The Accountant

JULY 1998

THE JOURNAL OF THE MALTA INSTITUTE OF ACCOUNTANTS

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Dissolution, insolvency and the role of the regulatory authorities – Part 2

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Regulated Business

Dissolution, insolvency and the role of the regulatory authorities PART 2

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The Banking Act of 1994

Through its various sections, the Banking Act, 1994 assigns powers and responsibilities not to one single authority, but to a number of different organs and entities. For the purposes of this article, it shall be useful to list them and to briefly consider their respective functions:

(a) The "*Competent Authority*" appointed in terms of section 3 (2) which as one would expect has been assigned the major part of the regulatory responsibilities, particularly the licensing and authorisation powers.

(b) The **Central Bank of Malta**, which has retained a number of interventionary powers some of which are of direct relevance to our present subject.

(c) The **Joint Banking Committee** which has been entrusted with the formulation of policies governing bank regulation and supervise and with monitoring the "*soundness of the banking system*" (section 27).

(d) the **Minister of Finance** to whom a number of powers are assigned under this Act, and who is indeed expected "*to exercise the powers conferred upon him by this Act to ensure compliance with the provisions of this Act...*" (section 3). The Minister nominates the Competent Authority and is authorised to issue regulations on a number of matters.

(e) The **Financial Services Tribunal** which has competence for hearing appeals from certain decisions taken by the Competent Authority. Section 10 establishes the composition, competence and the procedure of this tribunal.

The Central Bank has filled the role of *competent authority* from the date that the Banking Act of 1994 was brought into force. (see Legal Notice 166 of 1994 issued by the Minister of Finance). Juanita Bencini's paper "*Banks in Malta — some thorny issues*" carried in the last issue of this journal has already remarked on certain anomalous situations that this integration of the Central Bank with the *competent authority* may give rise to. It is relevant for the purpose of this present exercise to keep a clear conceptual distinction between the Central Bank and the *competent authority*.

This distinction did not arise in the previous Banking Act of 1970, where most of the regulatory powers had been vested in the Minister of Finance. In a number of cases the Minister was empowered to take certain action but in most cases only after consultation with the Central Bank of Malta. Under section 8 of the Act the Minister had the authority to suspend or revoke a banking licence in a number of situations including insolvency. Under section 18, the Minister after consulting the Central Bank could adopt a number of measures against a bank which is operating "*in a manner detrimental to the interests of its depositors or creditors, or... has insufficient assets to cover its liabilities, or...is likely to become unable to meet its obligations or is about to suspend payment, or ...that it has become unable to meet its obligations or has suspended payment....*". Following the adoption of the Banking Act of 1994, the 1970 Act now only applies to offshore banks registered in terms of the Malta Financial Services Centre Act subject to a few modifications introduced in the latter Act.

It is against this backdrop that we may now proceed to consider the unfortunate scenario of a bank duly licensed under the Banking Act, 1994 ending up in severe distress, whether financial or otherwise. In such a circumstance, both the Central Bank and the competent authority have powers to intervene. Intervention may occur at any of two distinct levels. **First,** the competent authority (not the Central Bank as such) may choose to take action in relation to the operator's licence. This would appear logical since it is the competent authority which issued the licence in the first place. Section 9 empowers the competent authority to restrict or to revoke a bank licence in a number of defined circumstances, including where a bank is unable to "*to meet its obligations*"

or "*can no longer be relied upon to meet its obligations towards depositors and creditors*". Other grounds include lack of sufficient assets to cover the bank's liabilities, suspension or imminent suspension of its payments, or where "*the Competent Authority considers that, by reason of the manner in which the bank is conducting or proposing to conduct its affairs, or for any other reason, the interests of the depositors or the bank are threatened.*". Any action taken by the competent authority by virtue of section 9 may be subjected to an appeal by the licence-holder to the Financial Services Tribunal established in terms of section 10 of the Act. In most cases, the submission of an appeal would not have the effect of suspending the operation of the decision of the competent authority.

A **second** level of intervention is offered by section 29, which is a rather lengthy and elaborate section. Here the Act establishes a radically different and alternative approach, where the Central Bank (in its own right now, not as competent authority) may itself take the initiative and take direct action against the distressed bank — irrespective, it would seem, of the competent authority. The Central Bank may put into place one or more of the remedial measures listed in section 29, namely:

(a) it may require the bank to wind up its business;
(b) it may appoint a competent person to act as liquidator for the purposes of winding up the bank's affairs;
(c) it may appoint "*a competent person to take charge of the bank's assets or any portion of them for the purpose of safeguarding the interests of depositors*";
(d) it may appoint "*a competent person to assume control of the business of the bank and either to carry on that business or to carry out suchother function or functions in respect of such business, or part thereof, as the Central Bank may direct.*".

In the last two cases, the person appointed by the Central Bank takes full control of the assets or business and assumes all the "*powers, functions and duties....exercisable by the company in general meeting or by the board of directors...to the exclusion of any other person*". (This formula substantially reproduces the wording of section 27(12) of the MFSC Act relating to the winding-up of offshore companies. This point has been briefly considered in the Part I of this paper.) Section 28 adds that the person nominated by the Central Bank replaces any other person who may have been appointed to take over the company's assets or business under any other law. Presumably this wording includes a liquidator who may have earlier been appointed in terms of the winding-up provisions of the Companies Act.

There are other features worthy of note in section 29:

(1) The Central Bank may "*require the Competent Authority*" to revoke or restrict the bank's licence in accordance with section 9. This rather peculiar power represents a rather inelegant way of defining inter-institutional collaboration and belittles the entity operating as *competent authority.* It would appear rather unusual and rare to find one authority imposing itself on another to the point where it can presume to instruct it to take a specific course of action.
(2) Again, similar to the position under the Investment Services Act, this section makes no specific reference to the rules of company legislation. We find no reference to the important provisions in the Companies Act which provide for the possibility of having a company wound up by the Court for inability to pay its debts (section 214(2)(a)(ii)), or for grounds of sufficient gravity (section 214 (2)(b)(iii)). Nor is there any reference to the power of the Registrar of Companies to file a winding up application where it appears to him "*expedient and in the public interest that a company should be dissolved and wound up*". From this brief analysis it seems to result that the relevant rules regarding the winding up of banking companies which arise under the Banking Act and the Companies Act are inadequately streamlined. It may be instructive to note that in a different context, specific reference to the Companies Act is made in section 31(11) of the Banking Act which deals with the appointment and responsibilities of auditors. This section states that "*in so far as the provisions of this section are inconsistent with the provisions of the Companies Act, 1995, the provisions of this section shall prevail and the provisions of the said Act shall, to the extent of the inconsistency, not apply to banks.*").
(3) There is no possibility of appeal to the Financial Services Tribunal from any action taken by the Central Bank under section 29.

As a general comment, it may be suggested that sections 9 and 29 seem not to exist all that well together, and that they may cause untidy duplication. The two sections cover similar ground, entrust two distinct statutory entities with authority to intervene to resolve one

factual set of circumstances — a bank in severe distress — and each of these entities can react in a different manner. Additionally, the Act seems rather inconsistent in withholding the availability of an appeal to the Tribunal from certain important decisions effecting a licence-holder taken by the Central Bank under section 29.

It would be useful at this juncture to refer briefly to the position under the English Banking Act of 1987 which seems to have served as a model for a number of provisions of our 1994 Act. Does the English Act present a similar inconsistency? The answer is in the negative. The 1987 Act confers on the Bank of England the authority to take direct action against a bank's licence, in which case an appeal would be possible to the special tribunal set up and regulated by sections 27 to 31 of that Act. This procedure is very similar to that established under section 9 and 10 of our Banking Act. On the other hand, where the Bank of England decides that a bank should be wound up, its action is limited to presenting a petition for winding up before the ordinary courts under the ordinary standard company legislation procedure. The Bank of England (whose regulatory authority in banking supervision is in the course of being assigned to the new Financial Services Authority) has no direct statutory power to appoint a controller or a liquidator itself.

The Financial Institutions Act, 1994

The remarks made in relation to our 1994 Banking Act apply in almost equal measure to the **Financial Institutions Act** of 1994. This should come as no surprise seeing that this Act was consciously drafted as an edited version of the Banking Act, which had already been presented to Parliament a short time earlier. In the Financial Institutions Act, sections 6 and 17 mirror sections 9 and 29 of the Banking Act with the same inconsistent approach to the Financial Services Tribunal and a rather clumsily sketched interaction between the competent authority and the Central Bank.

The Controlled Companies (Procedure for Liquidation) Act, 1995

Finally, a few words concerning the **Controlled Companies (Procedure for Liquidation) Act** of 1995, a short piece of legislation that merits a brief mention. This recent Act has a very restricted application as it only affects banks in respect of which the Central Bank has appointed a controller and has in addition made what is termed as "*an order for liquidation*" (section 3). Although there is no specific reference to the BICAL case, there can be no doubt that his Act was primarily intended to resolve certain long standing issues connected to the affairs of the BICAL bank. Proof of this is amply proved by the parliamentary debate on the bill. The BICAL qualifies as a controlled company for the purposes of this Act, and it is indeed relevant to note that this BICAL's banking licence has never actually been revoked but merely suspended. The bank has been under a Central Bank-appointed controller since 1973.

For reasons of space, I shall here limit myself to three further remarks. First, the provisions of this Act seem unconcerned with what has so far been a clear conceptual and practical distinction between the role of a controller and that of a liquidator. This distinction is drawn in the two Banking Acts of 1970 and 1994. The decision to appoint a controller, rather than a liquidator, indicates that the bank is being retained as a going concern controlled by the Central Bank appointee, with its operating licence kept in force. This 1995 Act now implies that the controller may also liquidate the bank. Secondly, contrary to what the Controlled Companies (Procedure for Liquidation) Act may suggest, the Banking Act of 1994 does not make provision for the issue of a liquidation order while the controller remains in office. Thirdly, this Act has introduced a remarkable blanket exemption in favour of any controller appointed under the Banking Act, with retrospective effect to the date of their appointment. The first BICAL controller was appointed in the early seventies. To the writer's knowledge, nothing similar to this provision is found under any other law in Malta.

The Malta Stock Exchange Act of 1990

This Act was passed in 1990. It established the Malta Stock Exchange and assigned to the Council of the Malta Stock Exchange the statutory responsibility for licensing stockbrokers and for authorising the listing of securities and other instruments on the Malta Stock Exchange. The Act contained a very clear statement that where its provisions or bye-laws are inconsistent with the Companies Act, the former were to prevail. The Act provides for the issue of licences to stockbrokers and for the restriction or cancellation of such licences.

Insofar as our present topic is concerned, the Council is not assigned any special powers to appoint controllers or liquidators, or to order the winding up of a licence-holder's affairs. Similarly, in respect of company securities listed on the Exchange, bye-law 6.01.12 which deals with the possibility of a suspension or cancellation of a listing (bye-law), makes no reference to the scenario of financial difficulties or insolvency. This bye-law assigns to a Listing Committee a broad power to order the suspension or cancellation of a listing "*as it thinks fit...to protect investors and to ensure an orderly market*". Such action does not bring about the dissolution of the listed company, which would therefore remain regulated by the Companies Act.

An important feature which deserves mention here is the *compensation fund*, established in pursuance of section 12 of the Act, and regulated in detail by Chapter 7 of the bye-laws. Section 12 of the Malta Stock Exchange Act establishes this fund in order to provide a cushion "*in the event of financial difficulties of any member to meet his obligations towards the investing public.*". The fund therefore only concerns the authorised stockbroking firms and does not apply to listed companies or other entities. The unfortunate problem with the Chapter 7 bye-laws is that they seem to go beyond the intentions of section 12, their enabling section. This section refers exclusively to a scenario of "*financial difficulties*", whereas the bye-laws also provide for the possibility of claiming compensation in the event of acts like fraud, negligence, omission and

breach of professional duty, which may not necessarily be connected to insolvency.

The New Insurance Legislation

A couple of short points shall be made in respect of the two new pieces of insurance legislation which are at the time of writing undergoing their final scrutiny at committee stage in Parliament. The two bills are the Insurance Business Act and the Insurance Brokers and Other Intermediaries Act. These shall completely replace the current Insurance Business Act that had been adopted in 1981 as the first comprehensive law on insurance in Malta. It may be immediately highlighted that many of the structures adopted in the new insurance legislation are modelled on the pattern introduced in the Investment Services Act and the Banking Act of 1994. These structures include the concept of "competent authority" and the appeal mechanism to the Financial Services Tribunal.

Of particular interest to our present exercise is the new Insurance Business Act. The main relevant provisions of the new Act would appear to be sections 25 to 28 and sections 41 to 42. Section 25 lists a number of circumstances where an operating authorisation issued by the competent authority would suffer what is termed as "*automatic revocation*". One of these circumstances is where the authorised company "*is declared bankrupt or goes into liquidation....or is otherwise dissolved.*". Section 26 authorises the competent authority to suspend or revoke an authorisation in a number of instances which include where a company is "*likely to become unable to meet its obligations, or can no longer be relied upon to fulfill or satisfy its obligations towards insureds, policyholders, creditors or other interested persons.*". Section 28 allows the competent authority to require a company to dissolve and wind up its business and to appoint a liquidator. As we have already seen when considering the Banking Act, the liquidator appointed under this section would take over the company's affairs "*to the exclusion of any other person*".

"*The dissolution and winding up of authorised companies*" is the marginal note which introduces the various provisions of section 41. This section makes explicit reference to the winding up provisions of the Companies Act The section requires the application of the winding up rules contained in the Companies Act to authorised companies which decide to resolve and wind up their affairs. Where the local operation is a branch of a foreign company, the winding up shall proceed on the basis of the company law rules regulating the head office of the foreign company. A number of other rules are being introduced in this section in order to better protect the interests of Maltese creditors and policyholders.

A striking innovation is the rule in section 48 that prohibits *long term life business* companies from winding up their affairs under the Companies Act rules relating to voluntary winding up. This implies that the winding up of such companies may only be carried out by the process described as *winding up by the Court*, a process which is amply dealt with in the 1995 Act and which offers much more protection to creditors, including policyholders.

A brief note on compensation schemes

No discussion concerning the insolvency of a licensed operator in the financial services field is complete without at least a brief consideration of what investor and depositor compensation schemes may be available under legislation or in terms of self-regulating private arrangements. The compensation fund established by the Malta Stock Exchange Act of 1990 and the Security Fund established under the Insurance Business Act of 1981 are the only two compensation funds in operation in Maltese financial services legislation.

Neither the of two Banking Acts of 1970 and 1994 make any reference to compensation funds, while the Investment Services Act gives authority to the Minister, acting on the advice of the competent authority, to "*establish schemes or make arrangements for the compensation of investors...where... the holders of a.. licence.. are unable to satisfy claims in respect of any civil liability incurred by them*".

Part XI of the new Insurance Business Act currently in its last stages of parliamentary debate, sets up a *Protection and Compensation Fund* which is intended to replace the current Security Fund. The new, more elaborately named Fund, whose objectives mirror those of the Security Fund shall not be restricted to insolvency situations, but shall extend also to certain traffic-related events including hit-and-run incidents.

The Cooperative Societies Act of 1978

This paper would not be complete without a few words on the law which regulates cooperative societies. The rules of company law do not apply to Cooperatives. Although actually quite similar to companies in several respects, these business organisations are regulated by a distinct special law passed in 1978, a law which perhaps has not received sufficient attention. Cooperatives share with companies a number of features, whereas a number of provisions are unique to cooperatives legislation. One of the most remarkable elements of the Cooperatives Act is the extensive range of functions and powers assigned to the Cooperatives Board. The Board is a regulatory body established by the Act to administer the provisions of the Act and to promote the setting up of and to license and supervise cooperatives in Malta. The Board enjoys a separate legal personality and operates with the relative autonomy devised for it under the Act. The law expects the Cooperative Board to play what may be described as an intrusive role and the extent of its functions is probably nowhere more dramatically illustrated than in the provisions dealing with the dissolution and winding-up of cooperatives. Practically every step in the dissolution and winding-up process is subjected to possible intervention by the Board.

The Cooperative Societies Act contemplates two broad methods of bringing about the termination of a cooperative's activity and existence:

(1) by the voluntary decision of the required majority of the members;
(2) by order of the Board following the holding of an inquiry.

In both eventualities the final say rests

with the Board, in view of the statement contained in section 101 that no cooperative may be dissolved "*save by an order of the Cooperatives Board*". In terms of Section 97, the Cooperatives Board may, "*on its own motion*", hold an inquiry into the working or financial condition of a society. If as a result of the inquiry, the Board in its discretion "*is of the opinion that such society ought to be wound up*", the Board may dissolve the society and appoint a liquidator.

The functions and duties of a liquidator of a cooperative society are found listed in section 102. Subsection (5), for instance, requires a liquidator to submit to the Cooperatives Board a progress report on the winding up every three months. The following section (section 103) after emphatically stating that "*A liquidator shall exercise his powers subject to the control and supervision of the Board.*", lays down an endless list of specific powers that the Board may exercise during the winding up process. To mention but a few, the Board may "*rescind or vary*" any decision taken by the liquidator, it may restrict his powers and it may decide to remove and replace him, and it may take control of all the assets and records of the cooperative being wound up.

It would appear that the intervention of the Board in this area borders on exaggeration and is a feature of the Act which one would certainly not like to see transported into our companies legislation.

Concluding Remark

This paper has attempted to focus on certain aspects of the role which statutory bodies, created by law to regulate and supervise particular sectors of regulated business, are being expected to play. Hopefully, this brief overview has sufficiently highlighted the extent of the involvement of the various regulatory bodies in the areas of insolvency and winding up, areas such bodies clearly cannot afford to be absent from completely. However, this exercise may have indicated that the legal provisions governing the mode and extent of the involvement by the regulatory bodies often vary considerably; in some places these provisions disclose a few inconsistencies and grey areas. It would therefore seem that a greater effort is needed to find the right balance between the different interests at play and to promote more harmonious coexistence between the various laws and statutory bodies involved.

The writer is the Director in charge of legal affairs at the Malta Financial Services Centre and a lecturer on financial services legislation at the University of Malta. The views expressed in this article are entirely his own and do not reflect any official position on any of the subjects raised. Part I of this article appeared in the last issue of The Accountant.

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