

Circular 02/2007

14th December 2007

Feedback Statement in relation to Circular 01/2007 dated 8th June 2007

1.0 Background

On 8th June 2007, the Malta Financial Services Authority (“MFSA”) issued Circular 01/2007, which enclosed a proposed draft Bill intended to replace the Special Funds (Regulation) Act (“the SFA”), together with an explanatory note outlining the principal features of the Bill and changes from the SFA and other general information. The Circular invited comments from interested parties on the proposed Bill.

2.0 Purpose of Feedback Statement

This Feedback Statement is being issued to address the feedback received in relation to Circular 01/2007 with respect to the proposed draft Bill. In this regard, the MFSA received feedback namely from one market participant, two law firms, one of which was acting on behalf of a market participant and one financial industry association.

The Bill has been updated as outlined in this Feedback Statement. Moreover, as already advised, the Bill may undergo further revisions following the necessary review and vetting by the Office of the Attorney General and the relevant Minister as well as during the Parliamentary stages.

This Feedback Statement is being circulated solely for information purposes.

3.0 Feedback Received in relation to the draft Bill intended to replace the SFA

GENERAL

3.1 Principle Based Legislation

The principle based approach to the new legislation was welcomed, as it was deemed to make interpretations and implementation of the requirements easier for the relevant institutions.

3.2 Definition of Beneficiary in article 2(1)

It was pointed out that the words “*whether a member of a retirement scheme or not*” in the definition of beneficiary in article 2(1), are superfluous and should be deleted. It was suggested that the definition of beneficiary in Directive 2003/41/EC - which

simply states that a beneficiary is a person who receives retirement benefits - should be adopted.

MFSA's Response:

MFSA agrees with the deletion of the words "whether a member of a retirement scheme or not" from the definition of beneficiary. The definition of "beneficiary" has been revised accordingly.

3.3 Definition of Retirement Scheme in article 2(1)

A number of comments were made with respect to the definition of Retirement Scheme in article 2(1), as follows:

- i. Reference was made to the proviso that a scheme or arrangement will not constitute a retirement scheme if it provides for the commencement of payment of retirement benefits at a date later than that on which the member attains the age of 70. It was stated that generally people are living, working and are being more active longer – however costs in retirement have increased. This is resulting in an increasing need for longer term personal savings as people cannot rely solely on support from state and/or occupational related pensions. Thus it was commented, that the restriction that retirement benefits cannot be paid at a date later than the age of seventy is no longer relevant, particularly in relation to personal pension schemes. It was suggested that the Bill should not impose any maximum age limit when benefits should be paid out, similar to the approach followed in twelve of the current EU Member States.

MFSA's Response:

The Bill has been revised to merely state, inter alia, that the payment of retirement benefits shall occur as specified in Rules supporting the Bill, which Rules shall be issued once the Bill is enacted. The Rules will then stipulate the dates when retirement benefits may be paid out.

With respect to the comments above, the MFSA considers that setting the latest age by when a retirement scheme can pay out retirement benefits to a member, gives the operators and members of retirement schemes an indication by when such benefits can be paid out at the latest. This time-frame also ensures that retirement benefits are actually paid out during retirement. However the MFSA understands that in view of changing demographics where people are living and working longer, there may be particular cases where an individual may wish to postpone the payment of retirement benefits at an age later than seventy. In this regard, the MFSA considers that the postponement of the pay-out of retirement benefits beyond the age of seventy should be at the option of the retirement scheme member rather than the retirement scheme operator, as long as the retirement scheme document provides such a possibility and such postponement is permissible in terms of any law related to retirement provisioning at the time. This approach will be stipulated in the Rules that will be issued regarding the payment of retirement benefits.

- ii. Reference was made to the fact that a scheme or arrangement will not constitute a retirement scheme if it provides for the payment of retirement benefits to five or fewer members.
- One comment considered that this threshold as too low. The suggestion was made for this threshold to be increased to at least twenty-five members on the basis that the costs associated with operating a small scheme (e.g. only for seven people) and ensuring compliance thereof with the regulatory framework will be disproportionate to the benefits. It was observed that small retirement schemes do not benefit from the economies of scale of the pooling of contributors which retirement schemes having a large number of members enjoy.
 - On the other hand, another respondent requested clarification of the rationale as to why schemes with five or fewer members are not considered a retirement scheme for the purposes of the RPA, since this would infer that schemes of this size would not be afforded the same protection as larger schemes.

MFSA's Response:

The Authority considers that the threshold in question should be retained as is.

With reference to the first comment listed above, the Authority would like to clarify that the regulatory framework permits the establishment of different types of retirement schemes – such as ‘multi-employer’ retirement schemes or ‘sector specific’ schemes or ‘open schemes’ – which could potentially be cost-effective alternatives for small companies in the instance that the administrative costs of operating individual small schemes transpire to be too high in relation to the benefits generated.

Further to the second comment listed above, the Authority would like to clarify that one-member arrangements would be able to apply to be regulated as a scheme under the Bill (once enacted) in terms of the ultimate proviso at the end of the definition of ‘retirement scheme’.

- iii. A comment was made that there is no indication of the form which a retirement scheme may take. It was recommended that the definition should at least state that a “retirement scheme” means a scheme, an arrangement, a contract, an agreement, a trust deed or rules with the principal purpose of providing retirement benefits and under which conditions – similar to the definition of pension scheme in Directive 2003/41/EC.

MFSA's Response:

The Authority would like to make reference to Article 37(2)(a) of the draft Bill which gives the power to the MFSA to issue Rules regarding the “legal form and constitution of retirement schemes and, or retirement funds, the governance, structuring and management of such retirement schemes and, or retirement funds”. The Authority will be outlining the possible legal forms that a retirement scheme may adopt in the Rules that will support this Bill once

enacted and that will be issued for consultation in due course. The Authority considers that adopting this approach – that is defining the legal form in Rules rather than in the Bill itself – provides the market with more operational flexibility.

- iv. It was pointed out that the definition fails to mention that “*retirement schemes*” are divided into three i.e. occupational retirement schemes, personal retirement schemes and overseas retirement schemes - whereas these terms are separately defined.

MFSA’s Response:

The Authority agrees with the suggestion that the definition of “retirement scheme” should clearly state that it captures both “occupational retirement schemes” as well as “personal retirement schemes”. This would make it clear which retirement schemes (i.e. occupational and personal) are captured by the term wherever this appears in the Bill. The definition of retirement scheme in the Bill has been revised accordingly.

3.4 Definition of Retirement Benefit in article 2(1)

A clarification was requested regarding the meaning of the phrase “*the expectation of reaching retirement*”, in particular what will be the benchmarks that will be used by the MFSA in determining when the expectation is said to arise.

MFSA’s Response:

There are no applicable benchmarks given that in reality retirement benefits can only be paid by reference to two possible scenarios – that is, when one reaches retirement, or in the case when the benefits are paid earlier, the benefits would have been paid in anticipation of reaching retirement.

The Authority also clarifies that the definition of retirement benefit has been transposed into the Bill from the EU Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision.

3.5 Definition of Retirement Benefit and Retirement Scheme in article 2(1)

Reference was made to the fact that the definitions of Retirement Benefit and Retirement Scheme imply that benefits may be paid automatically on “cessation of employment”. It was noted that these definitions were in part taken from Article 6(d) of the Directive 2003/41/EC and that the Rules to prescribe the circumstances in which this may be possible are awaited. However the respondent pointed out that in principle, it was against the automatic payment of benefits on cessation of employment. It was argued that job mobility is increasing and therefore an important feature of any pension scheme is its flexibility to move pension funds from one employment to another. If people are allowed or forced to access their benefits on leaving employment then many people will end up with no pension provision at all.

MFSA's Response:

The Authority clarifies that the wording of the respective definitions of retirement benefit and retirement scheme do not imply the automatic payment of retirement benefits on cessation of employment.

On a general note, the Authority explains that in terms of the definition of retirement scheme, the principal purpose of a scheme is the provision of retirement benefits. However, a retirement scheme may opt to provide cover for other matters such as death benefits and invalidity benefits.

More specifically:

- *with reference to the definition of retirement benefits, the Authority explains that the reference to “cessation of employment” is tied with the provision of supplementary benefits offered by the scheme on an ancillary basis – that is, benefits which a scheme may provide in addition to retirement benefits in cases of termination of employment.*
- *with reference to proviso (c)(ii) of the definition of retirement scheme, the Authority explains that in the instance that an employment is terminated (voluntary or otherwise), retirement benefits / rights ordinarily are either:*
 - *preserved within the retirement scheme of the previous employer or*
 - *transferred to a new scheme sponsored by the new employer*

The current Directives for Occupational Schemes provide for the transfer of benefits from one scheme to the other, which requirements are to be retained. However the MFSA is also cognisant of the circumstances where the retention or transfer by a scheme of benefits may be unduly cost ineffective (e.g. a young person joining an employer for only 2 years who might have earned only a small entitlement that would be unduly bureaucratic and cost ineffective to maintain and track for the next 30 years). In fact, the idea underlying the proviso (c)(ii) is to give the Authority the flexibility to allow a scheme to rationalise its beneficiary list in certain justifiable circumstances.

The Authority is minded to retain proviso (c)(ii) amending it slightly and also clarifying that its applicability is limited to occupational retirement schemes.

3.6 Service Provider vs Retirement Scheme Administrator in article 2(1)

It was observed that there is a fine line between the duties of a ‘service provider’ and ‘retirement scheme administrator’. These are both licensed to provide services listed in the First Schedule – however whilst the retirement scheme administrator is licensed to provide administration services only to a retirement scheme as referred to in this Schedule, the service provider is licensed to provide any one or more services referred to in the same Schedule to a retirement scheme / fund. The question was raised as to whether a scheme would need to appoint a separate administrator performing the functions in section 11 of the Bill when a service provider is licensed to provide all services, including administration.

MFSA's Response:

MFSA would like to clarify that:

- the term "service-provider" captures all the persons who are licensed to carry out one or more of the licensable services listed in the First Schedule of the Bill, including a Retirement Scheme Administrator,
- the term "retirement scheme administrator" refers to a service-provider who is at least licensed to "administer the operation of a Retirement Scheme" in terms of the Schedule to the Bill. The day-to-day duties associated with scheme administration will be stipulated by Rules issued by the Competent Authority in terms of article 37(2) of the Bill.

The terms in question were defined separately, since certain articles in the Bill apply solely to the Retirement Scheme Administrator as a service-provider, while other articles in the Bill apply to all service-providers.

In addition, a service-provider licensed to provide one or more of the services listed in the Schedule will require only one licence under the Bill. That licence will then specify which licensable activities in terms of the Schedule that service-provider is licensed to provide.

3.7 Definition of Retirement Fund

- i. A query was made as to whether this definition includes a sub-fund dealing with contributions made to retirement schemes of a fund where the fund itself is not established for the principal purpose of holding/investing the contributions made to one or more retirement schemes and/or to one or more overseas retirement schemes.

MFSA's Response

The Authority confirms that the establishment of sub-funds with the objective of providing retirement benefits under a SICAV whose objective is general and which may have other sub-funds with non-retirement related objectives would be acceptable - subject that the assets of each sub-fund are legally segregated and each sub-fund is hence considered as a segregated entity.

- ii. A query was made as to whether the MFSA will be issuing guidelines on what qualifies as an arrangement.

MFSA's Response:

The Authority intends to issue Rules regarding the legal form that a retirement scheme can take under Article 37(2)(a) of the draft Bill which gives the power to the MFSA to issue Rules regarding the "legal form and constitution of retirement schemes and, or retirement funds, the governance, structuring and management of such retirement schemes and, or retirement funds".

- iii. Reference was made to Article 7 of Directive 2003/41/EC which requires that the ‘principal purpose’ of occupational retirement schemes is limited to the provision of retirement benefits. A comment was made that extending this requirement to personal schemes may be too restrictive and therefore a suggestion was made that such personal schemes should be entitled to invest in other types of schemes.

MFSA’s Response:

The MFSA considers that the principal purpose of personal retirement schemes should also be the provision of retirement benefits – as this would distinguish personal retirement schemes from other savings schemes.

The MFSA clarifies that retirement schemes under the Bill (personal or occupational) are entitled to invest in a variety of instruments, subject to the diversification requirements stipulated by the MFSA.

3.8 Definition of Personal Retirement Scheme

Reference was made to the introduction of the definition of personal retirement scheme which was associated with the inclusion thereof in Article 64D(3) of the Social Security (Amendments) Act. The inclusion of such a term was seen as problematic:

- i. It was stated that the definitions of ‘personal retirement scheme’ and a ‘retirement scheme’ seem to contradict each other as it was argued that a personal retirement scheme can only provide benefits for an individual, whilst a retirement scheme is not a retirement scheme under the Bill if it provides benefits for five or fewer members. It was noted that by definition therefore a personal scheme would not be classified as a retirement scheme and the new Bill would seem not to apply.

MFSA’s Response:

Comments made under point 1(ii) above refer.

- ii. the definition of a personal retirement scheme states that it is a retirement scheme to which contributions are made solely by an individual for the benefit of that individual. It was commented that this definition is too restrictive as it would effectively prohibit a third party paying into a personal retirement scheme on behalf of an individual. Throughout Europe this restriction is not enforced, enabling an employer, a spouse, a grandparent or a parent to contribute to a scheme on behalf of an individual. We are sure it was not the intention to have such a restriction and would suggest an alternative definition is used.

MFSA's Response:

The MFSA confirms that a third party should be able to pay into a personal retirement arrangement on behalf of an individual. In this regard, the MFSA reviewed the definitions of 'occupational retirement scheme' and 'personal retirement scheme' which have been revised as follows:

"occupational retirement scheme" means a retirement scheme established by an employer or by a group of employers or by an association representing employers, jointly or separately, for the benefit of employees;

"personal retirement scheme" means a retirement scheme which is not an occupational retirement scheme and to which contributions are made for the benefit of an individual;

- iii. taking the above two points into consideration, the overall merits of including personal retirement schemes under the RPA was questioned. It was commented that these were not included originally in the SFA and are not required under the Directive 2003/41/EC. The inclusion now appears only due to the Social Security Amendments Act and it was suggest that consideration is given to only regulating personal schemes under the Insurance Business Act in order to avoid confusion.

MFSA's Response:

The SFA includes two definitions: one of a "scheme" which is general and another of "occupational scheme". Various parts of the SFA refer to 'scheme' and then certain articles relate specifically to 'occupational schemes'. Although the main focus of the SFA regards occupational schemes, it also captures personal retirement schemes. The aim of this new Bill is to make this coverage and distinction between occupational and personal schemes more clear.

Moreover, in terms of the amendments to the Social Security Act, personal schemes are to be regulated both under the Insurance legislation as well as under the SFA.

3.9 Definition of Biometric Risks

A comment was made that while biometric risks are defined in Article 2 of the Bill, this term does not appear elsewhere in the Bill.

MFSA's Response

The above definition has been deleted from the proposed Bill.

3.10 Article 3(3) of the Bill

A query was made as to whether the MFSA will be issuing any guidelines as to the interpretation of the phrase “in or from Malta”. The guidelines would be particularly useful to determine whether an “arrangement” is carrying on an activity “in or from within Malta”.

MFSA’s Response:

The Bill has been amended to give an indication of what constitutes “activity carried in or from Malta”.

3.11 Article 3(6) of the Bill

A query was made as to whether the MFSA will be providing any exemption to entities in possession of an investment services licence and/or banking licence.

MFSA Response:

Entities already in possession of an investment service licence and/or banking licence and/or insurance licence under the respective legislative frameworks will still need to apply for a licence under the Bill once enacted, if they want to carry out or provide any one or more of the services listed in the Schedule to the Bill. However, these entities will be subject to an abridged application procedure to avoid and minimise duplication of requirements of licensing.

3.12 Article 4(1) of the Bill

- i. A query was made as to whether it will be possible for a retirement scheme that is licensed in Malta to invest in an overseas retirement fund.

MFSA’s Response:

The Authority replies in the affirmative. A retirement scheme is not obliged to invest exclusively in local retirement funds or local instruments. A retirement scheme can invest in various categories of assets – local or foreign - in line with the principle of diversification.

- ii. A query was made as to whether it will be possible for a retirement scheme established overseas to invest in a retirement fund licensed in Malta.

MFSA’s Response:

The purpose of a retirement fund is indeed to accept contributions from local and/or foreign/overseas retirement schemes and manage those contributions. A Retirement Fund can be used as an investment vehicle by a single retirement scheme or overseas retirement scheme or can be used as a pooling investment vehicle for a number of retirement schemes or overseas retirement schemes.

3.13 Article 5(1) of the Bill

Reference was made to Article 19 of Directive 2003/41/EC which states that “member states shall not restrict institutions from appointing for the management of the investment portfolio investment managers established in another member state... and that member states shall not restrict institutions from appointing for the custody of assets custodians established in another member state..”. It was questioned whether the MFSA will be providing exemptions to article 5(1) of the Bill to cater for this article of the directive.

MFSA’s Response:

The Authority replies in the affirmative.

3.14 Article 8(4) of the Bill

It was observed that when considering whether to grant a licence or not, the concern should lie with the beneficiaries of the fund/scheme and the integrity of the financial system rather than protecting the “general public”.

MFSA’s Response:

The licensing criteria will focus on:

- (a) the protection of beneficiaries, members, and investors;*
- (b) the promotion of competition and choice; and*
- (c) the reputation and suitability of the applicant and in the case of the retirement scheme and, or retirement fund, the persons responsible thereof, and all other parties connected with the retirement scheme and, or the retirement fund as the case may be.*

3.15 Article 8(9) of the Bill - requirement for a person to be fit and proper

It was commented that the requirement for a qualifying shareholder to be a fit and proper person is unnecessary. It was opined that should such a requirement be necessary, then the fit and proper test should be shifted to a lower degree.

A clarification was requested as to whether the term qualifying shareholders also includes beneficial owners. It was recommended that the test should be made merely with respect to directors and management and not on owners.

MFSA’s Response:

No reason has been provided as to why the application of the fit and proper test on qualifying shareholders is considered unnecessary. The MFSA considers the fit and proper test as a critical part of the licensing process to ensure that only competent persons of integrity operate in the sector. MFSA will continue to apply the test to

qualifying shareholders (including beneficial owners), directors and managers of licensees and recognised persons under the proposed Bill.

This same principle is also adopted in other local financial services legislation.

3.16 Section 16

A clarification was requested as to what “defraying the expenses as stipulated in the scheme document” relates to.

MFSA’s Response:

Article 16 stipulates that the assets of a retirement scheme may only be used to pay retirement benefits to members and beneficiaries thereof and for the settlement of expenses / fees / charges that are outlined in the scheme document. Article 4 of the current SFA stipulates that the scheme document must list, inter alia, the expenses and costs payable by the scheme and how these are to be met – which requirement will be reflected in Rules issued by the Authority under the proposed Bill once enacted.

3.17 Investments in Immovable Property

It was pointed out that the purchase of immovable property as an asset of pension scheme – in particular personal pension scheme – should be permissible, as this has been one of the preferred personal long term investments for most individuals. Since pension investments are usually long term in nature, it is considered that investment in immovable property should be an integral part of the investment strategy underpinning any investment portfolio. It was suggested that the purchase of immovable property – even if to a limited extent – should be included in the list of acceptable instruments for retirement schemes.

MFSA’s Response:

The Authority considers that not more than 10% of a scheme’s assets should be invested in commercial property and property related companies.

3.18 Schedule 1

A request was made for MFSA to consider introducing Pensions Advice by financial intermediaries as a licensable activity in relation to the establishment of occupational retirement schemes.

MFSA’s Response:

The Authority confirms that it is considering whether the provision of advice in relation to retirement schemes should be regulated. However, this would be the subject of a separate consultation exercise.

3.19 Legal Notice 71 and 72 of 2006

Reference was made to the above legal notices which currently implement the provisions of Directive 2003/41/EC. It was queried whether similar subsidiary legislation will be issued under the RPA.

MFSA's Response:

The current subsidiary legislation issued under the SFA will eventually be reviewed to reflect the new Bill once the latter has been enacted. The provisions of the legal notices implementing Directive 2003/41/EC will continue to apply under the Bill once enacted.

3.20 Sundry Query

A question was made to whether there will there be any tax incentives with respect to the contributions made to retirement schemes.

MFSA's Response:

Taxation or otherwise of contributions made to retirement schemes is not a regulatory issue and falls outside the remit of the MFSA.

3.21 Other changes following the consultation period:

Certain sections of the Bill have been clarified further.