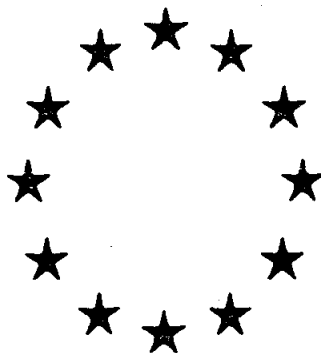


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INSURANCE INTERMEDIARIES
AND INVESTMENT
MANAGEMENT IN THE EC

DANIELA GAUCI

EDRC Information Paper 17



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Series Editors:

Peter G. Xuereb, LL.D. (Malta), LL.M. (London), Ph.D. (Cambridge)
Roderick Pace, B.A. (Hons), Dip. I.A., M.A. (Johns Hopkins) Ph.D. (Reading)

European Documentation and Research Centre,
University of Malta, Tal-Qroqq, Msida MSD 06
MALTA

Tel: (356) 3290-2001/2998
Fax: (356) 337624

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INTRODUCTION

Creating a single market in financial services within the EU presents particular difficulties due to the fact that the Member States have their own regulatory regimes which differ substantially throughout the Community. Regulation is a necessary element in financial services especially since the protection of the users of such services is necessary. Having different regulatory regimes would undermine the freedoms provided for by the Treaty of Rome, in particular the right of establishment and the freedom to provide services. This is so because national regimes usually inhibit the establishment of branches or subsidiaries and the provision of cross border services. Regulation in financial services is considered an important asset by most states, and therefore the challenge that arises is to adopt a form of regulation which is not in conflict with the single market.

As highlighted by the Commission Action Plan for the Single Market which was endorsed by the European Council in June 1997¹, both the sector of collective investment undertakings and insurance intermediaries are areas in which the single market² is still incomplete. Two Proposals³ have been brought forward in 1998 with regard to UCITS and the action plan paves the way for a proposal on amending the Insurance Intermediaries Directive by mid-2000.

SINGLE EUROPEAN PASSPORT

With regard to the regulation of insurance intermediaries and UCITS intermediaries, we must primarily refer to the concept of the "Single European Passport" which has developed in the financial services sector. This concept consists of three main characteristics⁴, which may be summarised as follows:

- once defined enterprises obtain an authorisation or licence to carry on certain activities from their "home" State regulator, the "host" State must allow them either to establish a branch or provide cross-border services in the "host" State, in relation to listed activities, without the need for further authorisation.
- the Member States have to harmonise certain minimum or "key" regulatory standards, the application of which they agree are the province of the "home" State.
- The principle of "home country control". This approach recognises the sole competence of the home state to authorise and prudentially supervise its home enterprises wherever they operate in the single market.⁵

¹ "Implementing the Framework for Financial Markets: Action Plan" - COM 1999 - 232 Final.

² Defined as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured, by Article 7a of the Treaty.

³ COM (1998) 449 final

COM (1998) 451 final

⁴ Economic and Legal Reform in Malta: EDRC Sept. 1995 - Pg. 227 - Eva Lomnicka.

⁵ It must be stated that on this point, the first directives, namely Directive 89/646 (The second Banking Coordination Directive) and Directive 93/22 (The Investment Services Directive), whilst conferring the role of prudential supervision on the home State, state that this is without prejudice to those provisions of these directives which give responsibility to the authorities of the host Member State.

CURRENT REGULATION OF INSURANCE INTERMEDIARIES IN THE EU

Prior to the introduction of the first Council directive on insurance intermediaries in December 1976⁶, only a few Member States⁷ maintained conditions whereby a person was not allowed to engage in business as an insurance intermediary unless he satisfied the conditions of access, and acquired the specific training and qualifications required by local law. The existence of such conditions in some Member States, but not in others, resulted in a constraint on the freedom to provide services in another Member State. An intermediary from a Member State without such conditions who decided to operate in another Member State would be required to fulfil these conditions. On the other hand, an intermediary moving from a Member State with such conditions to another without the conditions, would be able to do so without any hindrance.

The Directive applied to both self-employed intermediaries and to employed intermediaries. Employees were initially excluded from the directive in the early stages of negotiations. However, they eventually had to be included as, if they were not, their ability to exercise their right of free movement as workers would have been prejudiced.

The aim of facilitating the exercise of the freedoms of establishment and to provide services is tackled in articles 4,5,6 and 7 of the Directive which oblige those Member States which maintain conditions of access in the form of professional qualifications to accept work experience gained in another Member State as equivalent to those qualifications. Article 4 reads as follows:

“Where in a Member State the taking up or pursuit of any activity referred to in Article 2(1)(a) and (b)⁸ is subject to possession of general, commercial or professional knowledge and ability, that Member State shall accept as sufficient evidence of such knowledge and ability the fact that one of the activities in question has been pursued in another Member State for any of the following periods:

- (a) four consecutive years in an independent capacity or in a managerial capacity; or*
- (b) two consecutive years in an independent capacity or in a managerial capacity, where the beneficiary proves that he worked for at least three years with one or more insurance agents or brokers or with one or more insurance undertakings; or*
- (c) one year in an independent capacity or in a managerial capacity, where the beneficiary proves that for the activity in question he has received previous training attested by a certificate recognised by the State or regarded by a competent professional body as fully satisfying its requirements.”*

⁶ Directive 77/92. - OJL 26/14 - 1977.

Council Directive of 13th December 1976 on measures to facilitate the effective exercise of freedom of establishment and freedom to provide services in respect of the activities of insurance agents and brokers and, in particular, transitional measures in respect of those activities.

⁷ These states included the Netherlands, France and Belgium.

⁸ These refer particularly to insurance brokers and agents.

Articles 5 and 6 of the directive give similar regulations. Article 5 deals with the case where a Member State makes the taking up or pursuit of the activities of an insurance broker⁹ dependent on more stringent requirements than those which it lays down with regard to insurance agents¹⁰, giving more stringent requirements with regard to insurance brokers being set up in the Netherlands. On the other hand, Article 6 lays down the requirements with regard to insurance sub-agents¹¹. Article 7 makes an additional requirement to the above mentioned articles. It holds that the pursuit of the activity in question should not have ceased more than ten years before application to establish business in another Member State is made. However, if a shorter period is laid down in a Member State for its own nationals, that period must also be applied in respect of beneficiaries.

Where a Member State requires its own nationals to produce documentation establishing that they are of “good repute” or have not previously been made bankrupt or possess a certain financial standing, Article 10 provides for the mutual recognition by that State of the intermediary’s equivalent status in his Member State of origin.

From the above summary of the 1976 directive, it is evident that the aim of the Directive was to provide transitional measures. So much so that the preamble holds that:

“The purpose of this Directive will disappear once the co-ordination of conditions for the taking up and pursuit of the activities in question and the mutual recognition of diplomas, certificates and other formal qualifications have been achieved.”

The Directive allowed intermediaries to operate freely throughout the Community, although they could be required to show certificates of experience or “good repute” or other documentation issued by designated authorities in their home State, but the Directive was formulated with the aim of being replaced by another directive providing for the mutual recognition of professional qualifications and the co-ordination of Member States laws. However, it must be noted that the next initiative was to be taken no less than 16 years later with the Commission Recommendation on Insurance Intermediaries of 1992.¹²

The 1992 Recommendation has two main aims. The first is to encourage Member States to introduce rules providing for increased consumer protection for policy holders and other insureds in their dealings with insurance intermediaries. The second is to provide for

⁹ The activities of an insurance broker are defined in Article 2.1(a) as the “professional activities of persons who, acting with complete freedom as to their choice of undertaking, bring together, with a view to the insurance or re-insurance of risks, persons seeking insurance or reinsurance and insurance or reinsurance undertakings, carry out work preparatory to the conclusion of contracts of insurance or reinsurance and, where appropriate, assist in the administration and performance of such contracts, in particular in the event of a claim.”

¹⁰ Article 2.1(b) describes the activities of insurance agents as “the professional activities of persons instructed under one or more contracts or empowered to act in the name or on behalf of, or solely on behalf of, one or more insurance undertakings in introducing, proposing and carrying out work preparatory to the conclusion of, or in concluding contracts of insurance, or in assisting in the administration and performance of such contracts, in particular in the event of a claim.”

¹¹ The activities of sub-agents are described as those of persons acting on behalf of brokers and agents, and who among other things carry out introductory work, introduce insurance contracts or collect premiums, provided that no insurance commitments towards or on the part of the public are given as part of these operations.

¹² The Commission Recommendation on Insurance Intermediaries (92/48/EEC) - (OJL 1992, 19/32)

equality of competition between intermediaries by creating a more level playing field. The Recommendation seeks to achieve these aims by encouraging the Member States to adopt general guidelines for the regulation of intermediaries. The guidelines include the following:

- all Member States should regulate access to and the exercise of the activity of insurance intermediary through the introduction of minimum standards of professional competence as outlined in the Recommendation;¹³
- all persons engaged in business as an insurance intermediary must satisfy those standards, subject to limited exceptions;¹⁴
- all persons satisfying those standards must be registered.¹⁵

These objectives were intended to be neutral in effect between different types of intermediaries. No distinction is made between persons who mediate in insurance or reinsurance. This eliminates the incomprehensibility of the definitions found in the 1976 directive and it encompasses new forms of brokers, agents or sub-agents which could escape regulation under the directive if they did not fall within its definitions. It encompasses all persons who mediate in insurance and assurance, even legal entities such as banks, building societies, motor car dealers and others who distribute or sell insurance policies, whether on a full or part-time basis. Therefore, although reference is made to the definitions given in the Directive, the scope of the Recommendation is clearly wider than that of the Directive. Emphasis is placed in the Recommendation upon what the intermediary does in practice rather than on whether he calls himself a broker, agent or sub-agent. However, there is one exception. Article 2.2 provides that Member States need not apply this recommendation to persons providing insurance which does not require any general or specific knowledge and where such insurance covers the risk of loss or damage to goods supplied by that person, whose principal professional activity is other than providing advice on and selling insurance. This exemption is intended to cover situations where the insurance provided is ancillary to the contract of sale.

The aim of the recommendation is to lay down minimum standards of professional competence from intermediaries, without having the effect of limiting the number of intermediaries available to distribute insurance products. This is in the interest of insurers and insurance purchasers since without limiting the number of insurance intermediaries, it entitles insurance purchasers to expect a minimum standard of professional conduct. It must be stated that the aim of the Recommendation was not to replace the Directive but rather to co-exist alongside with it.

The main aim of the recommendation, as was the case with the directive, is the policyholder's protection. Both the Directive and the Recommendation contain provisions relating to the professional qualifications and competence of intermediaries, their professional conduct and financial standing. The Recommendation goes further and provides for compulsory professional indemnity insurance, compulsory registration and sanctions, and seeks, through disclosure requirements, to assist both policy holders and

¹³ Article 4 of the Recommendation.

¹⁴ Article 4 of the recommendation.

¹⁵ Article 5 of the Recommendation.

competent authorities in determining whether or not an intermediary is acting in an impartial and independent capacity.

The distinction between independent and dependent intermediaries is emphasised further in the recommendation than it was in the directive. The Directive defined brokers as persons

“acting with complete freedom as to their choice of undertaking, with a view to the insurance or reinsurance of risks...”¹⁶

The Recommendation makes the distinction by urging Member States to impose a duty upon brokers to disclose their connections with insurers. In fact, Article 3 holds that brokers shall:

“...disclose

- *to persons seeking insurance or reinsurance of risks, any direct legal or economic ties to an insurance undertaking or any shareholdings in or by such undertakings which could affect the complete freedom of choice of insurance undertaking,*
- *to a competent body, as determined by the Member State, the spread of business with different insurance undertakings over the previous year.”¹⁷*

Policyholders are mainly protected by the four requirements found in the Recommendation:

- Professional Competence;
- Compulsory professional indemnity insurance;
- Professional Conduct;
- Financial Capacity.

a) Professional Competence

With regard to professional competence, the Recommendation does not seek to harmonise Member States' national laws by laying down common professional qualifications for all insurance intermediaries. Nor does it provide for the mutual recognition of the national standards of professional experience, education and training applied in different States. Article 4.2 provides that:

“Insurance intermediaries shall possess general, commercial and professional knowledge and ability.... The level of such knowledge and ability shall be determined by the Member States. Such levels and their practical application may also be determined and administered by professional organisations recognised by a Member State”.

Therefore, the emphasis is on the fact that all insurance intermediaries possess an adequate degree of professional competence in order to be able to fulfil their obligations to actual and

¹⁶ Directive Article 2.1(a)

¹⁷ Recommendation Article 3.

potential policyholders and, commensurate with those obligations, to give such advice and assistance as may be required, rather than to harmonise Member States laws.

b) Compulsory Professional Indemnity Insurance

Article 4.3 holds that insurance intermediaries are obliged to secure and maintain:

“professional indemnity insurance and any other comparable guarantee against liability arising from professional negligence...”¹⁸

Introduced in the Recommendation, this requirement is for all insurance intermediaries and not just the “professional” intermediaries who may be subject to similar requirements by the national laws. The obligation to purchase insurance cover or a guarantee against a finding of professional negligence is only relieved if the intermediary benefits from cover provided by its employer or the insurer for which the intermediary is authorised to act.

c) Professional Conduct

The Recommendation demands that all Member States are to introduce rules providing that all persons who mediate in insurance, whether employed or self-employed, must be able to establish that they are of “good repute”. Persons not of “good repute” are barred from engaging in business as an insurance intermediary. The term “good repute” is not defined in the recommendation, and it is left to Member States to define the term and to apply it.

d) Financial Capacity

While the Directive recognised that a Member State may ask for information concerning an intermediary’s financial status before he is allowed to become established or provide services in the territory¹⁹, the Recommendation goes one step further and urges that Member states require that persons engaged as insurance intermediaries should maintain sufficient financial capacity.²⁰

The Recommendation also introduces the concept of registration. The Commission recommended that every Member State should introduce a compulsory national register listing all insurance intermediaries. No one will be allowed to carry on business as an insurance intermediary unless registered.

CURRENT REGULATION OF THE MANAGEMENT COMPANIES OF UCITS IN THE EU

1985 Directive

The first financial services Directive to adopt the “Single European Passport” approach was the UCITS Directive in 1985 concerning the coordination of laws, regulations and

¹⁸ Recommendation: Article 4.3

¹⁹ Directive: Article 10.5

²⁰ Recommendation: Article 4.5

administrative provisions relating to “undertakings for collective investment in transferable securities”. The UCITS Directive²¹, as stated in the preamble, seeks to establish common basic rules “for the authorisation, supervision, structure and activities of collective investment undertakings situated in the Member States and the information they must publish”²², with the aim of furthering the single market and ensuring a minimum standard of investment protection.

First of all it must be stated that the UCITS Directive of 1985 does not apply to all types of UCITS. In fact Article 2 excludes various types of UCITS from falling within the parameters of this directive²³. The Directive only applies to those UCITS whose sole object is the collective investment in transferable securities of capital raised from the public which operate on the principle of risk-spreading and whose units are redeemable out of the undertaking’s assets.

The Directive works as follows:

- Member States are obliged to apply the common regulatory standards to UCITS situated²⁴ within their borders;
- Then, in accordance with the Single European Passport concept, they must allow managers of investment services, from other Member States to market within their borders without applying their own authorisation provisions.

It must be noted that the Directive only lays down minimal standard rules. Therefore, each State may impose stricter rules on the management companies of UCITS in their State if they wish. The minimum standards stated in the Directive are set out in the Directive in Article 4 to Article 48.

Article 4 holds that:

“No UCITS shall carry on activities as such unless it has been authorised by the competent authorities of the Member State in which it is situated.... A unit trust shall be authorised only if the competent authorities have approved the management company, the fund rules and the choice of depositary.”

Then the same article introduces the concept of good repute, holding that the competent authorities may not authorize a UCITS if the directors²⁵ of the management company, of

²¹ Directive 85/611 - OJL 375/3

²² Directive 85/611 - Recital 4.

²³ The UCITS which are excluded are:

- UCITS of the closed-ended type;
- UCITS which raise capital without promoting the sale of their units to the public within the Community or any part of it;
- UCITS the units of which, under the fund rules or the investment company’s instruments of incorporation, may be sold only to the public in non-member countries;
- categories of UCITS prescribed by the regulations of the Member States in which such UCITS are situated,

²⁴ Article 3 defines the term situated. “...A UCITS shall be deemed to be situated in the Member State in which the investment company or the management company of the unit trust has its registered office. The Member States must require that the head office be situated in the same Member State as the registered office”.

the investment company or of the depositary are not of good repute or lack the experience required for the performance of their duties. Approval by the competent authorities is also required if the management company or the depositary are replaced, or the instruments of incorporation are changed.

The Directive moves on to give detailed rules on the following:

- Obligations regarding the structure of unit trusts;
- Obligations regarding the structure of investment companies and their depositaries;
- Obligations concerning the investment policies of UCITS;
- Obligations concerning information to be supplied to unit holders;
- Other general obligations of UCITS.

With regard to marketing in Member States other than that in which the UCITS is situated, Section VIII holds that a management company which markets units in another Member State must comply with the laws, regulations and administrative provisions in force in that State which do not fall within the field governed by this Directive and it must comply with the provisions governing advertising in that State. The “Competent Authorities” of each Member State, which must be public authorities or bodies appointed by public authorities²⁶, are competent to:

- supervise the UCITS, including their management, situated in that State; and
- with regard to UCITS which are not situated in that State, but which market their units there, the competent authority is only competent to supervise that the UCITS is in compliance with Section VIII with regard to the marketing of its units.

1998 Proposals

In 1993 the Commission had presented a proposal the main aim of which was to extend the scope of the Directive to other types of collective investment undertakings. However the Member States failed to agree on a common approach. In 1998 the Commission presented two proposals with regard to UCITS²⁷, the first focusing essentially on the “product” and the other focusing essentially on the “service provider”, i.e. the management company. In the new proposals the Commission has sought to explore new solutions as against the unwelcome ones included in the 1993 proposals.

The aim of the first proposal is to remove barriers to cross-border marketing of units of collective investment undertakings through:

- The extension of the freedom to be marketed throughout the EU to collective investment undertakings investing in financial assets other than transferable securities such as: units of collective investment undertakings; money market instruments; bank deposits; standardised options and futures contracts. Adequate information of investors will be ensured by new transparency requirements.

²⁵ Directors are those persons who, under the law or the instruments of incorporation, represent the management company, the investment company or the depositary, or who effectively determine the policy of the management company, the investment company or the depositary. (Article 4.3)

²⁶ Article 49.

²⁷ COM(1998) 451 final.; COM(1998) 449 final.

- Some of the provisions of the UCITS Directive will be amended in order to update the Directive in the light of new portfolio management techniques which have developed since 1985;
- The removal of interpretative uncertainties relating to a number of provisions of the UCITS Directive which hinder a uniform application of the Directive.

The Second proposal sought to reinforce the Single Market in the field of UCITS management companies by:

UP-DATING THE REGULATION FOR MANAGEMENT COMPANIES, ALIGNING IT WITH THAT EXISTING FOR OTHER OPERATORS OF THE FINANCIAL SERVICES AREA²⁸

This is of utmost importance considering the on-going growth of this sector. In particular these operators would receive a European Passport which - in accordance with the principles of the Treaty - would allow them to set up branches in other Member States and to operate within the EU under the freedom to provide services. For this purpose, the proposal lays down in Section III, Title A an authorisation procedure, adapting it to that existing for competing operators in the financial services area. On the basis of such authorisation, management companies will be allowed to set up within the EU their own distribution networks for the funds which they manage.

REVISING THE CURRENT RESTRICTIONS WHICH PREVENT MANAGEMENT COMPANIES FROM ENGAGING IN ACTIVITIES OTHER THAN THE MANAGEMENT OF ASSETS OF COMMON FUNDS/UNIT TRUSTS AND INVESTMENT COMPANIES

Taking into account the evolution of national laws which tend to overcome the usual segmentation between collective portfolio management²⁹ and individual portfolio management³⁰, the proposal aims to allow Member States to authorise management companies to engage in both types of management activities and also in another two non-core activities³¹, namely investment advice and safe-keeping of units of collective investment undertakings. However, for the sake of investor protection, management companies shall not be permitted to carry out additional activities.³²

²⁸ Such as banks, investment firms, etc.

²⁹ i.e. management of collective investment undertakings

³⁰ i.e. management of the portfolios of individual clients, including those of pension funds.

³¹ Refer to Article 5.3 of the Proposal.

³² At this point one must note that since the service of individual portfolio management is already regulated by the Investment Services Directive (ISD) - (Directive 93/22/EEC) - it is necessary to ensure a coherent solution with that Directive. Thus, the proposal states that management companies, the authorisation of which also covers the individual portfolio management service, are subject, for that activity only, to ISD provisions.

IDENTIFYING THE FUNCTIONS COMPRISED IN THE ACTIVITY OF COLLECTIVE PORTFOLIO MANAGEMENT AND DEFINING THE CONDITIONS UNDER WHICH SUCH FUNCTIONS CAN BE DELEGATED TO THIRD PARTIES

Considering the fact that today Member States have a different understanding on how the management of collective investment undertakings should be conceived and organised, it is necessary to ensure the mutual recognition of the different solutions adopted by Member States. The proposal, therefore, has the aim to make clear which functions can be considered to be comprised in the activity of collective portfolio management³³. The Proposal also makes clear the fact that Member States may permit management companies to delegate, for a more rational organisation of their business, functions to third parties, provided that certain pre-conditions are respected. The Proposal underlines that in no case can the management company's liabilities be affected by the fact that it has delegated its own functions.

MODERNISING THE INFORMATION DOCUMENTS TO BE GIVEN TO INVESTORS, AND INTRODUCTION OF SIMPLIFIED PROSPECTUSES

Through the Directive, it was considered appropriate to provide investors with a substantial amount of information, in order to enable them to make an informed judgement on the quality and desirability of the proposed investment in units of a given collective investment undertaking. However, this can be considered to be unsatisfactory, in the sense that it does not fit well with the needs of the average investor. The proposal takes the view that investor protection can be achieved more effectively through the provision of clear, simple and essential information.

For this reason, the proposal introduces simplified prospectuses.³⁴ This prospectus is conceived as a mandatory information document which has always to be offered to the potential investor (whether it is the home Member State or in the host Member State³⁵) before the conclusion of the contract. On the other hand, the distribution of the full prospectus containing more detailed information on the UCITS as well as the fund rules, or instruments of incorporation, will no longer be compulsory³⁶.

This second proposal, contrary to the Directive, lays down detailed rules with regard to the regulation of the management companies. In fact, the UCITS Directive contains no harmonised market access rules for management companies such as minimum capital requirements and it does not include rules ensuring the monitoring of the relevant shareholders in such companies. In the Directive, cross-border activity is regulated only from the point of view of the distribution of the "product", but nothing is said as to who may distribute units and it does not lay down rules regulating the establishment of branches and the free provision of services by management companies. The proposal would introduce a number of new Articles which refer to the new regulation of management

³³ In fact Annex no.2 gives a list of the functions included in the activity of collective portfolio management.

³⁴ These are included in the New Schedule C, which is to be added to the existing annex of the Directive.

³⁵ Proposal - Article 47

³⁶ Although such documents could still be obtained free of charge at the investor's request.

companies. These articles, namely articles 5 and 6, set out the criteria for granting authorisation in the home Member State to a management company and the cases in which the authorisation has to be withdrawn.³⁷

With regard to cross-border distribution of the units, the proposal holds that the double ex-ante notification required by the Directive (i.e. notification to the competent authorities of the Home Member State and another to the competent authorities of the Host Member State) will be changed. The proposal is that the management company will have to notify its intention to distribute the units of the collective investment undertakings it manages to the competent authorities of its home Member State, which are then to inform the authorities of the host country. In fact Article 6a.1 holds that

*“any management company wishing to establish a branch within the territory of another Member State shall notify the competent authorities of its ‘home’ Member State”.*³⁸

With regard to marketing rules, Article 46 holds that they still fall within the competence of the host Member State as is the case with the marketing carried on by insurance intermediaries. The Proposal does not change the existing rule according to which the distribution of the units may begin only after the expiry of a certain period of time³⁹ during which the host country authorities may check the compliance with such rules.

POSITION OF INSURANCE INTERMEDIARIES AND INVESTMENT MANAGEMENT COMPANIES IN MALTA

In 1994 we saw a significant, though inevitable turning point and a revolutionary overhaul in the Maltese financial services infrastructure. The initiatives taken to develop a comprehensive body of laws for the financial services sector range from the enactment of totally new laws to the enhancement, amendment and consolidation of existing legislation. Developments were made towards eliminating the onshore-offshore difference and an effort was made to redirecting the drive towards banking and investment services. The major amendments were the following:

Establishment of the Malta Financial Services Centre⁴⁰;
Investment Services Act (new)⁴¹;
Financial Institutions Act (new)⁴²;
Prevention of money laundering Act (new)⁴³;
Insider Dealing Act (new)⁴⁴;
Professional Secrecy Act (new)⁴⁵;

³⁷ These requirements are based on comparable requirements provided for by the Investment Services Directive for investment firms.

³⁸ The Article moves on to give a list of the required details to be given with such notification.

³⁹ When this includes the establishment of branches the time limit is 2 months, if without establishing branches, the time period is one month.

⁴⁰ Laws of Malta - Chapter 330.

⁴¹ Act XIV of 1994.

⁴² Act XXII of 1994.

⁴³ Act XIX of 1994.

⁴⁴ Act XXI of 1994

⁴⁵ Act XXIV of 1994.

Banking Act (revised)⁴⁶;
Recognition of Trusts Act (new)⁴⁷
Structural amendments to the Income Tax Act and introduction of Income Tax Management Act⁴⁸.
Amendment to the Insurance Business Act and the introduction of the Insurance Brokers and other Intermediaries Act. (1998)

A superficial analysis of these laws will show that the legislation is principally regulatory in nature. We have new laws to regulate companies, banks, investment services providers, trustees, nominees and insurance companies.

The need for this new legislation arose out of the fact that the relevant sections of our Civil Code had not been revised since the 1860s and this had left the Code intact, thus freezing it in the distant past. The same may also be said of the Commercial Code.

REGULATION OF INSURANCE INTERMEDIARIES

Legislation applied to the insurance sector has been recently modified by the amendments to the Insurance Business Act⁴⁹, and the introduction of the “Insurance Brokers and Other Intermediaries Act”, 1998. The new provisions are intended to follow EC Directives⁵⁰. The Act is supported by the Insurance Directives issued by MFSC⁵¹, which give more detailed information on the application of the Acts.

The “Insurance Brokers and Other Intermediaries Act, 1998”⁵² grants the Malta Financial Services Centre⁵³ the authority to issue Directives with regard to insurance intermediaries. Among the Directives already issued are those dealing with:

- Own funds of companies enrolled in the brokers list and carrying on business as Insurance Brokers⁵⁴ - a Directive which determines the components which make up the own funds of enrolled companies.
- Criteria of fitness and properness of insurance intermediaries⁵⁵. This requirement is extended to insurance Brokers, shareholders, directors, controllers and all persons who effectively manage the affairs and carry on the activities of an insurance company, including sub-agents. Similar to the Recommendation of 1992, this concept is wide enough to cover all persons dealing in insurance and does not distinguish among agents, brokers and sub-agents. The “Fit and proper” controls are a means of raising public

⁴⁶ Act XV of 1994.

⁴⁷ Act XX of 1994.

⁴⁸ Act XVIII of 1994.

⁴⁹ Amended by the Insurance Business Act, 1998.

⁵⁰ Report Updating the Commission Opinion on Malta’s Application for Membership - 1999.

⁵¹ The Malta Financial Services Centre.

⁵² Act No. XVIII of 1998, Section 4.

⁵³ MFSC is the competent authority appointed by the Minister responsible for Finance, in exercise of the powers conferred upon him by Section 3 of the Insurance Business Act, 1998.

⁵⁴ Insurance Intermediaries Directive 1 of 1999.

⁵⁵ Insurance Directive 2 of 1999.

confidence in the integrity of the insurance industry and a key element of an effective insurance supervisory system.

- Disclosure of information for clients⁵⁶. The scope of this Directive is to determine the information which a company shall disclose to a client before negotiations on a contract of insurance are commenced. An example which is similar to provisions of the 1992 EC Recommendation is that if a company is connected with an authorised company, it shall disclose such connection to the client. The Directive also requires that all the required disclosures are to be intelligibly expressed so as to be easily understood by the person to whom the disclosure is addressed, as a measure to protect the consumer.
- Insurance intermediaries advertisements and other promotional activities⁵⁷. The aim of this Directive is to issue guidelines on insurance intermediaries advertisements and other promotional activities issued by insurance intermediaries so that the clients' right to information which is not misleading is protected against unethical practice.
- Particulars of individuals⁵⁸ and companies⁵⁹ to be entered in the Brokers Register. The aim is to have a list of the particulars of all the individuals and companies acting as insurance brokers in Malta and to regulate the manner in which such persons shall apply for registration as insurance brokers. This concept of registration was also given importance in the 1992 EC Directive. The scope is that no person can sell insurance unless he is registered. On the other hand, no person can be registered unless he fulfils the required standards. Such registration is also required of persons acting as sub-agents.⁶⁰
- Qualifications of individuals applying for registration in the Brokers Register⁶¹. The combination of educational attainment and practical experience is also set out the EC Recommendation. The Directive goes into detail and gives minimal requirements of education and periods of experience. For example, a broker is required to have carried on business of insurance broking for a period of not less than five years during the last ten years⁶².

These Directives, together with the Act, aim at updating the regulation of insurance business in Malta, giving consumers a safer environment and ensuring the development of the insurance sector in Malta.

REGULATION OF INVESTMENT SERVICES MANAGERS

With regard to investment services, the relevant legislation is the "Investment Services Act" of 1994. This Act, together with the supporting guidelines⁶³, incorporates the core

⁵⁶ Insurance Intermediaries Directive 3 of 1999.

⁵⁷ Insurance Intermediaries Directive 5 of 1999.

⁵⁸ Insurance Intermediaries Directive 8 of 1999.

⁵⁹ Insurance intermediaries Directive 10 of 1999.

⁶⁰ Insurance Intermediaries Directive 16 of 1999.

⁶¹ Insurance Intermediaries Directive 9 of 1999.

⁶² Insurance Intermediaries Directive 9 of 1999 - Section 4.2(b).

⁶³ Investment Services Guidelines issued by MFSC.

measures found in the 1985 UCITS Directive. A clear example is the method of authorisation. Section 3(1) holds that:

“No person shall provide, or hold himself out as providing, an investment service in or from within Malta unless he is in possession of a valid investment service licence No collective investment scheme shall issue or create any units or carry out any activity in or from within Malta unless there is in respect of it a valid collective investment scheme licence.”

Such a licence⁶⁴ is to be granted by the competent authority⁶⁵. With regard to collective investment, it should be noted that the activities of the Licence Holder shall be limited to the “management” of collective investment schemes, except in respect of its own administration. The distinction between the Scheme/Fund itself and the Management Company is clear in the guidelines which hold that neither the Management company nor any of its associates shall deal with the Scheme itself as a principal unless the terms of the transaction or arrangement are on an arm’s length basis.⁶⁶

This concept of licensing is compatible with the 1985 UCITS directive in the sense that the competent authority will only grant a license if certain conditions are fulfilled. The conditions found in the Investment Services Act, and the Guidelines which support the Act, tend to be similar to the conditions found in the 1985 Directive. A clear example of this is the requirement of good repute. Section 6 of the Act prohibits the MFSC from granting an Investment Services Licence unless it is satisfied that the applicant is a fit and proper person to provide the investment services concerned and that the applicant will comply with and observe the appropriate rules and regulations. In general terms, there are three criteria which should be met, before the “fit and proper” test can be said to have been satisfied:

- (a) integrity;
- (b) competence; and
- (c) solvency.

Integrity involves the licence holder and its employees acting honestly and in a trustworthy fashion in relation to its clients and other parties. Competence demands that those carrying out the business of the licence holder, including the managers of investment funds, act in a knowledgeable, professional and efficient way, in compliance with the regulations. The nature and extent of the competence required will depend upon the job being performed. The MFSC will take into account the qualifications and experience of those involved, and the actual handling of business. Sound and prudent management, adequate resources, and a scrupulous attitude towards clients are essential. The business should be well organised, it should have adequate controls, and it should maintain sufficient records to demonstrate these attributes. Individuals should have a sufficient understanding of the business, and of the investment financial services and instruments (including the related markets) with

⁶⁴ Section 6 of the Investment Services Act provides detailed regulation of the power of the competent authority to refuse or grant a licence.

⁶⁵ Which is presently the MFSC.

⁶⁶ Investment Services Guidelines. Part C, Section 1, 11.04.

which they are dealing. Solvency involves ensuring the proper financial control and management of the business, which should have sufficient financial resources to meet not only the financial demands on the business but also the financial resources requirements established by the MFSC. These concepts are similar to the requirements found in the 1985 Directive. In fact, Article 4 of that Directive holds that no licence shall be granted to a UCITS if the directors and managers of such company are not of good repute. Such requirement of good repute is also extended to the whole duration of the carrying on of such business and not only prior to the granting of such licence.

The effect of section 3 is to require an Investment Services Licence to be held whether the Investment Service is being provided in Malta or overseas. If the Investment Service is being provided overseas from Malta, a Licence is required whatever kind of legal "person" is involved, including an individual. If the Investment Service is being provided overseas, from overseas, under section 3(2) an Investment Services Licence is required if the service is being provided by a body corporate, unincorporated body or association formed, established or constituted under the laws of Malta. The purpose of section 3(2) is to make it illegal for an entity to use Malta as a base for providing Investment Services overseas without having an Investment Services Licence. In practice, the MFSC is unlikely to grant an Investment Services Licence in respect of overseas activities unless they are conducted in a territory which is adequately regulated. To do otherwise would leave Malta vulnerable to unscrupulous operators with no recourse through the Maltese courts. The MFSC does not itself regulate operations carried out overseas⁶⁷.

With regard to collective investment, the Guidelines introduce the concept of a custodian which should be independent from the management company.

"The management company and the Custodian shall be separate persons independent of each other. They shall act independently and solely in the interests of the Unit Holders."

This is similar to the distinction made in the 1985 Directive between the management company and the "Depositary". In Article 15.2, the Directive holds that the depositary must be an institution which is subject to public control. It must also furnish sufficient financial and professional guarantees to be able effectively to pursue its business as depositary. The concept of independence is upheld in both cases. One must note that it is necessary that the depositary be established in Malta. Under the new proposal⁶⁸ for EC Member States, the requirement for the depositary to be in the same Member State is done away with.

Another similar factor is the concept of financial reporting. This is severely regulated in the guidelines issued by the MFSC which are drawn in particular detail, very often corresponding to the regulations found in the 1998 proposals for amendment to the 1985 Directive. The Licence Holder is also required to take out and maintain a professional indemnity insurance policy and other insurance policies of such classes and descriptions as stated in the guidelines. This ensures consumer protection which is the rationale of such regulation.

⁶⁷ Investment Services Guidelines - Part A: Section 3.

⁶⁸ I.e. the 1998 UCITS proposal (EC)

The liability of the licence holder for its own acts or omissions shall not be diminished if it has delegated functions and duties or entrusted to a third party some or all of the assets in its safe-keeping. This rule is also given particular importance in the 1998 proposal on UCITS where detailed rules are given on how such delegation can take place⁶⁹, and the concept of responsibility of the licence holder is upheld in all instances.

Advertising is also regulated in the sense that the MFSC is to grant consent with regard any promotional activity inviting persons to become or offer to become participants in a collective investment scheme, or any advertisement or activity containing information calculated to lead directly or indirectly to persons becoming or offering to become participants in such a scheme⁷⁰.

The requirement of having a prospectus appears in the guidelines which hold that managers of collective investment schemes are to provide

“... a prospectus, which shall be dated and the essential elements of which shall be kept up to date. The prospectus shall be offered to investors free of charge before they become committed to investing. All publicity comprising an invitation to purchase Units in a Scheme shall indicate that a prospectus exists and the places where it, and any documents updating it, may be obtained.”

This requirement is also compatible with the 1985 Directive. However, one must here mention the distinction made in the 1998 Proposal between the prospectus and a simplified prospectus⁷¹. The Proposal makes it obligatory that a simplified prospectus be given to investors, and the full prospectus is to be given free of charge to those investors who ask for it.

CONCLUSION

Users and suppliers in the financial services sector should be able to exploit freely the commercial opportunities offered by a single financial market, while benefiting from a high level of consumer protection. Both the adoption of the UCITS proposals of 1998 and any new proposals on insurance intermediaries are to keep these two objectives in mind. In fact the second UCITS proposal holds in its Preamble that “authorisation granted in the Management company’s home Member State must ensure investor protection and the stability of the financial system.”

⁶⁹ 2nd Proposal - Article 5g.

⁷⁰ Section 11(1) of the Investment Services Act.

⁷¹ 2nd Proposal - Article 33. “The simplified prospectus must be offered to subscribers free of charge before the conclusion of the contract.

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