MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Consultation Document on proposed amendments to the Listing Policies

[1.0] Background

The continued expansion of corporate bonds listed on the Malta Stock Exchange has raised a level of concern on the growing exposure of the retail investor to this market. Providing a tangible level of protection for these investors has been a subject which the Listing Authority has frequently examined and debated with the market. Efforts have been made to both raise investors' awareness of the possible risks faced when making an investment and to remind bond issuers on their responsibilities towards investors.

It was against this background that the first Listing Authority's policy document dated 16th August 2010 established the requirement for an entity seeking listing which targeted retail investors to establish a sinking fund and to also undergo a test of financial soundness prior to Listing. Since then the Listing Policies have been subject to amendments to both fine tune the Policies and to take into consideration feedback from the market on these.

The Listing Policies as last amended on 8th March 2012 are summarised in Section [2.0] for ease of reference. The full text of the Policy Document can be accessed on the MFSA website (http://www.mfsa.com.mt/pages/viewcontent.aspx?id=278).

[2.0] The Listing Policies

[2.1] Sinking Fund

The Listing Policies state that, when required, a sinking fund equivalent to 50% of the value of a maturing bond should be provided for. Issuers are required to make annual contributions calculated as a percentage of a company's profits after tax.

Provisions relating to the term for funding of sinking Funds the role of Sinking Fund Custodian and the Custodian's permitted activities are detailed in the Policy document.

The Policies provide parameters for the investment of Sinking Fund assets and the use they may be put to, including the ability of an issuer to buy back its own bonds.

[2.2] Financial Soundness Report

The Policies stipulate that an Applicant seeking Admissibility to Listing is required to demonstrate their financial soundness and strength to the Authority through the preparation of a Financial Soundness Report, which includes a Due Diligence Report prepared by an independent accountant and a Financial Analysis Summary by an independent stockbroker. The Financial Analysis Summary, a document available to investors which is attached to the Issuers Prospectus. This document is updated annually.

[2.3] Applicability of the Listing Policies

The applicability of the Listing Policies depends on whether the issue is subject to a minimum level of subscription and holding as follows:

- issues with no minimum level of subscription or subsequent holding
- issues which are subject to a minimum subscription and subsequent holding of €10,000 per individual investor or more but below € 50,000 and where the bond issue is directed to investors having the necessary expertise, experience and knowledge to be in a position to make their own investment decisions and to understand the risks involved
- issues which are subject to a minimum subscription and subsequent holding of €50,000 per individual investor or more.

The following table summarise the applicability of the Sinking Fund policy and the Financial Soundness policy to the three different types of issues:

Minimum investment and holding	Sinking Fund	Financial Soundness Report
NONE	YES	YES
€ 10,000 - € 50,000	YES	NO
€50,000 or more	NO	NO

The Policies exempt Government bond issues, bonds secured by easily realisable assets, those which have a credit rating and bonds issued by issuers subject to capital requirements under the EU Capital Requirements Directive or EU Solvency II Directive.

[3.0] Feedback on Consultation Paper dated 25th October 2012

The consultation paper issued on 25th October 2012 proposed exempting bonds issued with a final maturity date of five years or under from creating a sinking fund. The proposals excluded any bond from the exemption which was issued to finance the purchase of an asset which would eventually be sold and for which the sale proceeds would be used for the purpose of repaying investors.

The exemption proposed by the Authority was made on the basis that *the financial information available to the investor at the time of issue was sufficient for him to make a reasoned assessment of a short term investment,* and in doing this the Authority took into consideration the extensive nature of the newly established Financial Soundness Report.

Three respondents commented on the consultation paper with comments on the proposed exemption being mixed. While two responds saw value in having a sinking fund, one of these felt that the sinking fund policy as mandated by the Listing Policies had an adverse effect on the workings of the market. The third respondent was of the view that the introduction a sinking fund policy interfered with the smooth working of the corporate bond market and was opposed to the Policy in principle. All three respondents commented that the exemption for bonds with maturities of 5 years and under could lead to bond issuers opting to shorten maturities to five year maturities, rolling these over should this be necessary, to avoid creating a sinking fund. One of the respondent added that the exemption could lead to the undesirable effect of issuers mismatching the term of funding with what was needed to complete the project

While possible, the Listing Authority feels that this argument overlooks two important factors, firstly that an issuer should ideally match funding to project needs and secondly fixing of an interest rate for the project period is an important consideration in any funding proposition. Any mismatch between the time a project takes to completion and funding would be certainly identified by the Authority and the Issuer would need to justify this discrepancy before any listing is approved. Moreover the Listing Authority feels that the increase in listing costs in renewing a listing every five years when funding is required for a longer period should in itself be sufficient to mitigate against the rolling over a borrowing at maturity when this could be avoided.

Nevertheless the Listing Authority felt that in the light of the general feedback received on the Sinking Fund it was important to re-examine the whole policy as detailed in section [4.0] below.

[4.0] Proposals to amend the Listing Authority Policies

The Authority has re-examined the role of the sinking fund in the light of the feedback it received, the contributions made to date by issuers to their sinking funds (comparing these to the commitments made in the original prospectuses) and the effectiveness of the role of the sinking fund in the protection of investors. It additionally reviewed the value of deliverables made in a Financial Soundness Report in the light of documentation received by the Authority under this Policy and assessed the importance of the information that the Report provided to the Authority and investors alike.

The Listing Authority has concluded that the Financial Soundness Report is playing an important role in providing timely and accurate information to investors and is almost certainly a more effective tool for the protection of investors than the present Sinking Fund arrangement. The two main arguments militating against the retention of a policy mandating a sinking fund for bonds are: (a) the large element of unpredictability surrounding the creation of a sinking fund as a result of the varying level of the issuer’s profits, and (b) the element of moral hazard that this creates for retail investors who rely on the sinking fund as guaranteeing the repayment of their investment. The Authority is also conscious that while sinking fund assets are controlled by a Sinking Fund Custodian they are not ‘ring–fenced’ from the general assets of the issuer and are of little comfort to an investor should the insolvency of the issuer occur.

The role of the Sinking Fund as an effective measure of investor protection must further be questioned in the light of evidence that a significant proportion of contributions made by issuers under the Sinking Fund Policy go towards the purchase and cancellation of an issuer's outstanding bonds and while this arguably helps in the management of an Issuer's exposure towards the market it results in little if any funding actually going towards building a redemption fund.

In light of these experiences, the Authority is proposing to amend the Listing Policies by removing the requirement for the mandatory creation of a sinking fund, even when these are issued with maturities longer than 5 years, but to require a Financial Soundness Report for all bonds listed with a minimum subscription of less than €50,000. A Sinking Fund will however remain mandatory when the source of repayment of the bond issue is to be mainly from the sale of the asset funded by the borrowing. In the latter case, the amended policy will require a Sinking Fund without going into the merits of the manner in which the Sinking Fund should be provided for. It should be up to the Issuer to propose to the Authority how it intends to provide for a Sinking Fund and then the Authority will examine and determine if the proposal is acceptable or not. It is the Listing Authority's opinion that in this way the Issuer is more likely to present realistic and feasible projections, than is the case under the present policy.

[5.0] Other measures

Bond issuers applying for Admissibility to Listing should demonstrate that they have in place risk management policies which take into consideration any eventual maturity/refinancing risks that may occur at maturity of their bonds. The Authority does not exclude discussing increases in the level of the minimum subscription of an issuer's bonds where it is seen that the purpose of a borrowing is agreed as being unsuitable for the retail investor.

[6.0] Existing issues subject to the Sinking Fund

The proposed changes in the Listing Policies will not affect outstanding bonds for which a sinking fund is contemplated in the prospectus as Issuers will be obliged to fulfil their commitment to build a Sinking Fund in terms of the prospectus. In this respect the Authority will continue to supervise such Issuers making sure that they are abiding with the terms set in the prospectus and that the investors are properly informed with respect to the contributions being made to such Sinking Fund.

[7.0] Scope and validity of the Financial Soundness Reports

Presently the Listing Polices do not define the period during which the information contained in a Financial Soundness Report remains valid, nor do the Policies cover the contingency of an issuer/group applying for the listing of more than one bond during a year or issues being made by more than one company within the group.

The Listing Authority is proposing that the Due Diligence Report required as part of the Financial Soundness Report will have a validity of 12 months from the date of publication. It also proposes that any new borrowing made by the same company/group during those 12 months will not require the preparation of a fresh Due Diligence Report if the information contained in that Report is relevant to the new borrowing. A Financial Analysis Summary will however be needed for each new borrowing.

A single annual update of the Financial Analysis Summary will suffice where a company/group has multiple borrowings in situations where the information in the Financial Analysis Summary is drawn up to cover each of these borrowings.

[8.0] Revised Listing Policy Document

The proposed amendments to the Listing Authority policies are being indicated in the attached Appendix 1 by way of tracked changes.

[9.0] Consultation Period

The proposed amendments to the Listing Authority policies are being issued for consultation. The Listing Authority invites comments by not later than **5th March 2013**. Interested parties are to send their comments in writing addressed to the Chairman- Listing Committee (email: listcomm@MFSA.com.mt)

[10.0] Contacts

Any queries regarding the proposed amendments to the Listing Authority Policies are to be directed to:

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