

Listing Authority Policies

Feedback Statement further to Industry Responses to MFSA Circular 5th July, 2010

16th August 2010

1.0 Background

On the 5th July 2010, MFSA issued a circular entitled “*Consultation Document on Listing Authority Policies*”. The purpose of the circular was to provide the financial services industry and the general public with updated policies concerning the Sinking Fund requirements as well as the adoption of a new policy requiring a financial assessment report to be submitted by applicants for admissibility to listing of corporate bonds marketed to local retail investors. This circular also served as a consultation document on the new policies.

The Authority received comments from fourteen members of Malta’s financial services industry. An outline of the main comments received and the Authority’s position in relation thereto, is provided in Section 2.0. The position has been determined after a careful and thorough consideration of all the remarks and recommendations received.

Section 3 of this Feedback Statement provides a copy of the revised policies, which are applicable for new applications for admissibility to listing received as from the date of this circular.

2.0 Main Comments Received and the Listing Authority’s position

[2.1] General Comments

[a] *Comments:* Clarification was requested regarding the rationale behind the Authority’s decision to propose requirements on the sinking fund and financial soundness.

Remarks: The Authority has been monitoring the development of the Maltese corporate bond market for these last couple of years. In this regard, it has been noted that Maltese companies making public issues of bonds, have mainly targeted Maltese retail investors. As a matter of fact, when making a public issue of corporate bonds, marketing handled either directly or through the issue sponsor is directed primarily to retail investors as is the use of mail shots sent to residential addresses. Moreover, the minimum investment amount relating to these bond issues is generally kept within a range, which is within the reach of retail investors. The policy to establish a sinking fund, and the policy on financial soundness, have the purpose of setting conditions for admissibility to listing, which enhance retail investor protection. This

notwithstanding, it should be clarified that these policies do not have the purpose of guaranteeing the repayment of the bond on maturity.

[b] Comments: It has been suggested that in order to achieve further investor protection, companies could be restricted from issuing bonds for general funding purposes whilst instead requiring that bond proceeds are to be used to finance specific projects. Additionally, it has also been suggested that use of proceeds to finance equity participation by the issuer should not be permitted. Furthermore, a more stringent application route could be applied for issuers seeking to raise funds in order to repay existing debts.

Remarks: The Authority reviews each application for a bond issue on its own merit, and specific conditions may be applied depending on the purpose of the issue.

[2.2] Sinking Fund – Definition

Comments: A number of recommendations have been made for the amendment of the definition of a ‘*sinking fund*’.

Remarks: The Authority has thoroughly considered the various proposals made for the revision of the definition of a sinking fund and has amended the definition as follows:

‘The assets which the Issuer intends to use for the purpose of the repayment of (part of the) capital due on maturity of debt.’

[2.3] Sinking Fund – Applicability

[A] Comments: It has been suggested that the sinking fund requirement should not apply to issues of financial instruments which are secured and to regulated financial institutions in general. In this regard, it has been argued that since the apparent objective of the sinking fund, as contemplated by the Listing Authority, is to protect the local retail investor primarily against credit or default risk posed by the Issuer, and that such risk is deemed to be higher in the case of unsecured corporate debt securities, the sinking fund policy should therefore not apply to secured debt securities. It has also been recommended that the policy should in addition only apply where the Issuer is a Company formed and registered in accordance with the Companies Act and Malta is the Home Member State for the purposes of Chapters 8 and 9 of the Listing Rules. It has also been suggested that the sinking fund requirement could possibly be waived in the event that: **[i]** a bond issue (not the issuer) either enjoys an investment grade rating by a global credit rating agency, or **[ii]** in the case that the issuer is a licensed financial institution such as a bank or insurance company.

Remarks: The Authority agrees that it is reasonable to apply certain further exemptions from the requirement of establishing a sinking fund. In this regard, the applicability section of the policies, which require the establishment of a sinking fund, has been amended to include the following exemptions:

[i] where the issuer is subject to capital requirements as laid down in the EU Capital Requirements Directive or the EU Solvency II Directive;

[ii] where the bond is secured by easily realisable assets; and

[iii] where the bond issue has a credit rating which: [a] has been issued by a credit rating agency, that is regulated in terms of the EU Regulation on Credit Rating Agencies; and [b] is acceptable to the Authority.

This section has also been amended to clarify that a sinking fund will be required only with respect to Companies formed and registered in accordance with the Companies Act and where Malta is the Home Member State for the purposes of Chapters 8 and 9 of the Listing Rules and where the issuer is targeting retail investors.

[B] Comments: It has been suggested that the creation and maintenance of a sinking fund should be on a voluntary basis for issuers of unsecured debt securities and Issuers should have the option to adopt alternative safeguards (such as a bank guarantee and covenants) in the absence of such sinking fund, subject to the Listing Authority's approval.

Remarks: It is the Authority's position that a sinking fund should be mandatory and applied subject to the relevant exemptions.

[2.5] Sinking Fund – Required Funding of Sinking Fund

[A] Comments: Clarification was requested regarding the rationale behind the Authority's proposed method for the calculation of the assets which should be allocated to the sinking fund.

Remarks: There are various methods that may be applied for the determination of the amount, which should be allocated to a sinking fund. Moreover, there are a number of criteria which may be applied for the determination of which reserves/cash flows may be used for the purpose of funding the sinking fund. The Authority is of the view that calculating the yearly instalment as a percentage of the company's profits after tax but before preferred and ordinary dividends is the most reasonable and clear methodology for defining what should be allocated in the sinking fund.

[B] Comments: It has been suggested that if due to lack of profits the Issuer cannot in one year transfer funds to the Sinking Fund then the Issuer should make good for the shortfall in subsequent years if this is justified by profits.

Remarks: The Authority is in full agreement with the above-mentioned comment. In this regard, the section of the policies entitled '*Required Funding of Sinking Fund*' has been amended to include an additional sentence to the effect that: '*If due to lack of profits the Issuer cannot in one year transfer funds to the Sinking Fund, then the Issuer should make good for the shortfall in subsequent years when this is justified by profits*'.

[C] Comments: It has been remarked that the policy discourages Issuers from repurchasing and cancelling bonds early. In this regard, it is recommended that if the issuer has reduced the outstanding bonds by 50%, then it should be deemed that the Issuer had complied with the policy.

Remarks: To date the Authority has applied a policy that where the Issuer uses the sinking fund assets to purchase its own bonds for cancellation, it should still be required to maintain, by the time the outstanding bonds are due to mature, funds which are equal to half the amount which the issuer would require to redeem the remaining bonds. In view of the comments

received from the industry, regarding the implications of applying this policy, the Authority has decided that this should be revised to provide that where the issuer uses the sinking fund assets to purchase its own bonds, the required allocations to the sinking fund may be reduced by the said amount and the value of the sinking fund at the time of maturity of the bond should be at least 50% of the bonds originally issued, net of the bonds previously repurchased by the Issuer and cancelled.

[D] Comments: Clarification was requested as to whether the listing policies should also establish the minimum criteria in terms of percentage ranges that need to be respected when calculating the instalment for each year during the course of building up the sinking fund.

Remarks: The Authority is of the view that the percentage ranges, which dictate the amount to be allocated to the sinking fund, should be decided by the Issuer depending on its circumstances. This should be communicated to the Listing Authority at application stage.

[E] Comments: Clarification was requested as to whether the requirements to fund the sinking fund would nonetheless be triggered if the issuer does not generate a profit.

Remarks: The policy requires an allocation to the sinking fund, only where the Issuer has generated a profit. In the case where no allocation is made the public should be advised through a company announcement.

[2.6] Sinking Fund – Commencement Date

Comments: It has been recommended that the commencement date for the sinking fund should not be a matter of policy but rather a matter to be determined on a case by case basis depending on the specific bond issue and the source of the redemption proceeds.

Remarks: It is the Authority's view that for the sake of clarity and good order the sinking fund commencement date should be stipulated as a requirement in the policies.

[2.7] Sinking Fund – Sinking Fund Custodian

[A] Comments: Clarification was requested regarding the Listing Authority's decision to require the appointment of a Sinking Fund Custodian rather than a Trustee.

Remarks: In the Authority's view the term Sinking Fund Custodian is better suited to reflect the duties of the entity which has been entrusted with the role and duty to safeguard the assets within the sinking fund and to monitor the issuer with respect to the fulfilment of its obligation to establish a sinking fund.

[B] Comments: It has been suggested that the policies should clarify that the appointment of a Sinking Fund Custodian will not be applied retroactively and that with respect to the already existing issues, Issuers will be allowed to retain their currently appointed Trustee.

Remarks: The Authority confirms the above position. The policies have been amended accordingly.

[C] Comments: It has been suggested that the Listing Authority ought to consult with (local) entities that would be qualified to act as a Sinking Fund Custodian in order to gauge whether or not such entities would be willing to undertake the functions contemplated in the Sinking Fund policy (and at what cost to the Issuer).

Remarks: The consultation document on the policies dated 5th July, 2010 was *inter alia* sent to all entities, which qualify to act as Sinking Fund Custodian. In this regard, the Authority does not have any material evidence which indicates that such entities would not be willing to undertake the functions contemplated in the Sinking Fund policy.

[D] Comments: Clarification has been requested on the obligations and liabilities of the Sinking Fund Custodian in order to ascertain the viability of such role.

Remarks: The duties and obligations of the Sinking Fund Custodian are clearly established in the policies. With respect to the liability of the Sinking Fund Custodian, it is the Authority's view that this is a matter which should be decided between the issuer and the custodian and should be spelt out in the custody agreement between these two parties. To determine what might constitute the liabilities which ought to be assigned to the Sinking Fund Custodian, reference may be made to the Investment Services Act (Control of Assets) Regulations, 1998.

[E] Comments: It was recommended that the list of eligible entities which may be appointed as a Sinking Fund Custodian should be extended to include other entities which are approved to hold and control clients assets and money.

Remarks: The Authority agrees with the Industry's proposal as per the above. In this regard, the section of the policy entitled '*Sinking Fund Custodian*' has been amended to refer to the following entities:

[i] a central securities depository authorised in terms of the Financial Markets Act, 1990; and

[ii] EU registered entities established outside Malta and which have been authorised as either **[a]** a credit institution; or **[b]** an investment firm that has been authorised to provide the ancillary service of safekeeping and administration of financial instruments for the account of clients, including custodianship and related services, such as cash/collateral management; and which have passported into Malta.

[F] Comments: It was remarked that in order to avoid possible conflicts of interest, the Sinking Fund Custodian should not have any business relationship with the Issuer which could have a bearing on the Custodian's decision to authorise the use of the sinking fund as collateral.

Remarks: The Authority is of the view that given the small size of Malta's financial services community, the introduction of a blanket prohibition such as the one outlined above, is not feasible. In this regard, the Authority is also of the view that the above-mentioned conflict of interest may be resolved by reference to the European standard on conflicts of interest, stipulated in the Markets in Financial Instruments Directive. The Authority has revised the section of the policy entitled '*Sinking Fund*' to include the following requirements:

“The Sinking Fund Custodian shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest from adversely affecting the interest of bondholders.

Where the organisational or administrative arrangements made by the Sinking Fund Custodian to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to bondholders’ interests will be prevented, the Sinking Fund Custodian shall clearly disclose the nature and/or sources of conflicts of interest to the bondholders.”

[G] Comments: On the Sinking Fund Custodian’s duty to take control of the assets of the Sinking Fund, which must be segregated from the other assets of the Issuer, clarification was requested as to the meaning of the terms ‘*control*’ and ‘*segregated*’.

Remarks: The following is the Authority’s position regarding the meaning of:

‘*Control*’ - means the holding of assets belonging to, or on behalf of the Issuer, for the purpose of establishing a sinking fund; and

‘*Segregation*’ - means the separation of sinking fund assets from the assets of the Issuer by means of the holding of such assets in accounts which are in the name of the Sinking Fund Custodian i.e. a separate bank account if the sinking fund is made up of cash and/or separate securities account where the assets are financial instruments. The account would need to be held in the name of the Sinking Fund Custodian as a ‘*clients account*’.

[H] Comments: On the Sinking Fund Custodian’s duty to seek to ensure that at maturity date, the Sinking Fund will have accumulated at least 50% of the principal amount which will be paid to bondholders, clarification was requested as to the checks which should be carried out by the Sinking Fund Custodian in this regard.

Remarks: With respect to the checks which ought to be carried out by the Sinking Fund Custodian to seek to ensure that at maturity the sinking fund will have accumulated at least 50% of the principal amount, it is the Authority’s view that the Sinking Fund Custodian would be expected to:

[i] At inception: request the Issuer to provide the Sinking Fund Custodian with forecasts on how the sinking fund will be funded on a yearly basis in order to make up 50% of the principal amount; and

[ii] On a yearly basis: consider the amount which has been allocated to the sinking fund and request the issuer for clarifications/comfort where the amount is below that which was disclosed in the original forecast (as amended in view of the actual annual performance figures of the issuer, as disclosed in its financial statements).

[I] Comments: On the Sinking Fund Custodian’s duty to ensure that the failure of the Issuer to fully achieve the Sinking Fund was due to justifiable reasons, clarification was requested on what constitutes ‘*justifiable reasons*’.

Remarks: What constitutes justifiable reasons in the context of a failure by the Issuer to fully achieve the Sinking Fund is a matter which is at the discretion of the Sinking Fund Custodian

depending on the circumstances of the particular Issuer. For example, a situation might arise where the Issuer does not manage to generate profits throughout the life of the bond, or situations of *force majeure*, which have a significant impact on the Issuer's operations.

[J] Comments: On the Sinking Fund Custodian's duty to audit that no misappropriations would have taken place during the term of the bond, clarification was requested on the meaning of the term '*audit*' in the context of this requirement.

Remarks: The Authority has re-considered the particular duty, which is being referred to in the industry's comment as per the above and in this regard, it was decided that the phrase '*misappropriation would have taken place during the term of the bond*' should be replaced by the words '*the issuer has applied the funds in terms of these policies*', as the former may be interpreted as referring to situations where the Issuer might have committed a criminal offence, whilst the latter is wider in scope. With respect to the industry's query on the meaning of the term *audit* in the context of the duty of the Sinking Fund Custodian, where the Issuer has pledged assets to the sinking fund, this refers to the duty to verify at regular intervals that these assets are not used in a manner which falls short of the Issuer's commitment to the sinking fund.

[K] Comments: On the Sinking Fund Custodian's duty to draw up an annual report addressed to the Listing Authority and the bondholders, regarding the extent of compliance by the Issuer with the requirements relating to the Sinking Fund, it has been suggested that such report is circulated to the market by way of a company announcement, instead of being sent to bond-holders.

Remarks: The Authority agrees with the Industry's proposal as per the above. In this regard, the section of the policies entitled '*Sinking Fund Custodian*' has been amended in order to specify that the report by the Sinking Fund Custodian, which is to be included in the annual financial statements of the Issuer, should be circulated to the financial market by way of a company announcement. In this regard, the requirement to send this document directly to bondholders has been deleted.

[2.8] Sinking Fund – Use of Sinking Fund Assets

[A] Comments: It has been suggested that a wider range of options should be allowed with respect to the use/investment of sinking fund assets, including investment in locally listed bonds. Moreover, it has also been suggested that the cash within the sinking fund may be utilised to make a market in the securities of the issuer as this would help the liquidity in the market place.

Remarks: The Authority is of the view that a prudent approach should be applied with respect to the use/investment of the sinking fund assets. In this regard, it has therefore been decided that restrictions as proposed in the Authority's consultation document dated 5th July, 2010 should apply.

[B] Comments: It has been recommended that the sinking fund proceeds should be available as collateral at any point during the life time of the bond for the ongoing business operations of the issuer. In this regard, the comments received disagree with the Listing Authority's position that the assets held in the sinking fund should only be used as collateral where the Issuer is facing serious liquidity problems. Where the issuer is facing such problems which

could possibly lead to its insolvency, the giving of collateral could be treated as fraudulent preference in terms of the Companies Act. In this regard, one comment suggested that it would be prudent for the sinking fund assets to remain ‘*unpledgeable*’ at all times. Another respondent suggested that the assets comprising the sinking fund be pledged by the issuer to the custodian, who should hold such assets for and on behalf of all bondholders from time to time.

Remarks: The Authority agrees that the use of sinking fund assets in situations where there are clear indications that the Issuer may become insolvent could result in fraudulent preference in terms of the Companies Act, 1995. In this regard, the Authority would like to clarify that the Consultation Document intended to refer to “liquidity problems” and not to solvency issues.

The Authority is of the view that a Board of Directors’ resolution stating that the company needs the temporary use of assets of the sinking fund for liquidity purpose would need to be presented to the Sinking Fund Custodian to obtain the release of the assets. This course of action can only be used by the Board of Directors in situations of temporary liquidity shortages and not where the Board is aware or should have been aware of a situation which could lead to the insolvency of the issuer. Moreover, the issuer may not create or permit to subsist security over the sinking fund except with respect to the creation of a general privilege or hypothec with a credit institution. The prior approval of the Custodian would be required. In this regard, the Custodian is responsible to monitor compliance with this policy.

[2.9] Financial Soundness

[A] Comments: The most salient concern expressed by the industry regarding the financial soundness report, which is being proposed as a policy, relates to the parameters set for the expression of an opinion on financial soundness. In this regard, it has been pointed out that these parameters are too wide and would therefore make it too difficult (if not impossible) to express an objective opinion. In particular, reference was made to the difficulties in expressing an opinion on whether the Issuer honoured its past payment obligations in full, and on its ability to generate sufficient cash flow to service and repay the bond.

Remarks: In view of the above concerns, the Authority has revised the policy on the financial soundness report to:

[i] Give an indication of the type of checks, which ought to be carried out in order to allow the issue of an objective opinion on the financial soundness of the issuer. In this regard, the entity preparing the financial soundness report would *inter alia* be expected to carry out: **[a]** a detailed examination of the Issuer’s financial statements of the last three years and its recent management accounts; and **[b]** checks regarding the creditworthiness of the Company.

[ii] To reduce the period covered in the section of the report relating to the Issuer’s fulfilment of past obligations from a period of five years to a period of three years before the date of the Issue; and

[iii] Replace all references to the issuer's future performance in point [b] of the policy on financial soundness, with a general obligation to report on the financial soundness of the Company based on its present financial situation and its track record.

[B] *Comments:* It was suggested that the entity making the financial soundness report must declare its independence from the particular Issuer of financial instruments.

Remarks: The value of a financial soundness report depends on the extent to which the person issuing the report is in a position of making an objective assessment on the state of affairs of the company under consideration. This requires a high degree of independence from the issuer. On this basis, the Authority agrees with the recommendation made as per the above and has amended the policies accordingly.

[C] *Comments:* It was suggested to broaden the list of professionals that may prepare a financial soundness report to include sponsoring stockbrokers.

Remarks: As indicated above, the value of a financial soundness report depends on the extent to which the person who is issuing the report is independent from the Issuer. In terms of the Listing Rules a sponsoring stockbroker must be independent of the issuer. The Authority therefore concurs with the recommendation made as per the above and has extended the list of entities which may issue the financial soundness report to include sponsoring stockbrokers.

[D] *Comments:* In order to achieve better investor protection through transparency, it was suggested that the proposed financial soundness report ought to be made part of the Issuer's Prospectus.

Remarks: Transparency is fundamental to ensure real and proper integrity of financial markets. Therefore, the Authority agrees with the above suggestion. The policies have been amended accordingly.

Other Remarks: The policy on financial soundness has also been amended to refer to situations where the issuer is a special purpose vehicle of a group of companies, which has been established as the financing arm of the group. In such case the financial soundness report should refer to the situation of the group and in particular the companies within the group which will be feeding the finance arm with income as stipulated in the Issuer's prospectus. In the case where the bond issue is guaranteed the report on financial soundness will be extended to the guarantor.

The policy has also been amended to include additional exemptions from its application. In this regard, the Authority is of the view that in addition to credit institutions an exemption from the policy to submit a financial soundness report should also apply with respect to all institutions which are subject to prudential regulation based on the capital requirements directive and the Solvency II directive, Government bonds and where the issuer has obtained a credit rating which is acceptable to the Listing Authority.

3.0 Revised Listing Authority Policies

[I] Sinking Fund

Definition: The assets which the Issuer intends to use for the purpose of the repayment of (part of the) capital due on maturity of debt.

Applicability: The Sinking Fund should generally be a requirement applicable to companies formed and registered in accordance with the Companies Act and where Malta is the Home Member State for purposes of Chapters 8 and 9 of the Listing Rules and where the issuer is targeting retail investors. A bond issue will be considered as being targeted at retail investors where marketing, handled either directly or through the issue sponsor, is directed primarily to retail investors and/or the minimum investment amount is within a range which is within the reach of retail investors. The setup and operation of the sinking fund should be fully disclosed in the prospectus

The following exemptions from the applicability of the policy shall apply:

[a] Government bond issues;

[b] where the issuer is subject to capital requirements as laid down in the EU Capital Requirements Directive or the EU Solvency II Directive;

[c] where the bond is secured by easily realisable assets; and

[d] where the bond issue has a credit rating which: [i] has been issued by a credit rating agency, that is regulated in terms of the EU Regulation on Credit Rating Agencies; and [ii] is acceptable to the Authority.

Required Funding of Sinking Fund: The Issuer should make an annual instalment to the fund, which should be calculated as a percentage of the company's profits **after tax** but before preferred and ordinary dividends. Where the Company issuing the bond is a Special Purpose Vehicle (SPV) of a Group, the calculation must be extended to the profits of Group Companies financing the SPV. The required instalments should be made so as the value of the Sinking Fund at the time of maturity of the bonds is at least 50% of the bond originally issued. Where the issuer uses the sinking fund assets to purchase its own bonds, the required allocations to the sinking fund may be reduced by the said amount and the value of the sinking fund at the time of maturity of the bond should be at least 50% of the bonds originally issued, net of the bonds previously re-purchased by the Issuer and cancelled.

If due to lack of profits the Issuer cannot in one year transfer funds to the Sinking Fund, then the Issuer should make good for the shortfall in subsequent years when this is justified by profits.

Commencement Date: Issuers are to be required to commence funding the Sinking Fund by not later than 1 year from issue of the bonds if the term of the bond is 5 years or less and by not later than 2 years if the term of the bond is over 5 years.

Sinking Fund Custodian: The Sinking Fund Custodian must either be:

[i] a credit institution authorised by the MFSA;

[ii] an investment services licence holder having a Category 2, 3 or 4 licence issued by the MFSA;

[iii] a central securities depository authorised by the MFSA in terms of the Financial Markets Act, 1990; and

[iv] EU registered entities established outside Malta and which have been authorised as either [a] a credit institution; or [b] an investment firm that has been authorised to provide the ancillary service of safekeeping and administration of financial instruments for the account of clients, including custodianship and related services, such as cash/collateral management; and which have passported into Malta.

The Sinking Fund Custodian should undertake the following activities:-

[a] Take control of the assets of the Sinking Fund, which must be segregated from the other assets of the Issuer. In this regard, the term '*control*' shall be construed as referring to the holding of assets belonging to, or on behalf of the Issuer, for the purpose of establishing a sinking fund and where '*segregation*' means the separation of sinking fund assets from the assets of the Issuer by means of the holding of such assets in accounts which are in the name of the Sinking Fund Custodian i.e. a separate bank account if the sinking fund is made up of cash and/or separate securities account where the assets are financial instruments. The account would need to be held in the name of the Sinking Fund Custodian as a '*clients account*'.

[b] Monitor whether the Issuer actually fulfils the obligation to make a yearly payment to the Sinking Fund;

[c] Seek to ensure that at maturity date, the Sinking Fund will have accumulated at least 50% of the principal amount which will be paid to bond holders. If this is not possible, the Sinking Fund Custodian should ensure that the failure of the Issuer to fully achieve the Sinking Fund was due to justifiable reasons;

[d] In case where the Issuer had pledged assets to the Sinking Fund, the Sinking Fund Custodian should audit that the issuer has applied the funds in terms of these policies;

[e] Monitor that the portfolio of assets within the Sinking Fund is managed (by the Issuer or any other person appointed by the Issuer) within the parameters set in the investment allocation principles set by the Listing Authority as further detailed below;

[f] Authorise the use of the assets in the Sinking Fund where the Issuer is experiencing temporary liquidity problems;

[g] Draw up an annual report addressed to the Listing Authority, regarding the extent of compliance by the Issuer with the requirements relating to the Sinking Fund. A copy of such a report is to be included in the annual financial statements of the Issuer and shall be circulated to the market by way of a company announcement.

The Sinking Fund Custodian shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest from adversely affecting the interest of bondholders.

Where the organisational or administrative arrangements made by the Sinking Fund Custodian to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to bondholders' interests will be prevented, the Sinking Fund Custodian shall clearly disclose the nature and/or sources of conflicts of interest to the bondholders.

This policy will not be applied retroactively and with respect to the already existing issues, Issuers will be allowed to retain their currently appointed Trustee.

Use of Sinking Fund Assets: The use of the monies allocated to the Sinking Fund should be restricted to: **[i]** the repurchase of the securities of the same issue; and **[ii]** investment in admissible assets as follows:

- (a) at least 25 per cent of the total amount shall be maintained in an interest bearing bank account denominated in the same currency as the bonds and held with a bank established in the EEA or invested in Malta Treasury Bills; and
- (b) not more than 75 per cent of the total amount shall be invested as follows:
 - (i) at least 50 per cent (in this case 37.5 per cent of the total Sinking Fund) shall be invested in Malta Government Stocks or in local SICAVs that invest principally in Malta Government Stock; and
 - (ii) the balance may be invested in debt instruments denominated in the same currency as the bonds, issued by local or international entities which are unrelated to the Issuer, have an investment grade of not lower than "A" by a reputable credit rating agency and which are quoted on an investment exchange.

Moreover, the Issuer should only be allowed to use the assets within the Sinking Fund to obtain further financing from a credit institution for business purposes where it is facing temporary liquidity problems. In this regard, the issuer may not create or permit to subsist security over the sinking fund except with respect to the creation of a general privilege or general hypothec with a credit institution. Before the assets within the Sinking Fund are utilised to address such problems, the permission of the Sinking Fund Custodian should be obtained. In this regard, a Board of Directors' resolution stating that the company needs the temporary use of assets of the sinking fund for liquidity purpose would need to be presented to the Sinking Fund Custodian to obtain the release of the assets. Furthermore, the Listing Authority should be informed.

This course of action can only be used by the Board of Directors in situations of temporary liquidity shortages and not where the Board is aware or should have been aware of a situation which could lead to the insolvency of the issuer. The Sinking Fund Custodian is responsible to monitor compliance with this policy.

Disclosure in Prospectus: The Issuer's prospectus should include proper disclosure regarding the nature of the Sinking Fund (including the fact that): **[i]** the Sinking Fund assets remain the assets of the Issuer, **[ii]** the identity, the role and the function of the Sinking Fund Custodian **[iii]** the manner in which the amount to be allocated to the Sinking Fund will be

calculated; and [iv] the manner in which the regular disclosure to bond holders regarding the Sinking Fund will be carried out.

Disclosure in Directors' Report: A 'comply or explain' policy should be adopted wherein the Directors of the Issuer are required to include a section regarding compliance with the requirements of the Sinking Fund in their report included in the interim and annual financial statements of the Issuer. The report should clearly outline the reasons for any breaches of the Sinking Fund requirements.

[II] Financial Soundness of Applicants for Admissibility to Listing

Applicants for admissibility to listing of corporate debt securities aimed at local retail investors are to be required to demonstrate their financial soundness and strength to the Listing Authority. The assessment of the financial soundness and strength of applicants is to be made by the Issuer's auditors or bankers or sponsoring stockbroker, or by a credit rating agency.

For this purpose, as part of the application to the Listing Authority for admissibility to listing, Issuers are to submit a report drawn up by their auditors or bankers or sponsoring stockbroker or by a credit rating agency which should include:

- (a) The credit history of the Issuer, in particular the extent to which it has honoured its payment obligations to its bankers and other creditors over the past three years from the proposed date of the Issue;
- (b) An opinion on the financial stability of the Issuer, based on its financial situation, and its track record; and
- (c) Where the proceeds of the bonds are to be used to finance a specific project, an opinion as to whether in the worst case scenario, should the project not be successful, the Issuer will nonetheless have sufficient funds from its existing operations, to be able to honour its bond interest payments and repayment of capital upon maturity of its bonds.

The entity preparing the financial soundness report would *inter alia* be expected to carry out: [a] a detailed examination of the Issuer's financial statements of the last three years and its recent management accounts; and [b] checks regarding the creditworthiness of the Company.

Where the issuer is a special purpose vehicle of a group of companies, which has been established as the financing arm of the group, the financial soundness report should refer to the situation of the group and in particular the companies within the group which will be feeding the finance arm with income. In the case where the bond issue is guaranteed the report on financial soundness shall be extended to the guarantor.

The entity making the financial soundness report must declare its independence from the particular Issuer of debt financial instruments.

A copy of the financial soundness report shall be made part of the Issuer's prospectus.

The following exemptions from the applicability of the policy on the preparation of a financial soundness report shall apply:

[a] Government bond issues;

[b] where the issuer is subject to capital requirements as laid down in the EU Capital Requirements Directive or the EU Solvency II Directive; and

[d] where the bond issue has a credit rating which: **[i]** has been issued by a credit rating agency, that is regulated in terms of the EU Regulation on Credit Rating Agencies; and **[ii]** is acceptable to the Authority.

The Listing Authority may adopt further policies in the interests of retail investors which focus on requiring increased transparency by Issuers regarding their financial status, extent of aggregate borrowings and other matters.