Regulation and Supervision of the Financial Services Sector

Mdina – The Silent City, Malta

MFSA
MALTA FINANCIAL SERVICES AUTHORITY
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Introduction

Malta became a Member State of the European Union in 2004 and a member of the European Monetary Union [“EMU”] in 2008 when it adopted the Euro as its currency. The Maltese economy is based on tourism, manufacturing and services of which financial services is becoming one of the main pillars of the economy. Economic data published by AMECO [Annual Macro-Economic Database of the European Commission] show Malta as one of the best economic performing countries in the EU.

<table>
<thead>
<tr>
<th>Economic Performance</th>
<th>2013</th>
<th>2014</th>
<th>2015 *</th>
<th>Best Performing</th>
<th>Worst Performing</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Growth [Malta]</td>
<td>2.3</td>
<td>3.5</td>
<td>3.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP Growth [Eurozone]</td>
<td>-0.4</td>
<td>0.8</td>
<td>1.5</td>
<td>LU (5.6%)</td>
<td>CY (-2.3%)</td>
</tr>
<tr>
<td>GDP Growth [EU]</td>
<td>0.1</td>
<td>1.3</td>
<td>1.8</td>
<td>LU (5.6%)</td>
<td>CY (-2.3%)</td>
</tr>
<tr>
<td>Budget Deficit - % GDP [Malta]</td>
<td>-2.6</td>
<td>-2.1</td>
<td>-1.8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Budget Deficit - % GDP [Eurozone]</td>
<td>-2.9</td>
<td>-2.4</td>
<td>-2</td>
<td>DE (0.7%)</td>
<td>CY (-8.8%)</td>
</tr>
<tr>
<td>Budget Deficit - % GDP [EU]</td>
<td>-3.2</td>
<td>-2.9</td>
<td>-2.5</td>
<td>DK (1.2%)</td>
<td>CY (-8.8%)</td>
</tr>
<tr>
<td>National Debt -%GDP [Malta]</td>
<td>69.2</td>
<td>68</td>
<td>67.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Debt -%GDP [Eurozone]</td>
<td>93.2</td>
<td>94.2</td>
<td>94</td>
<td>EE (10.6%)</td>
<td>GR (177%)</td>
</tr>
<tr>
<td>National Debt -%GDP [EU]</td>
<td>87.3</td>
<td>88.6</td>
<td>88</td>
<td>EE (10.6%)</td>
<td>GR (177%)</td>
</tr>
<tr>
<td>Unemployment [Malta]</td>
<td>6.4</td>
<td>5.9</td>
<td>5.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployment [Eurozone]</td>
<td>12</td>
<td>11.6</td>
<td>11</td>
<td>DE (5%)</td>
<td>GR (26.5%)</td>
</tr>
<tr>
<td>Unemployment [Europe]</td>
<td>10.9</td>
<td>10.2</td>
<td>9.6</td>
<td>DE (5%)</td>
<td>GR (26.5%)</td>
</tr>
<tr>
<td>GDP per Capita [Malta]</td>
<td>17,200</td>
<td>18,600</td>
<td>19,500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP per Capital [Eurozone]</td>
<td>28,600</td>
<td>29,800</td>
<td>30,400</td>
<td>LU (88,500)</td>
<td>LV (12,1100)</td>
</tr>
<tr>
<td>GDP per capita [EU]</td>
<td>25,700</td>
<td>26,600</td>
<td>27,300</td>
<td>LU (88,500)</td>
<td>BU (5,800)</td>
</tr>
</tbody>
</table>

*Projected

Source: Annual Macro-Economic Database of the European Commission
Malta’s integration within the EU and the EMU has served to enhance further its establishment within the field of financial services. Malta has in fact been developing as a financial services jurisdiction since 1994. The regime regulating the financial services sector incorporates all EU financial services legislation and consequently operators benefit from the single market passporting rights under freedom of services and freedom of establishment.

The financial services sector has consistently expanded by around 25% in recent years and direct intermediation contributes 8.5% of GDP\(^1\). At least a similar amount is being contributed by indirect intermediation from the activities accountancy and law firms, corporate service providers and treasury companies. Over 90% of foreign direct investment is in the financial services sector.

The World Economic Forum Competitiveness Report 2015-2016 ranks Malta highly out of 148 countries. The following is a comparison with other European jurisdictions:

<table>
<thead>
<tr>
<th></th>
<th>Ireland</th>
<th>Luxembourg</th>
<th>United Kingdom</th>
<th>Malta</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Soundness of the Banking System</strong></td>
<td>126</td>
<td>12</td>
<td>63</td>
<td>15</td>
</tr>
<tr>
<td><strong>Strength of Auditing &amp; Reporting Standards</strong></td>
<td>59</td>
<td>8</td>
<td>15</td>
<td>20</td>
</tr>
<tr>
<td><strong>Regulation of Securities Exchanges</strong></td>
<td>53</td>
<td>5</td>
<td>21</td>
<td>25</td>
</tr>
</tbody>
</table>


1. Regulation and Supervision of Financial Services Companies

1.1 Jurisdiction – who is the regulator?

The Malta Financial Services Authority ("MFSA") is the single regulator of financial services. The MFSA regulates banking, financial institutions, insurance companies and insurance intermediaries, investment services companies and collective investment schemes, securities markets, recognized investment exchanges, trust management companies, company services providers and pension schemes. The MFSA is also responsible for the oversight of the financial market and is the competent authority for regulating stockbroking firms, investment exchanges, listed entities and market conduct. The MFSA is also the Listing Authority and approves admissibility to listing on Recognised Investment Exchanges and is also the Resolution Authority for credit institutions. The MFSA also houses the Registry of Companies.

\(^1\) Source: NSO Press Releases
Since 2004, Malta has gained a reputation for having robust regulatory regime with a highly approachable regulatory authority. Nonetheless, the Maltese regulatory framework provides space for promoters to be innovative and develop new products to meet the changing needs of the industry.

The MFSA encourages staff to meet directly with operators to discuss their requirements, prospective applications and mutual concerns. This proactive and transparent approach coupled with regular contact is a hallmark of the Maltese financial services industry. Investors can have confidence in Malta’s approach based on:

i. emphasis on disclosure;
ii. reliance on the “fit and proper” status of directors, senior management, service providers and qualifying shareholders. Indeed the MFSA has a “no diligence, no license” approach whereby anybody failing the due diligence will not be licensed; and
iii. continuous contact with the regulator.

The Maltese regulatory framework is a secure and stable framework for prudential and conduct supervision, consumer protection, market surveillance and prevention of money laundering.

Malta as an EU Member State transposes and implements all the Directives of the European Union. European regulations are directly applicable in all Member States including Malta, whereas Guidelines or Technical Standards issued by the European Supervisory Authorities are transposed within the national legislation.

English is the language of financial services business and hence all financial services legislation is in English. In the case where an interpretation issue arises between the Maltese and the English text, the English text prevails.

Malta is very pro-active in the EU financial services sector and has often topped the scoreboard of European Member States for the timely implementation of internal market rules for financial services.

1.2 Reporting by the MFSA

The MFSA was established under the Malta Financial Services Authority Act\(^2\) in 2002. Prior to that was the Malta Financial Services Centre established in 1994.

In terms of Article 28 of the MFSA Act, the MFSA is bound, as soon as may be, but not later than four months after the close of each financial year, to transmit to the House of Parliament, through the Minister of Finance, a copy of its annual accounts certified by the auditors together with a report on its activities during the previous year. Hence the MFSA is subject to parliamentary scrutiny.

\(^2\) Chapter 330 – Laws of Malta [hereinafter referred to as “MFSA Act”]
The Chairman of the MFSA is vested with the legal and judicial representation of the Authority. As such, the Chairman reports to the Parliamentary Public Accounts Committee to discuss the performance of the Authority as required.

The regulatory and supervisory activities of the Authority are also reviewed annually by the International Monetary Fund [“IMF”]. The MFSA is also a member of the three European Supervisory Authorities namely:

i. the European Banking Authority [EBA];
ii. the European Insurance and Occupational Pensions Authority [EIOPA] and
iii. the European Securities and Markets Authority [ESMA].

The MFSA also participates actively in the European System of Financial Supervisors [‘ESFS’] and the European Systemic Risk Board [“ESRB”].

The MFSA has also been involved in on-going work in the establishment of the Banking Union, in particular the Single Supervisory Mechanism (SSM) conferring banking supervisory powers to the European Central Bank (ECB) as from November 2014, and the proposed Single Resolution Mechanism. It is represented on the Supervisory Board which has been established to plan and carry out the ECB’s supervisory tasks, undertake preparatory work, and propose complete draft decisions for adoption by the ECB’s Governing Council.

1.3 Co-operation with other Regulatory Authorities

The Central Bank of Malta (“CBM”) and the MFSA co-operate through three Memoranda of Understanding (“MoUs”). Two MoUs signed in 2011 and 2013 deal with the Payment and Securities Settlement Systems and with the Exchange of Information in the fields of financial services respectively. In this regard, a Domestic Standing Committee was established to discuss regularly issues of relevance to both entities.

Furthermore, under the aegis of the ESRB, the MFSA and the CBM have concluded a third MoU for the purposes of setting up the Joint Financial Stability Board. The object of the Joint Financial Stability Board is to establish mechanisms of cooperation between the MFSA and the CBM for the purpose of formulating macro-prudential policy and contributing to the safeguard of the stability of the financial system as a whole in Malta. This includes strengthening the resilience of the financial system as a whole in Malta thereby ensuring a sustainable contribution of the financial sector to economic growth.

The MFSA also cooperates with the Financial Intelligence Analysis Unit through an MoU signed in 2014 regulating mutual assistance and exchange of information in the field of anti-money laundering/ countering terrorist financing and compliance supervision.
On the international scene, the MFSA has signed MoUs with 29 jurisdictions. The MFSA prefers to sign bilateral MoUs which besides exchange of information also include co-operation on training and the development of regulatory policies.

Furthermore the MFSA has signed the ESMA co-operation agreement with responsibility for the supervision of alternative investment funds with 39 non-EU securities regulators. The MFSA has also signed the multilateral MoUs with IOSCO and the International Association of Insurance Supervisors [IAIS]

1.4 Employees of the MFSA

The number of employees of the MFSA is approaching 300. All staff employed by the Authority is required to have a professional qualification. Depending on the requirements of the regulatory units, members of staff may be qualified in banking and finance, law or accountancy. The MFSA has an Employee Development Policy whereby members of staff are encouraged to further their studies. Around 70% of employees have a University first degree while around 30% have a second degree. Support staff is also encouraged to obtain diploma qualifications. As at 31 December 2014, a total of 168 staff members held a first degree whereas 65 held a post graduate degree or equivalent. 71 persons held a diploma in one of the current vocational disciplines.

![Qualified Staff Over Years](image)

Source: MFSA Annual Report 2014

Members of staff are also sent abroad for regulatory training organised amongst others by the Financial Conduct Authority³, BaFIN⁴, Banque de France, Bank for International Settlements and the Securities Exchange Commission. Alternatively, members of staff are also sent abroad for short visits for regulatory familiarisation to compliance departments of financial institutions.

Members of staff also have the opportunity of attending in-house training – indeed officials from BaFIN, the Financial Conduct Authority and the Securities Exchange Commission

³ UK Regulatory Authority
² Federal Financial Supervisory Authority of Germany
visit Malta on a regular basis to carry out in-house staff training on both on-site and off-site supervision.

1.5 Funding of the MFSA

The MFSA is primarily funded through the collection of fees payable by regulated entities and by partnerships registered with the Registry of Companies. Fees are approved by the Maltese Government following consultation with industry associations. Fees are normally fixed for a period of 5 years.

1.6 Setting of policies and creation of regulations

The Board of Governors is one of the main organs of the MFSA and under the MFSA Act\(^5\), it is entrusted with establishing the policies to be pursued thereby. In determining such policies, the Board of Governors follows any policy guidelines which may be set by the Maltese Government. The Chairman of the Authority chairs the Board of Governors. The Board approves regulatory policies which are subsequently implemented by the Supervisory Council. The Supervisory Council, which is chaired by the Director General, is responsible for the approval and issuance of licences and other authorisations for the processing of applications for such licences and authorisations. The Supervisory Council is also responsible for the monitoring and supervision of persons and other entities licenced or authorised by the Authority in the financial services sector\(^6\). Reproduced hereunder is the organisation chart of the MFSA.

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\(^5\) Article 6 of the MFSA Act
\(^6\) Article 10 of the MFSA Act
The MFSA is also empowered to advise the Maltese Government on matters relating to financial services. It proposes primary and secondary legislation. Furthermore, the Authority is empowered to issue Rules regulating the procedures and duties of persons licenced or authorised by it, or falling under its regulatory or supervisory functions. The Rules are binding on licence holders and the entities specified therein.

The MFSA takes a proactive approach to regulation and the creation of innovative legislation which conforms to EU legislation. This approach is important because these frameworks must not create regulatory arbitrage. The main area where innovation through regulation has taken place has been investment services with the introduction of the Incorporated Cell Company [ICC] and the Recognised Incorporated Cell Company [RICC] structures. The cell company concept lends flexibility to the structuring of various types of financial activities and products and has already been very successfully utilised in the insurance sector with the introduction of the Protected Cell Company [PCC]. Malta is the only Member State to have this type of legislation.

The cell company concept has also recently been extended to the re-insurance special purpose vehicles and to securitisation cell companies. The latter legislation is considered a first worldwide.

1.7 Supervision and Enforcement of Regulations

Under the MFSA Act and the different sectoral laws, the MFSA is empowered to carry out both onsite and offsite supervision. Reporting requirements depend on the applicable licence. The MFSA has extensive regulatory, investigative and enforcement powers. To this effect, the MFSA has the power to:

i. require information from any person including any documentation and may use any information as evidence (except in relation to documents and information which are privileged under the Criminal Code);
ii. appoint inspectors for conduct of more in-depth investigations as may be required;
iii. issue directives both generally and in specific circumstances and
iv. enter premises of persons on whom a notice of investigation has been served for the purposes of obtaining information.

The MFSA has the power to issue public warnings and to suspend or cancel a licence or to restrict a licensed entity’s operations. Furthermore, under Article 16A of the MFSA Act, the Authority may impose an administrative penalty on any licence holder should the person’s conduct, in the opinion of the MFSA, amount to a breach of the regulatory requirements applicable to the licence holder. All sanctions are published on the MFSA’s website (www.mfsa.com.mt). They may be viewed under the section: Announcements / Sanctions & Penalties.
2 The Supporting Infrastructure

Malta has the necessary infrastructure in place for continued expansion:

i. Malta has developed its infrastructure to meet the demands of a rapidly expanding sector.

ii. The University of Malta and various other financial training centres are producing sufficient graduates to meet the demand for lawyers, accountants, investment managers, fund managers, fund administrators etc. The MFSA has set up an Education Consultation Council composed of all finance industry training associations to coordinate the training and ensure that the training satisfies the competencies required by the regulator. Thus, newly licensed companies have no difficulty in recruiting locally qualified staff. There are currently 10,000 employees in the financial services sector. However, in order to keep abreast of developments, Malta introduced the Highly Qualified Persons Program allowing companies to attract non-Maltese professionals with special skills such as actuaries, investment managers etc.

iii. Maltese accountants are trained under IFRS, which Malta adopted in 1998;

iv. The Maltese legal profession is a long established profession and most professionals have had further training at major institutions overseas particularly in the UK. Maltese law firms are listed on Chambers, Martindale, Lex Mundi, Lexis Nexis etc. Maltese law firms have considerable international experience acting as correspondents for overseas law firms particularly from the City of London and the US. Some overseas firms are now directly involved in the Maltese financial services sector.

v. Malta follows an imputation system of taxation agreed with the EU in 2008. In 2008, the G20 placed Malta on the White List which means that Malta’s taxation system is based on internationally agreed tax standards. Malta exchanges information under the EU Savings Directive and applies the OECD clauses on exchange of information in the Double Tax Treaties. In 2012, Malta signed the OECD Multilateral Tax Exchange Information Agreement. A FATCA IGA agreement was signed in November 2013. Malta continues to expand its double tax treaty network. There are currently over 65 double tax treaties in force.
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