The Banker

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MALTA'S SUCCESS STORY
Economy

International comparison indices rate Malta's financial sector highly, proof that the banks, funds, fund managers, insurance companies and other firms that have set up business in the EU's smallest country have made a good choice. Michael Imeson reports.

Malta hit the international headlines earlier this year when two Libyan airforce pilots, apparently defecting from Colonel Muammar Gadaffi's regime, landed their fighter jets on the island. It was a high-profile example of a problem that has beset Malta, along with Italy and other southern Mediterranean countries, in recent years – large-scale illegal immigration from north Africa.

Yet Malta deserves to be in the news for positive reasons too, because it has a compelling economic success story to tell. The World Economic Forum's 'Global Competitiveness Report 2010-11' ranks Malta 11th out of 139 countries for 'financial market development', up from 13th in the previous year and 34th the year before that. Malta is also ranked eighth for 'strength of auditing and reporting standards' (up from 12th the previous year), 10th for 'soundness of banks' (up from 13th), 12th for 'regulation of securities exchanges' (up from 13th) and 50th in the overall 'global competitiveness' rankings (up from 52nd).

Malta used to be an offshore financial centre, but that all changed when it joined the EU in 2004. Its financial sector and legal and regulatory regime are fully compliant with EU requirements, and financial services account for 12% of the country's gross domestic product (GDP).

FROM BANKING TO FUNDS

Kenneth Farrugia, chairman of FinanceMalta, which promotes Malta as an international financial centre, says that although growth in banking has slowed in recent years, it has increased rapidly in funds and insurance. "Local clients are well serviced by the existing banks – such as Bank of Valletta, HSBC, Lombard and APS – so it is difficult for new players to penetrate the domestic market unless they have a compelling proposition," says Mr Farrugia, who is also general manager for Valletta Fund Services, the fund administration arm of Bank of Valletta. "The growth areas are in international banking," he adds.

"As far as the funds industry is concerned, a cluster has taken shape. There are more than 400 funds registered in Malta, including Ucits [Undertakings for Collective Investments in Transferable Securities] and hedge funds. This cluster has extended to the setting up of fund management companies – there are just under 70 on the island, most of which are foreign. We also have 18 fund administrators."

The EU's Alternative Investment Fund Managers Directive is attracting a lot of interest in Malta from EU and non-EU managers needing an EU platform from which to serve the European market. "Some fund managers will rethink their domiciles strategies and go for a European domicile, and Malta will benefit from that as we are considered an important jurisdiction," says Mr Farrugia.

Foreign direct investment [FDI] throughout the entire economy was €11.9bn at the end of June 2010, nearly double the previous year's amount. "There were significant equity capital injections into foreign companies, and 83% of that increase was in the area of financial intermediation," says Mr Farrugia. "That tells you that the financial industry is really taking off, but it also rings alarm bells because 83% is a high number and from a diversification point of view we would not want our economic growth to be over-dependent on financial services. That's why the government's 'Vision 2015', which is trying to grow the economy in six or seven core sectors, makes sense to us."

Even with regards to its role as a financial centre, Malta is not without its problems. It makes much out of being "a stepping stone between Europe and north Africa", but the war in Libya and unrest in other parts of the Maghreb region has taken the gloss off that selling point. "Political instability always brings these counties under the microscope and increases sovereign risk," says Mr Farrugia, but in countries such as Egypt, for example, the "short-term pain" will be followed by "long-term gain".

A potential lack of qualified people within Malta is also a threat. To address this, more students are taking university degrees that are linked to financial services, and the government is running child-care programmes and other incentives to attract women back to work. "If you have a child and return to work within the first year, you get a full year [of earnings] tax-free," says Mr Farrugia.

OUTPERFORMING THE EUROZONE

Many European countries are suffering from sluggish economic growth, and a handful have sovereign debt problems, but Malta does not fall into either category. It was hit by recession in 2009, but the downturn was shorter (only three quarters, against five for the euro area as a whole), and shallower (a contraction in GDP from the previous peak to the trough of 4.6%, compared with 5.3% for the euro area as a whole).

"During 2010, the Maltese economy experienced a strong cyclical upswing, led by a recovery in the electronic components and tourism industries, the export sectors worst hit by the recession," explains Michael Bonello, governor of the Central Bank of Malta. "All through the downturn, moreover, economic activity was underpinned by steady growth in the financial and related business services sectors. As a result, real GDP growth was 3.7% in 2010, while unemployment fell to 6.1% by January 2011. In the euro area, GDP is estimated to have grown by almost half as much, with unemployment remaining at about 10%.

"The fiscal deficit target of 3.9% of GDP for 2010 seems to have been met, while public debt rose slightly to about 69% of GDP," says Mr Bonello. "Although additional fiscal measures are required, the effort is smaller than that needed by the euro area, which recorded a deficit of more than 6% of GDP in 2010 and a debt ratio of about 85% of GDP."

The central bank's forecast for this year is for a more modest growth in output of about 2.5%, broadly in line with the expected normalisation in world trade, compared with about 1.7% for the euro area. Similarly, Malta's deficit and debt ratios are expected to end the year at just below 3% and 70% of GDP, respectively, compared with euro area averages of about 4.6% and 86.5%.

AVIATION TAKES OFF

Beyond financial services, Malta's main industries are tourism and manufacturing, but others are growing in importance. With a well-established maritime tradition, Malta has built up the second largest shipping register in Europe and the eighth largest in the world. Transport Malta is spearheading a drive to broaden the register beyond big commercial ships and persuade owners » and operators of luxury and commercial yachts to register and manage their vessels in Malta.

Malta is also a growing centre of excellence in aviation. Lufthansa Technik and SR Technics have aircraft-servicing operations on the island, the latter commencing operations in 2010. Transport Malta is using the presence of such companies, and the success of its ship and yacht register, to communicate the benefits of registering and managing aircraft in Malta to owners, operators, lessors and financiers of private and corporate jets.

In 2010, Malta ratified the Cape Town Convention, the international treaty that standardises aircraft transactions and registration. The government also passed the Aircraft Registration Act to implement the convention, to regulate the registration of aircraft and aircraft mortgages, and to make aircraft registration in Malta overall more attractive.

Joe Schembri, policy manager at Malta's Ministry of Infrastructure Transport and Communications (MITC), says that about 20 private jets have been registered since the middle of last year. "Enquiries are coming in from Europe, Russia, the Middle East and further afield," he says. "Last year we laid the foundations and started the marketing drive. This year we will follow up with further initiatives, such as fine-tuning the fiscal product, adopting the IS-BAO [International Standard for Business Aircraft Operations], and stepping up the marketing campaign. There are parallels with the finance and shipping sectors in terms of what we intend to achieve in aviation, such as no-nonsense legislation and excellent service."

FIGURE 1: NUMBER OF FINANCIAL FIRMS AND FUNDS* IN MALTA

Type of Company	end-2008	end-2009	end-2010
Credit institutions (banks)	22	23	25
Financial institutions (firms providing banking services but not taking deposits)	15	15	13
Funds,	n/a	395	410
of which: PIFs (hedge funds)	n/a	285	306
Fund managers	n/a	64	73
Fund administrators	n/a	13	18
Insurance companies,	41	45	50
of which: Captives	6	8	10
Protected Cell Companies	3	3	4
Insurers of domestic origin	8	8	8
Internationally oriented	24	26	28
Insurance brokers	28	28	28
Insurance managers**	12	13	13

* This table is not exhaustive, and for brevity excludes insurance agents, certain types of investment services firms, trusts, trustees, pension funds and others.
**Providers of management services to insurance companies that do not carry out these functions themselves.

Source: Malta Financial Services Authority

FDI DRIVE

Dr Austin Gatt, Malta's minister of infrastructure, transport and communications, is one of several ministers involved in encouraging more FDI into the country. As already mentioned, FDI in Malta at the end of June 2010 was nearly double the previous year's total of €6.1bn, according to the National Statistics Office.

"Today our focus on FDI is creating added value rather than simple job creation," says Mr Gatt. "We are usually more appreciative of investors who add value or give a service that we don't already have, rather than simply employing people." He cites finance, transport, IT, electronics and pharmaceuticals as particular areas of interest for foreign firms. "In pharmaceuticals, we have an exemption from international patent law which allows us to manufacture generic medicine much earlier than you can do anywhere else in the EU, so we are attracting a lot of FDI in generic medicine manufacture. The exemption has another 30 years to run."

In December last year, Arriva UK won a large public contract to provide a modern bus service in Malta, starting on July 3, 2011. The 400 bus owners, who between them currently operate 520 ageing and battered buses – some of them dating back to the 1950s and 1960s – are being bought out by the government for €55m. Arriva will replace them with 280 new vehicles, add new IT infrastructure and employ 1000 people.

"The arrangement with Arriva will allow us to cut the bus subsidy immediately to two-thirds of what it is now, and eventually to about 10%," says Mr Gatt, who is quick to point out that fare rises will be modest and strictly controlled. "We are attracting a lot of foreign investment in other infrastructure and transport projects, such as the new cruise line terminal, and the renovation of Fort St Elmo in Valletta, which will include a hotel."

On the IT and communications side, SmartCity Malta opened for business last October. It is a technology township with seafront views and is owned by Tecom Investments of the United Arab Emirates. So far $27m has been invested, and the eventual spend is projected to be $300m, making it the largest foreign investment in Malta's information, communications and technology sector.

> WE ARE APPRECIATIVE OF INVESTORS WHO ADD VALUE OR GIVE A SERVICE THAT WE DON'T ALREADY HAVE, RATHER THAN SIMPLY EMPLOYING PEOPLE ***Austin Gatt***

Due to its position in the middle of the Mediterranean, Malta is growing in popularity as a 'nearshore' location for foreign knowledge-based companies serving the entire EU single market. Costs are relatively low compared with many other EU countries, and its time-zone, infrastructure, support services and European culture make it an attractive alternative to far-flung offshore locations such as India and the Philippines. HSBC recently set up a call centre in Malta to service its premium UK market, and in February Hewlett-Packard announced it was setting up a project office in SmartCity.

"Malta's international airport is run by and owned on a long lease by an Austrian company, which has invested about Ð200m in it," says Mr Gatt. "It started five or six years ago, and is now building a business centre and hotel there. Malta Freeport is operated on a 65-year concession by CMA CGM, the third largest shipping line in the world. It has invested about €250m already and will invest another €100m over the next 10 years. The freeport is number four in the Mediterranean and the owners want to take it up to number two, handling 4 million TEUs [20-foot equivalent units, a standard measure to quantify container traffic] a year."

So although financial services have been attracting the greatest share of FDI, other sectors are doing their bit to bolster Malta's presence on the world map.

LAWRENCE GONZI
Interview

Malta has done well out of EU and eurozone membership, with clear benefits accruing not only to the financial services sector, but also to tourism and other sectors, as its prime minister, Lawrence Gonzi, explains. Interview by Michael Imeson.

Dr Lawrence Gonzi has been prime minister of Malta since 2004 and presided over the country's adoption of the euro. Membership of the EU and the eurozone are not universally supported in Malta, but there is a large degree of consensus on the fact that both have been tremendously successful in enabling Malta, the EU's smallest state by population and area, to punch far above its weight.

"Malta has not only managed to weather the economic turbulence but emerged stronger than other developed economies," says Mr Gonzi. "With faster growth rates than the European and eurozone averages throughout 2010, and an improving labour market, Malta's economic progress is being confirmed. The latest data shows that over the past year Malta has had the fastest employment growth rate – 3.4% – in the EU, and also the fourth lowest unemployment rate."

The prime minister attributes these trends to the country's membership of the EU, which it joined in 2004, and the eurozone, which it joined four years later, along with "targeted, timely and temporary support measures" implemented by the Maltese government. Fiscal discipline has also benefited the economy – Malta is one of only three EU countries that reduced its fiscal deficit in the period between 2008 and 2010.

WORLD STAGE

Regime changes in Tunisia and Egypt and civil war in Libya have thrust Malta onto the global stage because it is so close to north Africa and has long-standing trading and investment relationships with the region, in particular Libya. "Malta has close ties with north Africa, and we are concerned about the events that have taken place," says Mr Gonzi. "We have witnessed a humanitarian crisis unfold and are now seeing the effects through migratory flows to Europe with all the risks this brings."

WELCOME ARRIVALS

The sort of visitors Malta wants, of course, are tourists, and recently the country has been doing better than ever in attracting them. "Last year was a record year for Malta's tourism industry, surpassing all records in terms of bed nights, arrivals and spending," says Mr Gonzi (see figure 1).

The increases are partly down to a well-designed promotional and investment strategy, one that has been praised by the United Nations World Tourism Organisation. The strategy sought to increase both Malta's visibility and accessibility, with record budgets being allocated to tourism and tourism-related infrastructure projects.

"We are successfully moving away from the traditional sea-and-sun label that Malta was traditionally known for. Our advantage is not just our beaches and good climate in isolation, but also our culture, history, archaeology and small size," says Mr Gonzi. That is why visitors to Malta cannot avoid all the renovation and rebuilding work that is going on at the moment, the focus of which is on the capital Valletta.

"We commissioned Renzo Piano to design a new entrance to Valletta, regenerate and develop the old opera house ruins and build a new parliament," says Mr Gonzi. "We are investing in Valletta's accessibility through a vertical connection that will connect the Grand Harbour to the centre of Valletta through a panoramic lift. We are spending €36m restoring our old fortifications, where we will introduce a learning experience through special interactive centres and attractions."

THE BUSINESS OF MONEY

The financial sector has long been a key component of Malta's economy and has grown rapidly. The domestic market for financial services is naturally small, but the international market is large. "Since we joined the EU, our passporting rights have allowed financial institutions based here to offer their services throughout the single market," says Mr Gonzi. "This effectively eliminates the issue of smallness in our domestic market, since we now have the entire EU single market to operate in.

"Now that we live in an age where all financial services business is carried out electronically, geographical location and market size are not as important. Malta offers a strong skill base, IT infrastructure and favourable tax regime that international firms find attractive." TB

FIGURE 1: MALTA'S KEY TOURISM STATISTICS

	2010
Arrivals	+13%
Guest nights	+12%
Total expenditure	+22%
Cruise liner arrivals	+12%

Note: Percentages are percentage increases on 2009.

A GLOBAL REACH
Banking

Malta's domestic banking sector is small and follows traditional principles, yet a steadily growing international banking presence is capitalising on interesting new opportunities such as those presented by the island's emerging fund management and insurance industries. Michael Imeson reports.

Windy times: Bank of Valletta enjoyed a successful 2010, but is taking a prudent approach in 2011

There are only 25 banks in Malta, and two of them dominate: Bank of Valletta and HSBC, each with roughly 45% of the local market. However, most banking activity is internationally oriented, so although the domestic retail and business market is close to saturation point there are still plenty of opportunities.

The country's list of banks is diverse, albeit dominated by those of European origin. Besides the two already mentioned, the list includes Akbank, Banif, Bawag, CommBank Europe, Deutsche, Erste, FIMBank, Fortis, National Bank of Greece, Raiffeisen, Sparkasse, Turkiye Garanti and Volksbank. Banif, from Portugal, is a recent entrant and is aggressively targeting the local retail market. CommBank Europe, owned by Commonwealth Bank of Australia, uses the island as a European project finance centre.

FIMBank, a trade finance provider, is an interesting case. Its headquarters are in Malta, but it is largely owned by Kuwaiti interests, with the International Finance Corporation, an arm of the World Bank, having a 5.82% shareholding. FIMBank uses Malta as a base to provide trade finance services around the world, and it has offices or joint ventures in several other countries, including the US, Brazil, Russia, Singapore, Egypt and the United Arab Emirates.

SAFE AND SOUND

Apart from its relatively small size and international orientation, Malta's banking sector is characterised by its conventional banking principles. It has the 10th soundest banking system in the world according to the World Economic Forum's Competitiveness Index 2010-11, up three places from the previous year.

"The financial crisis didn't hit us as it did other centres, and that is mainly because of the prudent business model which banks here have been following," says James Bonello, secretary general of the Malta Bankers' Association (MBA). "On the funding side, retail banks have minimal interbank reliance or exposure as customer deposits cover all their lendings more than 1.6 times over. The internationally oriented banks also have stable deposit funding or are funded by the parent through intra-group loans and other mechanisms.

"On the asset side, the lending norms have always been very prudent. For example, the mortgage book of the two major banks is quite substantial because the culture here in

Malta is to own your house – that's the aspiration of all young couples – but the default rate on that book is negligible.

"There was some concern expressed by the recent International Monetary Fund mission here about the banks' high exposure to real estate, but banks started putting the brakes on property development financing some years ago. The percentage of a development they would now finance could be as low as 50%, and would typically not exceed 60% in the case of more deserving applications, so lending is conservative."

Mr Bonello says the same careful principles apply to banks' investments. "Their investment book has never been in exotic assets – it has been in very well rated securities. In the financial crisis, of course, all investments had to be marked to market and banks suffered a decline in market value. But apart from a relatively small loss on Lehman Brothers sustained by one bank, there were no shocks to the system." And who would have thought that Lehman wasn't a good investment?

FUTURE OPPORTUNITIES

Victor Rizzo Giusti, chairman of the MBA and general manager of Volksbank Malta, says only five or six of Malta's banks are involved in retail activity, Volksbank being one of them. "The domestic market is very small, so banking sector growth will be mainly on the international side," he says. As of September 2010, total assets of the country's banking sector amounted to about €50bn, some €37bn of which were with banks not doing much domestic business.

Much of the future growth will come from servicing other rapidly growing areas of finance in Malta, in particular the funds industry, including fund managers and fund administrators, and insurance, particularly captive insurance companies.

Companies are licensed by the Malta Financial Services Authority to operate either as 'credit institutions', which are fully fledged banks allowed to take deposits, or as 'financial institutions', which provide banking services but cannot take deposits. Figure 1 shows the numbers of each, and the growth trends over the past three years. Deutsche Bank has had a minor presence on the island for several years as a 'financial institution', but last year upgraded to a 'credit institution'. Its main reason for doing this was so it could act as a custodian for the growing number of fund managers on the island, which puts it in direct competition with Bank of Valletta's Valletta Fund Services and HSBC Securities Services (Malta).

FIGURE 1: CREDIT AND FINANCIAL INSTITUTIONS IN MALTA

	Total licences at end 2008	Total licences at end 2009	Total licences at end 2010
Credit institutions	22	23	25
Financial institutions	15	15	13

Source: Malta Financial Services Authority

During the course of 2010, two other companies were licensed as credit institutions – FCM Bank and IIG Bank (Malta) – and one – The International Banking Corporation (Malta) – had its licence revoked.

BIG IN A SMALL MARKET

HSBC has been on the island since it bought Mid-Med Bank from the government in 1999. The acquisition gave it a 40% to 45% share, depending on sector, of the domestic market, a share it has maintained in the face of stiff competition from its main rival Bank of Valletta. Nearly 30% of HSBC Bank Malta's shares remain in public hands and are quoted on the local stock exchange. Its 2010 results were good: profit before tax was €83.1m, up 16.7% on 2009; total assets were €5.7bn, up 10.7%; loans and advances to customers were €3.3bn, up 2.4% (the only key indicator to register slow growth); customer deposits were €4.5bn, up 9.2%; and return on equity was 16.1%, up from 15%.

Alan Richards, the bank's chief executive officer, says that in the aftermath of the 2009 recession, 2010 "was a difficult year, so the results are especially pleasing". "The local economy is performing relatively well, though any slowdown in growth in Europe will inevitably impact Malta's open economy," he warns. Pleasing results maybe, but Malta is a small nation – it is the smallest in the EU, by both land area (316 square kilometres) and population (413,000). So why should a bank as big as HSBC bother?

"It's an attractive market if you look at the returns we generate," says Mr Richards. "Our annual return for shareholders here over the past decade has been about 15% to 20%. By any international standards that's good."

> MALTA AS A SMALL TRADING NATION IS WELL CONNECTED WITH SOME IMPORTANT PARTS OF THE WORLD, ESPECIALLY IN EUROPE AND AFRICA
> *Alan Richards*

"It's not just about short-term returns, though. Malta as a small trading nation is well connected with some important parts of the world, especially in Europe and Africa. Malta is a strong bridgehead into north Africa and the Middle East. SmartCity Malta, a technology park on the picturesque coastline, is a major investment by a UAE company that will help the growth of the information and communications technology sector. And there are other new pockets of industry developing here, such as aviation, with SR Technics and Lufthansa Tecknik specialising in aircraft servicing. These developments all suit HSBC as an international bank and play to our strengths.

"Malta doesn't have a large domestic financial market, but neither do jurisdictions such as Bermuda or Jersey. Malta is gaining significant momentum as a creditable international financial centre in the eurozone and as an international bank we are well placed to help with that development."

PLAYING TO MALTA'S STRENGTHS

As well as employing about 1300 people in its various banking and other activities – which include insurance, asset management and fund services – HSBC set up a 500-seat call centre two or three years ago to serve its UK customers. Other countries were considered for this offshore activity, but Malta won because it is a relatively low-cost EU state, has a good information and communications technology infrastructure, "sensible regulations" and highly skilled people.

Mr Richards admits that the current instability in north Africa and the Middle East – including Libya, not far across the water and where many Maltese firms do business – is a business risk. On the other hand, Malta's tourism industry, which is one of the mainstays of the economy as the island has the advantage of a warm and sunny climate nearly all year round, may benefit from a redirection of winter sun tourists.

Chris Bond, head of global banking and markets at HSBC Bank Malta, says there is strong demand for his division's services. "In the first half of 2010 we were extremely active in the local corporate bond market. Of the 11 bonds issued last year, HSBC acted as lead manager for seven of them. Also, we » are seeing very strong growth in our funds business. As Malta develops its reputation as an international financial services centre, fund sponsors and promoters are choosing HSBC for its international credentials. We have a record pipeline of new mandates.

"Malta's diversified economy showed great resilience during the financial crisis. In 2009, it experienced negative growth of just 1.9%, versus an EU average of minus 4%. Then, in 2010, growth rebounded to 3.4%, again considerably stronger than the 1.7% EU average."

HSBC has a good number of customers in Malta for its wealth management products. "The investor base here is very much retail and high-net-worth oriented – there is a limited institutional investor base," says Mr Bond. "The Maltese are very prudent. They save for their future as opposed to borrow to consume. We identify their needs, bring in products from within the group that meet those needs, tailor them to the local market, and distribute them via the branch network and wealth management advisors.

"So equity-linked deposits have become very popular here. They provide the capital protection of a bank deposit, but give investors the opportunity to gain some significant upside potential. For example, in December HSBC Malta launched the 25th issue of its equity-linked deposit account, which can yield up to 6.25% a year. The return is linked to the performance of a currency basket composed of the Brazilian real, Indian rupee, Russian ruble and the Chinese renminbi against the euro, thus giving customers access to these high-growth emerging markets."

THE ORIGINAL LOCAL BANK

Bank of Valletta (BoV) is the longest established of Malta's two main banks. It was formed in 1974, but its roots go back to 1809. Its main shareholders are the Maltese government (25.23%) and UniCredit (14.55%), and it provides the full range of banking services, along with fund management and administration and insurance. It too enjoyed the fruits of last year's economic bounce-back. For the financial year ending September 30, 2010, profit before tax was €98.9m, up 20.1% on the previous year; total assets were €6.3bn, up 1.9%; and return on equity was an enviable 21.9%, up from 19.8%.

Roderick Chalmers, the bank's chairman, is still cautious at this stage in the cycle. "Although our results were good in 2010, I think prudence would be a good friend to have in 2011," he says. "It's still tough out there for the global banking system. In the first half of 2010 we were back in stable country, and business was looking good, but in the second half the world got the beginnings of the after-shock following the 2008-09 financial crisis – what was a banking problem has transferred into a public sector problem in parts of the eurozone, and the US is not far behind."

Although Malta's financial system held up better than most during the crisis, with no bank failures or state bailouts, it did feel the indirect effects. "We are plumbed into the network of global banks, and when they come under pressure we feel it," says Mr Chalmers. He is concerned that the sovereign debt problems in Europe, which started with Greece, moved on to Ireland and are now surrounding Portugal, may escalate.

"If it stops there, my judgement is that it will be containable," he says. "But if it starts sliding into Italy or Spain, you then have a problem of a different dimension. I think there is a commitment among the political classes in the eurozone to find a solution, but it will always be the minimum response at the last possible moment which is a very unhappy state of affairs for the markets. As a result, you see great skittishness and schizophrenia in the markets because they are not sure what is happening. The markets fear that a failure to find a solution to the eurozone's public sector problem will transfer the issue back into the banking sector – because who holds Greek, Irish, Portuguese and Spanish debt? It is the German, British, French and other banks."

BoV's financial markets book clawed back some of its unrealised mark-to-market losses in the first half of 2010, but the second half saw spreads widening again across the eurozone and that has had a negative impact on the value of its book. "It is a temporary impact because one of the issues that has helped us get through the difficult period is that we are a very liquid institution and have a virtually zero reliance on wholesale funding and are therefore able to sit on our portfolio until it matures," says Mr Chalmers. "Any adjustments tend to be temporary mark-to-market ones as opposed to long-term ones, but I think we will see a continuing widening of spread in 2011 in Europe."

As well as having plenty of liquidity, BoV is well-capitalised, as last year's EU-wide official stress-test demonstrated. Even so, the bank decided to raise €120m in two bond issues last year, just in case. Says Mr Chalmers: "Our capital ratios already comply with the Basel III requirements, but at the time of the uncertainty a year ago we thought that if there was funding available we should take it because, to quote an Otis Redding song, 'you don't miss your water 'til the well runs dry'." TB

ALTHOUGH [BANK OF VALLETTA'S] RESULTS WERE GOOD IN 2010, I THINK PRUDENCE WOULD BE A GOOD FRIEND TO HAVE IN 2011

Roderick Chalmers

MALTA WILL MAINTAIN ITS MOMENTUM

Tonio Fenech

Malta's finance minister, Tonio Fenech, explains how the country has expanded its economy beyond its banking sector as part of the country's Vision 2015 plan.

Despite being one of Europe's most open economies, Malta has managed to navigate successfully through the financial and economic storms that have created so much havoc around the globe since 2008.

We are dependent on the economies of our fellow EU states, who provide the bulk of the tourists visiting Malta as well as accounting for a good two-thirds of our exports. Despite this, growth through 2010 reached a very respectable 3.7% and indications are that growth will continue this year. Furthermore, Malta continues to avoid the problems of unemployment, and the country's overall financial health remains robust.

CONTINUING GROWTH

Malta did not escape the turmoil completely unscathed. Certain sectors were impacted more than others, and some sectors continued to register growth throughout the worst of the storm. Financial services continued to attract new international business and investment – not only in 2009, but also through 2010 and the first few months of 2011.

This is no coincidence. Malta's financial institutions, led by the major banks operating on the local market, continue to abide by sound core banking principles, and maintain a strong capital position, laying the ground for a relatively easy recovery. This stability and dedication to core values pervades the entire financial services sector, and contributes to the attraction of the island as a jurisdiction of choice.

Our 2011 budget, while tackling the deficit head on, provides initiatives to encourage job creation across the economy while seeking to guide investment to the sectors that show potential for growth into the future, alongside policies intended to ensure that Malta maintains a workforce with the skills needed to tackle a changing world.

BANKING ON SUCCESS

This gives us confidence that the growth of the past year will continue, and the financial services are set to continue to contribute strongly to growth. A few facts will serve to illustrate this.

In 1992, Malta's banking sector included just four domestic financial institutions; now Malta boasts 25 licensed banks. These banks cover practically the full range of banking services, and include global leaders as well as small, highly specialised banks.

International operators are now competing for domestic retail business alongside established Maltese institutions, helping individuals and businesses achieve their goals through increasingly competitive yet profitable service offerings.

Besides these retail operations, Malta hosts a number of online-only banks, taking advantage of the IT skills available to develop innovative service delivery channels.

There are other more focused operations on the island as well: leading trade finance institutions, for example, and others specialising in complex project and structured finance services. There are banks providing custodial services to Malta's growing collective investment funds business, while others provide wealth management services.

SOLID FOUNDATION

It bears repeating that this dynamic market is helped by Malta's robust yet flexible regulatory framework, coupled to a sound legal underpinning developed over the past 20 years, which has provided financial services operators with an environment that allows them to conduct business with confidence. This is a foundation that we are determined to continue to build upon through 2011 and indeed, in the years that follow.

We will continue to apply the formula that has yielded success so far. It is a simple one: marrying stringent supervision to an approachable regulator willing to listen to and deal with new directions fairly, and a proactive approach to legislation, to ensure it is updated and modified to meet the needs of an ever-evolving industry.

This approach has proved its worth over the years, and has ensured that Malta has been in a position to attract a wide range of business beyond banking to our shores. Captive insurance, investment funds and trust and fiduciary activity have proved as successful on the island as banking.

Indeed, funds domiciled in Malta boasted a net asset value of €8bn at the end of the second quarter of 2010 – a growth of 13% from the end of 2009. The bulk of the funds are professional investor funds, which accounted for all 51 new funds licensed during the first half of 2010. This trend has continued unabated in the months since then.

Captive insurance, a business which did not exist at all in Malta before 2004, is now a well-established sector. With 14 insurance management operations, including all the leading international firms, and 40 managed insurers, this is now an industry of substance. It is also one that is changing: the legislation has been updated regularly to take into account the changing demands placed upon it.

DIVERSIFIED PICTURE

The picture that emerges is one of a dynamic, diversified financial centre, underpinned by a legal and regulatory framework that is fully harmonised with EU legislation. This in itself is valuable, allowing firms domiciled and licensed in Malta to passport their services across the EU and European Economic Area.

Malta's tax regime, which has been approved by the EU and the Organisation for Economic Co-operation and Development, is an accessible and flexible regulator and a pool of skilled, experienced professionals continue to add value to organisations choosing to use Malta for their financial services needs.

Our commitment to the sector will continue, and will guide our path forward. Our vision for 2015 and beyond sees the continuation of growth and development of Malta as a financial services centre of excellence, serving a global client base. TB

REGULATION

FIRM BUT FLEXIBLE *Regulation*

Malta has a robust regulatory framework, but it is also a place where things can get done, with the MFSA, the single regulator, willing to advise firms so that their projects comply with regulations. Michael Imeson reports.

Professor Joseph Bannister, chairman of the Malta Financial Services Authority

Financial regulators tend to be regarded as a necessary evil by bankers and other market practitioners. They may recognise the importance of regulation, but they are equally aware of its burden. The typical approach is to find out what the regulator wants, tick all the boxes, then get on with business.

The Malta Financial Services Authority (MFSA) claims to be different. It says accessible and flexible are two of its hallmarks, but argues that it is not a soft touch. As a member of the EU, the country operates to high standards and firmly upholds all relevant EU laws and rules; but being a small country, it is easy to meet senior officials at short notice, and they can be understanding of an individual institution's issues and requirements. By the same token, however, if any firm or practitioner begins to act inappropriately, the regulator will soon find out. News travels fast on an island that is only 27 kilometres long and 14.5 kilometres wide.

GUIDING PRINCIPLES

Professor Joseph Bannister, the MFSA chairman for many years, is the recognised architect of the regulatory framework and responsible for its ethos and modus operandi. "The approach has been to meet companies and discuss the application of regulations with them, both at the pre- and post-licensing phase," he says. "Most importantly, the MFSA uses two guiding principles, particularly at the licensing phase – they are that the regulatory process must be exhaustive, and no licence is granted without proper due diligence.

"Malta's system follows the EU. After all, we are members of the EU, and we have not created our own system. We apply all the necessary regulations as required. With all the new regulations coming after the 2008 financial crisis, companies appreciate having regular meetings with the regulator. The 'firm but flexible' approach should not be taken to mean that we are dispensing with any regulation; the flexibility is about how we discuss a project and see how it can be modified to fit in with the regulations."

PASSING THE TEST

A 2003 IMF/World Bank review concluded that Malta's financial sector was well supervised. The EU also conducted a regulatory review prior to EU entry in 2004.

The MFSA carried out internal audits in 2005 and 2007, and another was due in 2009, but the board of governors decided that that audit should be an independent assessment along IMF/World Bank lines, and with a view to increasing transparency, it should be published.

Consequently, a team of experts that is normally used by the IMF and World Bank was called in last year to review how well Malta's regulatory structures complied with the Basel core principles for banking, IOSCO's International Organisation of Securities Commissions) principles for securities, and IAIS's (International Association of Insurance Supervisors) principles for insurance.

BOLD STEP

"This was rather a bold step because, obviously, nobody knew what the result was going to be," says Mr Bannister. "The team was led by Piero Ugolini, former assistant director at the IMF, who was also mission chief for the IMF/World Bank review of 2002-03. The results of the assessment, published in January this year, were excellent. For example, in the case of banking, the number of principles the MFSA was found to be compliant with increased from 11 in 2002-03 to 21, out of 25. An abridged and a long version of the report is available on the MFSA website."

REJECTING APPLICATIONS

Malta's financial sector has grown considerably, particularly since EU membership in 2004, but the MFSA says Malta does not have a policy of increasing the size of the sector for size's sake. The quality and integrity of the firms is paramount.

"We do reject applications, particularly those that go against our principles. Insurance and collective investment schemes have grown considerably, and the type and quality of companies seeking to obtain a licence indicates that the sector is well-regarded."

The tax regime for all companies, including those in the financial sector, is a favourable one, but it is not a tax haven, says Mr Bannister.

"Malta follows an imputation system of taxation. Companies pay 35% tax, and on declaration of a dividend, shareholders are entitled to claim a six-sevenths refund. I have not heard anyone criticising the tax regime as being unfair competition. It should be kept in mind that once the refund and dividend are repatriated by the shareholder to his country of residence, then they may be subject to further taxation."

Mr Bannister points out that Malta's tax system was agreed with the EU under the State Aid and Code of Conduct in 2007, and Malta does not feature in the OECD's list of tax havens. TB

MICHAEL BONELLO
Q&A

Michael Bonello, the governor of the Central Bank of Malta, outlines his country's key economic strengths, especially in the financial sector, and explains what is being done to remedy any weaknesses.

WRITER *Michael Imeson*

Q Malta's recession was shorter and shallower than the eurozone average, and its gross domestic product (GDP) growth rate for 2011 is forecast to be higher. What are the strengths of Malta's economy, and its weaknesses?

A The global economic crisis has shown that the Maltese economy is quite resilient to external shocks. This primarily reflects its diversification into high value-added activities such as pharmaceuticals, aircraft maintenance and financial services. This ongoing trend has been possible because of heavy investment in education and training, and the adaptability of the workforce. Political and economic stability, sound fundamentals and policy predictability, and membership of the euro area, reflected in a good credit rating, are other strengths.

And yet, the share of investment in GDP is still not high enough and this partly explains the slow growth in productivity. This is compounded by other supply-side constraints such as the insufficient investment in innovation, relatively low educational attainment levels and the low employment rate. Also, the domestic market is not large enough to prevent elements of monopoly power in some sectors, resulting in higher costs and consequent loss in competitiveness. Finally, excessive reliance by domestic investors on the property market has created a misallocation of resources, especially of financial capital and land.

Q How healthy is the country's financial sector?

A Back in 2003, an International Monetary Fund (IMF) and World Bank Financial Sector Assessment Programme (FSAP) found that Malta's financial sector was healthy and well supervised, with a comprehensive legal framework and strong adherence to most international standards and codes. In January 2011, an independent follow-up audit found a further, significant improvement in compliance. The latest World Economic Forum Global Competitiveness Index ranks Malta's financial market development in 11th place in the world.

The sector is growing rapidly into new areas, but banks – from 12 countries – still dominate. The domestically oriented banks maintain capital and liquidity ratios well above the regulatory minimum and their resilience is confirmed by stress-test results.

In 2010, customer deposits grew faster than loans and the return on equity averaged 13%. The internationally oriented banks are backed by high-quality capital and are controlled by large cross-border parents. The funds industry, however, has been the fastest-growing sector since 2008, with investment service providers, fund administrators and custodians, investment management companies and collective investment schemes leading the way, many having re-domiciled from other jurisdictions. In the insurance industry, reinsurers and cells in protected cell companies, as well as assets under management, have doubled since 2008. There are now 13 insurance managers and 10 captive insurance or affiliated insurance companies operating from Malta.

Q What measures have been taken to maintain the health of the financial sector?

A A rigorous but non-intrusive regulatory regime based on international best practice combined with easy access to the single regulator have given Malta a good name in this field. Other contributory factors are a legal framework based on common and civil law, 55 double-taxation treaties and a competitive fiscal regime, and membership of the euro area. The availability of qualified professionals at competitive salaries, reasonable office accommodation costs and good air and information and communications technology connections complement the package. Malta's two-centuries-old tradition of commercial banking based on a conservative funding model, in which loans are entirely financed by retail deposits, provides an additional source of comfort.

Q What are the sector's weaknesses? For example, many firms are becoming concerned about a future shortage of professional workers. What can be done about this?

A Rapid growth in any sector can easily give rise to bottlenecks and areas of weakness. With regard to staff availability, both the specialised educational institutions and the university are responding to the growing demand with new, often tailor-made courses. As for the high exposure of the banks to the real-estate sector, both in the form of loans and collateral held against them, they are being encouraged to increase provisions further in view of the recent increase in corporate non-performing loans.

Loan-to-value ratios are not excessive, however, averaging 72% and 62% for residential and commercial property loans, respectively. We are currently strengthening both our micro- and macroprudential supervisory capacities and another IMF/World Bank FSAP will be undertaken next year. TB