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THE NEW MFSA

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PLACING THE RECENT CHANGES IN DIFFERENT CONTEXTS

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Introduction

The scope of this brief paper is to explore various ways of looking at the MFSA and to attempt to place it within five different contexts. The MFSA is a complex entity with an interesting history and a very challenging present and future. It has been deeply affected by recent local and international developments. This paper shall try to show how one may gain a more complete understanding of the recent legislative changes in our financial services legislation and architecture by looking at them from different perspectives. Each context helps to construct a wider backdrop. To do this meaningfully, one needs to avoid undue distraction by legal details and instead retain focus on the wider picture.

Legislative changes never happen in a vacuum. And it would be a mistake to simply view the recent changes in the financial laws as a legal exercise which can be left to the lawyers to study and advise upon. That exercise needs to be done for practical purposes, but it is not enough. This paper shall deal with its subject without making any reference to any single legal article.

In this paper, the writer draws on eleven years of regulatory experience with the MIBA / MFSC / MFSA to analyse what the new MFSA represents as an institution growing up in an increasingly complex Maltese legislative and administrative mosaic. Placing it in a number of five different relevant contexts, the paper will attempt to show that there are various ways of looking at the MFSA recently reconstituted as the single regulator for financial services. The comments and conclusions are the writer's sole responsibility. The writer lectures on financial services and consumer at the University of Malta and heads the unit responsible for legal matters, EU and other international issues at the MFSA.

CONTEXT NO 1

Part of the background - MIBA and MFSC in a changing world

The MIBA is where it all started. The new MFSA is the direct legal and functional descendant of the original MIBA (the Malta International Business Authority). In 1994, MIBA was transformed into the MFSC and this later became the current MFSA. These changes occurred within the same piece of legislation, namely the original 1988 Malta International Business Activities Act. In other words, an entity being re-constituted not once but twice, and each time re-created as something bigger and more complex. This is quite an exceptional phenomenon.

MIBA was created at a time where offshore was still rather a useful business term which opened doors. Soon, however, MIBA and what it represented were eclipsed by developments overseas that made "offshore" sound suspicious, practically synonymous to "money-laundering". Offshore was also suspected of being EU-incompatible. By 1993, the honeymoon was over and even our then Minister seemed to wish we did not exist.

1994 was an end of an era, which - as often happens - also signalled a new beginning. Huge legislative reforms were drawn up and put into place. The name of the institution was changed, as were our personal designations within the institution. The changes reflected the radical change of direction and newly enhanced role of the institution; as MIBA, it played a limited role restricted to what always remained a smallish offshore sector, whereas as MFSC, it was assigned a much more extensive and varied list of duties. For the first time, the entity started having a regulatory contact with the consuming public. The MFSC was assigned supervisory responsibility for insurance and investment services. The new MFSC had new duties towards the consumers of financial services, especially insurance policyholders and investment services customers. It was required to combine its original offshore vocation with this new domestic role, making it a composite regulator for the first time. This was a tremendous change and meant an extraordinary break with the past. The creation of the MFSC also introduced the concept of consolidating all the supervisory responsibilities for financial services, up till then scattered among three different regulators. This idea is clearly borne out by the way the legislation was devised and by the relevant parliamentary debates.

In less than ten years, from its relatively humble beginnings as the single regulator for the small offshore business sector, the Authority grew into the single regulator for the entire financial services sector. My research to date indicates that this may be the only case where a strictly offshore regulator of a jurisdiction has developed into the single unitary regulator for all financial services. In practice, MIBA's functions and day to day activities largely focussed on the 2400 or so offshore companies. These were ordinary companies, mainly trading or asset-holding companies, and were not involved in the provision of any financial services. Indeed, MIBA's role in financial services was marginal, limited to five offshore banks. MIBA was in this sense very much a part-time financial regulator. To the contrary, the MFSA is a full-time regulator responsible for the entire financial services sector. It has also been assigned responsibility for the entire company compliance functionwhich, until 1997, resided with the Department of Trade. The MFSA is still responsible for the less than 100 surviving offshore companies, which now attract a very tiny part of its attention.

CONTEXT NO 2

A single regulator - among several single unified regulators in other countries

The MFSA is now the single unitary regulator for all financial services. This is not the place to discuss advantages and disadvantages. This aspect has been dealt with elsewhere. There are now a number of countries that have opted for a single regulatory system. Indeed, sometimes one comes across suggestions that there may be an element of fashionability in this area. But is the single regulator model a mere "plate of the day"? One hopes not. Certainly, these past few years have seen several other countries transforming their fragmented regulatory structures into a more unified consolidated approach. Interestingly, a brief comparative analysis shows that there is no one similar common single regulatory model. Even within the ranks of the single regulators, different structures have been implemented. As I have had occasion to say elsewhere, there is no one single one-size-fit-all model. There are variations and important differences.

One need only briefly consider single

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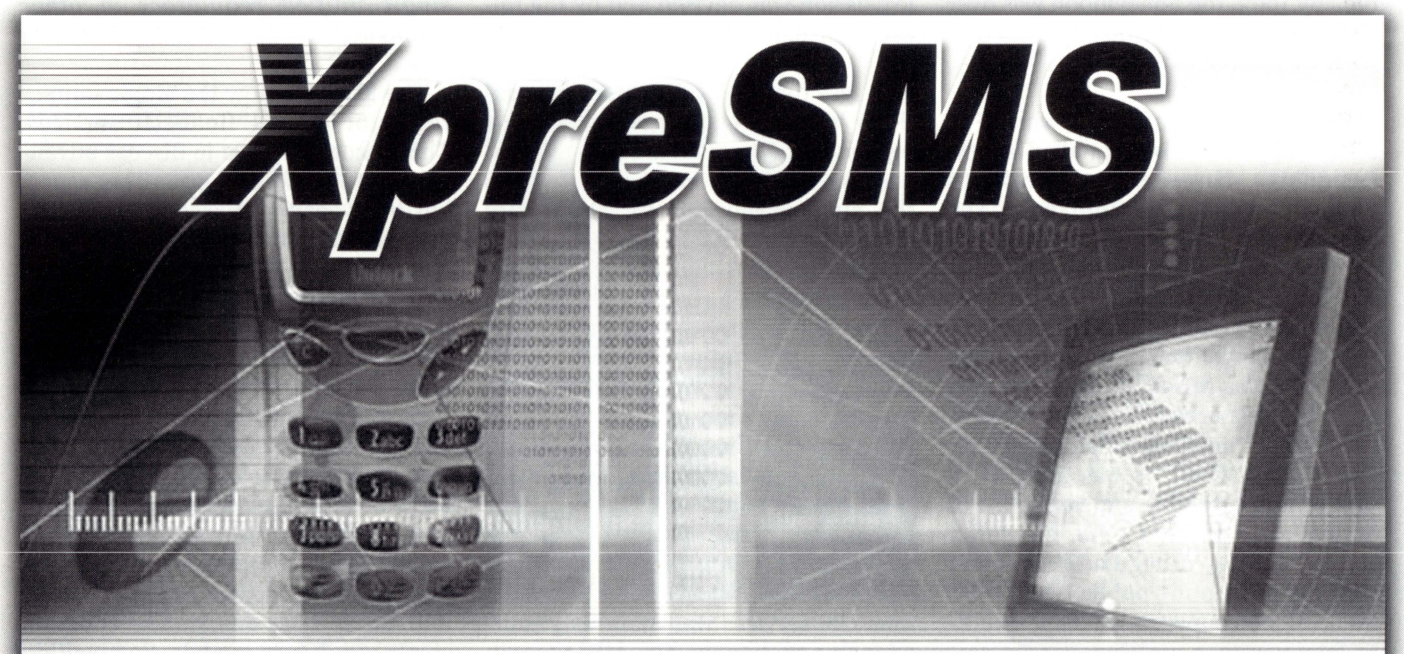

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regulatory structures recently introduced in three relative small countries comparable to Malta - Mauritius, Estonia and the Republic of Ireland, as well as the United Kingdom to realize how deep the differences can be. These are all recently established structures, and the UK is probably the most sizeable and relevant financial jurisdiction that has adopted a single regulatory model. The conception and the beginning of the construction of the Maltese model in 1993 preceded all of these. However, the UK and Estonia effectively put their single regulator into place a few years before Malta. The model closest to the one adopted in Malta is the FSA in the UK. Neither copied from the other. The more recent Irish approach basically merges the single regulator with the national central bank to create one huge new entity under one corporate name with two distinct functions. In this manner the Bank of Ireland is not completely excluded from playing a role in regulation, which it might have otherwise have lost. In Estonia and Mauritius, one detects a move towards consolidating supervision within the central bank structure, with consequential lack of administrative autonomy. The jurisdictions which have the national central bank as the single regulator are a very small minority; these include Singapore and The Gambia. Most countries still have a non-unified division of supervision following the three neat traditional categories of banking, securities and insurance supervision.

Clearly, there is no one fit-all system, and each country needs to determine the most appropriate model for its own circumstances. Relevant factors include the size of the country and of its population, the size and maturity of the jurisdiction's financial services sector, the country's political and economic development, the status and reputation of the national central bank and public expectations.

CONTEXT NO 3

The international context - The EU, WTO, MoU's and international sanctions

The world has undergone tremendous change these past ten years. Malta is on the brink of EU membership. Up to the late eighties and early nineties, there was no real broad local interest in the EU. The EU was then looked upon as little more that a useful group of friendly neighbouring nations, with some of which Malta carried out substantial trade. EU directives and regulations did not tax our minds in those innocent days. Our vocabulary still lacked words as transposition, update reports, screening process, peer reviews, and others. An EU Directorate had been set up and located in the Palace in Valletta, but that was pretty much all in the very early eighties. But here we are now, under a new brand, whose laws and operating practices have been certified not only by an EU Peer Review Team, but also by such organizations as the IMF-World Bank and the OECD. Things have changed.

The changing international scenario has affected our legislation and the way we position ourselves in the world. It has made us less parochial. In financial services, our laws and practices have had to undergo substantial often-radical changes in order to reflect the binding legal order of the EU. New concepts, measures and administrative structures have been introduced in order to meet EU requirements, in the same way that each accession country has had to do. This exercise has involved significant resources. Providing a sensible explanation of all relevant developments in this area would merit another article on its own. Clearly the concepts of the single passport, freedom to provide services without undue obstacles, the bank deposit guarantee scheme and the investor compensation scheme, market abuse offences, UCITs are all directly derived from the EU Acquis, and have become or are about to become part of our ordinary domestic law.

Another important development that may be identified in the recent amendments to the MFSA Act and other laws is the clear and unambiguous bias towards a more liberal framework for exchange of information and collaboration with other regulators in other countries. In the past three years or so, it was becoming evident that international financial services regulation was undergoing a subtle but profound change where confidentiality was concerned. More cross-border business was being carried out, and business enterprises were no longer fixed in one jurisdiction but operated and offered services in more than one country. This made regulation on a national basis insufficient. One recalls the difficulties and the challenges presented by banks such as Banco Ambrosiano and BCCI, with branches and subsidiaries scattered all over the universe. We know how existing regulatory set-ups failed to keep up with these far-flung operations. Lessons have been learnt the hard way and now much more openness and collaboration is expected between regulators.

These past months, the MFSA has sought to establish formal Memoranda of Understanding (MoU's) with foreign regulators, and has collaborated to the fullest extent possible with other regulators whenever required to. A major difficulty was that some provisions in the MFSC legislation of 1994 rendered such exchange of information and collaboration quite difficult. This is no longer the case, as the laws have been overhauled for this precise purpose. Actually, the creation of a single regulator has facilitated the possibility of collaboration with foreign regulators and international supervisory agencies. There is no longer any scope for confusion in the eyes of foreign regulators and international organizations as to who is responsible for what. One also recalls a time when different representatives from three different local agencies represented Malta at international supervisory meetings, and when foreign requests for information was relayed from one agency to another. From this perspective, a single regulator is good news to foreign regulators and organizations seeking assistance from Malta.

The recent revisions have therefore sought to broaden the scope for increased international collaboration, and several gateways are now in place whereby information may be exchanged under professional secrecy safeguards with other foreign regulators. One can trace important amendments for this purpose in the MFSA Act, the Investment Services Act, the

Professional Secrecy Act and the recently re-named Insider Dealing and Market Abuse Offences Act.

A third relevant development concerns the World Trade Organization that was established in 1995. Since that year, we have had to learn to place the WTO in our equation, even in financial services, though certainly not at the level of importance enjoyed by the EU. As a founding member of the WTO, Malta accepted an obligation to offer (or "schedule") a number of liberalization measures in the field of financial services. This was carried out in 1997 in pursuance of a special WTO agreement covering exclusively financial services liberalization. Each member state made an offer of this kind and these reveal huge variances. The Maltese commitments have had to be reflected in our local legislation and administrative practices. Together with the Central Bank of Malta and the Economic Affairs Ministry, the MFSA assists the Maltese Government in defining the way forward in furthering our participation in the WTO process in line with the EU's own commitments in this respect. By becoming a full member of the EU, Malta joins a regional grouping which is considered to operate a very liberal and open economy.

Sanctions form the fourth item in the MFSA international agenda. The MFSA has also a role to play in enforcing international sanctions and, indeed, part of its website is now dedicated to this subject. Following well-known terrorist activity, the importance of co-ordinated international preventative and enforcement procedures have been once again highlighted. Together with the Central Bank and other authorities, the MFSA nominates a representative to sit on the Sanctions Monitoring Board established under the National Interest (Enabling Powers) Act of 1993. This Act provides the mechanism whereby mandatory sanctions imposed by the UN Security Council become part of Maltese law and are enforceable accordingly. The role of the Board is primarily to monitor the workings of the sanctions transposed into law by way of ministerial regulations.

The first encounter with international sanctions dates to 1993 when MIBA took action to ensure that adequate safeguards were put in motion to ensure that the Malta offshore facility would not fall foul of the sanctions then in force against Yugoslavia. At one stage, MIBA took a drastic policy decision prohibiting any investment in offshore companies by any Yugoslavian interests; a step which went beyond the requirements of the UN sanctions. Following the adoption of a specific law, the present position is more coherent, transparent and predictable. Recent sanctions have been imposed on Afghanistan, Libya, the Sudan, Liberia and others. The 1993 legal framework shall also enable Malta to implement any measures that may be adopted by the EU.

CONTEXT NO 4

The MFSA as a public corporation - other public corporations and consolidations in other sectors

The MFSA enjoys the legal status of a public corporation set up under special legislation to carry out specified statutory duties in the public interest. Other public corporations have been similarly established. One may mention the ETC, the Malta Maritime Authority, the Water Services Corporation, the Enemalta Corporation, the Broadcasting Authority, the Malta Resources Authority and others. Each one of these was established by special Act of Parliament. Unlike companies and commercial partnerships, they do not have a statute and they do not have a general law regulating their behaviour.

The MFSA is a regulatory and licensing agency akin to the Broadcasting Authority, the Co-operatives Board and the Malta Tourism Authority established in 2000 by the Malta Tourism and Travel Services Act. Unlike the Enemalta Corporation and the Drydocks Corporation, the MFSA is not intended as a trading entity. The Malta Tourism Authority is also useful as it offers another parallel consolidation exercise being undertaken in a different economic sector. The MTA was set up to take over and merge all the various little authorities operating in the tourism sector that had been estab-

lished piece-meal over the past forty years. They included the NTOM and the Hotels and Catering Establishments Board. One may also usefully consider the recent establishment of Malta Enterprise. This newly established corporation has merged and consolidated the functions formerly undertaken by the MDC, Metco and IPSE. When these three separate consolidation exercises were being debated in Parliament, quite similar justifications were given particularly regarding economies of scale, greater efficiency, concentration and grouping of scarce resources and consequential synergies. The MFSA is therefore not the only single unitary agency overseeing a sector of economic life in Malta, resulting from the merging of previously fragmented allocation of functions.

There is a second aspect that merits consideration. MIBA had a very interesting internal structuring which was very different from that of other comparable public corporations of the time. Much of that original MIBA structure has managed to survive but some significant revisions reflecting the growth in the entity's functions, activities and staff have been introduced. The original division of roles within the MIBA allotted policy matters to a Board of Governors which is still there, while all operational and administrative matters were assigned to an Executive Committee, which no longer exists in its original shape. The head of the Executive Committee used to sit on the Board of Governors. This is no longer the case. The current situation, in brief, sees the functions formerly carried out by the Executive Committee now being shared between a Supervisory Council whose work is exclusively regulatory in nature, and a Management and Resources Board whose work is exclusively administrative and managerial. This division of labour is useful as it allows the new regulatory organ to concentrate exclusively on regulatory matters. This had not been the case with the former Executive Committee structure, although admittedly the extent of the offshore sector it regulated was limited.

Additionally, the law has sought to ensure that this new strict pigeon-holing structure does not generate a counter-productive disfunctional effect. It therefore requires the three major organs of the MFSA to meet in a Co-ordination Committee where messages and information are exchanged between them. This makes for better cohesion. Under the simpler MIBA Act arrangements, some cohesion was secured by having the Chief Executive of the Executive Committee sitting ex officio on the Board of Governors, and by having the Board Secretary servicing both organs.

The internal structure of the Authority has significant implications as it discloses how government envisages the financial services regulator to go about its task. One can observe how the law has attempted to adequately prepare and equip the new single regulatory agency for its new enhanced role.

CONTEXT NO 5

The MFSA as a consumer protection agency - responding to a new context of consumer and competition legislation

Consumer protection is the last context that shall be considered. For the first time, consumer protection is now specifically imposed as one of the functions of the Authority. The recent legislative amendments also require it to promote consumer choice and competition. This means that financial services legislation is now more in harmony with recent consumer affairs and competition legislation and administrative structures adopted by Parliament late in 1994. These laws were in fact adopted just a few weeks after the considerable MFSC package of laws was passed. Consumer and competition law may be considered as two relatively new complementary pillars of local commercial law and practice. As a result of the recent changes, they find themselves acknowledged and accepted in our financial services legislation. For the avoidance of doubt, perhaps one may clarify that this development has not made the MFSA a rival of the Office of Fair Competition. The resolution of competition issues remains primarily the domain of the Competition Office. Indeed, FSA last year, the MFSA referred a particular competition issue to that Office. What the law does is require the MFSA to consider competition issues when performing its tasks. In this way, the recent reforms have transformed the institution into one of Malta's consumer agencies, complementing the work done by the Department for Consumer Affairs and the Office for Fair Competition.

Consumer protection in financial services is a complex subject. The exercise would require an analysis of two increasingly complex legal fields. Starting with consumer legislation, the most important law is the Consumer Affairs Act adopted in 1994 but only brought into force in 1996. This Act provides fundamental definitions of such basic concepts as "consumer", "trader" and "services". It explains the role of the Director for Consumer Affairs and the work his Department undertakes in the interests of consumers. It establishes the Consumer Claims Tribunal and defines its competence over consumer-trader disputes. The recent amendments to the Act have introduced numerous new concepts and legal principles some of which are of EU origin.

In the financial services field, various Acts compete for attention. The newly styled MFSA Act provides the new list of functions of the Authority where consumer protection is for the first time directly mentioned. This development is complemented by the creation of a new statutory post, namely the office of the Consumer Complaints Manager who is set to play a very significant role in consumer protection in financial services in Malta. The emphasis is on the protection of the private investor, a concept which recalls the EU–derived definition of "consumer" adopted in the Consumer Affairs Act.

So, all in all, a very rich and increasingly complex framework where financial services and general consumer protection legislation meet, interact and complement each other. In this last section I have attempted to provide a cursory look at consumer protection elements in the new MFSA Act provisions. It would also have been useful to examine which, how and to what extent general consumer laws apply to consumers of financial services. Indeed, several of our consumer protection measures and laws apply to consumers of financial services. This exercise will have to be undertaken elsewhere.