Regulating Malta's finar

The Malta Financial Services Authority is the island's financial regulator and, just like the financial sector, is evolving to meet continuously changing circumstances. Prof. Joe V. Bannister, chairman of the MFSA, talks to MaltaToday about the authority's work and the dynamic face of financial services regulation

How has the role of the MFSA changed over the last ten years?

As a result of the financial crises, the MFSA continued to consolidate its position as the regulator and supervisor of the financial sector. Following the crises, the De Larossiere Report stated that supervisors have to concentrate more time on supervision and this led to the setting up of the Authorisation Unit to issue new licences.

The crises, however, also led to a separation of prudential supervision and conduct supervision i.e. consumer protection - the way companies conduct business with consumers. Some people are questioning why the MFSA is doing all this. The answer lies in the Directives such as Solvency II, CRD IV and MiFID II, which now totally govern the way the MFSA carries out its supervision. The correct transposition of these Directives into Maltese legislation is overseen by the European Commission. Also, the MFSA is subject to reviews by the European Supervisory Authorities and the IMF who ensure that these Directives are being correctly implemented.

Last year as part of the Banking Union, the MFSA became part of the Single Supervisory Mechanism within the ECB. This has necessitated changes in not only the way the MFSA supervises banks but also various internal changes particularly to our IT operations among others. During 2015, the MFSA became the Resolution Authority and in 2016, we are introducing the Internal Audit Function together with Quality Assurance. These are necessary changes under the SSM.

All these changes are having effects on the human and financial resources of the MFSA, however, we are so far coping with the situation. There is still more legislation to be implemented and this means that we have to keep monitoring the level of our human resources and continuously monitor our expenditure.

What steps has the MFSA taken to prepare investors and encourage financial advisors to provide a thorough assessment of investment benefits and risks?

It is first important to distinguish between the expectations of investors when receiving an investment service (such as advice), and the obligations of financial advisors when providing such a service.

When providing financial advice, a financial advisor is required to understand a prospective investor's needs and circumstances to enable him to recommend the right investment (or investment mix) for the investor. Financial advisors are therefore required to compile a Suitability Test, where the financial advisor asks the investor a number of questions to enable him to reach an understanding of the types of investments suitable for the investor's requirements.

As part of the suitability test, the financial advisor will ask a series of questions to establish the investor's:

Investment objectives - which may include questions about the investor's risk appetite and profile, and whether he wishes to invest for income or growth;

Financial situation - which may include questions about the investor's financial situation, source and extent of income, assets, and financial commitments and

Knowledge and experience - questions about the types of services and products the investor is familiar with, the nature, volume and frequency of previous transactions; as well as level of education, profession or former profession.

When carrying out educational campaigns, the MFSA emphasises the importance and relevance of this advisory process. Investors should provide clear and full answers during the process as this is the only manner for a financial advisor to be able to assess and give an objective and personalised recommendation to the investor.

Prior to investing, investors expect to be given a thorough explanation of the risks and benefits that apply to the different investment securities and products that the financial advisor may recommend.

Risks and potential returns vary greatly from investment to investment. For example, shares offer investors growth, but they can be volatile. Bonds provide fixed income although they come with varying risks. Collective investment schemes can provide growth, income or both but are also subject to volatility in the value of the underlying investments and lower potential earnings.

The ultimate aim of the whole process is to ensure that the investor, with the financial advisor's assistance, builds a diversified portfolio of investments. Careful investing involves building a diverse portfolio—one in which the investor's investments are spread over a range of investment choices, commensurate with the investor's risk appetitive and objectives.

The MFSA had announced that it had embarked on reviewing the conduct of business frameworks for financial intermediaries, and launched improved alternative company listing rules. How far has this been implemented?

In 2015, the MFSA established the Conduct Supervisory Unit with a view to supervise the conduct of business of various regulated persons and to place more focus on ensuring the fair treatment of customers by regulated entities. The MFSA has decided to adopt a staggered approach and the remit of the Unit will initially be limited to investment services licence holders, insurance companies, insurance intermediaries and credit institutions to the extent that these offer structured deposits as a product. To date, the main focus of the Unit has been the finalisation of a Conduct of Business Rulebook, which would apply to the abovementioned entities. In this regard, a draft of the Rulebook has been prepared and the Authority has also consulted with the industry on certain parts of this draft. It is envisaged that the other parts will also be issued for consultation in the first quarter of 2016. This Rulebook will mainly involve the transposition of the MIFID II Directive as well as the Insurance Distribution Directive (which will eventually replace the Insurance Mediation Directive).

In this regard, it is to be kept in mind that the Insurance Distribution Directive has not yet been formally published (although a political agreement has been reached on the text). Furthermore, it also appears that the implementation of the MIFID II Directive at EU level will be delayed. The MFSA is closely following these developments at EU level, prior to determining the implementation date of the Rulebook.

The Conduct Supervisory Unit is also undertaking informal discussions with a number of stakeholders including various associations representing the industry. The Unit is also considering the Feedback received from the industry with respect to the first Consultation with respect to the draft Rulebook as mentioned above. Meanwhile, a recruitment process is underway for the Conduct Supervisory Unit to have the necessary resources in place and once this is completed, the intention is for the Conduct Supervisory Unit to take on the responsibility for the supervision of the conduct of business of the abovementioned regulated persons on the basis of the Rules which are currently applicable until such time as the new Conduct of Business Rulebook will be brought into force.

Financial services have grown exponentially in Malta. What are the new challenges facing this sector?

The financial crisis has not affected the growth of the sector. Growth in itself brings challenges and everybody – the political parties, the industry and the regulator have to respond to these challenges. This is a highly mobile sector and we have to respond quickly.

We have had political consensus on financial services and it is important that this remains cast in stone. It is one of the major attractions and it is not only important that this continues but also the political parties approve necessary legislation quickly.

The sector has to respond to the main important challenges, which are the introduction of new regulations and investment in training. The response from industry to a consultation process is, if anything, very weak and it only comes from the same promoters. The response tends to come after implementation and then there is little the MFSA can do. Industry must understand that investment in training of staff is an asset for the future and not to expect the MFSA to carry out this training. The MFSA invests in training when new directives are being introduced but it can only give direction where training of staff such as risk managers and actuaries is involved.

The MFSA operates an open door policy. We have so far managed to meet companies at the pre- and during the application stage. We now find that other regulators in major jurisdictions are doing the same thing so we have to keep this initiative going. However, very often we are criticised for not doing enough. This is true for various reasons. Applications are continuously increasing in numbers that current staff levels cannot handle. We are continuously recruiting but staff has to be trained. Our salary structure is not attractive and unfortunately we are losing trained staff to industry. Furthermore more we now have an acute shortage of space to accommodate new recruits. These are not easy problems and we ask industry to co-operate with us particularly where issues of substance and due diligence are involved. The requirements of the MFSA need to be followed in order to protect the reputation of the country and the industry. There is no bending or going round the rules.

Last October, the MFSA issued two letters addressed to the Directors and Compliance Officers of Investment Services License Holders, regarding the Market Abuse Regulation and the Market Abuse Directive. What do the Market Abuse Regulations aim to achieve?

Market abuse is a concept that encompasses unlawful behaviour in financial markets and is understood to consist of insider dealing, disclosure of unpublished inside information and market manipulation. The success of financial markets depends on the extent to which such markets benefit from a high degree of investor confidence. Investors put their savings at risk because they trust that market players are honest. Market abuse on the other hand tells everybody that financial markets are manipulated and that only investors who are wealthy and have access to directors of listed companies can make money by investing through financial markets. Such behaviour damages the integrity of financial markets and investor confidence in general.

The Market Abuse Regulation prohibits market abuse, requires listed companies to make inside information public and grants National Competent Authorities, such as the MFSA, with the powers to monitor the financial markets, investigate suspicious transactions and take enforcement action where this is deemed necessary. The MFSA has a market monitoring function in place. It also has a team of officials whose supervisory work focuses on achieving market integrity. As reported in the Authority's annual reports, the MFSA carries out various reviews and investigations of

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suspicious transactions on a yearly basis. These have in certain instances resulted in regulatory action being taken against persons who were found to have committed market abuse. Financial markets are global and the MFSA also collaborates with competent authorities of other jurisdictions with regard to cross-border investigations of market abuse.

In what manner has the MFSA involved itself in the IIP programme and what are the long-term benefits or concerns about this scheme?

The MFSA has not involved itself in the IIP programme. The government simply asked for advice from the Chairman and there were discussions with Identity Malta on how the MFSA carries out the due diligence process.

Why does Malta continue to consolidate its position as an investment services hub within the single market?

The distinction between financial services and investment services is quite important because the various areas of areas of financial services have their ups and downs, so it is important to have a diversified sector and we need to keep consolidating this diversification by being innovative.

The MFSA has always been forward looking and has been very pro-active in creating structures within the framework of existing regulations particularly in asset management and insurance. This has resulted in an extensive development of the cell company structure.

Malta is the only member state of the EU to have introduced the Protected Cell Company for insurance business. A PCC is a single legal entity. It is structured in two parts namely, a non-cellular part (the core) and an unlimited number of cells. Despite the segregation of assets and liabilities that exists between protected cells and the core and among the protected cells themselves, a cell has no separate legal identity. Within a PCC structure, the cells are approved to write insurance and/

or reinsurance business. The core may or may not be authorised to write insurance and/or reinsurance business. The core maintains and controls all the activities of the PCC. The two most common types of PCC structures that can exist are:

Type 1 - In a typical PCC structure, the core does not write any insurance or reinsurance business.

Type 2 - The core and the cells write insurance and/or reinsurance business. The cell shall write all or a subset of the classes of insurance business underwritten by the core.

More recently, we extended the concept to Re-insurance Special Purpose Vehicles and to Securitization Vehicles for insurance and non-insurance business. The introduction of cells in the Securitization Vehicles instead of the traditional compartments is the first type of structure worldwide and has generated a lot of interest in Malta for the notification of Securitization Vehicles. The use of cell structure rather compartments give more robustness to the vehicle.

In case of asset management, we have seen the setting up of the Incorporated Cell Company [ICC] and Recognised Incorporated Cell Company [RICC]. The launch of the ICC SICAV generated significant of interest across the fund sector generally, with the consequence that the MFSA started receiving enquiries based on business models, where the core would function as an investment company. Most of the requests revolved around a 'platform' type of model that would involve an incorporated cell company providing standardised administrative services to any number of Incorporated Cells licensed as collective investment schemes.

These services, however, do not amount to the type of fund administration services that would normally require the engagement of a Recognised Fund Administrator, but deal mainly with routine contractual matters and start-up support. The activities to be carried out by a Recognised Incorporated Cell Company ("RICC") also differ from those of an ICC SICAV since the latter would also be licensed to carry out investment activity.

The MFSA therefore introduced the RICC framework with a specific set of conditions to cater for these requests. An RICC may only provide services of an administrative nature for which it is issued with a Recognition Certificate in terms of article 9A of the Investment Service Act.

Unlike the SICAV ICC structure, the new RICC structure provides promoters with a flexible ICC structure that may be used as a vehicle to achieve various objectives including the setting up of a fund platform. An RICC must be established as a limited liability company and may not carry out any licensable activity. The RICC will require a memorandum of association restricted to the provision of administrative services to its incorporated cells.

The future for creating innovative regulation is currently difficult to predict. There have been so many new regulations - about 42 in investment management - since the financial crises that these have to be digested first and market practice reviewed. There are areas where in 2016 the MFSA will be pro-active typically in the issue of debt instruments by private companies, new fund products etc. I also urge the industry to come forward and participate in the innovation process.

RSM consolidates as a leading mid-tier firm in Malta

The Accountancy firm Spiteri Bailey & Co is merging with the member firm of RSM in Malta with effect from 1 January 2016. As a result of this merger, RSM will rank as one of Malta's leading mid-tier firms.

The new, combined RSM will employ a unique talent pool of around 100 qualified full time professional staff in different disciplines including accounting, law, IT, tax and risk management. This enables RSM to provide holistic service solutions to its clients delivered by the best in class.

The merged entity which will continue to be an active member firm of RSM International will have 7 partners led by Managing Partner Maria Micallef and including Conrad Borg, Vladimiro Comodini, Joe Ellul Falzon, George Gregory, Karen Spiteri Bailey and William Spiteri Bailey. The partners will be supported by Gordon Micallef and Dr Timothy Zammit, Divisional Directors within the IT Advisory, and the Tax and Corporate service lines, respectively.

Commenting on the merger, Managing Partner Maria Micallef said, "In these past years RSM invested heavily in building in-house the necessary specialist competencies to provide holistic services of quality to our clients. Merging with a firm like Spiteri Bailey & Co will enable us to expand our service portfolio to mid-tier companies that are seeking to expand their business both locally and abroad. It will also help to increase our staff base with competent resources at a time when there is significant difficulty to recruit qualified staff. Very importantly, the cultures and work ethic of the respective firms are similar to each other, based on the ethos of delivering high quality work across all our assignments. We are looking forward to streamline the operation over the next few weeks, be of greater service to our clients and consolidate our position as one of Malta's leading mid-tier firms, within the RSM global network."

William Spiteri Bailey said, "The choice to merge with RSM comes after a careful process to define our long-term objectives and select the best path to help us get there. Merging with RSM feels like the natural step to take. The partners have known each other for a number of years. We enjoy a strong professional relationship based on mutual respect for our respective undertakings and we are joining a global network of like-minded professionals to service clients in a holistic manner."

The majority of services and staff will continue to be housed at the RSM offices in Mriehel while the Spiteri Bailey offices in B'Kara will temporarily house the audit service line. The firm will be moving to larger modern premises in 2016.

RSM International is the world's sixth largest provider of tax services, has the fifth largest firm in the US and the third largest in China. RSM International was the fastest growing top ten global network in 2014, posting an 18% increase in revenue, year-on-year, to US$4.4 billion for the year ending 31 December 2014.

The firm has recently adopted a unified global brand that reinforces the network's global position as the adviser of choice to entrepreneurial, growth-focused organisations.