recession on these sectors, the government provided financial assistance specifically targeted at particular firms which were willing to maintain and expand their operations in Malta. The government also embarked on a number of capital projects aimed at enhancing the infrastructure.

What was the extent of Malta’s recession?

Gross domestic product (GDP) fell by 1.9% in 2009, a smaller drop than that registered by the euro area. Furthermore, Malta’s peak-to-trough decline in GDP was estimated at 3%, whereas that of the euro area amounted to 4.7%.

Manufacturing and tourism took the brunt of the recession, but several service activities, such as remote gaming and financial and other related activities, continued to register healthy growth. Their resilience contributed to a narrowing of the current account deficit, from 9.2% of GDP in 2006 to a projected 3.7% in 2009.

Even in the labour market Malta fared reasonably well. Its latest unemployment rate - 7% in January 2010 - is one of the lowest in the euro area. In terms of inflation on the other hand, price trends in Malta in the first half of the year diverged from those in the euro area, although they converged gradually over the second half as energy and food prices, which had risen strongly in the early part of 2009, decelerated substantially.

Even on the fiscal front, Malta’s public finances performed relatively well, registering a smaller deficit than most other euro area countries. In fact, compared with the previous year, Malta’s fiscal deficit/GDP ratio declined to an estimated 3.8% in 2009 from 4.7% in 2008. At the same time, general government debt as a percentage of GDP stood at 66.8% in 2009, compared with an estimated 78.2% for the euro area as a whole.

What about the financial sector – how did it compare with the rest of the economy?

The financial sector’s gross value added, in nominal terms, grew by an impressive 33% in 2009. Furthermore, net financial inflows have contributed substantially to the contraction in the current account deficit. This notable performance by the financial sector was also reflected in the fact that new licences were issued by the Malta Financial Services Authority in 2009, to a commercial bank and a number of investment funds. In addition, the domestic banking sector remained stable and its resilience was confirmed by stress tests conducted by the Central Bank of Malta over the past two years.

Meanwhile, liquidity and capital ratios remain well above their regulatory minimum. Let me give some examples. Liquid assets to short-term liabilities stood at 43.9% in January 2010, compared with a regulatory minimum of 30%. The ratio of customer deposits to customer loans stood at about 127%, which confirms that customers’ deposits are large enough to finance the provision of loans by Malta’s banks. In terms of capital adequacy, the regulatory capital to risk-weighted assets and the regulatory Tier 1 capital to risk-weighted assets ratio stood at a healthy 15.2% and 12.7%, respectively, at the end of 2009. Profitability indicators have also improved steadily throughout 2009, driven largely by a partial reversal of the valuation losses incurred in 2008.

In terms of the risk assessment, there are some weaknesses which warrant attention. For example, non-performing loans have been on the increase, rising to 5.6% at the end of 2009 from 4.9% a year earlier. In addition, the domestic banking sector is highly exposed to the property market, both directly and indirectly through collateral. In view of these vulnerabilities, the bank has repeatedly encouraged the banks to strengthen their capital buffers further beyond statutory ratios.
What are your forecasts for Malta’s economy in 2010?

The Central Bank of Malta’s latest forecast points to GDP growth recovering to 1.2% this year, followed by 1.8% in 2011. The main engine of growth is expected to be domestic demand, with the contribution of net exports being negative in both years. Labour market conditions are expected to remain slack. Even though employment growth is projected to become positive again, the unemployment rate is projected to increase slightly from 6.9% in 2009 to 7.2% in 2010, before declining marginally to 7.1% in 2011. Price pressures are expected to remain subdued. HICP (harmonised index of consumer prices) inflation is forecast to decline to 1.6% in 2010 from 1.8% in 2009.

Has Malta’s adoption of the euro caused inflation to rise more than it otherwise would have done, and if so, how damaging has that been?

The inflationary effects of the introduction of the euro tended to be overstated throughout the euro area. Interestingly, consumer surveys showed that inflation perceptions actually declined in Malta in the first two months after its introduction.

According to Eurostat’s calculations, the total (one-off) impact of the euro changeover on headline inflation in Malta during, and immediately after, the changeover was estimated at about 0.2 and 0.3 percentage points. These estimates are in line with the experience of the first-wave countries in 2002 and of Slovenia in 2007.

Has adopting the euro restricted your ability to manage the economy?

Not in any significant way because the two traditional adjustment policy instruments, the exchange rate and the interest rate, were not viable policy options in Malta’s case, given its small size and openness and the fact that in the past it pursued a fixed exchange rate policy, characterised by a rigid link to a currency basket.

What are the main shortcomings of the Maltese economy?

A main weakness is the slow growth in productivity. This has undermined economic performance in recent years and delayed progress in achieving higher levels of convergence with the major euro area countries. In spite of the recent downsizing efforts, the public sector remains relatively large and over-manned, which also contributes to the overall poor productivity performance.

Another shortcoming in the economic structure is the low employment rate, 55.3% in 2008 compared to 66.1% in the euro area, which is the result of a low female employment rate (37.4% in 2008 compared to 58.8% in the euro area), a declining male employment rate (from 75% in 2000 to 72.5% in 2008) and a low average exit age from the labour market (59.8 years in 2008 compared with 61.4 years in the EU).

Relatively low educational attainment levels are another source of concern. For instance, in 2008, only 27.5% of the population aged between 25 and 64 had completed at least an upper secondary education in Malta compared with 66.7% in the euro area. In 2008, Malta’s expenditure on research and development was also low by international standards. It amounted to 0.5% of GDP compared with 1.9% in the euro area.

What are the latest trends in foreign direct investment?

According to the World Investment Report 2009, FDI flows into Malta as a percentage of gross fixed capital formation averaged 92% per annum between 2006 and 2008.

These figures are significantly affected by the activities of the international banks operating in Malta. The FDI stock has reflected these steady inflows, rising from 6.9% in 2009 to 7.2% in 2010, before declining marginally to 7.1% in 2011. Price pressures are expected to remain subdued. HICP (harmonised index of consumer prices) inflation is forecast to decline to 1.6% in 2010 from 1.8% in 2009.

Close co-operation between industry and academia has been an important factor behind the strong FDI inflows. Sectors where such co-operation has produced particularly good results include the insurance, pharmaceutical and aircraft maintenance industries.
SUPPLEMENT | MALTA

BANKING AND WEALTH MANAGEMENT

SOUND PRINCIPLES

Banking management

Malta has one of the soundest banking systems in the world, a testament to the reliable, old-fashioned principles adhered to by its leading credit institutions licence holders: Bank of Valletta and HSBC Bank Malta.

Writer Michael Imeson

Although Malta’s economy went into recession last year, in common with most of the rest of Europe, its banking system was virtually untouched by the financial crisis.

The reason? It sticks to good, old-fashioned banking principles. Its banks take a largely traditional approach to banking, preferring to act as intermediaries between retail depositors and borrowers, with wholesale funding playing a minor role, and following prudent lending policies. The result: substantial liquidity, adequate capital, no toxic assets, few bad debts... and no bailed out or failed banks.

It came as no surprise to the Maltese, then, when the World Economic Forum’s Global Competitiveness Report 2009/10 ranked the soundness of Malta’s banking system in 13th place.

In the mid-1990s there were only four retail banks serving the local population. Now there are 24 banks, or ‘credit institutions licence holders’ in official parlance, from several countries, serving local and international customers (see Figure 1, opposite). The total value of the banks’ assets at the end of 2009 stood at €41.2bn.

In addition, there are 15 ‘financial institution licence holders’ which are not licensed to take customer deposits, but fund their operations from shareholder capital or other funding sources, such as the inter-bank market. They provide lending, money transmission, foreign exchange, invoice discounting and other services (see Figure 2, overleaf).

The two biggest banks, Bank of Valletta and HSBC Bank Malta, account for about 90% of the local market, a share they are fighting hard to hold on to, especially since the arrival of Portugal’s Banif Bank in 2008, which is setting up a full branch network. Two other significant local banks are APS and Lombard, which have small branch networks.

Foreign banks such as Volksbank, Spar-kasse Bank and Mediterranean Bank have carved out local niches for themselves but also rely heavily on international business.

FIMBank, a trade finance specialist largely owned by Kuwaiti interests but in which the International Finance Corporation, an arm of the World Bank, has a 5.82% shareholding, is wholly focused on international markets. It uses Malta as a base from which to direct operations in eight other countries, including the US, Brazil, Russia, Singapore, Egypt and the United Arab Emirates.

Interestingly, Deutsche Bank, which has been on the island for some years as a ‘financial institution’ trading as Deutsche Financial Services (Malta), last month upgraded its status to ‘credit institution’ and changed its name to Deutsche Bank (Malta). The bank plans to increase its operations on the island, but not necessarily in local retail banking.

Bank of Valletta

Bank of Valletta Group (BoV) provides a full range of financial services, including retail, private and investment banking, fund management, fund administration and insurance. At the end of September 2009, it had €370m in Tier 1 capital and €6.2bn in total assets. It completed its largest ever bond issue last month – €50m of subordinated bonds at 4.8%. It was so oversubscribed it was able to offer a further €20m (€22.4m), and yet still had to close the subscription before lunchtime.

Tonio Depasquale, BoV’s chief executive officer, attributes the success of the issue to the bank’s deep roots in the community. “It has earned that community’s trust through its long and untarnished track record of stability, profitable performance and social consciousness,” he says.

“The bond issue has two main aims. The first is to lengthen the average duration of funding. The group funds all its retail business by a large customer deposit base, which has a relatively short duration but is extremely stable. The group now intends to stabilise its funding in the longer term by assuming liabilities with a longer duration.

“The second aim is to diversify sources of funding. The group wishes to supplement its funding sources, which are currently customer deposits, repo markets and the European Central Bank, by tapping the local credit market.”

Another objective is to strengthen the group’s Tier 2 capital, even though it is comfortably capitalised by any standard, with a Tier 1 ratio of 11.2% and a capital adequacy ratio of 14% at the end of September 2009. While it wants to avoid over-capitalisation, its strategy tends more towards capital conservation in anticipation of more stringent regulatory requirements coming up.

Malta was in recession last year, along
with most of the rest of Europe, yet BoV’s 2009 pre-tax profit was €81.8m, more than double its 2008 profit – though that has to be put in the context of a €101.8m profit in 2007.

“The first priority for BoV during the financial crisis was to come through without major damage to the balance sheet,” says Mr Depasquale. “The group managed this by using a three-pronged strategy: firstly, the maintenance of a strong capital base, which I have mentioned. The second factor was its conservative funding model, reflected in high holdings of liquid assets and low loan-deposit ratio.

“Thirdly, BoV lacked any exposure to toxic assets, or to asset-backed securities or other structured products which precipitated the crisis. Although we had to book substantial fair value mark downs when credit spreads widened and bond prices fell, actual impairment was minimal. Those mark downs are now coming back as price gains, and have played no small part in the recovery of our profitability.

“After the financial crisis came the economic downturn. During 2009, margin management was a key area of focus, as we had to respond to the long series of monetary policy actions by the European Central Bank, as it lowered its central intervention rate from 4.25% in October 2008 to 1% in May 2009. This rapid and sharp reduction in interest rates over a very short period had an adverse effect on our interest margin as most of the bank’s assets repriced immediately while the underlying deposits take longer to adjust to the lower rates.

“The effect of a narrowing interest margin was mitigated by the increased volumes registered in our retail business, as we remained strong market players on both sides of the balance sheet.

Margin income was supplemented by a good performance on fee income, especially in the cards business, trade finance, and in the management of local initial public offerings. Towards the end of the financial year the bank experienced a strong recovery in the sale of life assurance, funds and other investment products. At the same time, it managed to reduce costs by 1%. And thanks to its hands-on credit risk management, deterioration in credit quality was limited and contained, with impairment charges only slightly higher than the previous year’s.

So core performance, especially in the second half of the year, was satisfactory, and compared well with pre-crisis levels. The group’s only disappointment came from the poor performance of an Italian subsidiary of its general insurance company, but fortunately the impact on overall group profitability was immaterial.

As the economy picks up this year, Mr Depasquale says BoV will continue to provide credit to sustain the recovery, in a ‘responsible manner’ but at competitive prices to cope with increased competition.

“Our risk-management structures will ensure that quantity in lending does not come at the cost of quality,” he promises. “We will remain vigilant, prudent and focused on the sound management of our balance sheet. We will also continue to diversify our sources of income, tapping niche markets identified as offering good growth opportunities.”

**INCREASED COMPETITION**

With more banks entering the fray in Malta – most notably Portugal’s Banif two years ago – how is BoV planning to compete in a small domestic market? “We have always thrived on competition,” says Mr Depasquale. “Ever since HSBC set up shop in the local market, more than 10 years ago, we have managed to increase our market share on both deposits and lending. We offer competitive pricing, but in my opinion it is the quality of our service that gives us the edge over the competition.

He adds that BoV’s “qualitative” competitive edge is based on its constant focus on the customer, which is central to its “brand promise”. The bank has an intimate knowledge of the local market – “we pride ourselves on being the Maltese bank, and on the professionalism and dedication of our staff”.

![Figure 1: Credit institutions licence holders](source: MFSA)

**Figure 1: Credit institutions licence holders**

<table>
<thead>
<tr>
<th>Licence Holders</th>
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</thead>
<tbody>
<tr>
<td>Akbank</td>
</tr>
<tr>
<td>APS Bank</td>
</tr>
<tr>
<td>Banif Bank (Malta)</td>
</tr>
<tr>
<td>Bank of Valletta</td>
</tr>
<tr>
<td>BAWAG Malta Bank</td>
</tr>
<tr>
<td>CommBank Europe</td>
</tr>
<tr>
<td>Deutsche Bank (Malta)</td>
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<tr>
<td>Erste Bank (Malta)</td>
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<tr>
<td>FIMBank</td>
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<tr>
<td>Finansbank (Malta)</td>
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<tr>
<td>Fortis Malta</td>
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<tr>
<td>HSBC Bank Malta</td>
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<tr>
<td>Investkredit International Bank</td>
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<tr>
<td>Izola Bank</td>
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<tr>
<td>Lombard Bank Malta</td>
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<tr>
<td>Mediterranean Bank</td>
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<tr>
<td>Nemea Bank</td>
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<tr>
<td>Raiffeisen Malta Bank</td>
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<tr>
<td>Saadgroup Bank Europe</td>
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<tr>
<td>Sparkasse Bank Malta</td>
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<tr>
<td>The International Banking Corporation (Malta)</td>
</tr>
<tr>
<td>Garanti Bank</td>
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<tr>
<td>VoiceCash Bank</td>
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<tr>
<td>Volksbank Malta</td>
</tr>
</tbody>
</table>

Source: MFSA
Continuous professional education is taken seriously. The BoV Academy was recently inaugurated, and it offers courses ranging from highly technical subjects to personal development skills.

The bank has also been busy installing highly advanced ATMs in its branches, the latest at its Victoria branch in Gozo. “BoV has always been at the cutting edge of information technology and innovation, not least where customer interface is concerned,” he says. “We have been the local pioneers in ATMs, internet banking and other alternative delivery channels. Today, it is estimated that only about 15% of transactions are carried out through the branch network. The ‘super-ATMs’ that we are now installing are just the latest link in our service network, through which we aim to offer our customers the most efficient and secure retail banking distribution platform on the island.”

The bank is very supportive of the government’s strategy to promote the island as a regional financial services centre. “Thanks to state-of-the-art regulation, communication networks and a highly educated workforce, this strategy has already started to bear fruit,” says Mr Depasquale. “We are seeing a steady inflow of international financial institutions, especially in the fields of fund administration, captive insurance, as well as banks.

“The financial industry will grow if the concept of Malta as an international centre develops further. To this end, the industry must ensure that it remains always at the cutting edge of regulation, technology and continuous investment in people. Quality human resources are the key to a successful services industry, and financial services are no exception.”

HSBC BANK MALTA

HSBC Bank Malta, with more than 50 branches and offices, serves domestic and international customers. It is one of the largest private employers on the island, with more than 1300 staff at the bank itself. It has also created a further 500 jobs in a call centre that it established to serve the needs of its UK customers.

HSBC Malta last month reported a €71m profit for 2009, but that was 26% down on 2008. “Like all banks around the world, we’re not immune from margin compression,” says Chris Bond, HSBC Malta’s head of global banking and markets. “With interest rates at a low throughout the cycle, we’ve suffered the same degree of margin compression. But we haven’t had any type of government support. We haven’t needed it. We’ve remained profitable.

“If you look at our profitability for the two-year period during this financial crisis, we have made a total of €167m. That’s significantly more than our nearest rival here on the island. We have been generating returns on equity in excess of 15%, which I think you’d agree is the envy of most banks around the world. And, most importantly, we’ve remained open for business throughout this period and continue to be open for business for new opportunities.”

Mr Bond’s responsibilities extend across a range of activities, including asset management, fund administration, custody, investment banking, treasury and capital markets. “We have been enjoying an increasing number of enquiries from funds domiciled overseas now looking at Malta or new startups looking at Malta as a potential domicile, ranging from insurance companies to fund managers to professional treasury investment functions,” he says.

“We are using our international connectivity to bring these clients to Malta, in addition to which, we’re also very closely linked with our operations around the world. [HSBC’s] global banking and markets runs a hub-and-spoke organisational structure and we import best practice and expertise from the group to the benefit of our customers.

“For example, for our investors we have world selection, a suite of investment portfolios that are specifically tailored to their needs. And for our corporate customers, we help them manage their exposure to foreign exchange fluctuations and interest-rate fluctuations through a number of hedging products.”

The country’s top two banks could not be more different in overall profile, but they make a good double act – competing against each other to serve the needs of their local and international customers, yet working together to raise Malta’s profile on the global stage.

Figure 2: Financial institutions licence holders

| HSBC Bank Malta has been generating returns on equity in excess of 15%, which I think you’d agree is the envy of most banks around the world |
| Chris Bond |

Source: MFSA
Judging by the pattern of assets under management and the number of funds domiciled, Malta has made a name for itself as one of the most flourishing fund jurisdictions in Europe. The turning point has been Malta’s accession to the EU in 2004 which has further broadened Malta’s international dimension in the fund industry. From that point this industry recorded significant growth until the financial crisis in 2008. Even then, albeit assets under management have understandably reduced, the number of fund registrations continued to edge upwards.

One would ask, what would attract a fund manager or a fund sponsor to Malta when evaluating a number of alternative jurisdictions to set up a fund? I would think that the main factors one has to consider are the reputation of the jurisdiction as well as the seriousness and robustness of the legal, statutory and regulatory framework.

Malta’s legal, statutory and regulatory regime fits this bill. Malta’s regulator, the Malta Financial Services Authority, is conscious of its duty of care to investors and its approach to regulation is underpinned by this important consideration with clear emphasis being made on adequate disclosure requirements being in place. Having said this, the Malta Financial Services Authority is pragmatic in its approach and it would typically encourage early consultation by fund managers seeking to launch or re-domicile their fund to Malta. Even post-launch, the fund manager can maintain an ongoing dialogue with the regulator and this ensures that when problems or issues arise, they are tackled and addressed expeditiously and in a seamless manner. It is pertinent to note here that Malta’s proactiveness is also seen in the speed and the manner in which it adopts EU Directives which are in the main implemented after consultation with the industry. In fact, Malta is one of the most efficient member states when it comes to transposing EU laws within the local legal framework. The EU Internal Markets Commissioner, Michael Barnier, has said: “Malta deserves praise for its ranking in first position for the third consecutive time”.

**SETTING UP BUSINESS**

There is a number of factors that makes Malta attractive as a fund jurisdiction. By way of example it is worth mentioning that Malta is an EU domicile with a lower cost base, which compares very favourably to other well established jurisdictions. The Maltese are multilingual, with English and Italian being very widely spoken. Laws and regulations are published in both Maltese and English with the English version prevailing in most financial services firms. There is also the availability of experienced professional service providers, including lawyers, accountants and audit firms, including the ‘big four’ firms.

HSBC’s involvement in the Maltese fund industry traces its origins to 1996 when Tri-Med Fund Management (Malta) Ltd was set up to manage, promote and sell long-only funds to retail Maltese investors. Post Malta’s accession to the EU, HSBC’s fund management company started providing fund administration to third party funds. In 2007, we went a step further and we segregated the fund administration line of business from the mainstream investment business to set up a wholly owned and separate fund administration arm, HSBC Securities Services (Malta) Ltd.

At HSBC Securities Services (Malta) Ltd we see our relationship with the fund manager as a long term partnership. Accordingly, before quoting for new business, we undertake a careful review of the promoters and fund manager as well
“MALTA’S ACCESSION TO THE EU IN 2004 WAS A TURNING POINT FOR THE FUND INDUSTRY”

We take on in line with the fund manager’s expectations. Where we are not in a position to do so, and where there are more specialist group units tackling such a business, we will introduce the fund manager to the said unit within the HSBC Group in other jurisdictions.

FINDING THE RIGHT STRATEGY

Speaking of services, HSBC Securities Services (Malta) Ltd offers a comprehensive range of services which include net asset value (NAV) calculation/unit pricing, investor records processing and corporate management services. We have in our portfolio a broad and diverse range of asset classes including, bond funds, equity funds, money market funds, absolute return funds, property funds and a number of hedge fund strategies.

We also provide turnkey fund launch services. In this regard we provide guidance on the formation and launch process of a fund, introduce the fund to the regulator and other service providers, liaise with legal advisors/service providers appointed (as may be necessary) on the drawing up of the Fund’s Offering Memorandum and Constitutional Documents, Investment Management Agreement, Fund Administration Agreement etc. In short we will do the needful to ensure a seamless launch with a short time to market.

We maintain ongoing dialogue with our clients and we are aware of the fact that in most cases fund managers are seeking that (a) their NAV is issued in a timely and accurate manner; (b) they are receiving a quality service on other aspects of the business; and (c) there is low staff turnover. We strive to achieve all these client expectations and this contributes to our broadening and deepening of relationships with our customers. Indeed, our staff turnover is very low as we give merited importance to staff engagement, motivation and talent management.

IMPROVING TECHNOLOGY OPERATIONS

On the technology front we continue to invest. In 2009 we were the first company within the HSBC Group to migrate to Multifonds, a new state of the art fund accounting platform. Whilst in the current year we are improving the functionality of this platform, we are working in parallel to introduce the Group’s Transfer Agency Platform for investor records processing. We have a number of other projects lined up with a view to improving the robustness and reliability of our systems and to allow straight through processing. We remain conscious of the fact that technology is one of the backbones of our business and we continue to improve our operations and support client requirements.

Moving on to our custody business, we continue to enhance our product offering. When compared to local competition we offer a very competitive and flexible custody package and, more importantly, our customers benefit from one of the strongest balance sheets in the securities services industry, thus providing a good measure of comfort to our clients. An important recent development is the migration of our custody operations to HSBC’s global custody platform. This gives our clients a global reach with sub-custody arrangements in place for 92 markets in Asia Pacific, the Middle East, Europe, Africa and Latin America. This development places us in a unique position in the provision of custody services in Malta.

In conclusion, within the global banking and markets division of HSBC Bank Malta we can offer a bespoke and tailored service to funds from one source – be it fund administration, custody, corporate management services, FX dealing and other treasury services, or stockbroking, as well as banking services through our financial institution group – truly a one-stop shop. Clearly, HSBC remains a key player in the funds sector in Malta where its customers can benefit from local knowledge and the global expertise and footprint of one of the leading securities services providers globally.

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Website: hsbc.com.mt/html
ATTRACTION ALLCOMERS

Fund management

With 401 funds registered, many of which moved to the country upon it joining the EU six years ago, Malta has acquired a reputation as an attractive fund domicile that has drawn in custom from beyond its EU neighbours. Writer Michael Imeson

Malta has developed a sound reputation as a fund domicile, and with it a healthy fund management and fund administration sector. Joining the EU in 2004 sparked it all off, and adopting the euro in January 2008 helped further by removing foreign exchange costs for firms dealing with other eurozone members.

Accession to the EU brought the stamp of approval to Malta’s financial regulatory regime, and under the EU’s UCITS (Undertakings for Collective Investment in Transferable Securities) legislation, Malta can market appropriately licensed funds throughout the EU.

The statistics tell the story. There were 401 funds or collective investment schemes (CISs) registered in Malta at the end of September 2009 (see Table 1), of which 288 were hedge funds or professional investor funds (PIFs). The 328 locally based CISs had a net asset value of €6.5bn at the end of September 2009, according to the Malta Financial Services Authority (MFSA). This was a major advance on the situation in 2006, when there were 145 funds with a net asset value of €4.8bn; and in 2004 their value was only €1bn.

In February the MFSA signed a memorandum of understanding (MoU) with the China Securities Regulatory Commission to “protect and promote the development of the securities markets by providing a framework for co-operation, increased mutual understanding and the exchange of information”. The MoU puts Malta’s funds industry on the same footing as the major fund domiciles in the rest of the world, particularly in the EU, and will facilitate business for financial institutions in both countries. A similar agreement with the China Banking Regulatory Commission is expected to be signed shortly.

Chinese ‘qualified domestic institutional investors’ (fund managers) are now able to invest on behalf of Chinese investors into Malta-domiciled investment funds, both PIFs and UCITS funds, thereby opening up the sector to one of the world’s largest pools of capital. The arrangement also makes it possible for Maltese fund managers to invest in China under certain conditions.

FUND MANAGERS

Running Malta’s funds are 81 licensed fund managers and 13 fund administrators (see Table 2). Apex Fund Services (Malta), a local fund administrator which is part of this network, has its headquarters in Bermuda and around a dozen offices in other parts of the world. John Bohan, one of Apex’s owners, who is based in Ireland, says that the “surge in demand for regulated products and UCITS funds, coupled with the requirement for a robust banking environment, make Malta a perfect choice as a funds domicile”.

He says local laws make it easy to re-domicile funds to Malta from other approved jurisdictions, and the growth in the country’s funds industry has created many opportunities for banks and others to get involved in fund management and administration.

Bank of Valletta Group (BoV), which owns one of the island’s two main banks, has both a fund management arm, Valletta Fund Management (VFM), and a fund administration subsidiary, Valletta Fund Services (VFS). Both performed well last year in difficult circumstances.

“VFM’s funds under management have grown to record levels, albeit with a substantial proportion being represented by the La Vallette Malta Money Fund on which minimal margins are earned,” said BoV group chairman Roderick Chalmers in the company’s latest annual report.

“VFS’s portfolio of international business has shown encouraging growth, justifying the separate focus that was the rationale behind the establishment of this new and dedicated business entity, which is playing an important role in Malta’s development as an international financial services centre.”

AN INDUSTRY VOICE

Charles Azzopardi, vice-chairman of the Malta Funds Industry Association (MFIA) and managing director of HSBC Securities Services (Malta), a fund administrator, says the industry is now in its 14th year. “It began just after the necessary legislation, the Investment Services Act, was passed in 1994, after which the two major banks, Mid-Med Bank (now HSBC Bank Malta) and Bank of Valletta set up their respective fund management companies in 1995/96,” says Mr Azzopardi.

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**Table 1: Collective Investment Schemes (CISs)**

<table>
<thead>
<tr>
<th>Category</th>
<th>September 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail schemes: non-UCITS</td>
<td>62</td>
</tr>
<tr>
<td>Retail schemes: UCITS</td>
<td>51</td>
</tr>
<tr>
<td>Professional investor funds (PIFs)</td>
<td>288</td>
</tr>
<tr>
<td>Total</td>
<td>401</td>
</tr>
<tr>
<td>Recognised private CISs</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: MFSA

**Table 2: Investment Services Firms**

<table>
<thead>
<tr>
<th>Category</th>
<th>September 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total investment services licenses</td>
<td>81</td>
</tr>
<tr>
<td>Recognised fund administrators</td>
<td>13</td>
</tr>
</tbody>
</table>

Source: MFSA
Mr Azzopardi lists a number of factors that make Malta an attractive and alternative jurisdiction. “The island’s only natural resource, excluding the sun and the sea, is its people. The Maltese have managed to adapt and develop not just over the past decade and a half, but over the centuries.

“So one of the big pluses, in my opinion, is the availability of high-calibre and multi-lingual people in the most essential sectors of the business, be it the regulator, the service providers and other professionals such as the legal and audit firms on the island. Where else can a fund promoter convene, within a short period of time, week or so, meetings with lawyers, fund administrators, custodians and audit firms, and then the regulator? I have seen this happen.

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Mr Azzopardi lists a number of factors that make Malta an attractive and alternative jurisdiction. “The island’s only natural resource, excluding the sun and the sea, is its people. The Maltese have managed to adapt and develop not just over the past decade and a half, but over the centuries.

“So one of the big pluses, in my opinion, is the availability of high-calibre and multi-lingual people in the most essential sectors of the business, be it the regulator, the service providers and other professionals such as the legal and audit firms on the island. Where else can a fund promoter convene, within a short period of time, week or so, meetings with lawyers, fund administrators, custodians and audit firms, and then the regulator? I have seen this happen.

“Despite the global financial crisis and turmoil in 2008, Malta has weathered the storm quite well, as we saw fund promoters continuing to view Malta as an alternative and flourishing jurisdiction to domicile their funds, especially in the alternative investment funds space.”
Re-domiciliation of funds into Malta

International regulatory frameworks are resulting in more stringent rules for offshore centres. Malta is well-placed to strengthen its position in this market.

Malta has implemented flexible and effective re-domiciliation rules for corporate bodies in 2002, which have since then been successfully used by an increasing number of commercial companies and financial services vehicles, including collective investment funds. Corporate funds, be they companies or limited partnerships, incorporated in any jurisdiction except Financial Action Task Force (FATF) blacklisted countries — are allowed to migrate to Malta.

The main attraction of re-domiciliation is that the entity can maintain its corporate existence without the necessity of being wound up, with all the benefits this clearly entails in terms of cost-saving and continuity of infrastructure, operations and performance.

The financial crisis in 2008-9, the proposed Alternative Investment Fund Managers Directive (AIFM) and other initiatives taken by the EU, Organisation for Economic Co-operation and FATF, which are resulting in a tighter scrutiny of offshore jurisdictions and a global trend towards higher levels of regulation, is inevitably leading more fund promoters to shift their focus from the traditional offshore centres to regulated but ‘friendly’ onshore fund domiciles. This has earned Malta a place on the map of promoters’ domiciles of choice, particularly for the following reasons:

- Malta is traditionally a civil law jurisdiction, but its company law is largely based on UK company law, a mixture which facilitates the smooth continuation of entities originally set up under any legal system.
- As a member of the EU, Malta aligns its financial services laws with the acquis communautaire, making available the passporting and other harmonisation benefits sought by fund promoters targeting European investors.
- Malta applies international accounting and auditing standards and practices, making it easier for migrated entities to draw up their financial statements.
- Straightforward re-domiciliation procedure with clear and basic documentation submission requirements.
- Malta is cost-competitive, with salary and office costs, professional fees and other costs being about two-thirds of those prevailing in more established centres.
- MFSA, the single regulator of financial services, is very approachable and takes a pro-active and open approach to new proposals, and is committed to short response time.
- The availability of necessary infrastructure, technology, skilled human resources and choice of service providers.
- The Professional Investor Fund regime in Malta, available to three categories of non-retail investors, allows funds to invest in any asset classes and to adopt any investment strategy, to borrow without restrictions (with a few exceptions), and also to appoint foreign managers, custodians and other service providers, allowing migration of funds of any type (be they hedge funds, fund of funds, private equity, real estate or other funds) which can retain their operational infrastructure without modifications.
- Funds already listed outside Malta may retain their existing listing (subject to approval of the relevant exchange) and/or apply for listing (including a secondary listing) on Malta’s recognised investment exchange.
- Promoters of offshore funds can take opportunity from the re-domiciliation event to convert their fund into the UCITS brand (by complying with the documentation and infrastructure requirements of the UCITS Directive), thereby using Malta as a gateway to European markets.
- The tax neutrality on income and capital gains available at the level of the fund and non-resident investors, exemption from stamp duties, the extensive double tax treaty network Malta has with almost 50 countries and the refund mechanism (reducing the net tax leakage in Malta to 5%) provide excellent tax planning opportunities for migrating funds, their investors and also their managers and other service providers.

“MALTA HAS EARNED A PLACE ON THE MAP OF PROMOTERS’ ONSHORE DOMICILES OF CHOICE”

Joseph Saliba, partner, Mamo TCV Advocates

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AN INTERNATIONAL FLAVOUR

Insurance

Malta’s insurance sector is highly oriented towards international insurers, with insurance management companies based in the country heavily involved in helping to run them on behalf of their parent organisations. Writer Michael Imeson

The number of insurers in Malta has grown rapidly over the past five years, mainly because of an increase in international and captive insurance business, though there was a slowdown last year due to the overall economic environment.

There are now 37 internationally oriented insurance companies in the country, compared with 36 in 2008 and only nine in 2005 (see table opposite and Figure 1). Among them are eight captives and three protected cell companies (PCCs). A captive insurance company underwrites the risks of a parent company and its subsidiaries, or the risks of members of a trade or professional association. A PCC is a company which, in addition to its core, contains a number of segregated parts, or ‘cells’; each cell is legally independent from the others, as well as from the core, so its assets, liabilities and activities are ‘protected’ from the rest should any of the others get into trouble.

In addition, there are seven insurers that are locally oriented (see Figure 1, names in bold), writing mainly local business, including Middlesea Insurance and HSBC Life Assurance. Finally, not shown in either the table or Figure 1 are two non-EU insurance principals – American Home Assurance and QIC International.

Most, if not all of the internationally oriented insurers have appointed insurance managers to run their Maltese operations, and there are 12 such insurance managers on the island, up from six in 2005 (Figure 2). An insurance manager is an insurance company, broker or individual that provides management services to other insurance companies, including captives, where it is not feasible or cost-effective for an insurer to carry out these functions itself.

Malta offers pure captives, and captives writing third-party business, a number of benefits. These include EU membership, which allows Maltese captives to dispense with the need for fronting companies into the EU; EU-compliant regulation with additional flexibility and responsiveness; a headline corporate tax of 35%, but for captives insuring risks outside Malta, tax refunds which reduce the effective rate to 5%.

Other benefits include the PCC legislation; good local insurance, legal and accounting expertise; and regulations that allow captives to be easily relocated from other jurisdictions that have similar legislation.

MANAGEMENT OPPORTUNITIES

Insurance management has proved to be fertile ground. Among the 12 insurance managers active on the island are global big-hitters such as Aon, Marsh and Willis. The sort of management services provided to foreign insurers setting up in Malta range from carrying out feasibility studies on the viability of a project, and then incorporating the company and applying for a licence.

Once an insurance company is up and running, the insurance manager can then provide every service imaginable, such as insurance, reinsurance, accounting, cash management, risk management, company secretariat services and compliance services, even down to basic back-office functions such as payroll, IT and general administration.

According to a survey conducted by the Malta Insurance Management Association (MIMA) last year, the number of managed insurers and reinsurers in the country almost doubled between 2007 to 2009, from 20 to 38. The total gross premium written in Malta in 2008 by these insurers amounted to €122m, 28% above the 2007 figure. In addition, the gross fee revenues generated by the insurance managers in 2008 rose by almost 200% to €3.7m, from €1.3m in 2007, while the total cash and investments balance for insurers under management increased by 59% to €883m.

Former MIMA chairman John Tortell says the survey provides a clear indication that the international insurance market has become a substantial source of revenue in Malta’s financial services sector, “due largely to unrelenting efforts of all the licensed insurance managers to promote their services worldwide and the regulatory authorities to ensure a consistent application of the laws and regulations”.

However, the economic downturn last year injected a sober air of reality. Elizabeth Carbonaro, general manager of International Insurance Management Services (IIMS), which is owned by Middlesea Insurance, the country’s biggest local insurer, says many insurers were not keen on starting new ventures given the volatility of the markets.

“In 2008, more than 11 third-party writers and seven cells were registered, but in 2009 only two insurance companies and one cell were registered, one of which is managed by IIMS,” says Ms Carbonaro. “Having said that, I think 2009 can be seen as an explorative year by clients with a lot of interest being shown by potential clients. We do therefore have certain projects in the pipeline.”

LOCALLY ORIENTED INSURERS

The domestic insurance sector is not as developed as in the more mature EU states. The percentage of premiums collected as a proportion of the country’s gross domestic product (GDP) stood at 5.39% in 2008, compared with an EU average of 6.9%, according to the Malta Insurance Association.

However, for countries at a similar level of development, Malta has a higher level of insurance penetration than everywhere except Portugal. General insurance premiums amount to about 2.2% of GDP compared with the EU average of 3.25%, while premiums derived from life insurance products amount to about 4.2% of GDP compared with 5.5% for the EU as a whole.

Gross premiums written (GPW) for general business by insurance companies with head offices in Malta amounted to €650m in 2008 (€509m in 2007) according to figures published by the Malta Financial Services Authority towards the end of 2009. The increase in GPW came from risks insured both inside and outside Malta, the latter business attaining the largest increase (33% as against 3%). For 2008, the GPW for general business breaks down to €50.2m for accident and health, €88.5m for motor, €9.8m for aviation, marine and transport, €313.4m for fire and other damage to property, €104m for general liability, €5.4m for credit and suretyship, and €79m for other classes.

The Banker April 2010
Gross premiums written for life business by insurance companies with head offices in Malta amounted to €221.4m in 2008 (€265.2m in 2007). After registering a significant increase in GPW in 2007, there was a significant drop in 2008.

**HARD TIMES FOR SOME**

Middlesea Insurance had a difficult 2009. At an extraordinary general meeting (EGM) last November, executive chairman Mario Grech (who has since retired) revealed that the forecast post-tax loss for 2009 was €41.75m, compared with a loss of €20.6m in 2008 and a profit of €6.9m in 2007.

Middlesea companies operating in Malta ran at a profit last year. The problem has been the losses made by its Italian subsidiary, Progress Assicurazioni. Middlesea issued a statement in February this year saying it planned to wind it up.

Progress had made a profit for the group since its acquisition in 2001 up to the end of 2007. The “substantial” losses incurred since then had been caused by a number of factors, “the combination of which had a devastating impact”, said Mr Grech at the EGM.

The saga has placed an unprecedented strain on Middlesea’s capital resources, reducing its capital base from €85.8m in December 2007 to €40.1m in September 2009. It therefore made a capital call of €40.2m through a rights issue in December which was supported by the three main shareholders, Bank of Valletta, Mapfre Internacional and Munich Re, and was fully subscribed. It also negotiated additional bank financing of about €8m.

“The group will now strengthen its position in Malta by consolidating its participation in a market which has potential space for substantial growth,” said Mr Grech.

**GOOD TIMES FOR OTHERS**

It is certainly not all doom and gloom for local insurers. The fortunes of HSBC Life Assurance (Malta) are in direct contrast to those of Middlesea. HSBC’s insurance performance held up in a difficult environment. Regular premium sales were up in 2009 compared with the previous year. Life insurance operations generated a reasonable pre-tax profit, in the circumstances, of €11.7m, down 29% from the previous year.

Last year’s recession certainly made its mark on Malta’s domestic insurance market. But the ease with which Middlesea raised additional capital shows there is everything to play for as the economy recovers.

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**Figure 1: Fully licensed insurance principals (excluding captives and PCCs)**

- Arnold Clark Insurance (Malta) Ltd
- Arnold Clark Life Insurance (Malta) Ltd
- Axter Re Ltd
- Bastion Insurance Company Ltd
- Bavaria Reinsurance Malta Ltd
- Bray Insurance Company Ltd
- Caversham Insurance (Malta) Ltd
- Central General Ltd
- Central Life Ltd
- Citadel Insurance plc
- Elmo Insurance Ltd
- GasanMamo Insurance Ltd
- GlobalCapital Life Insurance Ltd
- Grafton (Europe) Insurance Company Ltd
- HSBC Life Assurance (Malta) Ltd
- International Diving Assurance Ltd
- Middlesea Insurance plc
- Middlesea Valletta Life Assurance Co Ltd
- Multi Risk Benefits Ltd
- Multi Risk Indemnity Company Ltd
- Munich Re of Malta plc
- Nissan International Insurance Ltd
- Platinum Insurance Ltd
- Practice Plan Insurance Ltd
- Propgen Insurance Ltd
- PSA Life Insurance Company Ltd
- RCI Insurance Ltd
- RCI Life Ltd
- Saint John’s Insurance Ltd
- Setanta Insurance Company Ltd
- Taurus Insurance Ltd
- Trinity Lane Insurance Company Ltd

Locally orientated are in bold.

The rest are internationally orientated.

Source: MFSA

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**Figure 2: Insurance managers**

- Abacus Risk Management Services PCC Ltd
- Alternative Risk Management (Malta) Ltd
- Aon Insurance Managers (Malta) Ltd
- Ark Insurance Management (Malta) Ltd
- FirstUnited Insurance Management Ltd
- Heritage Insurance Management (Malta) Ltd
- HSBC Insurance Management (Malta) Ltd
- Island Insurance Management Services Ltd
- JLT Insurance Management Malta Ltd
- Marsh Management Services Malta Ltd
- Willis Management (Malta) Ltd

Source: MFSA

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**INSURANCE COMPANIES OPERATING INTERNATIONALLY**

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<tr>
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<tr>
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<td>3* (10 cells)</td>
<td>3* (21 cells)</td>
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<tr>
<td><strong>Total</strong></td>
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<td><strong>10</strong></td>
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<td>Insurance managers</td>
<td>6</td>
<td>9</td>
<td>11</td>
<td>12</td>
<td>12</td>
</tr>
</tbody>
</table>

Source: MFSA *One of the PCCs is local
FIRM YET FLEXIBLE
Regulation

When a financial institution considers setting up in a new jurisdiction, it wants a regime that is robust, but also fair. For many, the Malta Financial Services Authority ticks all these boxes.

**Writer** Michael Imeson

THE MALTA FINANCIAL SERVICES AUTHORITY (MFSA), loosely based on the UK’s Financial Services Authority, is widely regarded as being a key factor in how successful the country has been in attracting foreign firms. As a member of the EU, it has the same regulatory model as other member states, but it is allowed some leeway, hence its reputation for being ‘firm yet flexible’.

The MFSA has moved away from a strictly rules-based approach towards one that is more principles based. It constantly reviews the rules and from time to time removes what is no longer required. It also looks at regulation in conjunction with the needs of the firms it regulates, and their businesses, and where it can be flexible, it is. The MFSA often refers to its activities as ‘services’ provided to ‘clients’, which is an indication of how accommodating it can be.

But it is not an easy touch. It runs a strict regime, and gets close to all of those it regulates and supervises – a comparatively simple job in such a small country. The benefits are twofold – the MFSA gains a better understanding of the soundness of licence holders, and that in turn allows it to be adaptable where possible.

Professor Joseph Bannister is the MFSA’s chairman, a position he has held since 1998. He wrote the model for it to become the single financial regulator in 2002 and managed many of the reforms of the late 1990s and early 2000s that allowed the financial sector to evolve. Mr Bannister was educated as a life scientist at Oxford, Cranfield and Malta, and is professor of biomedical sciences at the University of Malta.

“When financial institutions consider setting up in a new jurisdiction, the nature of the regulatory regime is always a factor,” says Mr Bannister. “They want a regime that is robust, but one that is also fair and not over-burdensome. They want to be able to discuss their concerns with the regulator, and be made to feel comfortable.” (A full interview with the professor can be viewed on www.thebanker/media in the Masterclass section, and a write-up appears on pages 88 and 89 of this month’s *The Banker*.)

IN THE MAINSTREAM

When Mr Bannister took over the helm at the MFSA, Malta was still an unreformed ‘off-shore’ jurisdiction. It had already begun reforms in preparation for joining the EU, and Mr Bannister continued that work so that by the time it joined the EU, the financial sector had been transformed.

As the authority’s website states, Malta was one of the first six countries in the world to reach an advanced accord on fiscal matters with the Organisation for Economic Co-operation and Development (OECD). “As a result of this agreement, Malta is not considered as a tax haven. It is actively involved with the OECD, the EU and the Commonwealth in modelling global regulatory policy,” says the authority. The country’s finance industry has therefore benefitted significantly from this policy.

The MFSA restructured itself in January, removing the ‘silo-based’ structure that had served it well since its creation in 2002, but which had become regarded as too limiting and unwieldy. It was replaced with a more integrated, harmonised structure with overlapping functions and responsibilities, intended to lead to greater consistency in licensing, supervision and internal communications.

A significant development took place towards the end of last year that will boost the pensions sector, and the MFSA had a hand in it. The UK’s HM Revenue & Customs recognised Malta as a jurisdiction where pension schemes, regulated by the MFSA, can be considered to be eligible for the status of qualifying recognised overseas pension schemes (QROPS) under UK law.

QROPS allow people who are no longer resident in the UK to transfer pension benefits in a UK recognised pension scheme to a recognised pension scheme elsewhere. This can provide certain tax benefits for both employees and employers. The MFSA is currently processing applications for the registration of pension schemes which, once authorised, can apply to be QROPS, providing additional business for firms involved in Malta’s pensions sector.
The credit crisis, discontinuity, financial services and Malta

The impact of the financial crisis has played a part in Malta’s rise as an international finance centre. Tonio Zarb at KPMG explains how the country is successfully weathering the storm.

The credit crisis has been likened by many to the great depression of the 1930s, both as to its impact and duration. The crisis has brought with it a time of discontinuity in which the certainties of yesterday seem much less certain than ever.

The impact of the current crisis is far reaching. We have seen global names disappear overnight and massive state support to bolster ailing financial services operators on an unprecedented scale. We have witnessed, first hand, the negative aspects of globalisation. This crisis represents the first in the economic globalisation era and the extent of its impact is also attributable to the interconnection of the global financial system. What started out as a problem in the US subprime mortgage market quickly spread to the whole world.

Certainly the crisis has underlined the dangers of irresponsible levels of leverage. It has brought to the fore the importance of responsible governance and transparency in our financial institutions. The role of the board of directors, and that of the audit committee, are central to this discussion. It has also shifted the attention onto risk management and how this can be integrated in the way banks and other financial institutions go about their business, how they ensure that they do not take on risks without adequate compensation and, even worse, without being aware of the real risks in the first place.

MALTA’S RESILIENT ECONOMY

The impact of the crisis is far reaching indeed with very few industries being spared. The resulting lack of liquidity in the capital markets coupled with the wide spread pessimism that it generated, left its toll not only on the financial services and the real estate sectors. Global trade has decreased, various industries suffered a significant drop in demand, tourist numbers have fallen – and the list goes on.

However, in this time of great discontinuity some have found opportunities. Malta has not been immune to the financial crisis – we have seen a drop in profits in the banking sector, a decrease in consumption generally, a fall in tourist arrivals and tourist spend in 2009, and a brake on the real estate market. Yet, with the benefit of hindsight, there is general agreement in Malta that the local economy has proven to be quite resilient and that we have not fared as badly as many others.

REALISING POTENTIAL

Perhaps the main source of good news is that the international financial services sector in Malta continued to perform well in spite of the global crisis. The significant increase in business we experienced in this sector since EU accession continued unabated in the last 24 months. Today there are some 580 regulated entities (including investment funds) up from 180 at the end of 2004, and about 11,500 other non-regulated entities operating in what we loosely define as the international financial services industry – more than double the number at the end of 2004.

This continuity of growth in this sector has now confirmed Malta as a serious player as an international financial services centre. In an October 2008 survey by the World Economic Forum on the stability of banks across the globe, Malta was ranked tenth underlining the perceived soundness of the island’s banking system. In January 2010, Malta placed second behind Luxembourg in the Fund Domiciles Stability Monitor Index. These results place Malta in a very good position, at this time of discontinuity, to take advantage of the move by investors towards well regulated, cost efficient and transparent jurisdictions.

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Pool of Support Services
Accountants, lawyers, consultants and more – Malta boasts a talented pool of professionals to cater for the financial service sector, and at a cheaper price than other European financial centres.

Writer Michael Imeson

KPMG, PricewaterhouseCoopers, Deloitte, Ernst & Young. You name them, Malta has them – the big four accountancy firms that is, and many more other professional support services firms as well. Every successful or aspiring financial centre needs a large choice of accountants, auditors, lawyers, consultants and other professionals to service their specialist needs, and Malta appears to have few deficiencies in that department.

The country’s service sector is long-established and comprehensive, and serves local customers and international clientele. What’s more, Maltese professionals’ fees are generally lower than those charged by their counterparts in other EU member states. Their growing role is proving essential to Malta’s financial services sector and the wider economy, and they have developed expertise in niche areas such as captive insurance, funds, trusts, wealth management and ship registration and management.

Ship registration is particularly interesting, since Malta has the second largest ship register in Europe and the eighth largest in the world, with about 5000 vessels registered. The Malta Maritime Authority merged with the Malta Transport Authority (primarily responsible for roads and buses) and the Civil Aviation Department in January this year into one organisation, Transport Malta. Many luxury and commercial yachts owned by wealthy individuals are registered and managed from Malta, and now Transport Malta is promoting itself as the best place to register executive jets. It targets not just the rich themselves, but also the people who handle their affairs – including their accountants, lawyers and financial advisors.

An Accountant’s View
The country needs more accountants than the Big Four can provide, which means there is a plentiful supply of other accounting and auditing firms, many of them owned by local companies such as Avanzia Tax Advisors and Ciantar Associates. They are all regulated by the Accountancy Board which oversees professional conduct and standards, and other aspects of practices and individuals operating in the profession.

Kevin Valenzia, territory senior partner for PwC in Valletta, says his country’s professional practice firms support a broad spectrum of needs. They compare well with those in other countries, offering the same high-quality and value-added service as their foreign counterparts. “Our firm evidences this – we provide the same services at the same quality levels as all other firms within the PwC network,” says Mr Valenzia. “Our people have gained significant work experience in PwC firms in, among other places, New York, London, Milan, Rome, Luxembourg and Jersey.”

Major Presence
PwC is by far the largest audit firm in Malta, with 15 partners, approximately 330 employees and a turnover of €15.4m in 2008. It does pretty much what it does everywhere else – provide audit, tax and business advisory services to business and financial organisations, from top-tier multinationals to small and medium-sized enterprises and public sector entities. The bedrock of its client base is “enterprises active in and committed to Malta”, says Mr Valenzia, but the success of the local financial sector has given it a more financial and international orientation in recent years.

“EU membership has brought about new opportunities for overseas work which the firm has been relentlessly pursuing,” he says. “International financial and tax services, and the provision of services to other firms within the PwC network, have been two areas benefiting from this trend, as has the statutory audit practice, which has enjoyed an influx of audits, conducted from Malta, of multinational companies operating in Malta. The result has been a remodelling of the practice, so that in 2008, 45% of income was derived from international clients.”

A large number of law firms operate on the island, and although the major international law firms are not there, most have relationships with local legal practices. Leading advocates on the island include Fenech & Fenech, Chetcuti Cauchi, Camilleri Preziosi, David Griscti & Associates, Mamo TCV and Ganado & Associates.

The Maltese legal profession is long-established. Most lawyers have post-graduate degrees in various practice areas, financial services included, and many have had further training at major institutions and international law firms overseas, primarily the UK.
The country’s law firms are regularly listed in Chambers, Legal 500, and other directories based on peer recommendations.

Fenech & Fenech is Malta’s oldest law firm. “We are engaged by banks, insurance companies, fund managers and promoters of investment funds to assist in setting up financial services businesses in Malta, and obtaining the necessary licences from the Malta Financial Services Authority,” says Dr Rosanne Bonnici, a partner at the firm.

It has expertise in many disciplines, including aviation asset financing, ship finance, structuring special purpose vehicles to be used in collective investment structures, redomiciling offshore insurance captives or investment funds to Malta, and trusts.

“We cover the full range of legal issues, including matters such as the structuring of a group’s operations from a tax planning point of view, general corporate and commercial issues, employment and immigration issues, and so forth,” says Ms Bonnici. “We are the only firm with a fully dedicated marine litigation department.”

“Malta is not aspiring to become a financial centre like New York, Frankfurt or London,” adds Ms Bonnici. “However, the past five years have shown that Malta is well down the road to become a pillar in the economy. Malta is now a recognised domicile of choice for the funds sector. A stronger interest from international banks is also being registered, with Deutsche Bank being the latest in a string of banks to be licensed in Malta.”

WIDE RANGE OF CONSULTANTS

There are many home-grown consultants on the island. The likes of Erremme Business Advisors, Aeqitas Strategy Consulting, Busuttil & Micallef and others provide advice, company formation services, contract drafting, back-office support and other services.

Erremme Business Advisors, for example, a management consultancy and accountancy firm established in 2002, has made a name for itself as a one-stop shop for startups and small to medium-sized growth companies in several sectors, including financial services. Managing director Reuben Buttigieg, who is also chairman of the management school at the Malta Institute of Management, spends a large part of his time promoting Malta as a potential Islamic financial centre. No sharia-compliant products are yet being offered in or from Malta, but Mr Buttigieg says it is only a matter of time before the island is used as a base to market such products to other parts of Europe and to north Africa.

One of the main problems for Islamic finance providers in Europe is that certain sharia-compliant banking products attract tax that conventional products do not. For example, the Islamic financing of a construction project in, say Italy, would involve various transfers of property from one entity to another that a conventional product would not involve, and these transfers would be subject to extra duty on documentation, capital gains tax and property tax. “However, a special purpose vehicle created in Malta to handle these Italian transfers would mitigate those taxes,” says Mr Buttigieg. “One of the transfers would still be subject to tax but the second would not, creating a level playing field for the Islamic product.”

He also sees opportunities for sharia-complaint funds to be domiciled in Malta, especially smaller funds which larger European jurisdictions may not consider worthwhile managing or administering. “We have a niche here which we can exploit, and I know of a number of applications for Islamic funds that are in process,” he says.

In north Africa, banking services and financial regulation lack sophistication, and Islamic finance is not encouraged in some countries for fear of business rapidly draining away from conventional banks and threatening their solvency. Mr Buttigieg believes this provides an opportunity for banks to set up in Malta to offer Islamic financial services to north Africa. “They would have a registered bank here, operating within our well-regulated regime, and a representative office in, say, Morocco, selling the Islamic products. The main market would be for sharia-compliant project finance.”

He points out that there are already banks using Malta to provide conventional products to north African countries – such as BAWAG Malta Bank, owned by Austrian and American interests – so it would not need a leap of faith to do the same for Islamic banking products. He admits, however, that for Islamic banking to happen in Malta, legal and regulatory changes would be needed.
GETTING THERE...
LIVING THERE

Travel

Anyone considering doing business in Malta will need to know a few practical things about flights, hotels and so on — and more if they are thinking of living there.

WRITER Michael Imeson

RUNNING AN INTERNATIONAL business from a sunny island in the Mediterranean may have many advantages, but there are a few practical disadvantages too. An obvious drawback is that you cannot just jump on a train to get to a neighbouring country, as you can if, say, you are in London and want to go to Paris, or you are in Frankfurt and need to get to Brussels. But then, most international business trips are made by air anyway, and Malta, though in the southern Mediterranean, is no more than two or three hours from most places in Europe.

Air Malta, the national airline, flies to many countries in Europe, and to places such as Tunisia and New York. A large number of other airlines have services to the island, though British Airways is an exception — a gap partly filled by Ryanair, bmibaby and easyJet. Malta joined the Schengen area of the EU in 2008, which makes travelling to and from other members of the area much easier than travelling throughout the rest of the EU. It is only a 20-minute taxi ride (£15) from the airport to the capital.

Once there, the choice of hotels in and around Valletta, the capital, is more than adequate. The well-known international chains are present such as the Hilton, InterContinental, Le Méridien, Radisson Blu, and Westin, but there are other five-star hotels such as the Grand Hotel Excelsior, Corinthia Palace and Phoenicia — and all are on, or close to, the Mediterranean coastline. There is also the boutique, family-run Xara (pronounced ‘shara’) Palace, luxurious, individual and possibly the most expensive hotel on the island.

In terms of being understood, English is the joint official language along with Maltese, a big advantage for international firms located there, all of which are in or around Valletta.

“Today, Maltese is used in most sectors of public life, including parliament, the church, the press and other media, and in general conversation. English is generally the preferred medium of instruction in schools, especially at the higher levels of the educational system,” explains Simon Ager, who runs www.omniglot.com.

DAYS OFF

As the island is only 27 kilometres long and 14.5km wide, it is easy to go sightseeing on days off or take a short boat trip to the quiet island of Gozo, with its striking Azure Window rock arch. There are not many beaches in Malta, as it is mainly rocky with cliffs, but there are plenty of sea and sun-based activities, historic buildings and sites to see, and classic Mediterranean food to eat.

The climate is warm and sunny, and even winter days can be pleasant, but it can get very hot in the summer in the urban areas (for details go to www.visitmalta.com). International Living, the magazine and website, last year rated Malta’s climate as the best in the world, with 96 points out of 100. “These islands, undiscovered jewels that most people couldn’t pinpoint on a map, offer blue skies and sunshine — even in January and February,” it said.

EXPATRIATE LIVING

Although Malta joined the EU in 2004, until 2011 there are still restrictions placed on EU and European Economic Area (EEA) nationals who wish to work in the country. They must obtain a residence permit if they intend to live in Malta for more than three months, and an employment licence. Visitors from outside the EU/EEA may need a visa.

The top rate of income tax is 35%, which compares favourably with other EU countries, such as the UK, where the top rate increases from 40% to 50% this month. EU nationals resident in Malta can get free medical treatment at government-funded hospitals and clinics. The main hospital, Mater Dei Hospital, is new and exceptionally good by European standards.

Being a small, crowded island, there are limits on the types of residential property foreigners can buy, in order to keep prices affordable for locals. Generally, a foreign national can buy only one residential property to be used as his or her primary residence, or as a holiday home during part of the year, according to www.property-abroad.com. “Even for EU member state nationals, the ability to own real estate in the country is limited,” it says. These restrictions are gradually relaxing to bring the country in line with the principles of the European single market.