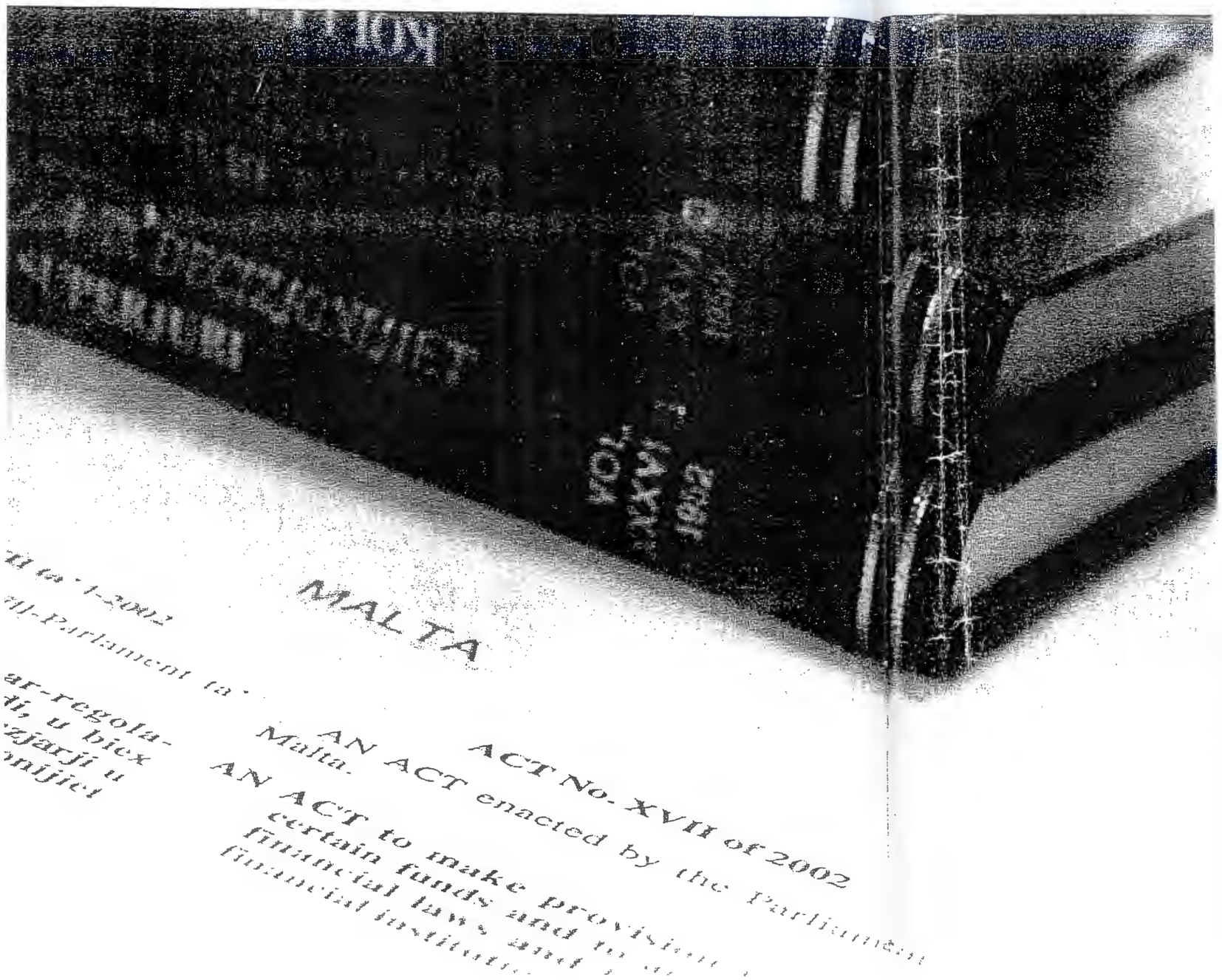
Recent amendments to Malta's financial services legislation

- a review of some major aspects of ACT no. XVII of 2002



MFSA
MALTA FINANCIAL SERVICES AUTHORITY

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The Special Funds Act (Act no XVII) is now law. It entered into force almost in its entirety on the 1st October 2002. This Act amends many of our financial services laws and deserves close attention. Building on previous legislation largely enacted in the period 1994-98, the new Act introduces a number of significant innovations and features. It contains no less than 291 sections divided into 16 different parts. Each part represents a different law. Parts I to III consists of the one and only brand new Act in this compendium under the title "An Act to make provision regulating retirement funds". Interestingly, the Act also makes a few changes to the Companies Act.

Readers will have noted that regrettably very little attention was given in the press to the Parliamentary debates on this important Bill. Indeed, no noticeable political controversy was stirred. This may mean that the Opposition in Parliament was still keen to retain the broad political consensus in this area and did not feel so strongly on the points in which it had declared its disagreement with government. The two issues that were contested were the additional autonomy given to the Central Bank and the duration of the Governor's term of office, and the assignment to the MFSA of the responsibility for banking supervision. One major reason why the press and other media looked elsewhere may have been the highly technical nature of the Bill which admittedly offered the media no concessions by way of amusement or light entertainment.

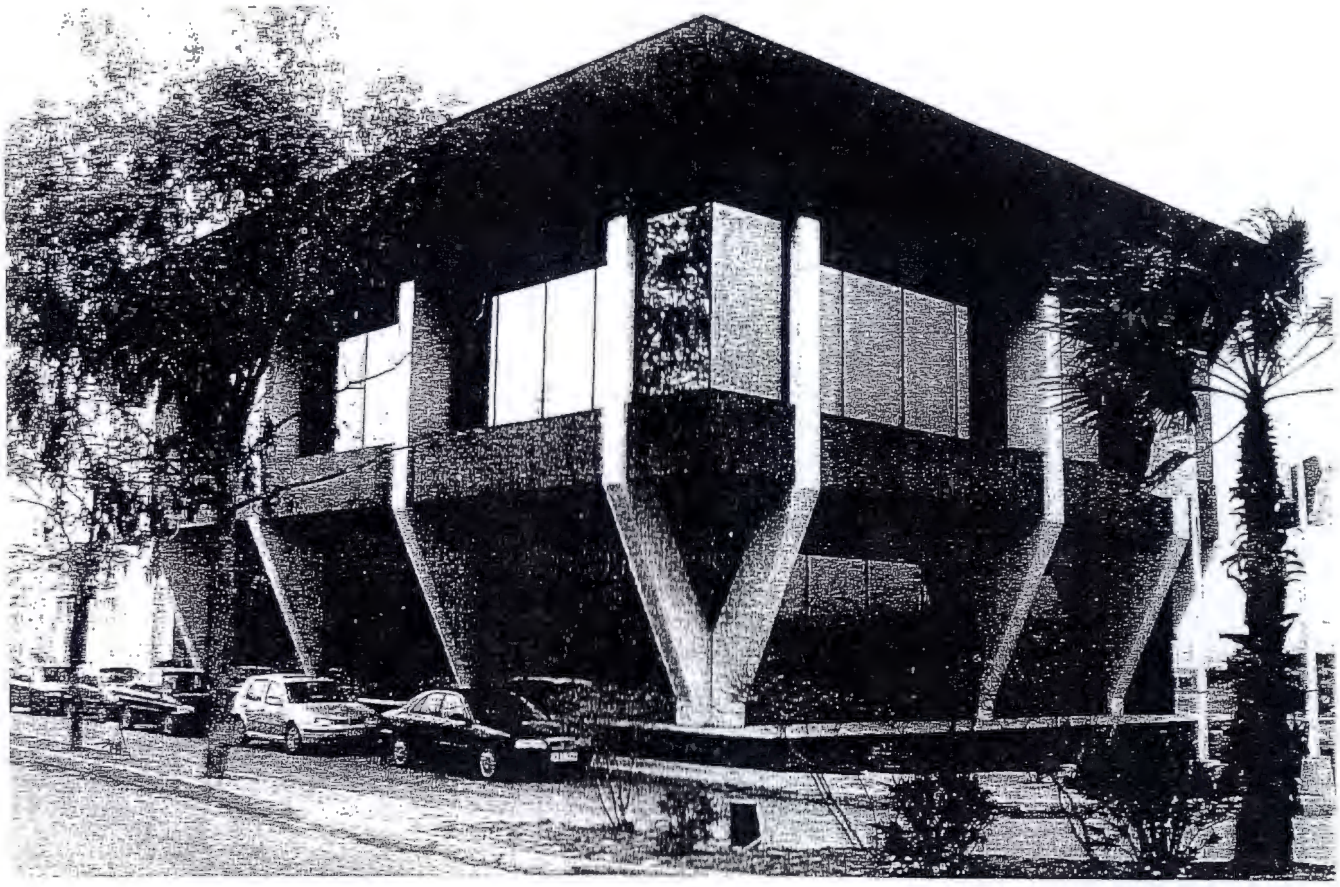
However, from a regulatory point of view, these changes are all extremely interesting.

This paper shall restrict itself to a brief discussion of six of the more interesting legal and regulatory reforms introduced by this recent Act.

(1) From MFSC to MFSA – changes in internal structures

The MFSC has been re-constituted as the Malta Financial Services Authority and its statutory functions are being revised to reflect its role as a single regulatory agency. It is not surprising that in the light of the huge new responsibilities placed on it, the MFSA's internal structures have had to be re-appraised. The 1994 reforms had left the original offshore authority MIBA structure almost untouched. This may have been adequate for a small organization – at its peak, the then MIBA had 24 employees. The current organization employs in excess of 120. Accordingly, the amendments provide a new internal architecture for the MFSA. A new Supervisory Council replaces the former Executive Committee, in place since 1989, as the regulatory arm of the new authority. This new Council is presided by the newly created Director-General and groups the heads of all the regulatory units. The amendments safeguard full continuity between the MFSC and the MFSA and between the former Executive Committee and the new Supervisory Council. This guarantees the continued validity of all licences and actions issued or taken under the old structure. The transition will be entirely painless.

The regulatory arm is no longer consolidated with the management function as was the case with the MIBA, where the Executive Committee was responsible for both regulatory supervision and internal management. Clearly, this proved unsustainable as the regulatory responsibilities increased and multiplied since 1994. The new law has created a new organ, the Management and Resource Board



("MRB") whose functions are strictly administrative and covers all management matters within the MFSA, including support services as IT, human resources, accounting and business development. The MRB will have nothing to do with the regulatory and supervisory functions of the Centre but is there to provide the services and facilities to allow the regulators to carry on with their work and to perform it efficiently. The MRB is headed by the Chief Operations Officer, another new post.

(2) Consumer protection function of the MFSA

The description of the functions of the Authority has been completely revamped. The MFSA has now been assigned a new strikingly explicit consumer protection orientation. Formerly this was only indirectly stated or implied. Now it is stated very specifically. The new Act has also established a new office for the specific purpose of handling of consumer complaints in relation to financial services. A Consumer Complaints Manager "CCM", answerable to the Supervisory Council, has been appointed.

It would be useful to reflect on the implications of this novel mechanism. The CCM is an employee of the MFSA at management level and reports to the regulatory arm of the authority. The CCM investigates and mediates. He tries to resolve complaints. He informs, explains and advises as appropriate in the circumstances. However, he does not have any judicial function, and he is neither a Tribunal nor an Ombudsman. As an official of the Authority, he is not entirely independent in his actions, and he is subject to the general policy directions given to the Authority by its Board of Governors. The CCM does not enjoy any enforcement powers. If he did, he would have duplicated (and competed with) the regulatory organ, the Supervisory Council. He reports his recommendations to this Council, which shall be free to accept them in part or in whole, or otherwise. Ultimately, decisions are taken by the Supervisory Council which alone may exercise the Authority's considerable executive powers.

In this context, it should be remembered that the consumer of financial services may also utilize remedies available under the general consumer legislation. The ordinary consumer retains the right to request help and advice from the Department of Consumer Affairs. Where the grievance falls within the terms of the Consumer Affairs Act of 1994, he may request to have his dispute referred to the Consumer Claims Tribunal. The competence of this Tribunal is open to claims of up to LM 1500.

(3) The Malta Stock Exchange

The Malta Stock Exchange Act of 1990 has been quite heavily revised. Indeed it has now been re-named the Financial Markets Act. This Act adopts the concepts of "competent authority", and introduces the concepts of "recognized investment exchanges" and the "Listing Authority". Stockbrokers shall henceforth be licensed under the Investment Services Act even for their stockbroking business and their former obligation to comply with the Stock Exchange bye-laws has been replaced by an obligation to abide by the relevant ISA Guidelines. The existing stock exchange shall be re-constituted as a recognized investment exchange immediately authorized under the Financial Markets Act in terms of the new Act. As such, it is now subject to supervision by the MFSA. Its regulatory role is now limited to acting as the

"Listing Authority" as defined in the new Act. This function shall devolve to the MFSA within a few months. What this means is that the Malta Stock Exchange which we have known for the past decade is now operating under a very different make-up. It is gradually losing its regulatory role becoming exclusively an operator of an exchange. The law allows the setting up of other alternative exchanges that can either seek niche sectors or compete for listings with the existing exchange.

(4) The Insider Dealing Act and the Professional Secrecy Act

The Insider Dealing Act of 1994 only caught and punished wrongdoing that can be brought within the meaning of insider dealing given in the Act. New market abuse and market manipulation offences have now been included in the Insider Dealing Act which has been accordingly re-named the Insider Dealing and Market Abuse Act. This development is long over-due. Market abuse offences include acts of securities market manipulation such as creating artificial transactions and spreading false rumours. These activities were formerly only dealt with in the bye-laws as administrative defaults. Now they have been "promoted" to criminal offences liable to the same harsh punishment as insider dealing offences.

Other amendments have clarified beyond any doubt that insider dealing and market abuse offences may be carried out either directly or indirectly, meaning either by the wrongdoer personally or by the interposition of a third person, including a nominee acting on his behalf. One also finds a substantial new clause allowing the maximum exchange of information and other forms of collaboration between Maltese authorities or between Maltese and overseas authorities with the aim of rooting out, detecting and punishing insider dealing and market abuse offences wherever they take place.

The Professional Secrecy Act has undergone small but interesting amendments. These have made it clearer than ever that professional secrecy is not a cloak or a shelter for illegal activity. New increased scope for the release of confidential information to public authorities is now set out in the Act whose originally severe confidentiality regime is being relaxed in the light of international disclosure expectations identified even before the 11th September event. Again one finds ample new gateways for the release of confidential information, particularly where the detection or punishment of criminal activity is involved.

(5) The Financial Services Tribunal

Interesting things have happened to the Financial Services Tribunal. In brief terms, this Tribunal has absorbed the former Malta Stock Exchange Tribunal, and has assumed new areas of competence. The principal regulations concerning the establishment, composition and core functions of the Tribunal are no longer found in the Banking Act but have been rightly re-located to the revised MFSA Act (new section 21). Some of the new provisions include the following:

(a) The Tribunal has been assigned considerable new competence to hear appeals regarding decisions taken by the competent authority, the listing authority and by recognized investment exchanges under the Financial Markets Act.

(b) The Tribunal has new powers to hear appeals with regard to retirement funds under the new Act on that subject.

(c) The Tribunal may now also hear appeals from aggrieved persons in certain matters under new provisions inserted in the Central Bank of Malta Act. These relate to payment systems and to the duties of "reporting agents". Under new section 52A, the Central Bank has been given power to impose administrative fines up to Lm5000.

(d) It has been vested with powers to order persons convicted of insider dealing or a market abuse offence to make a payment of compensation to victims who suffer loss as a result of their criminal act. Other consequential powers assigned under the original Malta Stock

Exchange Act to the Malta Stock Exchange Tribunal have been removed.

(e) Finally, the law now clearly states that an appeal has to be entered in writing by not later than thirty days from notification of the MFSA decision being contested, and the grounds for the appeal now have to be "explained clearly".

(6) Consolidation of supervisory functions

These recent reforms seal the consolidation of the supervision of banking and securities business under one single regulatory authority. Since the first January 2002, the MFSC has been vested with responsibility for both local banking and for the small residual offshore banking sector (now limited to two banks). Banking regulation had been differentiated into local and offshore in 1988 with the adoption of the Malta International Business Activities Act. The role of the Central Bank of Malta in banking supervision (in place since its creation under the Central Bank of Malta Act 1967) has now been brought to an end. Instead, a new emphasis on its role in monetary policy and its operational autonomy has been introduced. The Central Bank's statutory objectives have been re-formulated in new section 4, while a completely new part is now dedicated to "Monetary Policy" (Part II A) which envisages the setting up of a new Monetary Policy Advisory Council.

A similar process has occurred in investment services business. Stockbrokers now have only one single regulatory point of reference, whereas previously securities supervision was effectively divided between two agencies, the Malta Stock Exchange and the MFSC. (There would have been three agencies involved but the Registry of Companies - formerly a government department - has been integrated with the MFSC since 1997). This unlikely division of securities regulation between two separate agencies had occasioned some artificial distinctions, a measure of regulatory overlap and uncertainties not only locally but also in international circles. Stockbrokers are now considered licensed under the Investment Services Act. In the coming months, the MFSA shall also be appointed as the Listing Authority. At that point, the MFSC shall have evolved into a single securities regulator in the complete sense.

In this manner, the new amendments have completed the process conceived in 1993 for the re-shaping of Malta's regulatory framework. That initiative aimed at gradually developing a single unified regulatory authority for financial services in the medium term. A large part of the foundations for implementing this important political decision had been laid down in the legislation adopted by Parliament in 1994. These had included the establishment of the Malta Financial Services Centre replacing the Malta International Business Authority, the introduction of the concept of "competent authority", a new investment services law, changes in the insurance legislation and some other related changes that aligned the banking and other laws to the new policy objective.

One might be excused for suspecting that the single regulatory framework adopted in Malta simply mirrors the Financial Services Authority established in the UK quite recently. This claim would be historically incorrect. The decision taken by local authorities was taken in 1993 and was already partly implemented in the 1994 legislative reforms. A decision on somewhat similar lines was taken by the British Government only in 1997 soon after the election of the first Blair government. The two processes reveal more differences than may at first be imagined. The backdrop and the context of the reforms carried out in the two jurisdictions were hardly similar.

In 1997, the UK had a large financial services sector organized within a complex framework which mixed self-regulation and regulation within a rather fragmented regulatory map. The assumptions behind the Financial Services Act of 1986 were re-assessed and indeed contested. The new Labour government felt that self-regulation was no longer sustainable, that the Bank of England had to shed its regulatory function and that a single consolidated agency offered better guarantees of proper, streamlined and effective supervision over financial services firms and of better consumer protection.

In 1994, Malta's small financial services industry was still in its infancy, no appreciable investment services business had been developed and an upgrading of the existing legislation for banking and insurance was felt to be desperately over-due. Regulation was fragmented between three different public agencies, partly as a result of historical accident rather than design. A single comprehensive package, which also included a brand new Companies Act, was drawn up and a new lease of life was given to financial services regulation which was re-organized and properly streamlined for the first time.

Concluding remarks

The setting up of a single regulator for financial services is once again at the root of the latest amendments. The idea of having a single unified authority over a single sector is not new to Malta. The Malta Tourism Authority was established in 1999 with a similar objective (Act no. XII of 1999). With a bit of licence, one might even make a case for considering the Malta International Business Authority as the first single regulator, because its statutory functions under the 1988 Act gave it total and exclusive oversight and supervision over the entire offshore sector. The offshore sector comprised both ordinary companies and some financial services companies, including some banks and insurance companies. From its origins as a small single regulator responsible limitedly for a relatively small offshore sector, the MIBA has on the strength of successive legislative steps developed into a much bigger single regulator responsible for overseeing and supervising all financial services as well as corporate registration and administration.

The amendments incorporated in Act XVII should be seen as one of the final acts in the almost decade-long exercise of continuously upgrading and bringing our financial services legislation and administrative structures in line with the ever-changing international regulatory environment. The new Act introduces a distinctly outward-looking framework envisaging a greater degree of co-operation and collaboration with overseas authorities. Considered in their totality, the amendments represent a new point of departure for Malta's maturing financial and corporate sector which has certainly made huge advances since 1988-90 when the original Malta International Business Activities Act and the Malta Stock Exchange Act were put into place. ◆