

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Basel Core Principles (BCP)

International Organisation of Securities Commission (IOSCO)

International Association of Insurance Supervisors (IAIS)

Independent Assessment

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List of Acronyms

1.	AG	Attorney General
2.	AML/CFT	Anti-money laundering/Combating the financing of terrorism
3.	BA	Banking Act
4.	BCBS	Basel Committee for Banking Supervision
5.	BCP	Basel Core Principle
6.	CARD	Consolidated Admission Requirements Directive
7.	CBM	Central Bank of Malta
8.	CDD	Customer Due Diligence (Basle Committee paper)
9.	CDs	Certificates of Deposits
10.	CESR	Committee of European Securities Regulators
11.	CEOPS	Committee of European Insurance and Occupational Pensions Supervisors
12.	CFT	Combating the Financing of Terrorism
13.	CIS	Collective Investment Schemes
14.	CP	Core Principle
15.	CPSIPS	Core Principles for Systemically Important Payment Systems
16.	CPSS	Committee on Payment and Settlement Systems
17.	CA	Companies Act
18.	CC	Commercial Code
19.	CRD	Capital Requirements Directive
20.	CSD	Central Securities Depository
21.	CSS	Central Systems of Securities Settlement
22.	DMO	Debt Management Office
23.	DVP	Delivery Versus Payment
24.	EEA	European Economic Area
25.	Egmont	Egmont Group of Financial Intelligence Units
26.	EU	European Union
27.	EUR	EURO
28.	FATF	Financial Action Task Force on Money Laundering
29.	FIA	Financial Institutions Act
30.	FIAU	Financial Intelligence Analysis Unit
31.	FIU	Financial Intelligence Unit
32.	FSAP	Financial Sector Assessment Program
33.	FT	Financing of Terrorism
34.	IAIS	International Association of Insurance Supervisors
35.	IAS	International Accounting Standards
36.	IBA	Investment Business Act
37.	IBNR	Incurred But Not Reported (Claims)
38.	ICP	Insurance Core Principle
39.	IIA	Insurance Intermediaries Act
40.	IIR	Insurance Intermediation Rule
41.	IMD	EU Directive 2002/92/EC (Directive on Insurance Mediation)
42.	IOPS	International Organisation of Pension Supervisors
43.	IPSU	Insurance and Pensions Supervision Unit
44.	IOSCO	International Organization of Securities Commissions
45.	IPF	Investor Protection Fund
46.	IR	Insurance Rule (No./Year)
47.	ISA	Investment Services Act
48.	KYC	Know Your Customer
49.	Lm	Maltese lire/liri
50.	LN	Legal Notice (No./Year)

51.	LOLR	Lender-of-last-Resort
52.	MaRIS	Malta Real-Time Interbank Settlement System
53.	MFP Code	Code of Good Practices on Transparency in Monetary and Financial Policies
54.	MFSA	Malta Financial Services Authority
55.	ML	Money Laundering
56.	MLAT	Mutual Legal Assistance Treaty
57.	MLRO	Money Laundering Reporting Officer
58.	MiFID	Markets in Financial Instruments Directive
59.	MMoFU	Multilateral Memorandum of Understanding
60.	MONEYVA	Council of Europe Sub-Committee on Money Laundering
61.	MofF	Minister of Finance
62.	MOU	Memorandum of Understanding
63.	MSE	Malta Stock Exchange
64.	NCCT	Non-Cooperative Country or Territory
65.	NPL	Non-Performing Loans
66.	ORSA	Own Risk and Solvency Assessment
67.	PCC	Protected Cell Company
68.	PCF	Protection and Compensation Fund
69.	PDAC	Public Debt Advisory Committee
70.	PML	Probable Maximum Loss
71.	PIF	Professional Investor Fund
72.	PMLA	Prevention of Money Laundering Act, 1994 (as amended)
73.	PMLR	Prevention of Money Laundering Regulations, 1994
74.	PSA	Professional Secrecy Act
75.	P&L	Profit and Loss Statement
76.	QROPS	Qualifying Recognised Overseas Pension Scheme
77.	RMICAP	Risk Management and Internal Capital Adequacy Assessment Process
78.	ROA	Return on Assets
79.	ROE	Return on Equity
80.	RTGS	Real Time Gross Settlement System
81.	SR	Special Recommendation (of FATF on terrorist financing)
82.	SRO	Self-Regulatory Organization
83.	STR	Suspicious Transaction Report
84.	SRP	Supervisory Review Process (Solvency II)
85.	SWIFT	Society of Worldwide Interbank Financial Telecommunications
86.	UN	United Nations
87.	UNSCR	United Nations Security Council Resolution

Chapter 1: General Introduction

1.1 Introduction

Since its setup in 2002 as the single regulator for financial services, the MFSA has worked to ensure the creation of a reputable financial centre. As part of the initial efforts, the IMF / World Bank were requested in late 2002 and early 2003 to conduct a Financial Sector Assessment Programme (FSAP). The assessment concluded that Malta's financial system appeared to be healthy and well supervised with a comprehensive legal framework and strong adherence to most international standards and codes for regulatory and supervisory practices.

EU membership provided a further assessment of the MFSA's regulatory and supervisory regimes prior to accession in 2004 which has proved to be an important catalyst for the further development of the financial services industry. Malta currently benefits from the greater credibility conferred by EU-compliant legislation and regulation and has access to passporting rights across the markets of the Member States. Passporting rights allow financial institutions licensed by the MFSA to exploit previously unavailable avenues for growth. Malta is very pro-active in the development of the EU financial services sector. In May 2009 Malta topped the list of Member States together with Denmark for the timely implementation of internal market rules.

In order to maintain the highest standards in regulation and supervision, the Board of Governors of the MFSA requested that an internal audit of the MFSA regulatory activities is carried every two to three years following the IMF/World Bank assessment. Internal audits were carried out in 2005 and 2007. A further internal audit was due to be carried out in 2009, however, because of the number of new legislative changes were coming into force at EU level and because of changes in composition of the Supervisory Council, the internal audit was postponed to 2010. The Board noting that increased transparency was being requested from companies following the global financial crises, decided that the 2010 internal audit should take the form of an independent assessment and should be carried out using the same format as the FSAP and this assessment and future assessments should be made public.

Following the publication of the De Larosiere Report ¹ recommending increased emphasis on supervision, the EU Commission has moved towards the creation of three European Supervisory Authorities to deal with banking, insurance and pensions, securities and markets supervision. These Authorities will periodically organise and conduct peer review analyses of some or all of the activities of Competent Authorities to further enhance consistency in supervision across all Member States. It is envisaged that when conducting peer reviews, existing information and evaluations already made with regard to the Competent Authority concerned, shall be taken into account by the new Authorities. This independent assessment therefore assumes greater importance for the reputation of the MFSA.

¹ De Larosiere: The high-level group on financial supervision in the EU. Report 2009

1.2 Development of the Malta Financial Services Sector

Over the past 10 years Malta has continued to upgrade and consolidate a comprehensive legislative and regulatory framework for financial services activities as an ongoing process. A number of important factors have influenced the development of the sector during this period. These include:

1. The alignment of legislation to EU standards pre- and post- EU accession in May 2004. This includes the full transposition of EU directives and regulations on an ongoing basis including the implementation of the EU Financial Services Action Plan.
2. The preparation of the financial services sector for access to the single market in financial services and its consequent impact on the evolution of the industry.
3. The adoption of the Euro as the national currency on 1st January 2008
4. The new European supervisory framework that is emerging in the wake of the financial crisis

Also during this period the Central Bank of Malta became a member of the European Central Bank and part of the European System of Central Banks, while the Malta Financial Services Authority (MFSA) became a member of the European Committees of Supervisors (CESR, CEBS and CEIOPS) which will in 2011 become European Supervisory Authorities (EBA, EIOPA and ESMA). Following membership of International Organisation of Securities Commission (IOSCO) in 2002 the MFSA also became a member of the International Association of Insurance Supervisors (IAIS) in 2007. The Authority also signed an MMOU with IOSCO in 2006 and with IAIS in 2010.

The Authority is empowered to make arrangements for the mutual exchange of information and for other forms of co-operation and assistance in regulatory and supervisory matters. To date, the MFSA has signed 39 Bilateral and Multilateral Memoranda of Understand with various supervisory authorities across the world. MoUs have also been signed with the Central Bank, the Ministry of Finance and the Competition Authority in Malta. These range from mutual assistance and exchange of information to co-operation in the management of financial crisis situations.

Following the move to the single regulator in 2002 which brought the regulation of all financial services activities - including banking, securities, investment and trustee services, insurance and pensions and stock exchange - under the responsibility of the MFSA, **Malta continued to develop a comprehensive and integrated legal framework for the financial services sector through the enactment of new laws as well as the enhancement, amendment and consolidation of existing legislation.**

New legislation enacted over the last few years includes the Prevention of Financial Market Abuse Act (2005); the Securitisation Act (2006); the Insurance Intermediaries Act (2006); the Prevention of Money Laundering and Terrorist Financing Regulations (2008) and the Central Securities Depositories Regulations (2009).

On May 1, 2004 regulations related to the European Passport Rights for financial services came into force. The regulations brought into effect a notification procedure through which investment firms, insurance undertakings and credit institutions have to follow in order to establish a branch or provide services in another EU Member State.

Among the new or important updates in EU legislation that have been transposed (or are in the course of being transposed) into Maltese legislation are those related to the Takeover Directive (2004/25/EC), the Prospectus Directive (2003/71/EC), the Third Anti-Money Laundering Directive (2005/60/EC), the Insurance Mediation Directive (2002/92/EC), the Capital Requirements Directive (2006/48/EC), the Acquisitions Directive (2007/44/EC), the Deposit Guarantee Schemes Directive (94/19/EC), the Payment Services Directive (2007/64/EC), the Electronic Money Directive (2009/110/EC), the Solvency II Directive (2009/138/EC); the Markets in Financial Intermediation Directive (MiFID) (2004/39/EC); the Distance Selling Directive (97/7/EC) and the Undertakings for Collective Investment in Transferable Securities (UCITS IV) Directive (2009/65/EC).

Extensive reviews of the Companies Act, the Trusts and Trustees Act, the Financial Institutions Act, the Special Funds Act (to be re-named the Retirement Pensions Act) and the Listing Rules are also currently underway.

While the setting up of a strong regulatory and licensing financial services authority operating to the highest standards is central to the legislative programme, Malta's policies also give due importance to the processes of financial innovation and improvements in the organisation of the financial services sector and the availability of competent human resources.

The MFSA continuously monitors market developments in order to ensure that innovation does not outstrip regulation. Over the last decade the MFSA has managed to develop a refined framework for the regulation of alternative and other professional investment funds, adopted efficient company re-domiciliation procedures, successfully implemented protected cell company legislation, transposed the trust concept into a civil-law based system, and developed sophisticated regulation in the pensions sector. **These initiatives have ensured that the Authority stays ahead of the market in the development of the regulatory infrastructure, while enabling the market to develop new products and opportunities.**

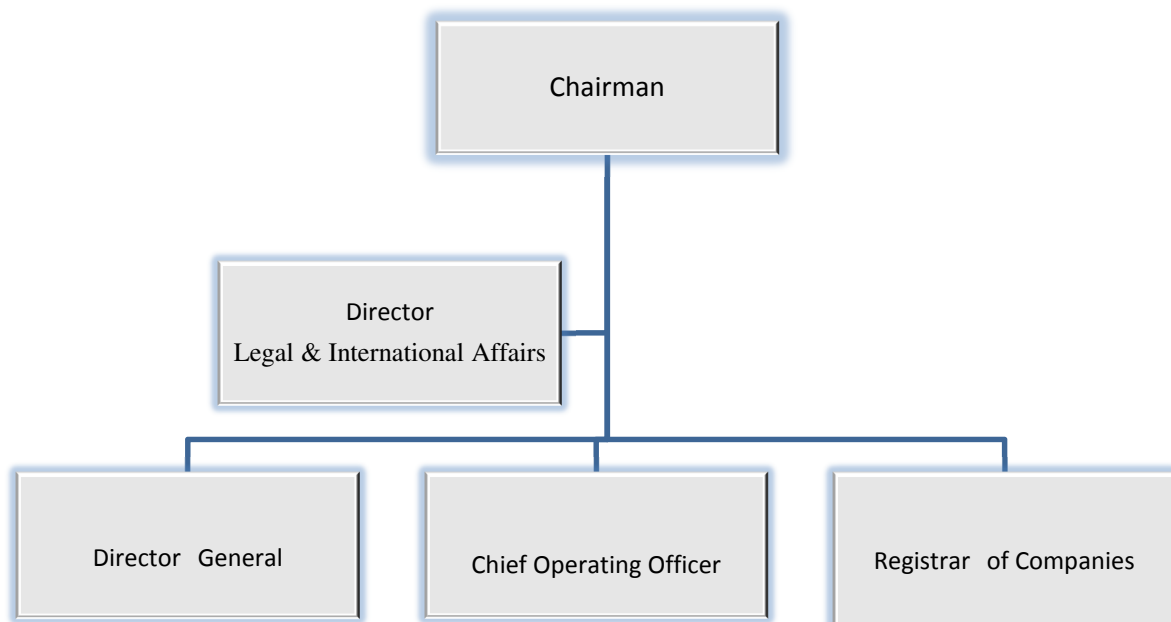
The MFSA is headed by a Chairman appointed by the Prime Minister and a Board of Governors that sets policy for the Authority. The Board of Governors is composed of seven members including the Chairman. A Coordination Committee exists to oversee the application of policies approved by the Board.

The organizational structure of the MFSA ensures that the regulatory and operational functions of the Authority are exercised within strict legal demarcations. The Board of Governors, presided by the Chairman, sets policy and general direction. The Supervisory Council, headed by the Director General, is exclusively responsible for issuing licences, regulation and supervision and the Board of Management and Resources is responsible for management operations and is headed by the Chief Operations Officer. **It is in charge of ensuring the day-to-day management of the Authority as regards, e.g., IT, human resources, and training.**

High-level co-ordination between the heads of these three organs is ensured at Co-ordination Committee level. The Registry of Companies, which is managed by the MFSA, is the fourth member of this Committee.

MFSA ORGANISATIONAL STRUCTURE

Composition of the Co-ordination Committee



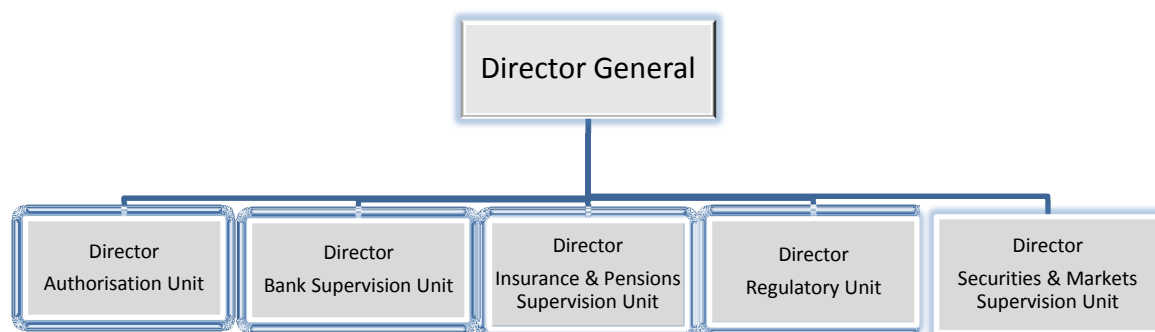
Following the amendments to the MFSA Act in 2002, the Authority also developed a Consumer Affairs Unit independently of the Supervisory Council. The role of Complaints Manager is to provide consumers of financial services with a free service for investigating complaints against financial entities. This has provided consumers with an additional channel of impartial redress by endeavouring to guide the parties to reach a mediated solution. The Unit is also heavily involved in consumer awareness and education initiatives.

On January 1, 2010 the MFSA adopted a new regulatory framework through changes in the manner in which the regulatory and supervisory functions are carried out within the Supervisory Council which is chaired by the Director General and is **attended as members by the Directors of the Supervisory Units (Banking, Securities and Markets, Insurance and Pensions), the Director of the Authorisation Unit, and the Director of the Regulatory Development Unit.**

The role of this Council is more operational and more directly influences supervision's on-going activities. Its designated role is to license, monitor and supervise all activities related to financial services. The primary objective of the reform was to deliver greater supervisory effectiveness and to ensure a better level of integration in the exercise of the regulatory functions. This greater harmonisation is expected to lead to a high level of consistency in functions such as licensing and risk-based supervision and improve co-operation and information-sharing across the Authority.

The new model for the Supervisory Council therefore represents an integrated approach to regulation and supervision being provided through a single Authorisation Unit, specialist Supervision Units for Banking, Insurance and Occupational Pensions and Securities and Markets, and a Regulatory Development Unit.

SUPERVISORY COUNCIL



The new Authorisation Unit is responsible for licensing of all financial services entities. The Unit receives and processes all applications for authorisation to conduct regulated financial services business in Malta. The remit of the new Regulatory Development Unit is to co-ordinate the development of cross-sector policy initiatives and to enable the MFSA to address market and regulatory developments as they arise. The Supervisory Units have a more focused risk-based approach to supervision with retained specialisations in banking, insurance and securities and markets.

1.3 Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT)

The Financial Intelligence Analysis Unit (FIAU) was set up in 2002 under the Prevention of Money Laundering Act (PMLA). Although the FIAU falls within the structure of the Ministry of Finance, the Economy and Investment, it is an independent agency and enjoys full autonomy in its operational activities. In accordance with Article 16 of the PMLA, the FIAU is responsible for the collection, collation, processing, analysis and dissemination of information with a view to combating money laundering and funding of terrorism.

1.4 The Maltese Financial Services Sector

As the Maltese economy becomes more service oriented, financial services are becoming important to the Malta's economic future. There is therefore a strong case for the industry to approach the sector's future growth with a strong determination to continue to push out the boundaries. A determination on the side of industry to compete and innovate will ensure a successful future and provide customers with more choice.

The financial services industry is valuable to Malta. It is therefore in the Malta's long-term and strategic interests to ensure that – subject to effective regulation and supervision – the financial services sector is improved and strengthened in order to maximise its contribution to the Maltese economy.

In terms of GDP, Malta is the 86 largest economy² The financial services industry has grown considerably in recent years although the real economy contracted by 2.2% in 2009 - after growing 2,1% in 2008 and 4% in 2007. Of a labour force of 177,532 (6/2010), about 7,000 are employed by insurers, financial intermediaries, and service providers. Another 1500 lawyers, accountants and other persons provide professional and ancillary services to the financial services sector. Despite this development, key figures show that there are still huge opportunities in the market.

² All figures taken from Sigma 2/2010 ("World Insurance 2009") and the CIA World Fact book

Malta's strengths have been its open market based economy, its regulatory, accounting and legal frameworks, its skilled labour force, its developing mass of financial services participants, as well as the use of English as a business language and the relative long-term stability and predictability of its tax regime.

The financial services industry is starting to play a vital role in the Maltese economy. The sector is much diversified and includes banking, insurance, asset management operations and a wide array of supporting professional services. The proportion of financial services in Malta is not high to warrant concerns about an “unbalanced” economy. The Gross Value Added (GVA) in the Financial Intermediation sector amounted to around 6 per cent of the total GVA in 2009 from 4.5 per cent in 2008 and 4.3 per cent in 2007. This is similar to the United States and less than Ireland and Luxembourg. The Gross Value Added per employee in the Financial Intermediation sector is around €50,000 per capita.

The industry is responsible for contributing almost 4.3 per cent of all tax collected in 2008, with total income tax collected from companies engaged in financial intermediation estimated to have reached over €100million in 2009 – financing much needed for Government revenue. It also contributes to the balance of payments by exporting services and products. In 2008, Foreign Direct Investment (FDI) flows in Malta in the Financial Intermediation sector amounted to 64 per cent of the total FDI while in 2007 it amounted to 28%.

Financial services also have a number of multiplier effects on the rest of the non-financial economy. This effect is vital to the national economy, for government and public services, for companies – whether international or domestic – and for citizens. Estimates for the total proportion of the economy made up by the financial services industry are difficult to resolve due to the effects of “financial intermediation services indirectly measured”. These include related services such as accountancy, legal and treasury services and the demand generated by the financial services sector for other indirect services, such as IT, telecommunications, publishing, hospitality and other business related. Data on these services is not normally published separately by the National Statistics Office.

The main core areas of the financial sector – banking, insurance, investments - support individuals and businesses by:

- providing finance for individuals, households, business and government,
- helping businesses and individuals manage their risks effectively, and
- allowing society to accumulate wealth through sensible investments.

Also payment systems and other types of financial services infrastructure such as clearing and settlement provide the mechanisms through which businesses and individuals can carry out transactions quickly and reliably through a global network.

The global financial crisis has had little or no direct effect on the Maltese financial services sector. None of the currently licensed banking institutions suffered a liquidity crisis although they suffered a lower return on their foreign investments which in some cases necessitated a strengthening of their balance sheet through the issue of corporate bonds.

1.4.1 Banking Sector

The Maltese banking sector consists of 23 credit institutions authorised to conduct business. Three of these are majority Maltese-owned while 20 are foreign credit institutions having a physical presence in Malta. 13 foreign credit institutions are from EU countries, five from non-EU countries and another two are branches from non-EU countries (Fig 1.1).

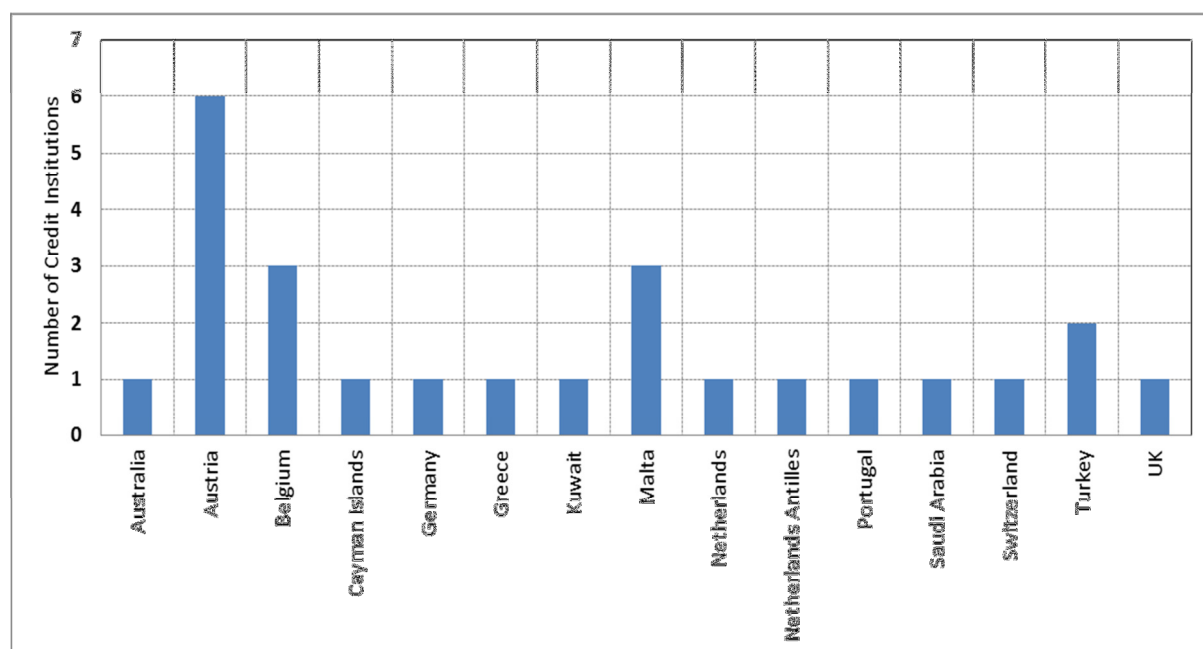


Figure 1.1: Number of Credit Institutions by Country of Origin of Major Shareholder

Complementing the traditional retail functions, banks are increasingly offering private and investment banking, project finance, treasury services and syndicated loans. Malta also hosts a number of institutions specializing in trade-related products such as structured trade finance, factoring and forfeiting.

At the start of the financial crisis in 2007, global banking operations experienced significant contractions in their balance sheets, however, the Maltese banking sector remained resilient due particularly to the strong capital base and liquidity of Maltese banks which continued to enjoy strong positive deposit to loan ratios. The banking system was reported to be the 13th soundest in the world by The World Economic Forum's Global Competitiveness Index 2009-2010.

During 2009, total deposits in the banking sector continued to grow, reaching €22 billion as of 31 December 2009, an increase of €0.7 billion or 3.1 per cent over 2008 and 13.8 per cent over 2007. In the domestic banking sector, total deposits amounted to €10.6 billion or 48.2 per cent of the total deposit liabilities in the banking sector. Deposits for the domestic banking sector in 2009 increased by 3.4 per cent over 2008. The corresponding figure for 2008 shows an increase of 1.3 per cent per cent over 2007 (Fig 1.2).

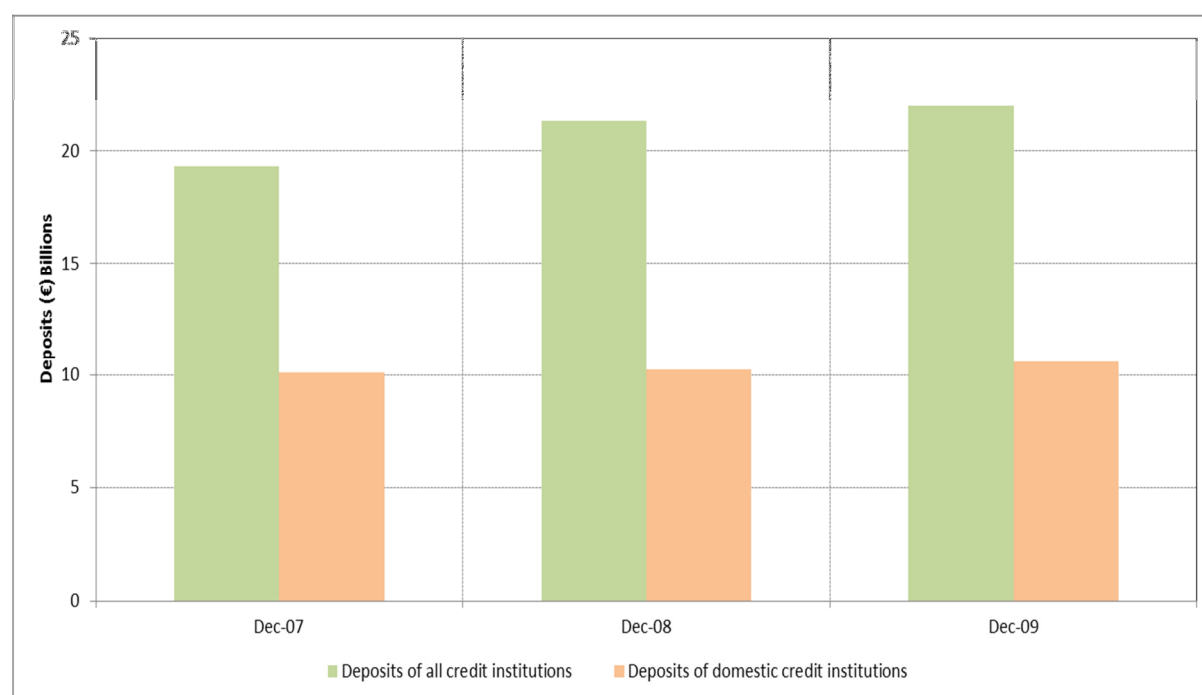


Figure 1.2: Bank Deposits of all Credit Institutions against Domestic Credit Institutions.

The prevalence of the traditional banking model in Malta, where banks fund their lending activities mainly from deposit taking, became more pronounced in 2008 and 2009 as it became increasingly difficult to tap liquidity from the international markets. It is clear that this model has paid dividends during the crisis. An analysis on the level of international lending and borrowing for 2009 by the banks licensed in Malta is illustrated in Figs 1.3 and 1.4 respectively.

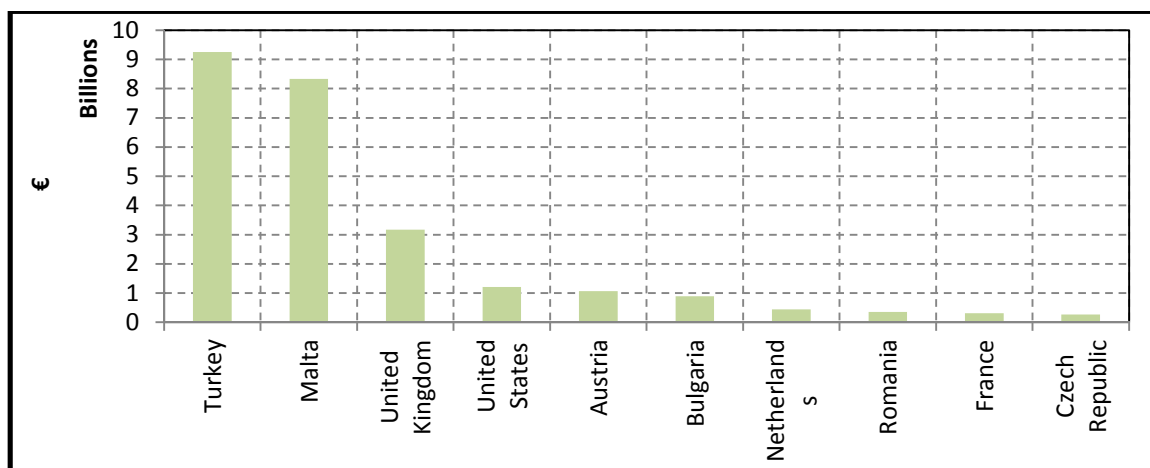


Figure 1.3: International Lending and Borrowing: Top Ten Countries by Assets

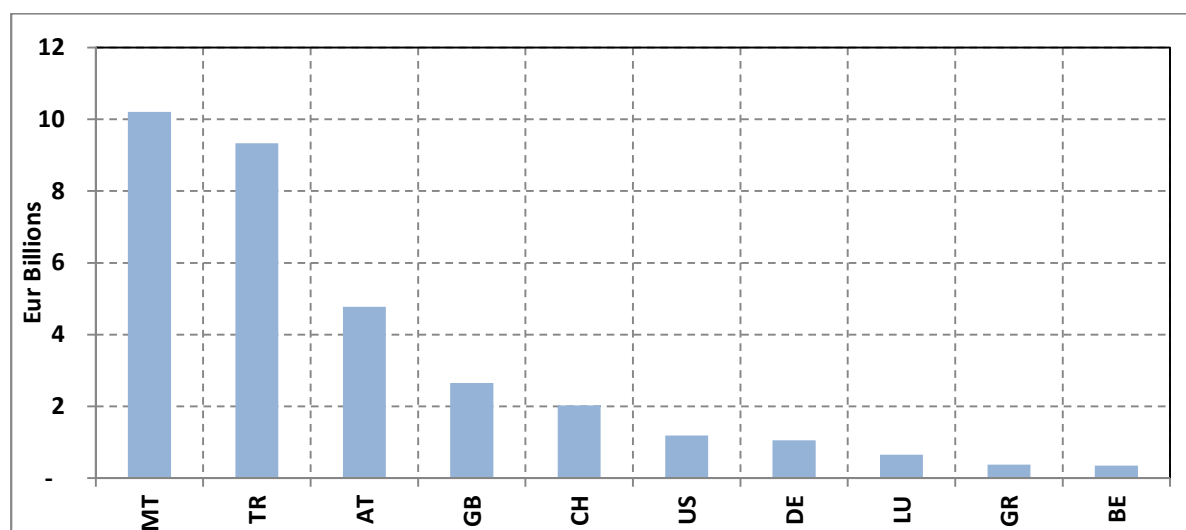


Figure 1.4: International Lending and Borrowing: Top Ten Countries by Liabilities

1.4.2 Investment Services Sector

The investment services sector continued to consolidate and expand with the establishment of more international providers. As at the end 2009, there were 88 investment services licence holders, an increase of 40% in the period 2007 – 2009. During this period, the number of authorized Category 2 investment services increased from 47 to 64 (Fig 1.5). Also other investment services companies had their licence extended to provide additional services.

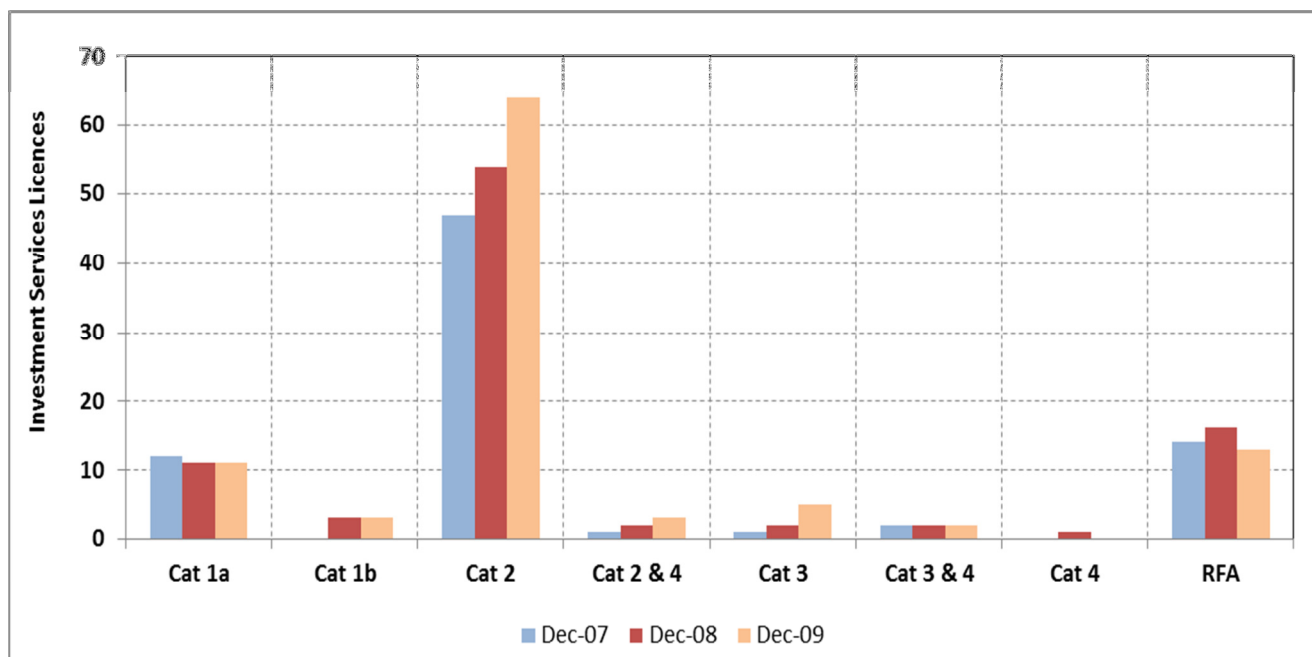


Figure 1.5 Investment Services Companies licensed during the Period 2007-2009

The number of newly licensed Collective Investment Schemes continued to increase overall although there was a slight decrease in the total number of licences in 2009. This was mainly due to secondary registered retail funds no longer being sold on the Maltese market. At the end of 2009, the total number of funds (including sub-funds) was 392 with the majority of the licences targeting Professional Investor Funds (Fig 1.6).

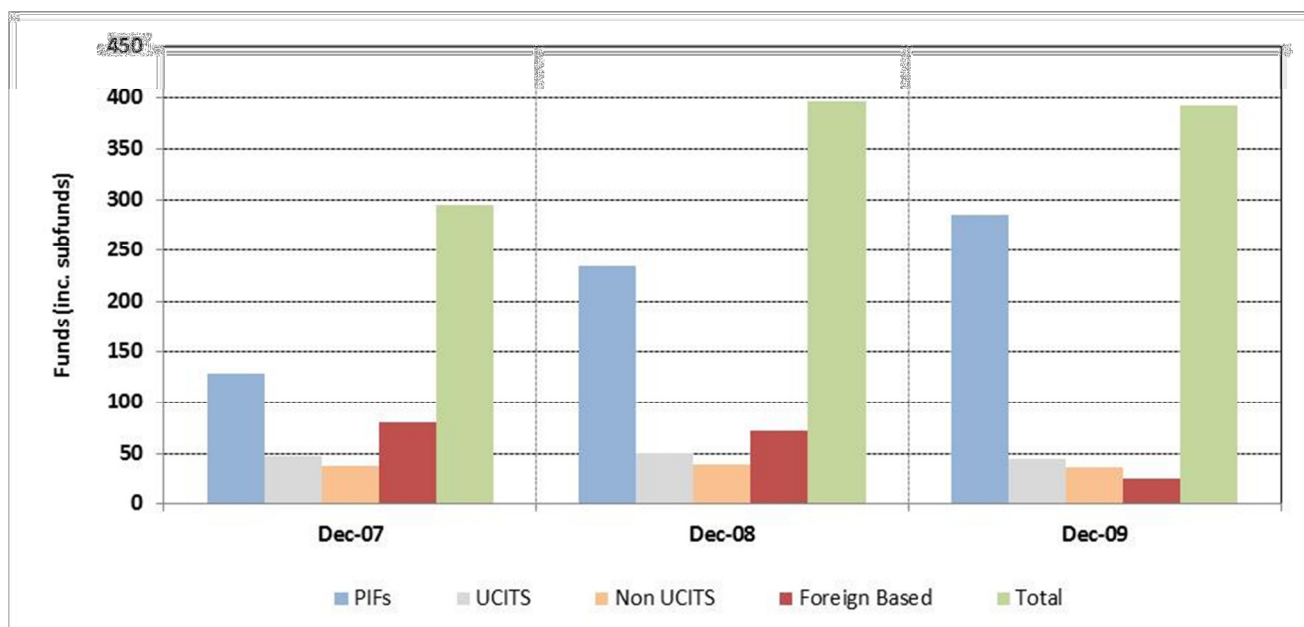


Figure 1.6 Collective Investment Schemes (including Sub-Funds) Licensed during the Period 2007-2009

The aggregate Net Asset Value (NAV) of Malta domiciled investment funds (PIFs, UCITS, and Non-UCITS) as at end of 2009 registered €7 billion. This represents a slight increase over the previous year. This increase in the NAV was due to a number of new funds starting operations during 2009 and a range of funds which started slowly recovering from the financial crises. Furthermore, a number of non-domiciled funds are also being serviced by Malta based fund and administration companies. The Net Asset Value (NAV) of these funds as at December 2009 amounted to around €0.8 billion.

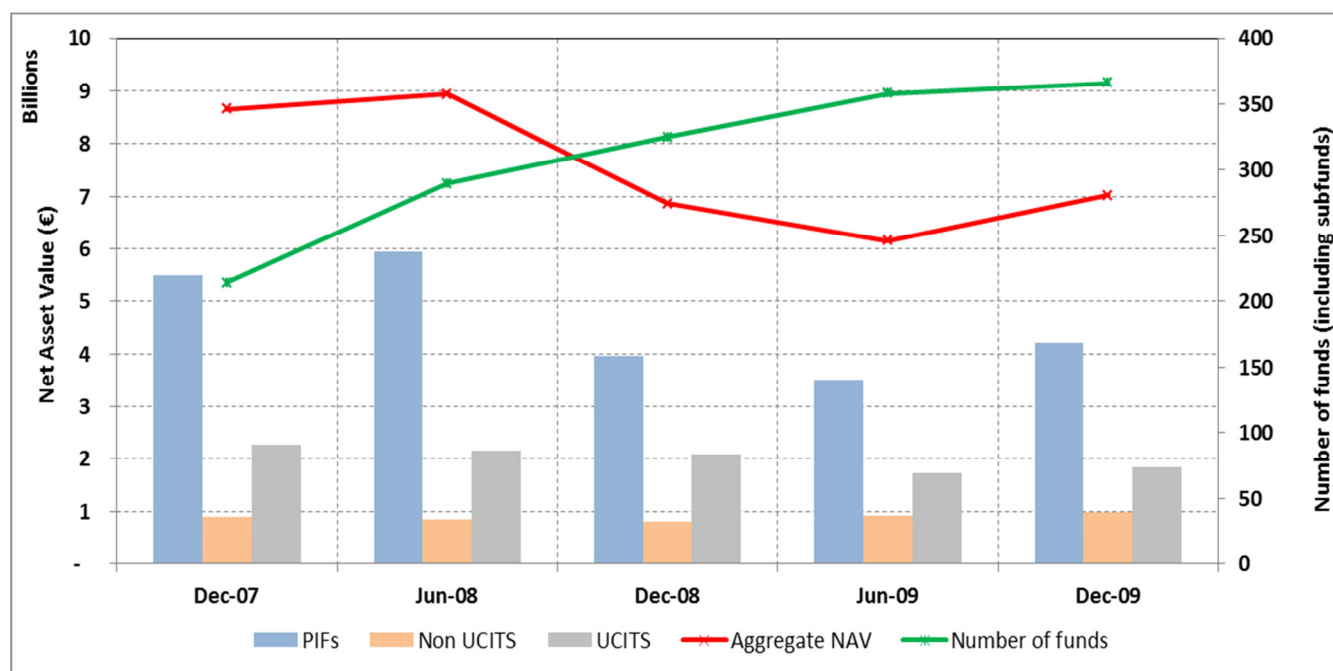


Figure 1.7 Net Asset Value against Number of Schemes (including Sub-Funds) for the Period 2007-2009

At the end of 2009, about 73 per cent of the Malta domiciled funds (including sub-funds) were managed from outside Malta, while 23 per cent of the funds were managed in Malta. Additionally, 4 per cent of the funds were self-managed funds. Also 46.8 per cent of the total funds domiciled in Malta were administered in Malta while 52.9 per cent of the funds were administered from outside Malta. Only 0.3 per cent of the funds are self-administered.

Malta has all the necessary infrastructure in place for the continued expansion of the investment services sector. Accountants are trained under IFRS, which Malta adopted in 1998. The World Economic Forum Report on Competitiveness (2009) places Malta 8th in the world regarding the strength of auditing and reporting standards. The challenge for the sector is to have sufficiently trained lawyers, accountants, investment managers, fund managers, fund administrators etc.

1.4.3 Insurance Sector

Malta has a developed insurance market (world rank 60³). In terms of insurance density Malta holds rank 33 world-wide with premiums per capita⁴ of € 657 (Life: € 430, Non-life: € 227), and rank 34 regarding market penetration with an overall rate of 4.7 (Life: 3.1, Non-life: 1.6). While these figures prove that Malta hosts an already developed insurance market, a comparison with some other regions and countries (Europe Top 10 average/Italy/France) suggests there is still room for growth. The Europe Top 10 average in terms of insurance density was € 3,706 in 2009, France stood at € 3,063 and Italy at € 1,958). The overall penetration of the EU Top 10 was 9.8% (Life: 6.56, Non-life: 3.22), France stood at 10.3 (7.2/3.1) and Italy at 7.8 (5.3/2.4)⁵.

Short after EU accession in 2004, there were 8 local insurers servicing the local market. By 30 June, 2010, 34 companies were authorised to carry out insurance business, plus 8 affiliated insurers and 3 Protected Cell Companies (Table 1.1).

Table 1.1: Authorised insurance undertakings in a timeline, 2004 – 2010

	Dec 2004	Dec 2005	Dec 2006	Dec 2007	Dec 2008	Dec 2009	June 2010
Local Insurers:							
Direct Insurers and Reinsurers	8	12	17	24	32	34	35
Affiliated Insurers	0	4	5	5	6	8	8
Protected Cell Companies	0	0	1	1	3	3	3
Foreign Insurers⁶	12	10	3	3	2	2	2

The section showing local insurers comprises 31 non-life insurers, 8 life insurers, 3 composites and 4 reinsurers. In addition, a number of EU/EEA insurers offer insurance services via the right of establishment (6 insurance companies) or the freedom to provide services (357 insurance and reinsurance companies).

³ in terms of premium

⁴ excluding cross-border business

⁵ Some of these figures taken from the Sigma report are provisional or estimated.

⁶ Insurers with its Head Office outside the EU/EEA which hold an authorisation to carry on insurance business in Malta

A separation of lines (general/long-term) has been established in line with EU Directives. Undertakings holding a licence for either of these lines may apply for taking up the other business under certain conditions⁷. IR 7/2009 regulates composites and calls for separate management of these lines as if the undertaking only ran business in one of these lines. Mainly, profits must not be mixed and the respective solvency margin must not be borne by the other kind of business. This option is only used by 3 composites.

Affiliated insurers (captives) and Protected Cell Companies (PCC) are particularly addressed in Maltese insurance regulations. In general, laws, rules and regulations are also applicable for affiliated insurers (captives and PCCs). However, they also benefit from facilitations in some ways, *inter alia*: captives are not required to publish in the newspapers their accounts, captives and companies writing insurance business outside of Malta need not contribute to the PCF and the custody of assets rules do only apply to non-EEA companies transacting business in Malta (LN 286/2007). An affiliated insurer may be set up as a PCC, the main effect being that assets in cells are segregated and protected from the liabilities of the company and of the other cells. On the market are 8 affiliated insurers and 3 PCCs administering 12 cells.

Insurance intermediaries are registered by the MFSA, or enrolled, if they are companies or tied intermediaries. At the end of 2009, 13 insurance managers, 16 agents, and 28 brokers were enrolled. Registered were 664 individuals, 23 of them being insurance managers, 28 agents, and 69 brokers. Besides, a vast number of agents and brokers from other EU/EEA Member States offer insurance services into Malta, mainly by freedom of services. Tables 1.2 and 1.3 show the largest companies in terms of assets and premiums.

Tables 1.2: largest companies in terms of assets.

	Line	Total Assets	
		in T €	Market Share %
Middle Sea Valletta Life	Life	1,004,598	25.6
HSBC Life Ass. (Malta)	Life	470,366	12.0
Munich Re of Malta plc	Reinsurer	435,672	11.1

⁷ Companies cannot carry on both long term business and general business unless the long term business is restricted to reinsurance; or the general business carried on by the company is restricted to accident and sickness (Article 9 IBA).

Multi Risk Indemnity	Non-Life	320,429	8.2
Ergon Insurance Ltd	Non-Life	245,770	6.3
"Big 5"		2.476.835	63,1

Table 1.3: Largest insurance companies / Gross Premium/Long-term and General insurance

Gross Premium					
Long term	in T €	Market Share %	General	in T €	Market Share %
Middlesea Valletta Life Assurance Co Ltd	122,081	37.6%	Multi Risk Indemnity Company Limited	157,006	22.2%
Munich Re	68,425	21.1%	Ergon Insurance Limited	65,173	9.2%
HSBC Life Assurance (Malta) Limited	55,898	17.2%	Munich Re	48,803	6.9%
Axeria Re Limited	18,544	5.7%	Nautilus Indemnity (Malta) Ltd	45,316	6.4%
Bavaria Reinsurance Malta Ltd	17,749	5.5%	White Rock Insurance (Europe) PCC Ltd	35,750	5.1%

On the way to an open insurance market in a flat world, market concentration has dropped considerably while the number of licenced undertakings has been considerably increasing. In 1999, the top three market players in long-term business held 99.3% market share (2009: 75.9%). During the same time, the top player in general business saw a decline in concentration from 70% to 22.2%. Concentration, at least in long-term business, is still high. Details are provided in Table 1.4.

Table 1.4: Insurance market concentration in the last years (in %)

Market Share %	1999	2004	2009
General business			
Largest Insurance Co.	70.0	40	22.2
3 Largest			38.3
10 Largest			71.1
Long term business			
Largest Insurance Co.	70.3	66	37.6
3 Largest	99.3	94	75.9
10 Largest			99.5

Table 1.5 shows how the insurance markets in Malta and Europe as a whole have become interdependent. 65.2% of shareholdings are in possession of EU-domiciled entities.

Table 1.5: Ownership of insurance companies

Maltese shareholding	21,7%
EU shareholding	65,2%
Non-EU shareholding	13,1%

Over the last 5 years, the market proved that was able to provide satisfactory returns in total (Table 1.6), showing quite impressive results for some years in each subsector (except composites, which can be considered a negative outlier and stressed the overall 2009 returns).

Table 1.6: Return on equity of insurance undertakings in Malta (in %)

	2005	2006	2007	2008	2009
Long term business	9.40	13.60	8.58	6.10	8.31
General business	18.60	6.40	18.77	11.55	5.57
Composites	-	2.60	6.12	-6.42	-80.40
Reinsurers	-	5.10	17.85	17.80	7.27
Total	15.70	8.0	14.86	10.01	0.73

Table 1.6 shows how insurance classes have contributed to overall premium growth over time. From 1999 to 2010, *General Liability* (with a growth factor of 81.9) and *Fire&Property* (53.7) were the classes which provided the strongest increase. In a 2005 to 2009 comparison, *Accident&Health* and *Aviation, Marine&Transport* showed the steepest growth (with factors of 7.2 and 6.6). In absolute terms, *Life* is the strongest contributor today (28.97%), closely followed by *Fire&Property* (28.91%).

Table 1.7: Insurance sector gross premiums written (in € m)

	1999	2005	2007	2008	2009
Long term					
Life		110.4	215.5	190.9	301.5
Unit linked		18.7	28.4	23.9	23.2
Total long term	43.1	129.1	243.9	214.8	324.6
General					
Accident and Health	2.5	8.76	25.4	50.2	63.6
Motor	12.3	54.5	61.5	88.5	111.5
Aviation, Marine and Transport	1.5	3.9	9.3	9.8	25.8
Fire and Other Damage to Property	5.6	66.9	274.3	313.4	300.9
General Liability	1.3	78.9	64.4	103.6	106.6
Credit and Suretyship	0.0	0.0	0.0	5.4	3.3
Others	0	0	73.7	78.7	104.3
Total	66.3	342.0	752.7	864.5	1,040.6

Fig 1.8 shows the diversification of investment portfolios of Maltese insurance companies. A high proportion of assets are invested in fixed-income securities and deposits while exposure to investment forms more volatile by nature seems modest.

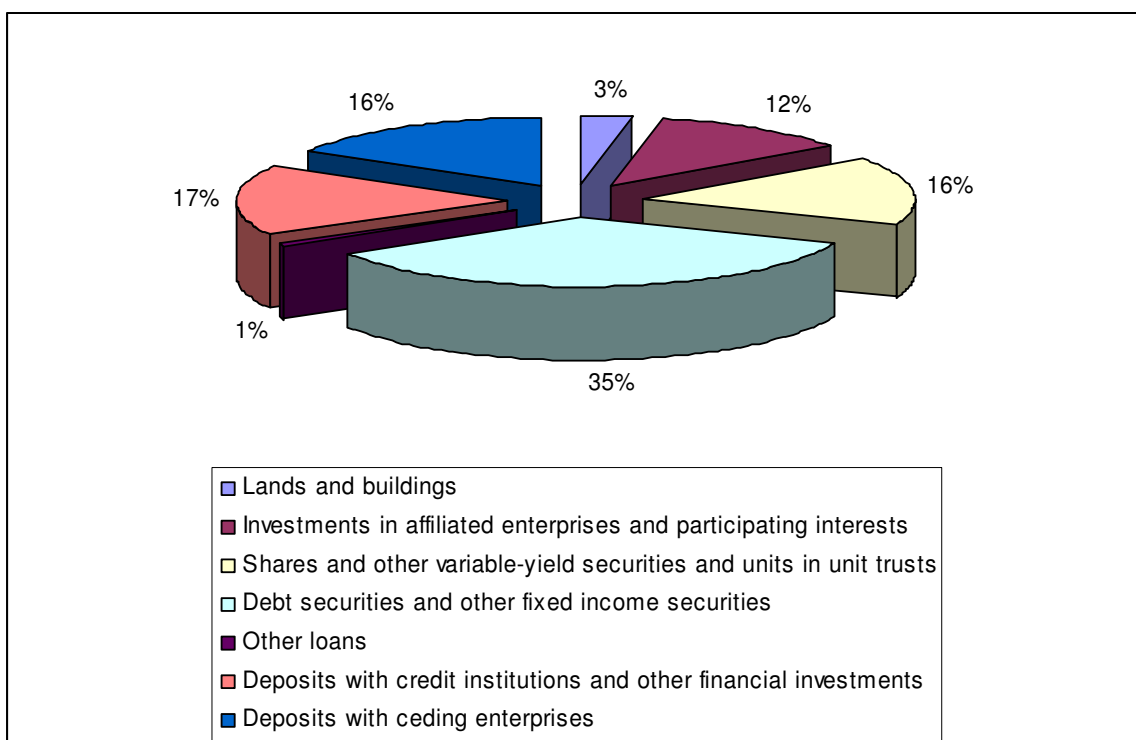


Figure 1.8. : Malta insurers' investment portfolio

Capital adequacy ratios (Table 1.8) have maintained more than comforting levels in the last years. During the financial crisis, rates have fallen quite noticeably, but are still maintaining very sufficient levels overall.

Table 1.8: Solvency cover 2007 – 2010 in %

Solvency Cover	2007	2008	2009	2.Q. 2010
Long-term	228	242	196	188
General	460	341	322	366
Reinsurers	501	772	498	334
Total	362	348	308	304

The pension sector itself as well as compliance to the IOPS Principles of Private Pension Supervision did not fall within the scope of the audit. Due to the rather small size of the sector, it was decided not to extend the scope of the assessment. Thus, some comments shall suffice. Encouraging steps have been taken to vitalize the pension business in Malta. At the time of the audit, four retirement schemes, four retirement scheme administrators, and three body corporates were authorised to carry out operations in Malta. The UK Revenue & Customs authority recognized Malta as a jurisdiction to which UK pensions could be transferred at the end of November. QROPS recognition

allows persons who are no longer resident in the UK to transfer pension benefits accumulated in a UK Recognised Pension Scheme to a recognized pension scheme situated outside the UK. The Special Funds (Regulation) Act of 2002, along with regulations (on subjects like registration of custodians, control of assets, registration fees etc.) and pensions directives (Standard Operational Conditions, guidance, forms etc.), provides a legal framework, but will be replaced by the Retirement Pensions Act soon. The new law is bound to offer more flexible arrangements and to attract multinational companies that may want to use Malta as a centre for their pensions-related operations. as a basis for the future development of the sector.

Chapter 2: Compliance of the Basel Core Principles for Effective Banking Supervision

An independent assessment to update the 2002/2003 FSAP evaluation was conducted during July 27-31 and September 6-7, 2010.

Piero Ugolini (former Assistant Director – IMF and mission Chief of the IMF/World Bank team that conducted the 2002/3 FSAP exercise) and Richard Nun (former Deputy Director – Texas Banking/Finance Commission, Austin-Texas; and currently peripatetic expert in banking Supervision – IMF and Centennial Group – Washington D.C.

2.0 General

As a part of the overall Malta FSAP 2002/3 assessment, a two-member team⁸ evaluated the effectiveness of banking supervision in October 2002. Banks in Malta are supervised by the Malta Financial Services Authority (MFSA), a consolidated supervisor that also oversees securities and insurance markets as well as Malta's company register system. As part of the update held in 2010 extensive discussions were held with the Director General of the MFSA, Director of Bank Supervision, managers and staff. Meetings were held with domestic, international, and offshore banks. Discussions were also conducted with external auditors, the Bankers Association, and the Financial Police (Economic Crimes Unit). The assessment benefited from information collected by other FSAP team members who evaluated compliance with the IAIS Core Principles, IOSCO Core Principles, the IMF MFP Transparency Code, and Anti-Money-Laundering/Combating Financing of Terrorism standards. The assessment team would like to thank its supervisory counterparts as well as all others for their full collaboration and openness and for the comprehensiveness of the provided information during all stages of the review.

As in the 2002/3 FSAP assessment, extensive discussions were held with all the relevant parties – directors, managers, and staff connected to the exercise. In the MFSA: the Chairman, the Director General, Banking Supervision Unit, Members of the Supervisory Council, Director Legal and International Affairs Unit, Authorisation Unit, and Regulatory Development Unit. The team met with the Permanent Secretary in the Ministry of Finance, Deputy Governor of the Central Bank of Malta, Director General of FIAU, and senior officials of the Malta Stock Exchange, Bank of Valletta, HSBC, Bawag and Mediterranean Bank. The team also met with representatives of the Malta Banking Association, the Malta Institute of Accountants, and the Auditors' Association.

The 2010 team would like to thank all the participants of the independent assessment for their full collaboration and openness and full disclosure of the relevant information.

2.1 Information and Methodology

The assessment was based on the Basel Committee's Methodology for assessing compliance with the *Basel Core Principles for Effective Banking Supervision*. Compliance with the Core Principles (CPs) has been assessed against both the "essential" criteria and "additional" criteria presented for each Principle in the Methodology. This indicates that the MFSA, in addition to seeking to fulfil the minimum standards, also strives to further apply international

⁸ Laura Ard (World Bank) and Paolo Corradino (Bank of Italy)

best practice. The assessment included a review of pertinent laws (Malta Financial Services Authority Act, Banking Act), *banking directives/rules*, banking notices, and selected legal notices as well as supervisory checklists and other related documents. Much of Malta's banking legislation, including directives/rules and other supporting documents, has recently been revised to further comply with European Union Directives and international practice. The assessment was based on the legislation and practice currently in place.

2.2 Regulatory and Legislative Developments

The independent assessment was based on a self-assessment performed by the newly re-structured Banking Supervision Unit (January 2010) and the revised October 2006 Basel Committee on Banking Supervision – Core Principles Methodology. The independent assessment 2010 was based on the legislation and practice in place in 2010. Below is the main list of the main Regulatory and Legislative changes occurred since the 2002 assessment.

Developments in 2004

During the year the Banking Unit affected a number of minor changes to Banking Rules. Most of the changes were included to bring the respective Rules in line with EU Directive 2000/12/EC.

The following subsidiary legislation was issued during the year:

- European Passport Rights for Credit Institutions Regulations, 2004
- Financial Conglomerates Regulations, 2004

By virtue of the Trust and Trustees Act 2004, minor amendments were also carried out to the Banking Act 1994 and the Financial Institutions Act 1994. These amendments provided the regulator with powers to issue directives for the supplementary regulation of credit and financial institutions when these institutions form part of a financial conglomerate.

The implementation of the MFSC Act in 1994 meant that no further licences for offshore banks could be issued. The legislation also provided for a ten year transition period, whereby existing banks under the 1988 Malta International Business Act had the option to convert to the onshore regime governed by the Banking Act (BA) and Banking Rules or close down their operations. Two banks opted to close down their operations while the other two converted to the onshore regime under the BA.

Developments in 2005

Various amendments were undertaken to a number of Banking Rules during the year. A major change carried out concerned the updating of schedules relating to the Statutory Financial Information in Banking Rule BR/06.⁹

⁹ In the context of the 2002/3 FSAP the term "Banking Directives" (BD) was used. However in 2007 the term "Banking Rules" (BR) was introduced in order to distinguish BD from European Union (EU) Directives.

The Electronic Money Institutions Directive EMID/01 was amended in order to exclude electronic money institutions operating under waiver conditions from benefiting under the provisions of the European Passport Rights for Credit Institutions Regulations. The amendment brought the Rule in line with Article 8(2) of the Directive 2000/46/EC. Changes were also incorporated to the European Passport Rights for Credit Institutions. Regulations were revised to include Electronic Money Institutions as provided for under EU Directive 2000/12/EC

The MFSA commenced the process of evaluating proposed amendments to a number of Banking Rules which would need to be amended with the provisions of the Capital Requirements Directive (CRD).

Also reviewed was Banking Rule BR/03 to bring it in line with CEBS Guidelines on prudential filters.

Developments in 2006

The MFSA continued with the process initiated in 2005 of evaluating the revision to the Banking Act 1994 as well as amendments to a number of Banking Rules which needed to be brought in line with the provisions of the Capital Requirements Directive (CRD) 2006/48/EC of the European Parliament and of the Council of the 14 June 2006 **relating to** the taking up and pursuit of the business of credit institutions (Recast) and Directive 2006/49/EC of the European Parliament and of the Council of the 14 June 2006 on the Capital Adequacy of Investment Firms and Credit Institutions (Recast). This comprised the transposition of those Directives through Banking Rules BR/01, BR/02, BR/03, BR/04, BR/06, BR/07, BR/08, BR/09 and BR/10.

Moreover, Banking Rule BR/06 was also amended in conjunction with the Central Bank of Malta to fine tune certain reporting aspects in line with regulatory and accounting standards. In addition a number of amendments reflecting the European Central Bank reporting requirements were also introduced. A series of technical and information meetings were held with credit institutions to explain the changes resulting from the transposition process and to evaluate problems identified during the parallel run exercise for the submission of returns by credit institutions carried out in July 2006.

Developments in 2007

As a result of the introduction of the Capital Requirements Directive (CRD) (2006/48/EC) and the Directive on Capital Adequacy of Investment Firms and Credit Institutions (Recast) (2006/49/EC) which came into effect in June 2006, the MFSA was required to amend the Banking Act as well as the relative Regulations issued thereunder. Following the work carried out on the Banking Act during 2005 and 2006, the relative revisions were approved by Parliament in 2007.

Work continued in order to transpose the above Directives into Banking Rules. This included all the amendments necessitated by the introduction of the CRD. The transitional period for adopting the CRD expired at the end of 2007 and therefore, as from 1 January 2008, all credit institutions were bound to abide by all the provisions.

As at end 2007 the necessary amendments to BR/02 (Large Exposures), BR/04 (Capital Requirements), BR/05 (Liquidity), BR/06 (Statutory Information), BR/10 (Consolidated Supervision) and BR/11 (Arm's Length Principle) had been carried out and the MFSA's

Banking Directives were transposed into Banking Rules, BR/03 (Own Funds) and BR/07 (Publication of Audited Financial Statements) were also amended and were at the consultation stage. However, work on the “old” Banking Directives BD/01 (Application Procedures and Requirements) and BD/08 (Capital Adequacy) has been practically concluded and these were issued for consultation during the first quarter of 2008.

During 2007, the Banking Unit also adopted the CEBS Guidelines on Pillar II of the CRD (GL03 issued on 25 January 2006) as well as the Guidelines on outsourcing by credit institutions (issued by CEBS on 14 December 2006) into a draft Banking Rule BR/12 (Guidelines for the Supervisory Review Process) and BR/13 (Outsourcing) respectively. These new Banking Rules were issued for consultation during the first quarter of 2008.

The CEBS Supervisory Disclosure Framework under Article 144 of the CRD was also launched on the MFSA website. The aim of the Supervisory Disclosure Framework is to allow meaningful comparisons of supervisory rules and practices across EU Member States, to enhance the effectiveness of supervision and to help promote a level playing field among EU Member States. The tables of information which are available from the website: www.mfsa.com.mt (Banking/Supervisory Disclosure) were developed by the CEBS Working Group on Supervisory Disclosure. Similar data is available on the websites of Competent Authorities in other EU Member States.

The Working Group composed of representatives of the MFSA, the Central Bank and the Ministry of Finance, and which was set up following the signing of the Memorandum of Understanding on Co-operation between Banking Supervisory Authorities, Central Banks and Finance Ministries of the EU regarding crisis situations in May 2005, held six meetings during 2007. The Group drew up a draft Framework for Crisis Management which seek to identify gaps in the legislation in the event of a crisis situation. A crisis simulation exercise organised between the three entities was supervised by an expert on crisis management from the Central Bank of Ireland. The main aim of this exercise was to test the exchange of information between the MFSA, the CBM and the Ministry of Finance in a crisis situation. Moreover, following the publication of the Payments Services Directive (PSD) in November 2007, the MFSA was also involved in meetings with the Central Bank of Malta to discuss the transposition of the Directive by November 2009.

Developments in 2008

The process of converting of Banking Directives and Financial Institutions Directives to an updated set of Rules which had begun during the previous year continued during 2008.. Rules published by the MFSA constitute the third tier of legislation below Primary Legislation (Acts of Parliament) and Subsidiary Legislation (Legal Notices).

Banking Rule 12 (Supervisory Review Process – Pillar II) was finalised and came into force in July 2008. The revision of Banking Rules BR/01 (Application Procedures), BR/03 (Own Funds Requirement) and BR/07 (Publication of Audited Financial Statements) in compliance with the process of implementation of the Capital Requirements Directive continued to be implanted.

Work was also started on BR/09 (Credit and Country Risk Provisioning) to incorporate the changes mainly arising from new International Financial Reporting Standards (IFRS) and on BR/14 (Outsourcing). The MFSA issued consultation documents on these two Banking Rules.

The drafting of amendments to the Financial Institutions Act, 1994 and of a new Financial Institutions Rule aimed at the implementation and transposition of the EU Payment Services Directive (PSD) was initiated. A number of consultation meetings were also held between the Banking Unit and the Central Bank of Malta.

During 2008, the following Legal Notices (LN) were published:

LN 57 European Passport Rights for Credit Institutions (Amendment) Regulations, 2008

LN 76 Banking Act (Capital Adequacy) Regulations, 2008

LN 163 Interest Rate on Offshore Loans (Repeal) Order 2008

LN 351 Credit Institutions (Fees) (Amendment) Regulations, 2008

LN 352 European Passport Rights for Credit Institutions (Amendment) Regulations, 2008

Developments in 2009

The Financial Institutions (Amendment) Bill (Cap. 376) transposed the provisions of Title I and Title II of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC (“Payment Services Directive”). The transposition of the Payment Services Directive (PSD) has also involved the updating of Financial Institutions Rules FIR/01 and FIR/02.

The process concerning the transposition and implementation of Directive 2007/44/EC of the European Parliament and of the Council of 5 September 2007 amending Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector (“The Acquisitions Directive”) was finalised in 2009. The transposition process entailed amendments to the Banking Act, as well as the drafting of a new rule, Banking Rule BR/13. During the drafting process the MFSA was guided by the 3L3 Committees of European Financial Supervisors (CEBS, CESR and CEIOPS) Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC issued on 18 December 2008. Banking Rule BR/13, which eventually came into force on 1 January 2010.

Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC (“E-Money Directive”) was published in the Official Journal on 10 December 2009. In the months leading up to the publication of this Directive, the Banking Unit submitted comments on the draft text of the proposed Directive to the EU Working Party on the E-Money Directive. The transposition process of this Directive is expected to be finalised by end of 2010.

During 2009, the MFSA proceeded with the revision to the Banking Act and the Banking Rules in line with the Capital Requirements Directive (‘CRD’). Banking Rule BR/03/2008 dealing with own funds of credit institutions was updated in line with the requisites of the Capital Requirements Directive – Chapter 2 – “Technical Instruments of Prudential Supervision” and the CEBS publication dated 21 December 2004, entitled “Guidelines on Prudential Filters for Regulatory Capital”.

During the year the MFSA also provided feedback on the proposed amendments to Directives 2006/48/EC and 2006/49/EC relating to capital requirements for the trading book and for re-securitisation and supervisory review of remuneration policies. Following the introduction of Directive 2009/27/EC of 7 April 2009, amending certain Annexes to Directive 2006/49/EC of the European Parliament and of the Council as regards technical provision concerning risk management, the Banking Unit further amended Banking Rule BR/08 dealing with the capital adequacy of credit institutions authorised under the Banking Act 1994.

Following the consultation procedure, the MFSA issued Banking Rule BR/14/2009 on outsourcing of credit institutions. This Rule was drafted in line with the CEBS publication dated 14 December 2006, entitled “Guidelines on Outsourcing”. The MFSA felt the need to implement the principles underlying the aforementioned CEBS Guidelines due to the increasing use of outsourcing by credit institutions, including on a cross-border basis, and its implications for effective prudential supervision.

The Depositor Compensation Scheme Regulations were amended to transpose the provisions of Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards coverage level and pay out delay.

During 2009 the following Legal Notices (LN) were published:

LN 227 of 2009 Depositor Compensation Scheme (Amendment) Regulations, 2009

LN 355 of 2009 European Passport Rights for Credit Institutions (Amendment) Regulations, 2009

2.3 Institutional and macro-prudential setting—market structure

As at the 2002/3 FSAP assessment, the MFSA was the consolidated supervisor charged with the oversight of Malta’s financial sector including credit and financial institutions (including banking), insurance, investment services.. The MFSA also acts as the Registrar of Companies. The MSE regulatory role was transferred to the MFSA on October 1, 2002. The CBM also possessed financial sector oversight responsibilities through the conduct of its monetary policy, monitoring the overall financial stability of the system, and in operating and overseeing payment systems. The MFSA and the CBM operate in partnership and at the 2002/3 FSAP were in the process of formalizing arrangements for sharing of information and cooperative operating agreements.

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A Memorandum of Understanding (MOU) was signed between the CBM and MFSA on 4 February 2003 covering the Exchange of Information in the fields of Financial Services.

Malta became an EU member state, as from May 2004. A Memorandum entered into effect on 1 June 2008 and replaced the Memorandum of Understanding on Cooperation between the Banking Supervisors, Central Banks and Finance Ministries of the European Union in Financial Crisis Situations, which entered into force on 1 July 2005.

The Banking Supervision Unit (BSU) has one director supported by three deputy directors in charge of the functional activities: Banking Regulation and Compliance, Onsite Supervision, and Offsite Supervision and Methodology. A total of 20 staff work in the banking supervision unit. Banking Supervision is guided by goals and objectives of the MFSA Act an enumerated in an internal procedures document. Banking supervision has adopted a “risk-based” approach which integrates each of the pertinent supervisory functions into the oversight activity. Suggestions for fine-tuning the supervisory policy, approach, and bank strategies are provided in various areas of the assessment that follows.

Resources allocated to the BSU ensure that personnel are provided with technical training through attendance at seminars and conferences both locally and overseas. BSU personnel participate in EU and CEBS working groups either remotely or through attendance at meetings of particular working groups where necessary. However, the BSU makes it a point that senior officials attend all meetings of colleges of supervisors.

The Maltese banking system consists of a domestic and an international component operating independently of one another. The domestic component is highly concentrated and consists of four banks. Two of these (Bank of Valletta and HSBC Malta) are roughly of comparable size. They dominate the system and represent between them more than 90 per cent of domestic system assets with almost equal share of the deposit base and loan markets for residents. They are perceived to be “too big to fail”. As a matter of fact, Moody’s credit ratings for these two banks are explicitly based on this assumption. They also dominate the non-life insurance and securities sector through subsidiaries and affiliates.

As a result, two of the offshore banks were to relinquish their offshore status; one merged into HSBC Malta and the other acquired an onshore license to operate both domestically and internationally. The third plans to acquire an onshore international banking license in late 2003. This will complete the process of bringing past offshore activities under the now existing common umbrella of financial supervision and regulation.

The Government has relatively limited involvement in the banking system. It has divested much of its ownership and currently has a remaining holding (25 per cent) in the large domestic bank, Bank of Valletta. The Government’s stake and the original Banco di Sicilia holding (15 per cent) now owned by Unicredito are for sale. However, the Government has yet to find a buyer that it could accept as a suitable strategic partner for Bank of Valletta, since potential buyers do not seem to be interested in a minority share of the bank. Currently Bank of Valletta is no longer on the market. The government’s share remains at 25%.

Financial soundness indicators and stress test results suggest that the domestic banks are currently healthy, albeit exposed to Malta’s narrow economic base. As a result, the resiliency of the banking system could be strained in the event of a systemic crisis. This is largely due to three structural factors: (i) the banking system is dominated by two large banks, which makes the system as a whole highly dependent on these two banks’ financial condition; (ii) banks might have difficulty coping with shocks that are more systemic in nature due to the limited diversification of their loan portfolios; and (iii) the banks’ ability to absorb unexpected declines in the average quality of their credit exposures is heavily dependent on their ability to liquidate the collateral pledged by borrowers at prices that are broadly consistent with the face value of the collateral

The MFSA and the CBM drew attention to the CEBS (Committee of European Banking Supervisors of the European Union) stress test exercise that was undertaken by all EU Member States in July 2010. The supervisory authorities in each Member State were involved in this exercise which was conducted in close co-operation with the European Central Bank (ECB).

Consequently, since the authorities were not required to take subsidiaries of foreign banks operating in Malta into consideration, Bank of Valletta plc, which has a substantial share of the domestic banking market, was selected to be stress tested by the national authorities.

The Central Bank of Malta and the Malta Financial Services Authority collaborated with Bank of Valletta plc in order to carry out the stress test exercise applying the set parameters within the established macro-economic scenarios that also include an assessment of sovereign risk.

The results of the stress tests of all participating banks were made public on 23 July 2010.

2.4 General preconditions for effective banking supervision

The setting and circumstances in which the banking sector operates are generally satisfactory. The legislative framework for banking law and the powers provided to the MFSA to set implementing regulation are adequate although certain issues were cited in the assessment below. However, the legislative framework surrounding collateral and loan recovery requires strengthening. The foreclosure process can be lengthy and costly given the inefficiencies in the legal system. This is particularly critical as approximately 75 per cent of the collateral held by banks is in the form of real estate. Although the value of real estate has historically demonstrated a consistent upward trend, the process of valuing real estate, banks' review of appraisal reports, and the supervisor's process of assessing collateral values for purposes of asset classification and provisioning should be evaluated to ensure prudent and realistic valuations.

The financial and enterprise sectors are required to use International Accounting Standards (IAS). Banks are audited according to international standards by recognized international auditing firms. The MFSA has full access to the auditors' reports and to the auditors themselves. The Banking Act provides the supervisor with the powers to hold trilateral meetings with the bank and the auditors as well as to prescribe as necessary additional needed auditor reviews. Discussions within the banking sector indicated that good communications exist between all parties.

The payment and securities settlement infrastructure in Malta is generally sound. Some areas are sophisticated with a high level of automation, such as the RTGS system, MaRIS, and the technical operation of the securities settlement system. However, certain issues exist which require attention and are addressed elsewhere in this report. They include the need to streamline the retail payments infrastructure, the need to adopt and implement the delivery versus payment securities settlement process, and the need to ensure continuous, on-going and effective regulation and supervision of the Central Securities Depository.

The Maltese legislature finalised the transposition of the Payment Services Directive (PSD) into domestic legislation. CBM Directive No 1 (incorporating Titles III and IV of the PSD) was issued in October 2009. Changes to FIA relating to Titles I and II of the PSD have been issued in March 2010 and FIR/01 with the relevant changes relating to the set-up of PIs was subsequently issued. The BSU is in the final stages of issuing FIR/02 with the relevant amendments relating to the technical aspects of capital adequacy requirements of PIs arising from the PSD.

The bank supervisor to date has not resorted to severe forms of remedial actions or license revocation. Notwithstanding, a broad framework for resolution of distressed banks is provided in the banking legislation. While these powers can be deployed as the supervisor deems necessary, there is a need to develop additional intermediate tools to help facilitate remedial supervisory action on a timely basis. These additional tools and/or steps might include the use of prompt corrective action steps that are triggered by defined capital adequacy thresholds or other supervisory concerns and that are intensified on a graduated basis. Written corrective action plans or agreements entered into by the supervisor and the given bank could also be considered. Additional elements are discussed further in the assessment that follows, including the supervisor's actual use of corrective action tools and the timeliness of actions therein, that could further strengthen the corrective action toolkit.

The Central Bank prepared a contingency plan in 2000/2001 that was designed to help coordinate actions in the event of a crisis. This plan was updated, partly as a result of the creation of the MFSA. It outlines various actions to be taken given the nature and severity of a financial market crisis. An MOU was agreed and signed February 4, 2003.

The legislative amendments enabling the setting up of a Deposit Guarantee Scheme and the Investor Compensation Scheme were approved by the Parliament in July 2002 and entered into force on January 3, 2003. The Scheme is under the general control of a Management Committee, appointed by the MFSA, and will be a body corporate having a distinct legal personality. Its objectives are to establish arrangements, after consultations with the Competent Authority, for the making of payments to depositors, to manage contributions made by participants, and to advise the MFSA on matters related to the compensation of depositors.

Every credit institution that is licensed in Malta under the Banking Act participates in the Scheme, including a branch of a credit institution operating in another country. The total amount of compensation that may be paid out to any depositor is the lesser of 90 per cent of that depositor's eligible deposits, or up to Lm 8,500 (in line with the EU minimum level of protection of €20,000).

Pursuant to the agreement of the Ecofin Council meeting of 7 October 2008, the Government on 8 October 2008 announced that the level of depositor protection was increased from €20,000 to €100,000.

2.5 Principle-by-principle assessment

The assessment of the CPs is based on a five-part assessment system: compliant, largely compliant, materially non-compliant, non-compliant, and non-applicable. A principle is considered **compliant** whenever all essential criteria are generally met without any

significant deficiencies. A principle is considered **largely compliant** whenever only minor shortcomings are observed, which do not raise any concerns about the authority's ability and intent to achieve full compliance with the principle within a prescribed period of time. A principle will be considered **materially non-compliant** whenever, despite progress, the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance. A principle will be considered **non-compliant** whenever no substantive progress toward compliance has been achieved. A principle will be considered **non-applicable** whenever, in the view of the assessor, the CP does not apply given the structural, legal and institutional features of a country.

At the MFSA's request, each Core Principle was assessed using both the essential and additional criteria prescribed by the Core Principles Methodology. However, consistent with Basel Committee guidance, the ratings that follow are based on the essential criteria to allow for standardized comparisons of ratings across countries. Notwithstanding this, the methodology directs that the assessment must "consider a chain of related requirements, which may encompass laws, prudential regulation, supervisory guidelines, on-site examinations and off-site analysis, supervisory reporting and public disclosures, and evidence of enforcement or non-enforcement." It further directs that "the assessment must be in sufficient depth to allow a judgment on whether criteria are fulfilled in practice, not just in concept. Laws and regulations need be effectively enforced and complied with.

2.6 Main findings of the 2010 Independent Assessment

Considerable progress has been made by the MFSA after taking over the responsibility of supervising the banking sector from the Central Bank of Malta in January 2002. Subsequently, the entry into the EU in 2004 has had the main impact of introducing in the Malta financial sector all the EU Directives aimed at strengthening and ameliorating the soundness of the banking sector. As a result of these relevant changes, this audit has found a significant improvement in the overall compliance to the BCPs (Table 2.1).

As shown in the Tables 2.2 and 2.3, this independent assessment concludes that the MFSA is "Compliant" with twenty Principles and "Largely Compliant" with the five remaining Principles; there are no instances where the MFSA is Materially Non-Compliant or Non-Compliant. This compares favorably with the 2002/2003 FSAP where the MFSA was "Compliant" with eleven Principles, "Largely Compliant" with twelve Principles, and "Materially Non-Compliant" with one Principle (Table 2.4).

As recommended in the 2002/3 FSAP, the MFSA and the CBM signed an MOU in February 2003 to share information and operate in partnership. This cooperation is working very well. Relevant information is shared between the two authorities and the MFSA contributes to the preparation of the Stability Report prepared by the CBM. In May 2005, another MOU between CBM, MFSA, and MOF was signed to work together on a crisis situation. A simulation exercise was conducted in 2007 with the assistance of an outside expert from the Central Bank of Ireland.

Table 2.1 below summarizes the main recommendations to improve Compliance, and extensive discussions on detailed measures and steps to be taken were discussed with the MFSA officials during the audit.

The main challenges facing the MFSA are the growth and the proliferation of products and services within the banking sector. Therefore, the MFSA should continue the ongoing policy of recruiting and retaining qualified staff and providing training to keep pace with the growth and sophistication of the banking sector. The recent re-organization within the MFSA and the consolidation of licensing under the Authorization Unit is a positive response to these challenges. The policy of using assistance of foreign experts for specialized training and advice should continue. The current cumbersome procedures to recruit MFSA staff should be streamlined and shortened.

Table 2.1 Recommended Action Plan to Improve Compliance with the Basel Core Principles (2002/3 FSAP)

Reference Principle	Recommended Action
CP 1 – Objectives, independence, powers, etc. CP 1.2 Independence, etc.	Obligations arising from new/amended EU legislation, new regulatory requirements, and the need to increase the scope and frequency of on-site inspections will require additional staff. The MFSA should explore alternatives for recruiting and retaining well-qualified staff, particularly for the Banking Supervision Unit.
CP 1.4 Legal powers	The issue of monetary fines should be re-visited with the two-fold aim of (i) more explicitly defining the circumstances when fines will be applied and (ii) more closely linking the amounts of fines to the severity of the infraction.
CP 11 – Exposures to related parties	Further consideration should be given to deducting the aggregate of connected party exposures from capital for capital adequacy calculations; also, an aggregate limit should be established, relative to capital, for the total of all exposures to all connected persons.

<p>CP 19-21 – Methods of on-going supervision</p> <p>CP 19 Supervisory approach, and</p> <p>CP 20 Supervisory techniques</p>	<p>As a matter of standard practice, regular meetings should be held with bank management and boards of directors. At a minimum, two types of meetings are recommended: (i) a tri-partite meeting involving the MFSA, the external auditor, and bank senior management (including the internal auditor), the purpose of such meeting being to review the results of the annual external audit; and (ii) a meeting with the board of directors of a bank following each full scope examination, the purpose being to review the findings and conclusions of the examination and to solicit feedback from non-executive directors and allow them to ask questions directly to the regulator.</p>
<p>CP 23 – Corrective and remedial powers</p>	<p>Adopt and follow a formal policy for applying corrective measures and regulatory enforcement actions. For optimal benefit, the policy should link the form and content of a regulatory response to objective, measurable criteria tied to the nature and severity of bank condition and operations, e.g. capital adequacy, violations of laws or rules, unsafe or unsound banking practices, mismanagement. The policy should provide for progressively more restrictive sanctions as risk increases yet allow for judgment and discretion to tailor independents to unique circumstances.</p>

Table 2.2 Update 2010 Independent Assessment - Summary Compliance with the Basel Core Principles—ROSCs

Core Principle	Comments
1. Objectives, independence, powers, transparency, and cooperation	Compliant
1.1 Responsibilities and objectives	Compliant
1.2 Independence, accountability and transparency	Largely Compliant – Pending legislation to become Compliant
1.3 Legal framework	Compliant
1.4 Legal powers	Compliant – Monetary fees more explicit
1.5 Legal protection	Compliant
1.6 Cooperation	Compliant
2. Permissible activities	Compliant
3. Licensing criteria	Compliant

4. Transfer of significant ownership	Compliant
5. Major acquisitions	Compliant
6. Capital adequacy	Compliant
7. Risk management process	Compliant
8. Credit risk	Compliant
9. Problem assets, provisions, and reserves	Compliant
10. Large exposure limits	Compliant
11. Exposure to related parties	Largely Compliant- Consider aggregate limit
12. Country and transfer risks	Compliant
13. Market risks	Compliant
14. Liquidity risk	Compliant
15. Operational risk	Compliant
16. Interest rate risk in the banking book	Compliant
17. Internal control and audit	Compliant
18. Abuse of financial services	Compliant
19. Supervisory approach	Largely Compliant-Meet with management board
20. Supervisory techniques	Largely Compliant - see CP19 above
21. Supervisory reporting	Compliant
22. Accounting and disclosure	Compliant
23. Corrective and remedial powers of supervisors	Largely compliant- Adopt formal policy corrective actions
24. Consolidated supervision	Compliant
25. Home-host relationships	Compliant

Table 2.3 Update 2010 Independent Assessment - Summary Compliance with the Basel Core Principles—Detailed Assessments

Core Principle	Grading	Comments
1. Objectives, independence, powers, transparency, and cooperation	C	
1.1 Responsibilities and objectives	C	

1.2 Independence, accountability and transparency	LC	Appointment of MFSA as the competent authority for banking supervision and publicly disclosing reasons for dismissal are necessary to fully comply with this principle. Additional resources are needed in terms of well-qualified, experienced personnel for the Bank Supervision Unit. The recruitment process must be streamlined and shortened.
1.3 Legal framework	C	
1.4 Legal powers	C	Notwithstanding the current practice and deterrent effect of public disclosure for non-compliance, the circumstances for which monetary fines will be imposed could be defined more explicitly and the amounts of fines linked more closely to the severity and nature of infractions.
1.5 Legal protection	C	
1.6 Cooperation	C	
2. Permissible activities	C	
3. Licensing criteria	C	
4. Transfer of significant ownership	C	
5. Major acquisitions	C	
6. Capital adequacy	C	
7. Risk management process	C	
8. Credit risk	C	
9. Problem assets, provisions, and reserves	C	
10. Large exposure limits	C	
11. Exposure to related parties	LC	Current best practice is to deduct the total of connected party exposures from capital for capital adequacy calculations and also to impose an aggregate limit, relative to capital, for the total of all exposures to all connected persons.
12. Country and transfer risks	C	
13. Market risks	C	
14. Liquidity risk	C	
15. Operational risk	C	

16. Interest rate risk in the banking book	C	
17. Internal control and audit	C	
18. Abuse of financial services	C	
19. Supervisory approach	LC	As standard practice, meetings should be held with bank management and/or boards of directors on at least two occasions: following receipt of the annual external audit report, and at the conclusion of each full-scope on-site examination.
20. Supervisory techniques	LC	(refer to comment above)
21. Supervisory reporting	C	
22. Accounting and disclosure	C	
23. Corrective and remedial powers of supervisors	LC	Adopt a formal policy for applying corrective measures and enforcement actions with responses tied to condition and performance and progressively applied.
24. Consolidated supervision	C	
25. Home-host relationships	C	
Aggregate: Compliant (C) – #, Largely compliant (LC) – #, Materially noncompliant (MNC) – #, Noncompliant (NC) – #, Not applicable (N/A) – #		

Table 2.4 COMPARISON of COMPLIANCE – 2002/3 FSAP vs 2010 Independent Assessment

Core Principle		Assessment ^a	
		2003	2010
1	Objectives, independence, powers, transparency and cooperation		
1.1	Responsibilities and objectives	C	C
1.2	Independence, accountability and transparency	LC	LC
1.3	Legal framework	C	C
1.4	Legal powers	LC	C
1.5	Legal protection	C	C
1.6	Cooperation	LC	C
2	Permissible activities	C	C
3	Licensing criteria	C	C
4	Transfer of significant ownership	C	C
5	Major acquisitions	C	C
6	Capital adequacy	LC	C
7	Risk management process	NA ^b	C
8	Credit risk	C	C
9	Problem assets, provisions and reserves	LC	C
10	Large exposure limits	C	C
11	Exposures to related parties	LC	LC
12	Country and transfer risks	C	C
13	Market risks	LC	C
14	Liquidity risk	LC	C
15	Operational risk	NA ^c	C
16	Interest rate risk	NA ³	C
17	Internal control and audit	LC	C
18	Abuse of financial services	LC	C
19	Supervisory approach	LC	LC
20	Supervisory techniques	LC	LC

21	Supervisory reporting	LC	C
22	Accounting and disclosure	C	C
23	Corrective and remedial powers	MNC	LC
24	Consolidated supervision	C	C
25	Home-host relationships	LC	C

^a C-Compliant; LC-Largely compliant; MNC-Materially non-compliant; NC-non-compliant; NA-not applicable. Upgraded assessments are shaded in green

^b Not shown as separate CP in 2003; added in 2006 revision of BCPs.

^c Previously included as part of CP 13, Other risks; added as separate CP in 2006

2.7 MFSA Response (Banking Supervision Unit) to the 2010 Independent Assessment

Core Principle	Comments
1.2	The question of recruitment as well as the retention of well-qualified and experienced personnel is one faced by all supervisory units within the MFSA. Accordingly, given the ever more comprehensive evolution of regulatory requirements within the EU, the MFSA will continue to dedicate appropriate resources for training and develop appropriate career structures for staff to undertake the increasingly complex role of banking regulation and supervision.
11	<p>As part of the oversight of banks, the BSU continuously monitors the situation in respect of all connected lending by means of data received at the Off-Site Section through the statutory information submitted by banks as required by Banking Rule BR/06. Schedule AD which forms part of the package of statutory returns in BR/06 requires banks to report on a quarterly basis loans on the following categories of connected persons:</p> <ul style="list-style-type: none"> - Directors and connected /related parties; - Staff members and connected /related parties; - Significant and qualifying shareholders and connected/related parties; - (External) Auditors and connected/related parties. <p>Moreover, on-site inspections may also be undertaken specifically in order to gauge that the level of connected lending disclosed in the prudential returns reflects the reality of any lending. As to whether CRD requirements actually stipulate that the total of connected party exposures should be deducted from capital adequacy, it should be noted that loans to staff are not considered as connected person in terms of the CRD. However, even though this area has so far not given cause of concern, the BSU will continue to monitor its development and if necessary, the powers provided to the MFSA under the Pillar II process will be utilized to tackle any concerns generated by a particular bank in this area.</p>
19 -20	The BSU acknowledges the value of conducting meetings with the boards of directors and had started doing so after the IMF/WB FSAP in 2003. However, it was necessary to suspend the meetings in 2007 when priorities relating to CRD implementation took precedence. It should be noted that meetings with boards of banks have now been resumed. On September 16, 2010, a meeting was held with the board of directors of one of the Austrian subsidiaries.

	<p>It should also be pointed out that the BSU already holds tripartite (MFSA/bank/auditors) or bipartite (MFSA/auditors) meetings (depending on circumstances) when auditors' findings indicate the need to do so, or when a specific request is made by the auditing firm. The BSU believes that meeting the Board at the conclusion of each full-scope on-site inspection concluded by its inspectors will add value to the overall assessment of the bank's internal governance framework. The BSU will, in future strive to hold meetings with banks' Boards of Directors as frequently as possible, always keeping in mind the risk-based approach to supervision adopted by the BSU and resources available. However, it should be emphasized that holding such meetings with a full board may sometimes be difficult to arrange as various banks having board members who reside overseas.</p>
23	<p>The BSU is of the opinion that legislation as currently drafted is adequate for applying corrective measures. However, in order to strengthen even further this area, the BSU will, in the near future, be formalizing and improving on the existing informal framework currently applied when taking corrective measures and enforcement actions so that the application of these measures would be officially formalized and implemented.</p>

2.8 Detailed Assessment

1. The assessment of compliance of each principle should be made based on the following four-grade scale: **compliant**, **largely compliant**, **materially non-compliant**, and **non-compliant**. A "not applicable" grading can be used under certain circumstances.

- Compliant** – A country will be considered compliant with a Principle when all essential criteria applicable for this country are met without any significant deficiencies. There may be instances, of course, where a country can demonstrate that the Principle has been achieved by other means. Conversely, due to the specific conditions in individual countries, the essential criteria may not always be sufficient to achieve the objective of the Principle, and therefore other measures may also be needed in order for the aspect of banking supervision addressed by the Principle to be considered effective.
- Largely compliant** – A country will be considered largely compliant with a Principle whenever only minor shortcomings are observed which do not raise any concerns about the authority's ability and clear intent to achieve full compliance with the Principle within a prescribed period of time. The assessment "largely compliant" can be used when the system does not meet all essential criteria, but the overall effectiveness is sufficiently good, and no material risks are left unaddressed.
- Materially non-compliant** – A country will be considered materially non-compliant with a Principle whenever there are severe shortcomings, despite the existence of formal rules, regulations and procedures, and there is evidence that supervision has clearly not been effective, that practical implementation is weak, or that the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance. It is acknowledged that the "gap" between "largely compliant" and

“materially non-compliant” is wide, and that the choice may be difficult. On the other hand, the intention has been to force the assessors to make a clear statement.

- **Non-compliant** – A country will be considered non-compliant with a Principle whenever there has been no substantive implementation of the Principle, several essential criteria are not complied with or supervision is manifestly ineffective.

In addition, a Principle will be considered not applicable when, in the view of the assessor, the Principle does not apply given the structural, legal and institutional features of a country.

Table 2.5 Detailed Assessment of Compliance with the Basel Core Principles

Principle 1.	Objectives, autonomy, powers, and resources. An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their on-going supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Principle 1(1).	Responsibilities and objectives. An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.
Description	<p>Essential Criteria:</p> <p><i>Legal Framework and Minimum Prudential Standards:</i> The Banking Act (BA), the Malta Financial Services Authority Act (MFSA Act), and Legal Notices (LN) form the legislative framework for the banking sector and the banking supervision activity. LNs qualify as secondary legislation. Banking Notices (BN) are also issued by the MFSA. While they do not have the force of law, they prescribe international best practice for which banks are expected to comply. Selected parts of banking legislation take the form of “Legal Notices” (LN). Specifically, penalties and sanctions are prescribed in LN 155. LNs are documents that are designed to deal with the “public good” (for example, bank holidays). These documents are vetted by the Office of the Attorney General for consistency and translation, as well as to ensure that they are legally correct and in compliance with the Constitution and primary legislation. Once vetted, they are approved for publication by the Minister. They have the force of secondary legislation. Each legislative vehicle works to provide the banking sector and supervision with an adequate legal framework.</p> <p>Banking legislation has been updated a number of times during the last ten years in anticipation of establishing the new consolidated supervisor. In 1996, partly as a consequence of the decision to move toward EU accession, the Maltese Government chose to eliminate offshore banking activity that had been initiated in 1988. The objectives and responsibilities for the conduct of banking supervision are clearly enumerated in banking legislation. The specific responsibility of supervision is assigned to the MFSA’s Banking Supervision Unit that reports to the Supervisory Council, an internal committee composed of the Director General and the Directors of each supervisory Unit. The Supervisory Council is the organ that sets the policies</p>

	<p>and guidelines of the Unit and endorses the amendments to the Banking Legislation proposed by the BSU, after an informal consultation with the practitioners (Article 10 of the MFSA Act 2002). Another committee, the Board of Management and Resources, is chaired by the Chief Operating Officer and is in charge of ensuring the day-to-day management of the Authority as regards IT, human resources, training etc. It has no powers of supervision.</p> <p>The BA assigns certain responsibilities to the MFSA in deciding when and how to affect the orderly resolution of a problem bank. The BA Art. 9 sets forth the conditions under which a bank's license can be restricted or revoked. Art. 25 provides for co-operation and sharing of information and also provides for such processes, however, with respect to supervision on a consolidated basis. Art. 28 provides for the liaison between the MFSA and the Central Bank on problem credit institutions where it is likely that "the (subject bank) will become unable to meet its obligations or that it is about to suspend payment." Art. 29 provides the MFSA the authority to take control of problem credit institutions.</p> <p>The Central Bank is the "other agency" with which the MFSA must coordinate its actions on, primarily, severely distressed institutions. The law provides for certain cooperation and information exchange. The two entities also signed a temporary agreement that addresses their working relationship. The Parties hereby agree to co-operate in the field of financial services, particularly through the exchange of information acquired in the course of carrying out duties entrusted by law, be they of a regulatory or economic nature, for the purposes of ensuring the overall safety and soundness of the financial system in Malta and of keeping the same under constant surveillance. While the agreement does not expand the detail on when and how to communicate about a severely distressed bank, the MoU deals with the subject of problem banks.</p> <p>Additional Criteria:</p> <p>A yearly on-site inspection program is prepared as a part of working procedures in the Banking Supervision Unit. It is approved by the Director General as Chairman of the Supervisory Council. The Unit's performance together with others is gauged through the quarterly Activities Reports. In addition, the Central Bank's Annual Report and its quarterly publications also comment on the performance of the banking system.</p> <p>Information on the financial strength and performance of the industry is provided to the public both through the publication by the credit institutions of their annual Audited Financial Statements and through the Central Bank's Quarterly Review Publication. The MFSA's web site also includes relevant information on the sector.</p> <p><u>2010 update</u></p> <p>Following Malta's accession to the EU in 2004, new banking rules and other forms of legislation were adopted. A more comprehensive framework was created. This new framework incorporates EU Directives and follows international standards. Banking Rules (BR), previously known as Banking Directives, were introduced in 1994 as part of the <i>Legal Framework and Minimum Prudential Standards</i>. BRs are binding measures having the force of law and are applicable to regulated entities and credit institutions. The MFSA has authority to directly issue BRs, following consultation with practitioners with respect to licensed entities.</p> <p>The Central Bank is the "other agency" with which MFSA must coordinate</p>
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	<p>actions, primarily in respect of severely distressed institutions. The law provides for certain cooperation and information exchange. The two entities signed two Memoranda of Understanding in February 2003. The MFSA and CBM have created a Standing Committee that meets on a regular basis- quarterly- to discuss matters of mutual interest and to monitor developments that could have a bearing on the MFSA's oversight function and/or the CBM's role to safeguard financial stability.</p> <p>The specific responsibility of supervision is assigned to the MFSA's Banking Supervision Unit which reports to the Supervisory Council, an internal committee composed of the Director General and the Directors of each supervisory Unit. Beginning January 2010, the Supervisory Council includes the Authorization Unit and the Regulatory Development Unit. The specific responsibility for licensing of all credit and financial institutions is assigned to the newly established Authorization Unit within the MFSA.</p> <p>Following the signing of the Memorandum of Understanding on Co-operation between banking supervisory authorities, central banks and finance ministries within the EU, the issue of crisis situations has been addressed by a Working Group(WG) set up in May 2005. The WG includes the Central Bank of Malta, the Ministry of Finance and the MFSA. The WG meets several times annually and has drawn up a draft Framework for Crisis Management which seeks to identify gaps in local legislation in the event of a crisis situation. In 2007, a crisis simulation exercise organised by the three entities was supervised by an expert on crisis management from the Central Bank of Ireland. The primary objective of the exercise was to test the exchange of information between the MFSA, the CBM and the Ministry of Finance. The Annual Report of the MFSA contains articles on the work carried out by inter alia the Banking Supervision Unit.</p>
Assessment	2002/3 FSAP – Compliant; 2010 Independent Assessment – Compliant
Comments	<p><u>2003</u>: While the structure of the MFSA is clearly established, the internal governance could be further developed and more clearly defined.</p> <p><u>2010 update</u></p> <p>The recommendation to adopt “Rules of Procedure” outlining the Supervisory Council's oversight role and procedures was implemented in 2005. The Rules determine inter alia the Supervisory Council's decision-making responsibilities and information flows from the respective supervisory units. The nature and timing of institutional information, particularly if deteriorating trends or problems are detected, remain to be established.</p> <p>The MFSA has the authority to issue BRs after consultation with the industry. The standard comment period of three weeks may not allow sufficient time for thorough review and comments for some institutions, especially for foreign-based institutions. Therefore, it is recommended that the comment period be lengthened to a minimum for four weeks and preferably six in certain cases.</p> <p>The recommendation regarding signature authority for bank examination reports was also implemented. While the Director of the Banking Supervision Unit is always a signatory of such reports, when circumstances merit (e.g. on identification of high risk problems), the Director General of the MFSA signs correspondence.</p>

Principle 1(2).	Independence, accountability and transparency. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties.
Description	<p>Essential Criteria:</p> <p>MFSA is an independent authority ruled by Act of Parliament; it is not a part of the Government but is considered a part of the public sector. Government can give only general policy guidelines but cannot interfere in the main business of the MFSA, the supervisory activity.</p> <p>BA Art. 3(1) provides for the appointment of a Competent Authority in terms of the Act. Once appointed by the Minister of Finance, the Competent Authority is independent in its operations in terms of the Act. The Board of Governors, Supervisory Council and Executive Co-Ordination Committee are fully independent in the obtainment and deployment of the MFSA's resources as per Art. 13 of the MFSA Act.</p> <p>There is no explicit provision in the law for the members of the Board or of the Supervisory Council not to take or seek instructions from state authorities, any other public bodies or a legal or natural person. However, professionalism, impartiality, credibility and integrity of the supervisory agency and its staff are provided by Art. 6 the MFSA Act.</p> <p>While banking supervision, under the MFSA, can be considered independent, there are three key points that are influenced by the MoF. This does not necessarily compromise the independence of banking supervision, but combined, may present structural vulnerability. The particular areas are:</p> <ul style="list-style-type: none"> • The MoF is responsible for the appointment of the "Competent Authority" for banking supervision. Thereafter, the responsibilities and duties of the supervisor are specified by law. • The structure of penalties (LN 155) is reviewed and vetted by the Attorney General since penalties fall under the "public good". Thereafter, the penalty structure is tabled in Parliament and signed by the MoF. Currently, the level of penalties provided is inconsequential for the nature of the specified infraction and in magnitude. There is indication that the level of penalties can be influenced by the Attorney General's office. The MoF is responsible for appointing the members of the Financial Services Tribunal. Thereafter, the members' role and tenure are fixed by law. <p><i>Resources:</i></p> <p>The banking supervision function is financed as part of the total budget of the MFSA whose revenues come from the license fees of licensed entities, from the registration of companies and from the revenues generated through other fees received by the Company Registry, which is also a part of the MFSA's activity.</p> <p>However, while most of other bank supervisory staff originally came from the Central Bank, the MFSA has been able to recruit individuals either internally or from the marketplace (commercial banks, auditing firms), due in large part to the good reputation of bank supervision in Malta and to salary scales, which are competitive with the private sector. Funding exists for selected training activities that can include graduate program and courses offered by international institutions (BIS, FSI) and foreign authorities (e.g. UK FSA).</p> <p><u>2010 update</u></p>

	<p>A circular issued by the Office of the Prime Minister (OPM) -OPM No 14/2005 of April 25, 2005 has introduced a process for recruitment in the Public Sector Organizations. Under this process, recruitment in the MFSA has to follow these procedures. The intent of the OPM circular was to “ ensure a more efficient and effective Public Service and Public Sector”</p> <p>Additional Criteria:</p> <p>The Board of Directors of the MFSA is appointed (and can be removed) by the Prime Minister from among people of experience in the financial field and personal probity for a term of 5 years that is renewable. The disclosure of the reason for removal of office of the head of supervisory authority is at discretion of the Government. In the past no such a case occurred</p> <p>The Board has only general powers as regards the policy and appoints the Director General, who chairs the Supervisory Council.</p>
Assessment	<p>2002/3FSAP – Largely Compliant; 2010 Independent Assessment – Largely Compliant</p>
Comments	<p>2003 FSAP: The MFSA is considered generally independent. The assessors found no practical obstructions to the MFSA’s daily activities or to its ability to fulfil its supervisory responsibility without political influence.</p> <p>By design, the MoF is responsible for key aspects of supervisory appointment, legislation, penalties, and dispute process. While this structure may not compromise independence, independence would be further anchored if these aspects were reviewed and designed slightly differently.</p> <ul style="list-style-type: none"> • The Government and the MFSA could consider introducing changes to the process whereby the law specifically states that the MoF <i>shall</i> appoint the MFSA as the Competent Authority for banking supervision. • Furthermore, typically the penalties and sanction structure is provided by the pertinent banking legislation. The penalty structure should, in fact, be reviewed with a view to increasing the upper limits for penalty assessment to provide more meaningful impact if and when warranted. The structure should be anchored in the primary legislation, approved by Parliament, rather than subject to the Attorney General and MoF vetting and approval process that can influence the magnitude of subject penalties. • The reasons for dismissal of the head of the Competent Authority, its Board, or a member of the dispute tribunal, if and when such a circumstance occurs, should be publicly disclosed. <p>The budget and resources should receive regular evaluation to ensure, that with the changing landscape of the banking sector, the supervisory capacity can keep pace with and effectively address the issues that arise.</p> <p><u>2010 update</u></p> <p>While resources to date have been generally adequate for the scale and scope of MFSA's supervisory functions, new regulatory requirements and obligations resulting from coming changes in EU legislative frameworks will have various implications for staffing. This, along with the need to increase the frequency and scope of on-site examinations, particularly through SREPs, will require additional staff. However, the 2005 OPM Circular has delayed considerably the time required for recruiting staff in the MFSA. As a result of the cumbersome process</p>

	<p>and administrative layers under which the MFSA has to operate the recruitment process could take several months and impact on the workload of the MFSA staff. The process should be streamlined and shortened.</p> <p>Regarding training, staff will attend seminars offered by amongst others, the Deutsche Bundesbank, the BIS, the FSA, the Committee of European Banking Supervisors, and its respective working groups.</p> <p>The MFSA Act is being amended to require that the MoF will appoint the MFSA as the Competent Authority for banking supervision. The authorities also are giving consideration to public disclosure of the reasons for dismissal in the event that the head of the authority is dismissed. Regarding penalties, Legal Notice 155 was amended in 2007. While the penalty amounts specified in law may appear low, they conform to local standards and, in the context of Malta, the quantum of a penalty is less important as a deterrent than public disclosure. Since 2004, the MFSA publishes penalties and sanctions on its website (i.e. name-and-shame), and future removal from the website is linked to the severity of the misconduct that gave rise to the penalty or sanction.</p> <p><u>Enacting the amendment regarding the appointment of MFSA as the competent authority for banking supervision and publicly disclosing the reasons for dismissals as indicated above; and shortening the recruitment process of MFSA staff would avail upgrading this principle to Compliant.</u></p>
Principle 1(3).	Legal framework. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their on-going supervision.
Description	<p>Essential Criteria: [See also CP 1(5).] BA Art's. 3(1), 5, and 9 authorize the MFSA to conduct banking supervision, including the granting and withdrawing of licenses. BA Art. 4(2) empowers the MFSA to make, amend and withdraw Banking and Electronic Money Institutions Rules (without changing laws), and in practice, this is actively done. BA Art's. 19 and 20 empower the MFSA to require credit institutions to submit any information it deems appropriate. A specific Banking Rule (BR/06) fixes the format of the prudential returns that are monthly for balance sheet items and quarterly as regards profit and loss and other prudential requirements, such as, large exposures and capital adequacy.</p> <p>Additional Criteria: (none)</p>
Assessment	2002/3 FSAP – Compliant; 2010 Independent Assessment – Compliant
Comments	2003 FSAP: (none); 2010 Independent Assessment: (none)
Principle 1(4).	Legal powers. A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.
Description	<p>Essential Criteria: The MFSA Act, Art. 4 specifies the functions of the supervisor including authorities to “regulate, monitor, and supervise financial services.” Also, MFSA is empowered to</p>

“monitor and keep under review trading and business practices relating to the supply of financial services ...,” and “to ensure high standards of conduct and management throughout the financial system.” BA Art. 4 goes on to authorize the supervisor to make banking rules to carry out the BA. Through practice, both on and off site supervision, the supervisor uses and applies the law. However, as stated in CP 22 (Enforcement), the supervisor does not cite, as explicit violations of law, infractions of the BA in reports of examination. Infractions related to **BRs** may be indicated in the text of reports of examination; however, interconnected violations of law caused by a single circumstance or several are not always explicitly presented. It will communicate with bank management when such a situation occurs, verbally or through other written communications. Qualitative judgment is used by the supervisor as it applies law, rules, and safety and soundness. However, as stated in CP 22, additional emphasis is encouraged in drawing conclusions regarding credit quality and risk, risk management processes, and bank management and board oversight.

BA Art. 22 allows the supervisor to appoint persons to investigate the conduct of a bank’s business or its ownership and/or control. The Article goes on to provide full access by the supervisor to bank records.

BA Art. 9 provides the authority to take various remedial actions in the case the subject bank’s viability is threatened or the supervisor determines that “the interests of the depositors of the credit institution are threatened.” There are no specific legal provisions that provide for a series of graduated supervisory responses based on declining capital adequacy past certain specified thresholds (prompt corrective action based on capital (PCA)). The penalties and sanctions available to the supervisor include restrictions on the banking license, removal of any officer, (qualifying) ownership divestiture under certain situations, and the requirement for a bank to take or refrain from any action.

The Legal Notice 155, as secondary legislation, sets the range of fines and imprisonment terms. The terms within the Legal Notice are established by the Attorney General and approved by the MoF. There are two notable features of the Notice: 1) penalties are not fixed by Parliament within the context of the Banking Law, and 2) the magnitude of the penalties is inconsequential, particularly for the realm of offences considered “financial crimes.” Few penalties have been assessed to date.

2010 update

Provisions in the BA, which are based on EU Directives, allow MFSA to impose corrective measures on licensed institutions; however, the BA does not explicitly refer to a prompt corrective action framework because such framework is not envisaged in EU Directives.

Article 9(2, 3) of the BA authorizes MFSA to apply corrective and remedial measures. In addition, the MFSA has adopted, within the context of the Pillar 2 framework which covers all banking risks, prudential measures as part of Banking Rule BR/12; the first such measure states "...prudential measures to address issues identified either through the SREP or as part of on-going supervision, should be applied promptly."

Finally, the MFSA, under the Capital Requirements Directive (CRD), has authority to take appropriate prudential measures pursuant to Pillar II of the Supervisory Review and Evaluation Process (SREP) on banks where the results of an Internal Capital Adequacy Assessment Process (ICAAP) are less than satisfactory.

	<p>The maximum penalty, applicable upon breach of BA Art. 35 (1), concealment of material facts and statement of misleading information, is not less than €232.94 (LM 100) or more than €1,164,686.70 (LM 500,000). Prison term cannot exceed two years.</p> <p>Other examples of monetary fines include: € 232.94 (LM 100) per day for: “failure of own funds of bank to attain prescribed level within period determined by the (supervisor)” € 23.29 (LM 10) per day for: “failure to furnish information or documents as required by the (supervisor) within the specified time” € 11,646.87 (LM 5,000) for: “failure to appoint an auditor” € 58.23 (LM 25) per day for: “failure to forward to (supervisor) and/or Central Bank, or to publish, or to exhibit a copy of financial statements”</p> <p>Additional Criteria: (none)</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: The supervisor has been provided the authority to apply and interpret, using its qualitative judgment, banking law and regulation, including the authority to draw conclusions about safety and soundness. A remedial or corrective action framework exists, but requires enhancement. The range of sanctions would be more complete if they included a fuller set of intermediate measures. [EC 4] [See also CP 22]</p> <p>The MFSA should revisit the process of setting penalties and fines to ensure it results in an effective set of measures, evaluate the level of fines and penalties with an eye to increasing the magnitude, and consider establishing a set of PCA trigger points and supervisory responses.</p> <p><u>2010 update</u> The penalty amounts specified in law may appear low; however, they conform to local standards. Moreover, in the context of Malta, the amount of a fine is less of a deterrent than public disclosure. Since 2004, the MFSA publishes penalties and sanctions on its website (i.e. "name-and-shame"), and future removal from the website is linked to the severity of the misconduct that gave rise to the penalty or sanction. It is still recommended, however, that the issue of monetary fines be revisited with the two-fold aim of (i) more explicitly defining the circumstances when fines will be applied and (ii) more closely linking the amounts of fines to the severity of the infraction.</p>
Principle 1(5).	Legal protection. A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	<p>Essential Criteria: Art. 29 of the MFSA Act, Cap. 330 provides the necessary protection for supervisors in carrying out their duties with the exemption from legal liability for the officers unless an act is done in bad faith.</p> <p>Additional Criteria: (none)</p>
Assessment	2002/3 FSAP – Compliant; 2010 Independent Assessment – Compliant

Comments	2003: (none); 2010: (none)
Principle 1(6).	Cooperation. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	<p>Essential Criteria: Art's. 17(2) and 18 of the MFSA Act provide the sharing of information between the MFSA and the Central Bank and between the MFSA and foreign authorities.</p> <p>Even if some MoUs are in the pipeline, there is no MoU already signed. Informal and periodic cooperation with foreign banking authorities is already in place. The protection of confidentiality is provided by Art. 34 of the BA.</p> <p>[See also CP 25]</p> <p>Additional Criteria: (none)</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: The law provides the MFSA full authority to share needed information with other agencies related to financial sector oversight.</p> <p><u>2010 update</u> The MFSA has concluded several bilateral Memoranda of Understanding (MOUs) with foreign financial services regulators and is a signatory to specialized multilateral MOUs. The following Memoranda of Understanding are now in effect: Bilateral MOUs with Foreign Regulators – 24 Letter Agreements with Foreign Regulators – 2 Multilateral MOUs and Protocols – 9 Bilateral MOUs with Local Authorities – 3</p> <p>(A detailed listing of individual agreements is available on the MFSA web-site)</p> <p>In addition to formalizing the information-sharing process through bilateral and multi-lateral agreements, cooperation among regulators has been enhanced by colleges of supervisors whose role has gained increasing importance in the aftermath of the global financial crisis. Art. 25A of the BA, adopted in 2007, specifically requires the MFSA to cooperate closely with overseas regulatory authorities on a consolidated basis, and MFSA is doing so on both a formal and informal basis particularly for implementation of the Capital Requirement Directive (CRD).</p>
Principle 2.	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined and the use of the word “bank” in names should be controlled as far as possible.
Description	<p>Essential Criteria: Art. 2(1) of the BA contains a precise definition of the word “bank” or “credit institution” and “banking business.” Banking activities are listed in the Schedule of the BA.. The activities, except for collecting deposits (reserved for banking institutions only) can also be undertaken by non-bank financial institution.</p>

	<p>The MFSA oversees on the correct use of the word “bank.” In case of violations, the authority is able to inform the Police Department, the body in charge of making an inquiry.</p> <p>Additional Criteria: (none)</p>
Assessment	2002/3 FSAP – Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: The BA is in technical compliance with the Principle. Misuse of the word “bank” is subject to the penalties specified in Legal Notice 155. However, although the magnitude of these punitive measures has been considered in the 2003 FSAP as relatively inconsequential, this is an issue beyond the BSU’s control.</p> <p><u>2010 update</u> Until June 2010, a financial institution, licensed under the Financial Institutions Act, was able to include the term “bank” in its name subject to approval from the MFSA in terms of BA Art. 12. Recent changes to FIR/01 have removed this provision. The only exception now applies to electronic money institutions which are regulated by a Banking Rule. To date, no such institution is authorized in Malta. This situation will change with the implementation by April 2011 of the requirements of the new EU Directive on EMIs – 2009/110/EC. As a result of the transposition of this Directive in Malta an EMI will no longer be classified as a bank/credit institution but it will be effectively another type of financial institution regulated by the provisions of the FIA instead of the BA.</p>
Principle 3.	<p>Licensing criteria. The licensing authority must have the power to set criteria and to reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.</p>
Description	<p>Essential Criteria: BA Art. 6(2) empowers the MFSA to issue a banking rule (BR) establishing licensing criteria. The criteria for obtaining a banking license from the MFSA are laid down in BA Art. 7 and further supported by <u>BR/01</u>. It stipulates that no license can be granted unless the applicant has a minimum capital of <u>Euro 5 million</u>, in line with the European standards (<u>Art. 9 EU Directive 2006/48/EC</u>).</p> <p>BA Art. 32 provides that “(a) no person who has been adjudged bankrupt or has made a composition with his creditors or has been an officer of a credit institution which has had its license revoked under article 9(2); ... or (b) who is interdicted or incapacitated or who has been involved in money laundering or found guilty of a crime affecting public trust, theft, fraud, extortion or of knowingly receiving property obtained by theft or fraud, shall act or continue to act as an officer of a credit institution.”</p> <p>All applicants have to submit information on the promoters, auditors, directors, controllers, qualifying shareholders for “fit and proper” due diligence. Suitability tests are conducted by the supervisor on a case-by-case approach also taking into account the information directly gathered. The applicants must also produce a business plan, with three-year financial projections, and a copy of their statutes.</p> <p>The MFSA has 6 months after an application is received to authorize or not. In general,</p>

	<p>MFSA tends to examine a preliminary draft of the application before the beginning of the process.</p> <p>If the bank is established by a foreign entity, the MFSA verifies the standards of the jurisdiction the foreign bank is coming from. The fit and proper test is extended also to the <i>qualifying</i> shareholders.</p> <p>BA Art. 9(2) provides that the MFSA may impose restrictions on a license or may revoke the license.</p> <p>Additional Criteria: When assessing the application for a banking license, the ability of the shareholders to supply additional financial support is included. The MFSA also requests letters of parent company with a commitment to provide liquidity at all times is necessary.</p> <p>The supervisor verifies that the directors have an adequate knowledge of the types of activities the bank intends to pursue. The authority monitors, in its day-by-day supervision, the progress of new entrants in meeting their goals.</p> <p>It is the policy of the supervisor to confirm with its foreign supervisory counterparts that they have given their consent for the applicant to establish a presence in Malta through a branch or a subsidiary undertaking. The supervisor also seeks assurances and conduct rigorous due diligence examinations with the relevant foreign supervisory authorities and with other agencies as part of the authorization process.</p>
Assessment	2002/3 FSAP – Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: General suitability tests are conducted by the supervisor even if guidelines are not formalized. However, objective criteria that guide suitability evaluations of bank directors, management, and significant shareholders should be explicitly included in supporting regulation.</p> <p><u>2010 update</u> In January 2010, as part of the restructuring of the MFSA, responsibility for authorizing and licensing all financial institutions was consolidated in the Authorization Unit. Feedback and cooperation on technical aspects relating to the license application process continues to be requested and obtained from the various supervisory units.</p> <p>Objective criteria for assessing applications have been amended recently by adopting the five criteria based on the requirements of EU Directive 2007/44/EC and as amplified in the 3L3 Guidelines and Banking Rule BR/13 which applies to the suitability of qualifying shareholders in cases of proposed mergers and acquisitions in banks. Assessment criteria that are deemed applicable for proposed qualifying shareholders are also considered in evaluating the suitability of bank directors and senior executive management.</p>
Principle 4.	Transfer of significant ownership. The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Description	<p>Essential Criteria: Qualifying (10 per cent, 20 per cent, 30 per cent and 50 per cent) shareholdings in a bank can be acquired only after the previous consent of the MFSA (BA Art. 13).</p>

	<p>A takeover of a listed bank should be previously authorized. The MFSA, being the keeper of the Registry of Companies, has the list of shareholders of all the banks.</p> <p>The supervisor has full authority to reject any proposal for ownership if they do not meet the specified criteria.</p> <p>Additional Criteria: The supervisor requires the names and holdings of all significant <i>and qualifying</i> shareholders to be reported as changes occur.</p>
Assessment	2002/3 FSAP– Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: The MFSA is not entitled to receive information on pacts or agreements among shareholders to control a bank. Such power should be provided to allow the authority to have a clear picture of the governance of the bank.</p> <p>2010 update Paragraph 14(b) of BR/13 requires persons to disclose to the MFSA when they are acting in concert, i.e. a pact or agreement among shareholders. Changes to the BA, made in 2009, require notification to the MFSA following the acquisition of a significant holding (i.e. 5%).</p>
Principle 5.	Major acquisitions. The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	<p>Essential Criteria: BA Art. 15 prohibits banks from acquiring more than 5 per cent of the equity of an “investee” company, which is not a credit institution and limits such investments by a bank to a maximum of 15 per cent of its own funds. The total amount of such holdings should not exceed 60 per cent of the own funds. If these two latter limits are exceeded due to unavoidable circumstances, the supervisor shall require the bank to increase its own funds accordingly; the shares held temporarily during a financial reconstruction or rescue operation (from debts previously contracted) or during the normal course of underwriting shall not be considered significant shareholdings.</p> <p>The Supervisory Council will establish the basis for approval of exceptions to the 5 per cent limit given the above circumstance. Banks are required to obtain prior approval before realizing an exception to the limit.</p> <p>However, the attitude is very strict regarding the acquisition of stakes in whatsoever non-financial companies. Even auxiliary companies are included in the “ceilings” related to stakes in non-financial companies.</p> <p>The law conforms to the EU directive, which requires strict investment limits and requires notification of such investments. There are no required approvals for investments below the specified limits, which are manageable in relation to a bank’s capital.</p> <p>Additional Criteria: (none)</p>

Assessment	2002/3 FSAP – Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: (no comments)</p> <p><u>2010 update</u> The banking law conforms to the relevant articles in EU Directive 2006/48/EC, which require strict investment limits and notification of such investments. Approvals are not required for investments below the specified limits, which are deemed manageable in relation to a bank’s capital. Those limits are 5% of an entity’s capital; 15% of a bank’s own funds in relation to a single investment and 60% aggregate limit on all such investments.</p>
Principle 6.	Capital adequacy. Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.
Description	<p>Essential Criteria: The main capital Banking Directives were issued in application of BA Art. 17(1). They refer to the definition of the components of capital (BD/03-Own Funds) and the calculation of a minimum capital ratio (BD/04-Capital Requirements; BD/08-Capital Adequacy). All the Banking Directives are based on the Basel Committee Standards and EU requirements.</p> <p>In particular, a bank is obliged to maintain capital adequacy of at least 8 percent (BD (BR)/04 Art. 5) which is consistent with the Basel Capital Accord. BD (BR)/04 Art. 6 allows the MFSA to set a higher minimum banking book ratio.</p> <p>The minimum capital adequacy ratio (including trading book) is 8% of risk-weighted assets.</p> <p>A bank is obliged to ensure that capital adequacy has to be maintained both on a solo and on a consolidated basis (art. 9 BD (BR)/04). The required capital ratio includes on balance and off balance sheet risks (BR/04-Art. 10): the general framework and the risk weightings are consistent with the Basel Committee’s regulations.</p> <p>The MFSA practices a regulatory and supervisory approach that looks at banks also on a consolidated basis.</p> <p>BA Art. 17 (1) (c) directs the MFSA to require a subject credit institution to take the necessary measures to restore its capital adequacy ratio as established in the pertinent BD(BR) within a specified time frame. BA 9(2) authorizes (but does not require) the MFSA to impose restrictions on a license or revoke the license if the credit institution “fails to comply with any provision of the Act” or “no longer possesses sufficient (not defined) own funds.” BA Art. 9(3) lists several of the restrictions the MFSA <i>may</i> include (removal/replacement of a bank’s officer; shareholder divestiture; refrain or to take any action, transaction, or business activity; other actions as specified by Art. 9).</p> <p>BA Art. 19 establishes that credit institutions are obliged to report, in the manner specified in the Banking Rules. The prudential returns, sent on a CD with a covering letter, are examined and commented in the quarterly report referred to the single bank.</p>

	<p>Per BR/04 Art. 6, the supervisor is authorized to set a higher level of prudential requirements for a problem bank. However, such a measure has not been taken yet. The MFSA is not empowered to raise the weightings for the calculation of individually weighted assets in existing legislation.</p> <p>Additional Criteria: The Banking Rule has been modeled on the requisites of The EU Directive 2006/48 that is consistent with the Basel Capital Accord Basel II.</p> <p>BA Art. 9(2) and 35(3) empower the supervisor to take action in case of non-compliance with the Banking Act, even if the type of supervisory intervention is not precisely identified. BA Art. 9(3) provides several of the supervisory actions the supervisor <i>may</i> take as a result of violation of BA Art. 9 (2).</p> <p>BR/08 Art. 22 states that the supervisor expects all banks to employ risk management systems that can calculate their financial position with accuracy at any time. It also states that institutions are “expected to have an internal set-up based on internationally accepted practices to measure on a controlling basis market related risks including interest rate risks on all the institution’s business and settlement/delivery risks.”</p> <p>BA Art. 7(1) fixes a minimum absolute amount of capital for banks at €5 million regardless of the kind of activities they will develop.</p> <p><u>2010 update</u> Since 2006, the capital adequacy framework has been upgraded in line with the relevant EU initiatives. The current framework (BR/04 and BR/08) implements the Basel II Framework for Pillar I capital requirements.</p> <p>In respect of Pillar II requirements of the Basel II framework, Art. 17B of the BA requires a credit institution to establish robust governance arrangements, Art. 17C requires credit institutions to establish an ICAAP and Art. 17D requires MFSA to conduct SREPs over licensed credit institutions. The aim of these provisions is to ensure that credit institutions have sufficient capital to support all material risks, including Pillar II risks.</p> <p>BA Art. 16A(2) requires that a specific own funds requirement in excess of the minimum level laid down in the above mentioned sub-article shall be imposed by the competent authority at least on credit institutions which do not meet the requirements laid down in a Banking Rule and in Art. 17B of this Act, or in respect of which a negative determination has been made on the issue described in article 17D(3) of this Act, if the sole application of other measures is unlikely to improve the arrangements, processes, mechanisms and strategies sufficiently within an appropriate timeframe.</p>
Assessment	2002/3FSAP - Largely Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: The legal requirements addressing capital adequacy are in general compliance with CP 6. However, certain aspects of supervisory practice impact the rating of this principle.</p> <p>The BA and BRs are consistent with international/EU standards. However, in practice, when a number of misclassified credits are identified during an examination, the resulting ramifications to loan loss reserves, earnings, and capital are not, as a matter of</p>

	<p>practice, calculated as a part of the official results of the examination. If a case were to present itself where significant re-classification of credit was required by the supervisor and the resulting capital impact was significant, this calculation would be imperative to assess the subject bank's true level of capital adequacy. As indicated in CP 22, the results of a bank examination should be considered definitive, and capital impact should be calculated and included in the report of examination. This affects the rigor with which the capital requirements are applied and adequacy is assessed. (EC 1)</p> <p>BA Art. 9 (2) (d) allows the supervisor to restrict or revoke a license if a bank "no longer possesses sufficient own funds." The term "sufficient" should be defined and linked to required action. Banks that fail to notify the supervisor of a fall in their capital ratio are subject to the administrative penalties provided in Legal Notice 155.</p> <p><u>2010 update</u> Pillar II provisions have strengthened the MFSA's remit in the area of capital adequacy. Subsequent to the 2003 FSAP, the on-site examination report formats were amended to incorporate the FSAP recommendations, and further, if there are material differences between the ratings assigned by the bank and those assigned by MFSA, the impact of changes to provisions and the capital adequacy ratios are discussed and disclosed in the reports. This procedure is included as part of the General Instructions for On-Site Examinations.</p> <p>The MFSA also now has legal authority in BR/09 to require an institution to make the necessary adjustments to provisions and ultimately to earnings and capital.</p> <p>In respect of own funds, the term "sufficient" is interpreted to encompass all of an institution's risks. Thus, if a bank's own funds are not covering all risks embodied in Pillar I and Pillar II, then the level of own funds is not "sufficient." The authorities indicated that consideration will be given to incorporating the sufficient threshold into a policy framework for corrective measures and enforcement actions.</p>
Principle 7. [new CP added in 2006 revision of Core Principles]	<p>Risk management process. Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.</p>
Description	<p>2003: (new Core Principle; not reflected separately in 2003 assessment.)</p> <p><u>2010 update</u> Articles 17B, C and D of the BA, added in 2007, address Internal Governance, Internal Capital Adequacy Assessment Process (ICAAP), and Supervisory Review and Evaluation Process (SREP), respectively. In addition, BR/12-Supervisory Review Process of Credit Institutions (authorized under the Banking Act 1994) was introduced in 2009; it is modelled on the European Union Directive 2006/48/EC and relevant CEBS Guidelines. The following Appendices and Annexes are included to ensure that credit institutions have sufficient capital to support all material risks inherent in their business activities.</p>

	<p>Appendix 1 – Internal Governance</p> <p>Appendix 2 – ICAAP</p> <p>Annex 2A: ICAAP Report – Recommended Structure</p> <p>Annex 2B: Technical Criteria on Organization and Treatment of Risks</p> <p>Annex 2C: List of Definitions</p> <p>Annex 2D: Principles on Stress Testing</p> <p>Annex 2E: Principles for Remuneration Policies</p> <p>Annex 2F: Principles for the Management of IRRBB</p> <p>Annex 2G: Principles for the Management of Concentration Risk</p> <p>Annex 2H: Principles on Risk Management</p> <p>Appendix 3 – SREP</p> <p>Annex 3A: SREP-ICAAP Interaction Process</p> <p>Annex 3B: Technical Criteria on SREP</p> <p>Annex 3C: Prudential Measures</p>
Assessment	2002/3 FSAP – (not applicable); 2010 Independent Assessment – Compliant
Comments	<p>2003: (not applicable)</p> <p><u>2010 update</u></p> <p>(1) The MFSA introduced BR/12, Supervisory Review Process of Credit Institutions, whereby all banks are required to develop an ICAAP. The ICAAP requires banks to have a comprehensive process to identify, evaluate, monitor and mitigate all risks. Banks are then required to develop methods to calculate the amount of capital necessary for each risk and any buffer over and above the regulatory minimum requirement. Each bank must submit its ICAAP to the MFSA annually while ensuring that the process is on-going.</p> <p>After receipt of an ICAAP, the MFSA conducts a SREP to validate the contents of the ICAAP. To date, on-site visits have been conducted for those banks deemed systemically important; desk-based exercises have been conducted for all other banks. The results of SREPs have been communicated to the banks with indications of actions required to ensure adequate capital for the size and complexity of the institution.</p> <p>(2) BR/12 includes an extensive appendix which specifies internal governance principles that banks must implement and adhere to. MFSA monitors and ensures implementation of the requirements of the rule.</p> <p>(3) The MFSA is able, on the basis of the SREPs, to ensure that appropriate risk management policies, procedures and limits are documented, implemented and regularly reviewed, and that exceptions are promptly corrected.</p> <p>(4) Performance of an ICAAP is the responsibility of a bank's board of directors. During an SREP, the MFSA reviews minutes of the board and its committees to ensure that relevant risks are properly identified, measured, and mitigated. Evaluations are also made to ensure that board policies are adequate in scope and fully implemented.</p> <p>(5) Local retail banks do not yet employ models for their capital adequacy requirements but a provision in BR/12 covers such and there are references in the ICAAP Framework (Annex 2A) for such. A number of local banks do use models to measure risk but such models are largely used to provide additional</p>

	<p>information for decision making by management. The use of these models for capital adequacy purposes must be approved by MFSA.</p> <p>(6) The MFSA ensures that specific banking risks are thoroughly addressed pursuant to the following individual BRs:</p> <p>BR/04: Credit risk BR/08: Market risks BR/05: Liquidity risk BR/12: Interest rate risk in banking book (Annex 2F) BR/04: Operational risk</p>
Principle 8.	<p>Credit risk. Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.</p>
Description	<p>Essential Criteria:</p> <p>The supervisor requires that all banks have appropriate policies and risk controls for key activity areas. Specifically, BR/01 (Licensing), 02 (Large Exposures), 09 (Credit and Country Risk Provisioning), BN/01 (Management of Credit Risk), and 03 (Internal Control Systems) address the various areas of policy development and board and management oversight.</p> <p>BR/01 (40) states that (in order to be regarded as conducting prudent business, a bank must) “maintain adequate accounting and other records and adequate systems of control of its business and records that are commensurate with its needs and particular circumstances”</p> <p>BR/02 (Large Exposures) further states that a bank “must take into account the spreading of risk.” Relevant factors to take into account in setting (bank) policy “and considering the acceptability of particular exposures include, for example, the standing of the customer, the nature of the credit institution's relationship with the customer, the nature and extent of security to be taken against an exposure, the maturity of an exposure, and the credit institution's expertise in the particular type of transaction. Exposures to customers connected to the credit institution, for example, subsidiary or sister companies and to companies with common directors, should be prudently assessed.”</p> <p>BN/03 (Internal Control Systems) addresses the responsibility of the Boards of Directors in that they are “ultimately responsible to approve and review the overall business strategies and important policies of the credit institution. The Board has also to maintain an effective internal control process, be aware of the major risks facing the institution and to provide guidance and oversight to Senior Management. The Board members must be objective, capable and inquisitive with a good knowledge of the institution’s activities and related risks. As stated in Article 40 of the Banking Rule (BR/01) it is recommended that some Board Directors are independent from the daily management of the credit institution. In this regard, the activities of the Board of Directors should include:</p> <ul style="list-style-type: none"> • periodic discussions with management regarding the effectiveness of the internal control system; • timely review of evaluations of internal controls made by management, internal and external auditors;

	<ul style="list-style-type: none"> • assurance that the concerns raised by external auditors and supervisory authorities on internal control weaknesses are followed up by management; and • periodic reviews to test the adequacy of the institution’s strategy and risk limits.” <p>BN/01 reflects the issues discussed in the Basel Committee’s <i>“Principles for the Management of Credit Risk”</i> and explicitly enumerates the role of the Board of Directors and senior management in the prudent oversight of credit risk through policies, procedures, risk rating, monitoring, etc.</p> <p>Banks are directed to make credit decisions free of conflicting interests, on an arm’s length basis, through both the BA A.15. Specifically, section (b) states a bank may not “grant credit ... or extend other banking services under terms and conditions more favourable than the bank would have otherwise applied ... (i) to any one of its directors or their spouses ... as well as third parties. It goes on to set a limit, in any case, for unsecured credit to connected parties in the aggregate of €23,293.73 (LM 10,000).</p> <p>Through provisions of the BA, the supervisor has access to all bank records and personnel as necessary to carry out its duties and responsibilities.</p> <p><i>Supervisory Practice</i></p> <p>All banks submit their policy documents, including those on Credit Risk and Investments, to the supervisor for evaluation. In the evaluation of these policies, the supervisor evaluates compliance with all regulatory requirements and ensures that such policies are available to all bank personnel.</p> <p>The supervisor assesses the on-going adequacy of the banks’ policies, practices and procedures through regular onsite examinations of credit risks and related risks and through on-going monitoring through monthly and quarterly regulatory reporting. All credit institutions are also required to inform the supervisor when their policy documents and operating manuals are changed. The supervisor has the right, and does exercise such power, to recommend the introduction of certain policies and amendments to existing policies.</p> <p>During onsite examinations of credit risk, the supervisor evaluates the full range of credit related activities. In addition to evaluating policies and procedures as indicated above, the examiners select a sample of credits, including all internally classified credits, and any other subjectively chosen credits. Thereafter, they evaluate the underwriting standards, management oversight, and internal classification of the credit. In doing so for the selected set of credits, they draw conclusions about the nature of a bank’s credit risk exposures and of credit administration processes. Conclusions are well supported and detailed, evidencing sound supervisory review.</p> <p>Additional Criteria:</p> <p>The supervisor requires banks to have in place policies, procedures and committees to ensure the proper division of responsibilities and duties. BN/01 also requires that banks have in place prudent limits for credits and borrower relationships over and above the large exposures limit. However, there is no specific requirement that banks’ credit policies require large credits to be approved at a higher managerial (or board) level in the bank. <u>Compliance with the BN and the provisions of the Act and relative BRs (e.g. BR/12)</u> is evaluated through supervisory review of a bank’s credit policy documents. As a part of the examination process, the organization and division of duties and/or responsibilities within the credit institution is assessed.</p>
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	<p>During onsite examinations and according to BN/03 (Internal Controls) <i>and other BRs</i>, the supervisors are required to verify that adequate management information systems are in place and that bank management monitors the total indebtedness of borrowers.</p> <p><u>2010 update:</u> BN/03 constitutes best practice guidelines while BR/12, Risk Management Principles constitutes binding measures. On-site examinations show that banks consistently follow these practices.</p>
Assessment	2002/3 FSAP – Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: The supervisor performs a thorough review of bank policies, procedures, and individual credits. Conclusions are detailed and reflect sound analysis. However, conclusions regarding credit and other risks could be even more effective if taken a further step to more concisely draw conclusions about overall risk levels, relative to the total portfolio and capital, risk identification and management systems, and board and management oversight.</p> <p><u>2010 update</u> Issues of risk management and Board and management responsibilities, analysis of banking risks, provisioning for country risk, and additional training in the area of market risk were cited in the 2003 FSAP Report as issues requiring attention. These have been addressed by MFSA. The MFSA also continues to expand and enhance Questionnaires and Checklists for use during on-site inspections to evaluate the nature of the particular risk areas overseen.</p>
Principle 9. [formerly CP 8]	Problem assets, provisions and reserves. Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.
Description	<p>Essential Criteria: The BA Art. 17(a) and BR/09 are the primary legislation guiding asset risk rating and loan loss provisioning. BN/01 (Credit Risk Management) outlines best practices based on the Basel Committee’s “<i>Principles for the Management of Credit Risk.</i>” BR/09 represents the first classification and provisioning rules set by the supervisor. Prior to the Rule, no set rules existed for provisioning.</p> <p>The BA requires that every licensed bank maintain adequate provisions for bad and doubtful debts. BR/09 requires all credit institutions to have formalized and documented procedures to ensure that their loans and advances portfolios are reviewed and monitored on a regular basis. This process should include a system of classification of loans and advances into categories such as ‘regular’, ‘watch’, ‘substandard’, ‘doubtful’ and ‘loss’. Accordingly, all assets whose collection is in doubt should be specifically provided. The balance of the portfolio should carry a general provision as well. The asset quality of the credit institutions’ loan portfolio, the adequacy of loan loss provisions, and compliance to established policies and systems are evaluated during regular onsite examinations. The external auditors also review banks’ classification and provisioning policies as well as the application of the policies. This is specifically evaluated by the supervisor during its review of external auditors’ management letters at financial year-end.</p> <p>All assets are subject to BR/09 and the classification and provisioning requirements</p>

therein. However, there are currently no specific regulatory requirements to include off-balance-sheet items. In practice, off-balance sheet exposures are taken into consideration for classification and provisioning purposes and are verified during onsite examinations. Off balance sheet items are also addressed in the revised Banking Notice BN/01 on Credit Risk Management.

BR/09 requires that assets be classified on the basis of recoverability of funds reflected in the “current sound worth and paying capacity of the borrower.” The **BR** goes on to state (Art. 9) that minimum levels of specific provisions shall be provided for assets that have been identified as doubtful either because of overdue repayments or for other circumstance under which the bank considers collection of funds to be in doubt.” Also, (Art. 13) “banks should undertake their own assessment of the possibility of recovery of funds and, irrespective of the minimum levels of provisions provided for under the **BR**, provide accordingly.” At a minimum, banks must classify their assets according to the payment history (past due) status of the asset:

- *watch*: past due 30 to 60 days
- *substandard*: past due 60 to 90 days
- *doubtful*: past due 90 days (interest past due over 180 days shall be taken to interest expense
- *loss*: “loans and advance which are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.”

Regarding loss, the **BR** further indicates that (Art. 18) “nevertheless, a write-off will often be prompted following a specific event, such as the fact that insolvency proceedings or other formal recovery action has been concluded,” and, Art. 32 addresses credits that remain in the doubtful category for over 24 months shall be further specifically provided for by 10 per cent of the outstanding balance. This may not apply if the bank can support that the value of security is closely monitored.

Provisioning requirements apply to doubtful credits. While a credit may be classified doubtful, the provisioning rate varies according to, again, the past due status (Art. 28) and applies to the *unsecured* portion:

- 3 to 6 months: 25 per cent,
- 6 to 12 months: 50 per cent,
- over 12 months: 100 per cent,
- if a credit is past due for over 90 days and for other reasons doubts full repayment, the bank shall immediately provide for the full, unsecured portion.

BR/09 requires that (Art. 19) banks establish review systems that identify and report credits warranting special attention to bank management and boards. BN/01 (Art. 52, 53) requires an institution to have a system of managing problem credits. Management of such credits is evaluated during onsite examinations.

The supervisor has the authority to require a bank to strengthen its lending practices and level of provisions according to BA Art. 17(a) and further discussed in **BR/09** (Art. 17). If deterioration in a bank’s portfolio or overall condition is identified by the supervisor, it will direct, through reports of examination and other communications with senior management, the bank to address and strengthen its practices.

While the supervisor, through **BR/09**, requires banks to have systems for continually assessing the credit quality of their portfolios, the requirement for on-going review of collateral valuations and strength of guarantees is implied. Banks are required to

	<p>produce financial statements consistent with IAS, which calls for fair value statements. However, there is no explicit supervisory policy on evaluating and judging collateral values (the majority of which is real estate) or the process through which banks determine value.</p> <p>Additional Criteria: Per BR/09, banks must suspend interest on loans past due more than 180 days. BR/09 Art. 25 provides that rescheduled loans should not be immediately upgraded until the related repayment problems are rectified. Loans are classified as doubtful when they are considered impaired (90 days).</p> <p>There are no explicit collateral valuation guidelines, nor does BR/09 require banks to specifically review large credits on an individual basis (although this would be implicitly captured in the internal credit review requirements in BR/09).</p> <p><u>2010 update</u> MFSA has considered the issue of collateral valuation guidelines in reply to previous internal audit exercises. Although the MFSA may lack the expertise and technical knowledge necessary to develop class-specific collateral guidelines, the role of the regulator is not to set rules for valuing collateral but rather to determine whether a bank has adequate procedures for evaluating the quality of collateral and the assumptions supporting values, and further whether a bank periodically re-assesses collateral to ensure adequate security coverage.</p> <p>The classification criteria in BR/09 provided for the earlier identification of problems and more pro-active provisioning for potential loss. Some changes may be necessary to reconcile with EU standards and IAS/IFRS; however, the existing methodology appears adequate for the local context.</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: The legal and supervisory framework is in substantial technical compliance with this Principle. However, there is room for improvement in several areas. Guidelines for collateral valuation should be considered, particularly since the supervisor gives substantial credit for collateral in the provisioning guidelines and since the vast majority of the collateral in this market is real estate. Banks should be required to reflect well-supported, realistic valuations, have their own appraisal guidelines, specific methods for appraisal should be specified, and guidelines for ensuring that values are independently obtained and not influenced by lending motivations, and prudently reviewed by the bank thereafter (EC8, 10).</p> <p>While recognizing that debt recovery of non-performing credit is slow and can take up to 10 years to realize residential property security, the guidelines for writing off or classifying assets as <i>loss</i> could be tightened. BR/09 requires assets to be considered loss when they are no longer “bankable assets.” However, alternatively it also allows assets to remain on banks’ books for an extended period of time. If assets have not, in fact, been recovered within a reasonable period of time, they should not, for purposes of IAS and financial statement, be considered “bankable assets.” The BR and its application can be strengthened in this area.(EC 4)</p> <p>When updating BR/09, the supervisor should also consider requiring banks, through policy, to include off-balance sheet items (EC3) in the classification and provisioning process, including in the Rule stringent provisions for upgrading classified assets,</p>

	<p>placing credits back on an accruing status if and when warranted, and rebooking credits that have been written off. An updated BR/09 should also have as one of its focal points, the objective of ensuring that banks accurately reflect the fair value of their assets in financial reporting, through in part, accurate classification of assets, accurate and timely loan loss provisioning, well-supported collateral values.</p> <p>Lastly, as stated in CP 8, the supervisor conducts a thorough evaluation of individual credits, credit administration, and systems and controls during onsite reviews. However, it could further enhance its effectiveness, in practice, by increasingly elevating and focusing on borrowers' repayment capacity in addition to historical performance or past due status. More robust conclusions about overall risk levels, relative to the total portfolio and capital, risk identification and management systems, and board and management oversight are also needed to tie together the work already performed by the supervisor.</p> <p><u>2010 update</u></p> <p>The MFSA recognizes that there is heavy reliance on property as collateral within Malta; however, adoption of a national real estate price index requires technical input from the Central Bank, the NSO, the local Chamber of Architects, and other entities. While not explicitly addressed in the on-site examination manual, the MFSA reviews collateral valuations prepared by independent, bank-appointed architects to evaluate the reasonableness of assumptions and conclusions.</p> <p>The MFSA also notes that the provisioning requirements contained in BR/09 are more stringent than EU requirements. On average, banks discount the market values of pledged properties by approximately 30% thereby creating a level of comfort that loan portfolios are not inflated by fluctuations in market valuations of properties. In January 2008, the MFSA formalized the discounting process in BR/04 and the Capital Requirement Directive (CRD) by requiring a 30% discount on residential properties and a 50% discount for commercial properties.</p> <p>Revisions are pending to IAS 39, which once finalized, will be adopted in BR/09 so as to reconcile to the extent possible this Rule with IFRS. The MFSA established an internal working group (together with representatives from the CBM) in July 2010 to review BR/09 and make recommendations for changes where necessary. The review will also include the requirements for upgrading classified assets, returning NPL's to accrual status and re-booking loans that previously were written-off. The goal of these efforts is to ensure that banks accurately and timely grade assets, that exposures are well supported by realistic collateral values, and provisions are fully adequate to reflect loss potential.</p> <p>Regarding credit analysis, on-site examiners continue to include individual loan write-ups in examination reports, and all credit risk reports include a recalculation of the capital ratio when down-grading of credit facilities results in higher levels of loan loss provisions, and the final conclusions of the inspection indicate these results.</p>
<p>Principle 10. [formerly CP 9]</p>	<p>Large exposure limits. Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.</p>

Description	<p>Essential Criteria:</p> <p>BA Art. 16 establishes the authority of the supervisor to prescribe rules for large exposures. BR/02, updated to comply with the related EU Directive, sets forth the rules and requirements for the monitoring and control of the same. Exposures to single borrowers or groups of related borrowers are not allowed to exceed 25 percent of Own Funds. BR/02 also defines a large exposure as 10 percent of own funds, the aggregate of which are limited to 800 percent of the bank's or group's consolidated own funds. The BA also sets limits on the extent of shareholding by banks in other banking subsidiaries and non-banking subsidiaries. "Exposures" include all claims and transactions of a client, both on and off balance sheet. BR/02 is applicable on a solo and on a consolidated basis.</p> <p>A "group of borrowers" or "closely related group" has been upgraded to be consistent with the relevant EU directive and is defined as: "(a) two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others, or (b) two or more natural or legal persons between whom there is no relationship of control, as defined in (a) above, but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all the others would be likely to encounter repayment difficulties." (BR/02 Art. 16) In practice, the supervisor, during onsite examinations, evaluates large borrowers and related relationships. The supervisor has the discretion to identify and aggregate debt that has not otherwise been identified or reported to the MFSA.</p> <p>BR/02 Art. 19 requires "every credit institution to have sound administrative and accounting procedures together with adequate internal control mechanisms for the purpose of identifying, monitoring, and recording all large exposures and subsequent changes...." The required management information systems and overall compliance with BR/02 are evaluated during onsite examinations, and the offsite process monitors such exposures through monthly and quarterly returns.</p> <p>Additional Criteria: (See above for definitions and limits on large exposures.)</p>
Assessment	2002/3 FSAP – Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: The legal framework and the supervisory practice are compliant with this Principle. However, as cited in CP 16 and CP 22, the supervisor should adopt the practice of citing violations of law in reports of examination. Violation of the large exposures limit, particularly when repeated and/or when involving a classified credit or relationship, should represent a serious infraction of law. Citing violations of law in reports of examination as well as through written correspondence (if such a condition is identified through the offsite process) establishes a pattern or practice that, eventually if continued, will require a supervisory response.</p> <p>2010 update Further changes to BR/02 are being considered in the context of requirements arising from the transposition of CRD II 2009/111/EC.</p>
Principle 11. [formerly CP 10]	Exposures to related parties. In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and

	write-offs of such exposures are made according to standard policies and processes.
Description	<p>Essential Criteria:</p> <p>The definition of “connected or related parties” for purposes of this Principle are included in 1) the BA Art. 2(1) under the definition of “director,” and, per the MFSA Self-Assessment, 2) the BA Art. 2(1) under the definition of “connected parties,” referencing BR/02 Art. 16 (Large Exposures), and BN/01, particularly Art. 14 (avoiding conflicts of interest in the lending function). Also, BA Art. 15 more specifically discusses the relationship of directors with the subject bank.</p> <p>The MFSA Self-Assessment refers to BR/02 Art. 16 (b) for the definition of “connected parties”: “two or more natural or legal persons between whom there is no relationship of control, as defined in (a) above, but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all the others would be likely to encounter repayment difficulties.” While this addresses connected parties for purposes of combining borrower indebtedness, it is unclear that this definition relates directly to parties “related” to the bank for purposes of considering them “insiders.”</p> <p>BR/02 Art. 25 furthermore requires: “Exposures to corporate bodies or persons connected to the lending credit institution, its officers or controllers require special care to ensure that a proper objective assessment is undertaken for the clear commercial advantage of the lending credit institution.” BR/02 requires regulatory reporting of all “exposures to connected persons connected to reporting bank,” “Exposures to Non-bank Subsidiaries,” and “Exposures to Subsidiary Credit Institutions.”</p> <p>More directly, the BA Art. 2(1) defines “director” as: “an individual occupying the position of director of a company, by whatever name he may be called, empowered to carry out substantially the same functions in relation to the direction of the company as those carried out by a director and in respect of a company registered or incorporated outside Malta includes a member of a local board or agent or representative of that company.”</p> <p>BA Art. 15 provides restrictions on “directors” and banks’ related interests: A credit institution, to the exclusion of an electronic money institution shall not:</p> <ul style="list-style-type: none"> (a) grant any credit facility against the security of its own shares or against any other securities issued by the credit institution itself or against any shares or any other securities of another body corporate in which the credit institution has control; (b) grant or permit to be outstanding, unsecured credit facilities or extend other banking services under terms and conditions more favourable than the credit institution would have otherwise applied - <ul style="list-style-type: none"> (i) to any one of its directors or their spouses whether jointly or severally as well as with third parties; provided that, in any case where unsecured credit facilities are granted, these shall not in the aggregate exceed the sum of €23,293.73 (LM 10,000); (ii) to any person in whom or in which the credit institution or any one or more of its directors is interested as a director, partner, manager, agent or member (other than as a shareholder in a company listed on the Malta Stock Exchange), or to any person of whom or of which any one or more of the bank's directors is a guarantor; (iii) to anybody of persons in which the bank or any one or more of its directors jointly or severally maintains control, not being itself a credit institution or the parent undertaking of the credit institution, a subsidiary of this parent undertaking or a subsidiary of the credit institution; and where the competent authority has reason to believe that such favourable terms and

	<p>conditions have been applied, it shall have the power to require the credit institution to rectify the position and if the credit institution fails to take the necessary action to rectify the position as required, the competent authority shall take such measures as it deems appropriate until the position is rectified;</p> <p>(c) grant to or permit to be outstanding in respect of any officer, other than a director, or any employee, unsecured credit facilities that in the aggregate exceed twelve months' emolument of such officer or employee; BN/01 provides MFSA guidelines on banks' management of credit risk-based on established best practices. Art. 14 more specifically directs that the board of directors must avoid "conflicts of interest leading to the overriding of the credit-granting and monitoring processes in instances of potential credits introduced by members of the board; and remuneration policies that contradict the institution's credit risk strategy." BN/01 also requires, among other things, Board approval and periodic review of significant credit risk strategies and policies.</p> <p>The only expanded definition of a connected party over and above directors is provided in BN/01, Art. 33 footnote: "related parties can include a credit institution's subsidiaries and affiliates, its major shareholders, directors, and senior management and their direct and related interests, as well as any party that the institution exerts control over or that exerts control over the bank." Therefore, the definition of a "connected or related" person <i>to the subject bank or consolidated company</i> for purposes of addressing and regulating relationships with "related parties" is limited in banking legislation to directors, their related interests, and to entities that banks control (except in the case of another credit institution and its subsidiaries) as defined above. The legislative definition does not include executive bank management, significant shareholders, or auditors and the related interests therein. Directors, their related interests, and banks' related institutional interests (with the exceptions), as defined above, are explicitly limited to receive bank credit on terms "no more favourable" than non-related counterparties.</p> <p>There are no explicit requirements for certain transactions with "related parties" to receive approval by the bank's board of directors.</p> <p>The supervisor does not require specific and separate procedures to prevent persons benefiting from the loan from being part of the preparation of the loan assessment or of the decision itself, although BN/03 on Internal Control Systems and BN/01 on Credit Risk Management require prudent segregation of duties within the bank itself and prudent underwriting standards, respectively. The limit for related party lending is specified above in BA Art. 15, aggregate of all unsecured loans to directors cannot exceed €23,293.73 (LM 10,000). No other limits or deductions for related party lending are provided.</p> <p>Banks are required, through BR/02, to report "exposures to connected parties connected to the reporting bank" and "exposures to subsidiary credit institutions." Connected parties, for purposes of reporting, are directors and their related interests as defined by BA Art. 15.</p> <p>Additional Criteria: BN/01 Art. 33 expands the definition of connected party to include executive bank management (and their related interests), significant shareholders (and their related interests), or auditors in the definition of connected or related parties.</p> <p>The reporting information on aggregate lending to connected and related parties does</p>
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	<p>not appear to include indebtedness of executive management, significant shareholders (and their related interests), or bank auditors. Limits on aggregate exposures to connected and related parties are the same as those for other borrowers, except with the proviso of aggregate unsecured credit limit on directors.</p> <p><i>Supervisory Practice</i></p> <p>During onsite examinations, transactions with related persons are evaluated. The examiners review the subject bank's IT system, the credit register, the selected loan portfolio, quarterly regulatory reporting, and Board minutes to identify and evaluate indebtedness of directors. Also, the internal audit process is evaluated to determine that it also incorporates such into its reviews.</p> <p><u>2010 update</u></p> <p>Following the recommendation of the 2002/3 FSAP Banking Rule BR/11 extension of the applicability of the arm's length principle by credit institutions authorized under the Banking Act 1994 was issued pursuant to the proviso to article 15(1) (a) (b) of the Act- Prohibited Transactions. This rule extends the applicability of the "arm's length" principle both in relation to the granting of credit facilities and to the extension of other banking services by credit institutions. Thus, in granting credit facilities and in extending banking services, credit institutions shall have procedures to ensure that the connected persons are not granted nor have outstanding credit facilities or other banking services under terms more favourable than those applied to other persons.</p> <p>BN/03-Internal Control Systems and BN/01-Credit Risk Management – both issued by the MFSA as best practice guidelines - require prudent segregation of duties and prudent underwriting standards, respectively.</p> <p>Reports submitted by banks to the MFSA provide information on aggregate lending to connected and related parties and include indebtedness of executive management, significant shareholders (and their related interests), or bank auditors.</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Largely Compliant
Comments	<p>2003: [i] The definition of connected parties should be expanded in banking legislation to include all pertinent parties, similar to that listed in the BN/01, Art. 33. (EC 1).</p> <p>[ii] Connected party transactions should be defined not only to include bank borrowing, but also all other business transactions with the bank.</p> <p>[iii] Specific Board approval, over certain established thresholds, should be required on director and executive management level transactions with the subject individual abstaining from voting. (EC 3, 4)</p> <p>[iv] The requirement that connected party transactions should be at an "arm's length distance" should be further defined. (EC 2)</p> <p>[v] The supervisor could give consideration to requiring deduction of connected party extensions of credit from capital. (EC 5)</p> <p>Subsequent Event: Following the assessment of this Principle, an amendment to the BA, Art. 15 (1) was introduced and passed by the House of Representatives that</p>

	<p>provided for an extension of the law through banking rules. The Rule extends the application of the principle “arm’s length distance” to credit institutions’ significant and qualifying shareholders, officers, auditors, consultants, and all related interests therein. It goes on to direct that persons benefiting from credit facilities or banking services should not take part in the preparation and the assessment leading to the approval decision.</p> <p>The final approval and implementation of this Rule addressed many of the outstanding issues cited above. More specifically, it addressed issues outstanding in EC 1, 2, 4, 6. The Rule does not explicitly require subject transactions to be approved by the bank’s Boards. However, this is considered also to fall under the more general requirement for prudent credit management. Additional Criteria 1, 2 have also been addressed. The new Rule strengthens compliance with this Principle. Full compliance was achieved upon full implementation of the new elements and on-going supervision thereafter.</p> <p>As a result of these subsequent actions and the final approval and implementation of the Rule, the compliance rating has been upgraded to Largely Compliant.</p> <p><u>2010 update</u></p> <p>The definition of connected parties has been amended to conform to EU Directives and thus addresses recommendations [i], [ii], and [iv] above. The latest amendments relate to 2006/48/EC and further changes will be required in respect of Directive 2009/111/EC (CRDII). Although specific limits exist in respect of unsecured exposures to connected parties, there are no limits on the aggregate exposures to all connected persons.</p> <p>In respect of recommendations [iii] and [v] above, the Banking Act and Rules do not set specific thresholds for abstaining from voting nor is there a requirement to deduct connected party exposures from capital; however, the authorities indicated they will give further consideration to these matters and to establishing aggregate limits for exposures to all connected persons.</p>
Principle 12. [formerly CP 11]	Country and transfer risks. Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks.
Description	<p>Essential Criteria:</p> <p>In recent years, with the advent of international credit institutions operating from Malta and the liberalization of controls banks hold wider international exposures; country and transfer risks now assume higher importance.</p> <p>BR/09 on Credit and Country Risk Provisioning provides the qualitative and quantitative criteria on which these risks have to be monitored.</p> <p>BR/09 Art. 33 and 34 define country risk as being composed by sovereign risk, transfer risk and other risks originating from international financing (normally covered in the area of credit export insurance).</p> <p>BR/09 Art. 47 states that financial assets in insolvent countries have to be fully provisioned, those in highly problematic shall be considered doubtful, those in problematic or in temporary difficulties shall be considered as normal risks.</p> <p>BN/03 sets out a best practice procedure to check onsite IT, risk management and</p>

	<p>internal systems to handle properly this family of risks.</p> <p>BR/02 Art. 52 (Large Exposures) clearly states that the MFSA does not consider appropriate to publish guideline percentages for an acceptable level of exposure to single countries. However, the banks are expected to set prudent limits for country exposure on the basis of their own risk assessments. The same is for the level of provisioning. So the banks are completely autonomous and they will be judged by the auditors and the MFSA, that assesses country risk in the course of its onsite examinations (see risk management assessment checklist).</p> <p>The level of country risk in the system is relatively low.</p> <p>Additional Criteria: (none)</p>
Assessment	2002/3 FSAP – Compliant; 2010 Independent Assessment - Compliant
Comments	<p>2003: The overall framework complies with essential criteria. However, in order to make country risk provisioning more consistent throughout the system, some kind of general benchmarking (i.e. guidelines by Maltese Bankers Association in accordance with the MFSA and/or the Central Bank) could be instituted to ensure consistent treatment of like exposures.</p> <p>While the level of country transfer risk in the form of direct lending and transactions is relatively low, the MFSA has incorporated this risk into its requirements for sound credit risk management in banks (Art. 21 BN/01). The role of senior management in this matter should be timely verified.</p> <p><u>2010 update</u> The MFSA considers, and the assessors concur, that Pillar II of the CRD is sufficient to address these risks.</p>
Principle 13. [formerly CP 12]	Market risk. Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.
Description	<p>Essential Criteria:</p> <p>The overall exposure of the Maltese banking system to market risk is relatively low. However, with the introduction of the Capital Adequacy Directive (BR/08), credit institutions <i>were</i> required to distinguish between their banking and trading book activities. Banks are requested to have systems to measure and monitor their market risk, including interest rate risk and settlement/ delivery risk (BR/08 Art. 22). They are also required banks to have policy statements defining their trading book activities. Such documents are agreed upon with the supervisor. Compliance with the BR and internal policies as well as with limits is evaluated during onsite examinations. Monitoring and control is undertaken through quarterly returns received under BR/08 and BR/04.</p> <p>BR/08 empowers the MFSA to impose a specific capital charge and/or specific limits on market risks. BR/08 sets out the criteria and addresses the use of models in the measurement and calculation of market risks. At present no bank has a VAR model validated by the MFSA.</p> <p>BN 03, Notice on Internal control Systems, addresses on a broad basis, the role and</p>

	<p>responsibilities the Board and management have in ensuring that proper policies and controls exist to address various institutional risks and the reporting of that risk.</p> <p>The supervisory authority reviews and evaluates market risks in onsite and offsite examinations through using a set of checklists that address market and other risks. Although these guidelines provide overall direction for review, there is a need to expand the checklists into formalized examination procedures that provide more guidance and specificity to both the supervisors and the banks themselves.</p> <p>Additional Criteria: The supervisor evaluates market risk through both on and off site reviews. It uses checklists to assist in the process. BN 03 also directs boards' and management's role in the overall internal control process of the bank. Using these documents as a basis, the supervisor evaluates management and MIS.</p> <p><u>2010 update</u> Market risk is integrated into the ICAAP document for internal capital requirement purposes and to the ICAAP-SREP interaction process. Specific limits for foreign exchange risk were removed with adoption of the Euro in 2008, although retaining limits for net open positions in terms of the relevant provisions found in BR/08 in non-Euro currencies may be justified.</p> <p>The MFSA has, thus far, conducted regular off-site analyses for all banks and on-site inspections at the major banks in order to evaluate market risk. Following introduction of BR/12, the MFSA is also conducting a review of all material risks in banks including market risk.</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: The overall legislation for market risk oversight is in place, and selected staff has been devoted to this area. However, there is a need to draw higher level examination and supervisory conclusions about the overall risk management environment and board and management oversight, pursuant to BN 03. (EC 4, 6) Also, more detailed guidance through not only the existing checklists and overall BN 03, but through more fully developed examination procedures should be prepared. (EC 7) While selected staff focus on market risk, continued efforts to expose and train the overall staff to increasingly sophisticated market risk issues is encouraged.</p> <p><u>2010 update</u> During on-site inspections, examiners determine whether limits, systems and controls exist and confirm compliance. Thus far, there have been no occasions for the MFSA to impose limits on locally-licensed banks.</p> <p>The MFSA maintains close communication and continuous exchange of information with the CBM regarding market risks and stability of the financial system, both formally and informally. Under auspices of the Domestic Stand Group, the MFSA and the CBM have in the past three years conducted crisis management simulation exercises as well as a systemic impact assessment during 2009.</p>
Principle 14. [formerly CP 13]	Liquidity risk. Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies

	and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.
Description	<p>Essential Criteria:</p> <p>BN/03 (internal controls) is a directive on the framework for the evaluation of the control systems that includes the oversight of the Board. The compliance to these provisions is examined onsite through interviews and questionnaire. The MFSA promotes the set-up of several committees (Audit, ALCO, Credit, and Finance Committee) to strengthen the risk management process.</p> <p>As regards the liquidity, BR/05 requires continuous liquidity oversight and establishes the criteria for a maturity ladder and a minimum liquid assets ratio. – <i>CEBS Guidance</i>.</p> <p>BN/04 identifies best practices on Interest Rate Risk Management in order to provide guidance to the credit institutions with reference to board and management oversight, adequate risk management policies and procedures, risk measurement, monitoring and control functions and comprehensive internal controls. [refer also to CP 16, Interest Rate risk]</p> <p>There are no specific requirements for operational risks; they are examined onsite in connection with the single remaining risk profiles related to the business lines inspected (e.g. credit risk). In view of the implementation of new Basel Accord, a specific reflection has been started with the two main domestic banks. [refer also to CP 15, Operational risk]</p> <p>Even if a credit institution does not have a trading book, the capital requirements for foreign exchange risk are applicable (Annex I BR/08). [refer also to CP 13, Market risk]</p> <p>In the analysis of a bank's Risk Management Framework (see Internal Control Checklist for risk assessment), foreign exchange risk is analysed for "sensitivity to market risk" rating. [refer also to CP 13, Market Risk]</p> <p>Additional Criteria:</p> <p>To date no rule has been issued requiring capital allocation to other risks different from credit and market risk, although the supervisor is allowed to do so, in general terms, by BA Art. 4(2). BR/07 requires the banks to disclose information on all the risks arising from the activities undertaken by the institution. This includes also disclosure required by the IAS 32 and the management of operational and legal risks.</p> <p>The Central Bank receives daily information on banks' foreign exchange exposure and liquidity positions. The MFSA receives monthly information on the same. If, in the interim, an aberration in the positions occurs, the Central Bank notifies the MFSA. Management of foreign exchange positions is evaluated during onsite examinations.</p> <p>2010 update</p> <p>The MFSA intends to amend BR/05 to incorporate the relevant provisions from CEBS and BIS guidelines on Liquidity Buffers and Liquidity Risk Management. Moreover, the MFSA requires institutions to actively monitor and mitigate their Liquidity Risk on a day-to-day basis and to provide details of Liquidity Funding Contingency Plans in ICAAP assessments.</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Compliant

Comments	<p>2003: While the MFSA requires that individual banks have appropriate risk management processes, specifically in liquidity and interest rate risk areas, there is a need to consider the overall risk management processes in a bank's operation. BN03 establishes the responsibilities of Boards and management in the internal control and risk monitoring process. However, the supervisor should draw more concise conclusions about the risk profile and management of the various risks in the reports of examination. (EC 1,2) The supervisor has appropriately identified individuals that have and can conduct more specialized bank reviews. However, there remains a need to further enhance the overall staff's training in this area. Examination procedures for the analysis of risk exposure also need to be prepared.</p> <p><u>2010 update</u> On-going training for this and all other areas is a normal process of MFSA's approach to supervision.</p>
Principle 15. [formerly CP 13]	Operational risk. Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.
Description	<p>2003: (new Core Principle; not reflected separately in 2003 assessment.)</p> <p><u>2010 update</u> BR/04 Appendix 4 requires credit institutions to hold own funds against operational risk in accordance with the methodologies set out in three approaches: Basic Indicator Approach; Standardised Approach; and Advanced Measurement Approach. CEBS also provides guidelines on Operational Risk Mitigation Techniques.</p> <p>BR/12, Annex 2H requires banks to implement general risk management principles as adopted from the equivalent CEBS guidelines. Such guidelines encompass control and mitigation of operational risk.</p> <p>Following issue of Basel II/EU Directive 2006/48/EC, banks now are required to allocate capital for operational risk through BR/04 and for Pillar II risks through BR/12.</p>
Assessment	2002/3 FSAP – (not applicable); 2010 Independent Assessment – Compliant
Comments	<p>2003: (previously included as part of CP 13, Other risks)</p> <p><u>2010 update</u> The MFSA indicated that specific CEBS guidelines contained in the “Compendium of Supplementary Guidelines on Implementation Issues of Operational Risk” will be reviewed with a view to incorporating them into BR/12 or BR/04.</p>
Principle 16. [formerly CP 13]	Interest rate risk in the banking book. Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well-defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk.
Description	2003: (new Core Principle; not reflected separately in 2003 assessment.)

	<p><u>2010 update</u> BR/12, Principles for Management of Interest Rate Risk in the Banking Book (IRRBB), outlines principles for institutions and provides guidance for supervisors.</p> <p>Banks are required by BR/12, Annex 2F (adopted from CEBS Guidelines) to implement specific principles for managing IRRBB, and the MFSA emphasizes the principle of proportionality.</p>
Assessment	2002/3 FSAP – (not applicable); 2010 Independent Assessment – Compliant
Comments	<p>2003: (previously included as part of CP 13, Other risks)</p> <p><u>2010 update</u> The requirements of BR/12 are applied by the MFSA in a proportionate manner to reflect the nature, scale and complexity of the activities of an institution and are reflected accordingly in ICAAPs and SREPs. Although a formal definition of proportionality does not yet exist, the MFSA requires institutions to apply the concept in practical terms relative to the size and complexity of the institution. It is also noted that the majority of loans in banks' loan portfolios are on a variable rate basis and the bulk of deposits are non-interest bearing demand deposits or short-term time deposits, thereby mitigating interest rate risk.</p>
Principle 17. [formerly CP 14]	<p>Internal control and audit. Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.</p>
Description	<p>Essential Criteria: A bank must demonstrate that it possesses the technical, organizational and personnel preparedness and management and control systems, including an internal control and audit departments, and a system of risk management prior to commencing banking business.</p> <p>BR/01 refers to the need of a mix of executive and non-executive directors on the Board of the banks. BN/03 (on Internal Control Systems) presents the role of boards and management in the internal control process. Examiners test against this guidance in the examination process. The Maltese banks are encouraged to have an Audit Committee that is composed by mostly non-executive Directors.</p> <p>Various Banking Rules, particularly, as stated above in several instances, BR/12 and Bank Notices require appropriate internal controls, adequate to a credit institution's business activities. During onsite examinations, the supervisor reviews the organizational structure (duties and responsibilities, delegation of powers, decision-making procedures), accounting procedures, checks and balances. (BN/03, BA Art. 7(1)b)</p> <p>The supervisor regularly, through its onsite examination process, meets with the internal audit function to determine issues recently identified. Furthermore, the</p>

	<p>supervisor periodically conducts specific evaluations of the internal audit structure and level of auditing. This is done by holding discussions with the internal auditor regarding the audit program, findings in the various areas, and evaluating those findings during the onsite examination process. The supervisor, through this process, also determines if the auditor is independent, has free access to all bank records and is adequately staffed.</p> <p>Professional competence, integrity, skills etc. of the members of statutory board, supervisory board, top management and controller is a condition for obtaining a banking license (Art. 40 BR/01).</p> <p>Additional Criteria: BR/01 prescribes that the Board consists of a mix of executive and non-executive directors of experience.</p> <p>BN/03 requires the Internal Auditor to report to the Audit Committee (except for small banks).</p> <p><u>2010 update</u> BR/01 refers to the need for a mix of executive and non-executive directors on boards of directors of banks and BN/03 (on Internal Control Systems) addresses the role of boards and management in the internal control process. Examiners test against this guidance in the examination process. The Maltese banks are encouraged to have an Audit Committee (requirement for listed institutions) that is composed entirely of non-executive Directors.</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: While the legal requirements specified by the Essential Criteria are generally met, review of reports of examination and discussions with supervisors indicated that enforcement of strong board governance in ensuring adequate internal control and audit processes should be further emphasized. Reports of examination could be enhanced by drawing more concise conclusions about the adequacy of board and management oversight. In particular, the guidelines in BN 03 could be re-enforced, ensuring the proper composition and function of banks' audit committees. (EC 1,2,3)</p> <p>Also, the role and activity of the external auditors in the assessment of the risk exposure (especially credit risk and provisions), and their relationship with the Audit Committee, should be specifically verified.</p> <p><u>2010 update</u> When conducting SREPs, the MFSA evaluates corporate structure, internal governance, and the internal controls of an institution. Within this context, BA Art 17B was added to the Banking Act in 2007 to address internal governance and BR/12 incorporates CEBS requirements; relevant appendices of BR/12 provide explicit principles.</p>
Principle 18. [formerly CP 15]	Abuse of financial services. (Previously Money Laundering) Supervisors must be satisfied that banks have adequate policies and processes in place, including strict “know-your-customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.
Description	Essential Criteria:

	<p>Banks are required to comply with the Prevention of Money Laundering Act and Regulations (PMLR) of 1994. Credit institutions licensed in terms of the BA and the Malta Financial Services Authority Act have to comply with prevention of money laundering Guidance Notes, which complement the relative legislation. Compliance with prevention of money laundering standards is a license condition.</p> <p>The Prevention of Money Laundering Regulations are featured as Legal Notice 195/94 as amended by 156/2000 and 298/2002 <i>and as further amended by inter alia LN/199 of 2003, LN/42 of 2006, LN/180 of 2008, LN/328 of 2009</i>. This Legal Notice is issued in terms of the PML Act. The penalties established in cases of non-compliance are included in the main legislation itself. Furthermore, Legal Notice 155/99 issued in terms of the Banking Act itself includes an administrative fine for failure to abide with license conditions.</p> <p>The Guidance Notes aim to establish clear lines of responsibility and accountability with respect to persons authorized to carry on ‘relevant financial business’, and to ensure that policies, procedures and controls are maintained to the highest possible standards. The Regulation and Notes require that banks to:</p> <ul style="list-style-type: none"> • maintain proper customer identification, record keeping, and internal reporting procedures; • ensure employees are aware of: PML Act and regulations, Guidance Note procedures; • train employees periodically in the recognition and handling of suspicious transactions; • appoint a Money Laundering Reporting Officer (MLRO) with explicit responsibilities for ensuring compliance, who possesses the appropriate authorities for information access and to disclose information to the appropriate officials; • maintain internal Money Laundering Handbooks issued as part of the on-going training process of credit institution employees. <p>Banks are required to file, for regulatory purposes, a copy of any Suspicious Transactions Report filed under the Regulation. The BA Art. 34 specifically removes liability of a reporting person who transmits information regarding suspicious activity in good faith. The BA Art. 25 allows for information sharing in general with other foreign and domestic supervisors. Banks are required to have a statement on ethics and professional behaviour.</p> <p>Adherence to the AML legislation is monitored through onsite examinations that feature as a regular element in the various annual inspection programs. AML examinations are conducted approximately once every two years for each institution. Also, when a bank is undergoing an examination in another area of risk, AML procedures applicable to that area are covered. The supervisor evaluates the internal audit procedures for AML periodically to determine scope and quality of coverage. A specific checklist or examination procedure is followed includes all of the requirements contained in the legislation.</p> <p>Additional Criteria:</p> <p>The AML laws and guidance notes comply with international practices such as the FATF recommendations. Malta has set up the FIAU in October 2002 and to extend regulations to all economic and business articles. Nominee companies were a weakness in Malta’s anti-money laundering controls as they acted as an obstacle to the identification of beneficial owners. Nominees were required to provide financial institutions with information on beneficial owners for accounts held and by 2004</p>
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	<p>nominee companies were phased out.</p> <p>All supervisory staff is trained on the prevention and detection of money laundering, and under PMLR 11, the supervisor possesses the legal obligation to report any suspicious activity of which it becomes aware.</p> <p>Officials of the Banking Unit have participated in international fora on fraud and anti-money laundering measures. The Malta Financial Services Authority, as the competent authority, is a member of an ad hoc Joint Committee on the Prevention of Money Laundering, chaired by the Central Bank, which includes representation of the banking sector.</p> <p>The Banking Unit is called upon regularly to organize training for its own staff and for credit and financial institutions, law enforcement agencies and relevant government bodies.</p> <p><u>2010 update</u> The FIAU has the primary responsibility for assessing compliance with laws and regulations in this area. Considerable progress has been achieved by the FIAU since its establishment in October 2002. The relevant AML/CFT regulations have been reviewed in the context of the Third Money Laundering Directive and revisions made to conform. The MFSA cooperates with FIAU to achieve adherence to this criterion. Guidance Notes drafted by the FIAU have now been issued for consultation.</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: Law and Guidance Notes are in technical compliance with the Principle. Supervisory practice is also in substantial compliance with the given criteria. The FIAU has been established, and the phasing out of nominee accounts.</p> <p>An explicit requirement for a policy statement on ethics and professional behaviour should be introduced, as well as administrative penalties for banks failing to comply with the MFSA and money laundering guidelines.</p> <p><u>2010 update</u> Training for AML/CFT matters is now conducted by the FIAU, and several initiatives have been organized in this area over the years. A training seminar on ML/FT was held in 2009 for the MFSA staff, and inspectors from the Banking Supervision Unit continue to participate in international fora.</p> <p>During on-site inspections, banks' internal guidelines are reviewed to assess compliance to the new regulations and examiners collect information on behalf of the FIAU during on-site inspections. FIAU inspectors may participate in conjunction with the MFSA's on-site inspection or carry out their own assessment at licensed subject-persons.</p>
Principle 19. [formerly CP 17]	Supervisory approach. An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.

Description	<p>Essential Criteria:</p> <p>As stated, BA A. 25(7) provides for bilateral and trilateral meetings with credit institutions' management and external auditors. The MFSA practices on-going communication with institutions' management, and invariably meetings with senior management are undertaken prior to and following on site examinations. In addition, meetings are held with management as necessary to discuss new products and other areas of interest as needed and as determined by the condition and status of the subject institution.</p> <p>The supervisor has a thorough understanding of the activities of its banks through on-going surveillance conducted by the combined on site and off site supervisory functions and meetings with management as necessary.</p> <p>BA Art. 28 (a) requires bank management to advise the MFSA of any <i>material</i> adverse developments.</p> <p>BA Art. 7 and BD/01 requires evaluation of management during the licensing process. This requirement is continuous per BA A. 20(8). A. 32 provides for the disqualification of officers under certain circumstances, and A. 9(3) allows the supervisor to remove or replace officers of a credit institution.</p> <p>While the BA, BD, and practice call for and ensure on-going communication with management, communication with Board of Directors is remiss. Reports of (on site) examination are not addressed to the Board of Directors and the supervisor does not communicate with the Board of Directors on a regular basis. If an extenuating circumstance or supervisory concern arises, the supervisor indicated that the Board would be contacted.</p> <p>Additional Criteria: (none in 2003)</p> <p><u>2010 update</u> Given the relatively low number of banks authorized locally, the MFSA has developed and maintained a thorough and forward-looking understanding of the operations and risk profiles of individual banks and the banking system; complex banking groups do not, at present, exist in Malta. Liaison and collaboration with the CBM on many issues not only on a formal basis through the auspices of the CBM/MFSA Standing Committee, but also in the stress testing of individual banks, has provided valuable knowledge on the system in aggregate.</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Largely Compliant
Comments	<p>2003: The supervisory process does not include regular communication with bank boards. (EC 1) All contact with institutions is directed to executive management. While the Internal Audit, by law, is required to report to the Board and the External Audit also reports to the Board (or a committee thereof), supervisory reports do not receive the same elevation. There are instances where the supervisors have identified significant issues and have not met and reported to the board their concerns. By law and through the supervisory framework policy, Boards of Directors are held accountable for the safe and sound operation of their institution. In order that proper governance is enforced and the Boards are reminded of their responsibility, as well as for the supervisor to properly discharge its responsibility, all reports of examination should go to the board of directors. Likewise, at a minimum, a meeting should be held with each institution's board once a year or once during the supervisory cycle. This</p>

	<p>channel of communication should be opened and developed in the immediate future.</p> <p><u>2010 update</u></p> <p>Officials in the Banking Supervision Unit acknowledge the value of conducting meetings with the boards of directors and had started doing so after the FSAP in 2003; however, it was necessary to suspend the meetings in 2007 when CRD priorities took precedence. Officials indicated that meetings with boards will be resumed before YE-2010 [refer also to CP-20 below].</p> <p>At a minimum, two types of meetings are recommended: (i) an annual tri-partite meeting involving the MFSA, the external auditor, and bank senior management (including the internal auditor), the purpose of such meeting being to review the results of the annual external audit; and (ii) a meeting with the board of directors of a bank following each full scope examination, the purpose being to review the findings and conclusions of the examination and to solicit feedback from non-executive directors and allow them to ask questions directly to the regulator.</p>
Principle 20. [formerly CP 16]	Supervisory techniques. An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.
Description	<p>Essential Criteria:</p> <p>The banking supervisor is guided by an operating policy, “The Framework of Banking Supervision” that was adopted during the time bank supervision resided in the Central Bank. It prescribes a risk-based approach to supervision, states that the safe and sound operation of an institution rests with the directors and senior managers of an institution, and expects the inspectors to be able to understand the risks of an institution as well as its management quality. It describes the overall activity of both the on and off site functions, calls for an annual examination plan, and sets forth the CAMEL rating system. The policy describes the overall activity appropriately and sets forth the practice of supervision. Accordingly, the off-site and on-site reports are very comprehensive and descriptive of the issues in the subject financial institutions.</p> <p>Three departments, including on-site and off-site supervision, form the bank supervisory framework of the MFSA. The function possesses a full range of tools provided through the regulatory framework, external audit function, comprehensive prudential reporting, onsite evaluation, and communications with bank management. The bank specific oversight process is balanced between off and onsite, with the off-site function monitoring, on an on-going and quantitative basis, performance trends and regulatory compliance monthly and quarterly. The off-site function also verifies and closely analyses the annual published audited statements for consistency and for accuracy against prudential returns. The above reporting and analysis is further supported by verification of regulatory reports and evaluation of compliance with legislation by the onsite function. The two functions are generally well integrated to avoid supervisory gaps. As discussed below and in other areas of this assessment, continuing the implementation of a risk-based approach, which explicitly places increased responsibility and accountability on Boards and executive management (i.e. strengthening corporate governance), is encouraged. Monitoring overall trends and developments has, to date, been the domain of the Central Bank in its Financial Stability Department.</p> <p>The on-site function utilizes information from a variety of sources in order to plan and target each bank examination. Recent off site analyses, prudential reports, annual reports, external audit management letters and bank responses, and requested information from the bank is reviewed. Through this process and using examination checklists, the examination team focuses on areas of risk and scopes the subject</p>

	<p>examination accordingly.</p> <p>Internal control review is an integral part of the examination process, and is complemented by review of each bank's internal audit to assess 1) the propriety of the internal review process, its independence, and management and Board reporting, and 2) the level of reliance the examiners can place on the function.</p> <p>BA Art. 19 (1), 20 (1) requires credit institutions to submit information to the MFSA as required for offsite monitoring purposes. BR/02, 03, 04, 05, 06, and 08, contain formats of reports that have to be submitted. BA Art. 20 (3)(a) requires, upon written notice served on a credit institution, that the institution provide a report by an accountant or other person with relevant professional skill on, or on any aspect of, any matter about which the competent authority has required or could require the institution to provide information. Art. 22(1) authorizes the MFSA to verify such data. Art. 25 (7) authorizes bilateral and trilateral meetings between the credit institution, the MFSA, and the institution's external auditor as needed, always to be chaired by the MFSA.</p> <p>Additional Criteria:</p> <p>The effectiveness of on and off site supervision has on a number of occasions been monitored, primarily according to the annual activity report, which evaluates the work done by the Banking Supervision Unit. The report may also be forwarded to the Director General who assesses the results achieved against the pre-set program drawn up by the BSU and any ad hoc requirements that may have arisen during the course of the annual program period. Reference to MFSA Annual Report.</p> <p>The supervisor has full access to banks' internal and external audit reports, as provided by BA Art. 22 (5) and (7) which states that no documentation or information can be withheld from the supervisor. Art. 25(3) provides for bilateral / trilateral external auditor meetings.</p> <p>Through off-site and on-site work, discussions with bank management, and review of internal audit, the supervisor establishes the key risks to which banks are exposed. Supervisory oversight is then prioritized accordingly.</p> <p>The Professional Secrecy Act (1994) provides for the confidentiality of information acquired in the course of carrying out supervision. BA Art. 19(5) states that information furnished by any credit institution shall be regarded as confidential except that the supervisor shall furnish such information as may be required by the Minister or Central Bank and shall inform the Minister and the Central Bank if at any time there is concern regarding the condition of the subject credit institution.</p> <p><u>2010 update</u></p> <p>Reports of on-site examinations now address many aspects of bank conditions and performance including, inter alia, credit quality, risk management processes, bank management and board oversight. Moreover, reports have been tailored to incorporate recommendations offered by previous FSAP assessors.</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Largely Compliant
Comments	<p>2003: While the process of supervision is comprehensive, several next steps were identified that could further enhance the function:</p> <ul style="list-style-type: none"> • Focus increasingly on drawing conclusions about risk and on the adequacy of board and management oversight in the individual reports, both on and off site.(EC 1) • Procedures for both on and off site activities should be formalized and used

	<p>during each supervisory event. On site procedures from an examination manual could be tailored to each institution, included in the work papers for each examination, and should reflect the responses of the examiner performing the step.</p> <ul style="list-style-type: none"> • Further consideration should be given to the role and function of the Supervisory Council to determine its governance function for the MFSA. “Rules of procedure” should be prescribed for the Council that determine, in part, reports it should receive, information regarding critical issues disclosed during examinations, supervisory responses and actions the department should take, and overall decision making process. • Evaluate the frequency of on and off site events to ensure that developing and existing risks are addressed in a timely manner. (EC 1) • Due to their systemic implications, domestic banks receive primary supervisory attention. The supervisory approach should continue to evaluate, on an on-going basis, the international banking sector ensure that potential risks do not arise and go undetected. Supervisory strategies should be developed for each bank, both domestic and international, in the marketplace. (EC 1) <p>Consideration could be given to enhancing the MFSA’s role in identifying and monitoring the risk and risk levels in the industry as a whole. This is particularly pertinent to the MFSA as it has access to first-hand knowledge of the business strategies, risk exposures, and risk management systems within the banking industry. This activity could be designed to complement that performed by the Central Bank. (EC 2).</p> <p><u>2010 update</u></p> <p>Acting on recommendations in the 2003 FSAP, the MFSA-BSU began holding meetings with boards of directors of several banks, and there are various other occasions where MFSA officials meet with executive managers and directors of institutions. Due to priorities of CRD transposition and the implementation of ICAAPs and SREPs, regular meetings were suspended but will be resumed later in 2010. [refer also to CP-19 above.]</p> <p>A priority is the need for additional experienced personnel in order that the Banking Supervision Unit can fulfil its increasing responsibilities for on-site inspections, ICAAPs, SREPs, enhance compliance with all CRD’s requirements, and the full array of risk assessments.</p>
Principle 21. [formerly CP 18 and 19]	Supervisory reporting. Supervisors must have a means of collecting, reviewing and analysing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.
Description	<p>Essential Criteria:</p> <p>Supervisory information is validated specifically through on site examinations and also through the use of external auditors and their work in verifying internal accounting systems and controls. The supervisor also receives, analyses, and comments on the external auditors management letters and responds to all license holders. Furthermore, bilateral and trilateral communications occur, as provided in the BA, as needed. The BA Art. 20(3) (a) also provides the supervisor with the authority to commission, at bank cost, specific reviews of identified areas as it deems necessary.</p> <p>BA Art. 31 require that each year every institution shall appoint an approved auditor to</p>

	<p>report on the financial statements of the consolidated institution and on all financial statements prepared by the credit institution. If an institution fails to appoint an auditor or at any time fails to fill a vacancy in the office of an auditor, the supervisor has the power to appoint an auditor. Art. 31 (2) goes on to specify the statements that shall be contained in the auditors' report regarding information access, accuracy, and fair and true view. It further requires that the auditors' report shall be read together with the report of the directors of the institution at the annual meeting of the shareholders. The institution is required to provide the supervisor with the notice of appointment of the auditors and certain changes therein. The supervisor can require an institution to change its auditors if they are deemed unfit. The auditor, under this Article, must immediately advise the supervisor if he decides to qualify the report or becomes aware of any matter, which could have a serious, adverse impact on the depositors of the subject institution.</p> <p>The supervisor has the authority, per BA Art.20, to make use of external auditors to examine specific aspects of banks' operations. It further lays out the information access provisions for such an appointed auditor or representative of the MFSA when performing reviews. Art. 25(7) provides for tri-lateral and bilateral meetings between the supervisor and the institution's external auditor with or without the presence of the institution. Art. 26(6) authorizes the supervisor, if necessary, to produce regulations under which such accountants are to operate when so appointed for the purposes of the BA.</p> <p>The BA Art. 21 provide the supervisor full access to the institution and its information. While nothing in the law prohibits access to the board of directors, the supervisor typically does not access or present to the board of directors. (See CP 17 above.)</p> <p>Checklists, which guide the onsite examination process, are reviewed and used during the validation procedure. However, formal examination procedures have not been adopted by the department.</p> <p>Additional Criteria:</p> <p>While the supervisor has access to bank boards of directors by law, it does not make a practice of meeting and communicating with them on a regular basis. Therefore, if aberrations of reported information are identified through the validation process, they may not be reported to the boards on a timely basis. This may result in a delay in requiring board attention and remedial action. See CP 17 and 22 for ratings and discussions that incorporate these aspects of communication and enforcement.</p> <p>The supervisor, as noted above, meets periodically with external auditors as allowed by law.</p> <p><u>2010 update</u></p> <p>The Banking Supervision Unit has a formal inspection manual that is comprehensive and includes detailed guidance for conducting inspections, part of which includes verifying the accuracy and reliability of data submitted to the MFSA in off-site returns.</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Compliant
Comments	2003: The use of more formal examination procedures could help to guide the on-site process as well as to document and support examiner work if and when called into question. The supervisor should consider adopting a policy of regular communication with bank boards to enforce sound governance and to convey to the boards their responsibilities in the safe and sound operation of the bank. See CP 16, 17, and 22 for

	<p>more thorough discussion.</p> <p>2010 update The Banking Supervision Unit is in the process of updating the inspection manual and re-starting regular meetings with banks' boards of directors.</p>
Principle 22. [formerly CP 21]	<p>Accounting and disclosure. Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.</p>
Description	<p>Essential Criteria:</p> <p>BA Art. 19 and the supporting BR/06 provide the supervisor the authority to request all pertinent information from a bank. BR/06 specifically directs the information and format that the information is to be submitted. Banks are required to adhere to IAS, in both their annual published financial statements and as a basis for on-going regulatory reporting. The supervisor has the authority to set the format and nature of regulatory reporting. Verification of regulatory reports is performed during banks' onsite examinations. The offsite supervisors review all regulatory reports for accuracy to the extent possible and also carefully verify and reconcile annual published statements to reported figures at year end. BR/07 prescribes the (minimum) format for annual published statements, consistent with IAS/IFRS and based on EU Directives. BA Art. 33 requires "every officer of a credit institution to take all reasonable steps to: (b) ensure that no incorrect information is provided either wilfully or as the result of gross negligence."</p> <p>BA Art. 31 (1)(a) requires "every credit institution each year (to) appoint an approved auditor whose duty shall be to report on the financial statements of the credit institution examined by them and on all financial statements prepared by the credit institution." This section of the BA goes on to specify the statements and opinions the auditors must make and to require that the auditors' report be presented at the annual meeting of shareholders. Section 6, 8, 9 specify required communication by the auditor or credit institution in certain cases such as resignation of the auditor, qualification of financial statements, and auditor identification of "any matter which relates to and may have a serious adverse effect upon the depositors of the credit institution....."BA Art. 31 (7) gives the MFSA the authority to require a credit institution to change its appointed auditors under certain conditions. All audit reports, including management letters and any other accompanying schedules are required to be submitted to the supervisor. BN/03 establishes the role and responsibilities of the external auditor.</p> <p>Communication is conducted with banks' external auditors as needed and is provided through the BA Art. 25 (7) and BN/03. The BA Art. 26 (1) specifically provides for the lifting of professional secrecy to the external auditor in order to communicate with the supervisor as necessary. BA Art. 30 requires banks to publish and display their annual audited financial statements within four months of the close of the financial year. Through BR/07, the supervisor has set the format of the published statements. Through Art. 20 of the BA, the MFSA has the right to require a credit institution to provide a report by an accountant (or other person) on any matter about which the supervisor has required. This, along with BN/03, allows the supervisor to set, under certain circumstances, the scope or standards in external audit reports.</p> <p>BA Art. 19 (5) and Art. 34 requires all bank information to be treated confidentially except in certain cases: in order to comply with law, court directive, and suspected money laundering.</p> <p>The supervisors, while placing reliance on and assigning responsibility to the external</p>

	<p>auditors, are not solely dependent upon the work of the external auditors to perform onsite work. Primary reliance is placed on the supervisory staff itself for onsite assessment and verification of financial information.</p> <p>Additional Criteria: BA Art. 30 and BR/07 establish the legal requirements for annual publication of financial statements. Banks that are listed on the Malta Stock Exchange are required to publish six month interim statements.</p> <p>BN/03 provides guidelines and best practice benchmarks for sound internal control systems, internal audit processes, and responsibilities of external audit. The supervisor routinely evaluates banks' internal audit functions to assess their effectiveness and the level of reliance the supervisor can place on them.</p> <p>BA Art. 26 and 31 require the external auditors to report to the supervisor any matters of material, adverse significance and protect the auditors from breaches of confidentiality in these cases.</p>
Assessment	2002/3 FSAP – Compliant; 2010 Independent assessment – Compliant
Comments	<p>2003: The framework and legal structure for regulatory reporting, external audit, and financial statement disclosure is in place and functioning. The BA requires that all information submitted to the supervisor be accurate and truthful. The verification process for information accuracy consists of the onsite examination process and external / internal audit. The use of enforcement provisions, including penalties, in instances of inaccurate financial statement to the supervisor and the public, has not been frequently required. However, as such cases occur, the supervisor should establish and use tests of materiality and well as substance to determine what remedial actions should be taken. The supervisor should not delay action when required, particularly in cases where the bank has misstated its position to the public and the regulator. Further discussion and rating of enforcement provisions and the use therein is provided in CP 22.</p> <p><u>2010 update</u> In 2008, the Companies Act was amended to require companies to prepare annual accounts in accordance with generally accepted accounting principles and practices as defined under the Accountancy Profession Act and regulations made there under. The Accountancy Profession (Accounting and Auditing Standards) Regulations 2009 then define generally accepted accounting principles and practices as meaning adherence to international accounting standards as adopted by the EU.</p> <p>Material changes to the regulatory framework of the accounting and auditing profession required by the EU 8th Council Directive on statutory audits of annual accounts and consolidated accounts resulted in review and revisions to the legislation relating to the accounting profession in Malta.</p> <p>The 8th Council Directive obliges EU Member States to have an effective system of public oversight for statutory auditors and audit firms. In 2005, the Accountancy Board enacted Directive 4 which delegated responsibility for quality assurance to the Quality Assurance Oversight Committee (QAOC). The QAOC is the policy-making body and regulatory of the quality assurance function in the accounting and auditing profession in Malta, and its main objective is to ensure that audit firms maintain the highest professional standards.</p>

	<p>The Quality Assurance Unit (QAU) conducts quality reviews of audit firms as the appointed agent of QAOC. The QAU conducts reviews in terms of the Accountancy Profession Act including conducting on-site visits, monitoring compliance with returns, and other issues relating to audit quality.</p> <p>On-site examinations conducted by the MFSA-BSU also compare their findings to internal audit results and management letters issued by external auditors.</p>
Principle 23. [formerly CP 22]	<p>Corrective and remedial powers of supervisors. Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation.</p>
Description	<p>Essential Criteria:</p> <p><i>Legal Framework</i></p> <p>The <i>legal framework</i> surrounding enforcement powers of the supervisor is relatively broad. Offenses that trigger supervisory response are enumerated through several provisions in the BA. The available enforcement actions or corrective action tools range from moral suasion, which has been the most frequent supervisory response, to relatively inconsequential penalties, the magnitude that is prescribed by the Attorney General and signed off by the MoF. Finally, in more severe situations, the bank is placed, in effect, in administration or the license is revoked.</p> <p>There is no intermediate remedial tool provided between the lesser effects of monetary penalties and the more severe actions of restricting licenses. There is no graduated system of enforcement provided in the law that is triggered by declining capital thresholds. BA Art. 33 and 35 address the duties of officers (directors, partners, managers, company secretary, or any person acting in such a capacity) and allow supervisory actions (penalties and imprisonment) against “any person” for certain offenses.</p> <p><i>Penalties and Sanctions:</i></p> <p>Penalties are assessed when an offense, as specified in the law, occurs. BA Art. 35 (3) establishes what is considered an offense. Art. 35 (3) states “any person” who:</p> <ul style="list-style-type: none"> (a) contravenes or fails to comply with any of the provisions of this Act; (b) contravenes or fails to comply with the provisions of any banking rule, electronic money institutions directive, regulation or license condition; (c) fails to comply with any lawful order or requirement of the competent authority or the Central Bank; (d) fails to comply with any lawful order or requirement of the Financial Services Tribunal; (e) fails to comply with any lawful order or requirement of any other person made under this Act; (f) without reasonable excuse alters, suppresses, conceals, destroys or refuses to produce any document which he is lawfully required to produce by any person under this Act, <p>shall be guilty of an offence.</p> <p>Therefore, based on this section, penalties may be applied. BN 155 details the nature of offenses and the maximum penalty. However, the magnitude of penalties is relatively inconsequential. See CP 1 (4) for a sample listing of allowed penalties.</p>

License Restrictions / Revocation

BA Art. 9 (1, 2, 3) provides the basis for automatic license suspension, license restriction or revocation and the types of restrictions that may be applied under the given circumstance. In addition to other license related circumstances, Section 2 of this Article states that the supervisor *may* impose restrictions on a license or *may* revoke a license in any of the following circumstances:

- (a) if any document or information accompanying an application for a license or any information given in connection therewith is false in any material particular or if the holder of a license conceals from, or fails to notify to the competent authority any document or information or change therein which it was its duty to reveal or notify under this Act; or
- (b) if the holder ceases to carry on banking business in Malta for more than 6 months; or
- (c) if the holder fails to comply with any of the provisions of this Act or with the conditions under which the license is granted; or
- (d) if the holder no longer possesses sufficient own funds; or
- (e) if the holder is likely to become unable to meet its obligations or can no longer be relied upon to fulfil its obligations towards depositors and creditors; or
- (f) if the holder has insufficient assets to cover its liabilities; or
- (g) if the holder has suspended payment or is about to suspend payment; or
- (h) if the competent authority considers that, by reason of the manner in which the credit institution is conducting or proposes to conduct its affairs, or for any other reason, the interests of the depositors of the credit institution are threatened.

Restrictions provided in Section 3 of the Article, on the basis of Section 2 above, shall be those the supervisor “shall consider appropriate for the proper compliance by the credit institution with the provisions of this Article and the conditions, if any, of its license and for the protection of depositors and may include:

- (a) the removal of any officer of the credit institution or the replacement of any officer by such person as the supervisor may designate;
- (b) the requirement for any person who directly or indirectly possesses a qualifying shareholding in the credit institution to divest himself of all or part of that holding;
- (c) the requirement for the credit institution to take or refrain from any action;
- (d) the requirement that the credit institution be prohibited from undertaking any transaction or transactions or any class of business or be permitted to undertake any transaction or transactions or any class of business only upon such terms as the competent authority may prescribe.

Furthermore, BA Art. 29 provides that if, based on any information submitted by a bank or its related interests or based on an investigation of the credit institution, any of the conditions of Section 2 arise, the supervisor may, after consulting with the Central Bank,

- (a) require the credit institution to remedy the matter;
- (b) appoint a person to advise the institution;
- (c) appoint a competent person to take charge of the assets of the credit institution for the purpose of safeguarding the interests of depositors;
- (d) appoint a person to assume control of the institution;
- (e) require the credit institution to wind up its business;
- (f) appoint a person to act as liquidator;
- (g) fix the remuneration of any person appointed under this article.

Supervisory Practice/ Application of Enforcement Tools

To date, the supervisor has used primarily moral suasion to encourage banks to address identified issues and violations of law. The supervisor is keenly aware and concerned with the repercussions of supervisory actions in a market as small as Malta's where

information and concern spread quickly. Therefore, it has relied on on-going communications with management, targeted onsite examinations, and supervisory follow up to address concerns. Discussions with the banking community and with external auditors indicate that market participants respect both the role and the opinion of the banking regulator. In the past, this approach has worked generally well but has also resulted in protracted efforts to trigger bank management action and resolution of issues in banks deemed “too big to fail.” In cases where there are clear cut concerns that do not receive prompt bank management response, the supervisor is obligated to take more decisive and swifter action. Several concrete examples of protracted negotiations and workout situations with banks were observed.

As a result, issues were identified during the evaluation of supervisory practice that impacted the assessment of this Principle and its application. Each observation creates a contagion effect for the next issue and can result in delayed remedial action as observed in the case specifically reviewed:

- a) the results of the supervisors’ credit examinations do not produce quantitative measures of impact on the level of classified assets, required provisions, earnings, and capital. As a result, supervisory action based on capital levels and / or deficiencies, if such a case were to occur, may not be concretely triggered.
- b) the supervisor, in certain circumstances, has iterated the results of examinations and the needed bank management responses over extended periods of time. This can result in delayed corrective action in deteriorating situations.
- c) if banks’ loan classification / risk identification systems are found to be deficient with substantial classification errors disclosed during the examination, a recalculation of the level of classified assets (and therefore risk), loan loss provision, earnings impact, and capital adequacy is not performed. Results are not reflected in the report of examination, and an assessment of the resulting (in) accuracy of recent past financial and regulatory reports is not made.
- d) if the above situation (b) exists, that is if a bank’s risk identification process is determined to be inaccurate and results in misstatement of financial and regulatory information, this is not, as a result, considered a violation of law or BR.
- e) while the supervisors test for legal compliance during onsite examinations, if violations of law or BR are identified, they are not explicitly cited in the report of examination nor is a comment about the extent of a bank’s legal compliance (in the reviewed area) provided. This, therefore, does not create a documentary trail that can be used to track a bank’s history of compliance.
- f) reports of examination are not sent or presented to banks’ boards of directors. Therefore, boards may not receive critical supervisory information including that addressing bank management performance. As a result, the supervisor bypasses an opportunity to reinforce strong board governance by emphasizing boards’ responsibility and accountability to respond to supervisory issues. Likewise, an opportunity to build and maintain open dialogue with boards is bypassed.
- g) in addition, the levels of the penalties provided in LN 155 are inconsequential in their magnitude. (See CP 1(4)) The level of penalties for breaches of banking law and directives are vetted by the Attorney General and approved by the MoF; they are not set more independently via the banking law or legislation. The structure and magnitude of the penalties or sanctions should not be under the purview of the Attorney General and/or the MoF.

Additional Criteria:

There are no specific provisions in law or regulations that mitigate against the supervisor unduly delaying appropriate corrective actions.

As few, if any, have been required to date, the supervisor does not have an established system through which it addresses all significant remedial actions in written form to the

	<p>board of directors.</p> <p><u>2010 update</u></p> <p>Regarding recommendations made in 2003 (see above), officials noted the following changes:</p> <p>[1] bank boards of directors now receive formal reports of inspection and are required to sign an acknowledgement form indicating that they have received and read the reports;</p> <p>[2] reports of inspection now incorporate quantitative data showing the impact of asset classifications and provisions on earnings and capital; also, management's responses to examination findings are considered and factored into subsequent supervisory strategies;</p> <p>[3] material differences between banker classifications and MFSA classifications are incorporated into assessments of provisions, earnings and capital and, where appropriate, are indicated as breaches of regulations; BR/09 regarding asset classifications and provisioning has significantly reduced differences;</p> <p>[4] MFSA-BSU officials agreed that a policy for applying graduated corrective measures and enforcement actions would be beneficial and efforts will be taken to formalize existing practices, which are largely in line with standard prompt corrective action methodologies;</p> <p>[5] penalties for breaches of laws are fixed in law and while they appear nominal, public disclosure of a penalty or sanction is more a deterrent than the quantum of a penalty.</p>
Assessment	2002/3 FSAP - Materially Non-compliant; 2010 Independent Assessment – Largely Compliant
Comments	<p>2003: The remedial action and enforcement aspect of supervision requires strengthening. Past supervisory operating procedure and culture have created an environment of tolerance, as banks have been required to rectify identified problems.</p> <p>Certain unsafe and unsound banking practices have been identified by the supervisor (and in some cases have become market knowledge) that require timely supervisory attention. The current and future banking environment will likely require a more structured response from the regulator if and when unsafe practices are identified. As the market evolves and becomes more transparent, allowing market participants to work out of problems over an extended period of time may not be a viable alternative. International history demonstrates that many times the market is aware of bank problems before the supervisor identifies them and/or decisively acts. In cases where the supervisor becomes aware of critical problems in a bank or with bank management and does not take prompt corrective action, the MFSA assumes a certain level of reputation and potentially, legal risk. The supervisor should take steps to enhance its remedial response process, the use of the law and the tools provided therein, and the use of other corrective action options to set the stage for the future. (EC 1,3)</p> <p>The description above offers a number of embedded recommendations:</p> <ul style="list-style-type: none"> • [1] <i>Bank boards</i> should receive reports of examination and be required to sign and return to the supervisor, a note indicating they have received and reviewed (not necessarily agreed) with the report. Boards should likewise be required to oversee and be informed of the bank's response to the supervisor following an examination on in any case of concern highlighted by the supervisor. • [2] <i>Results of bank examinations</i> should produce quantitative measures of impact on classified assets, provisions, and earnings and capital positions. Remedial actions should be taken on this basis if the condition of the bank warrants. Management

	<p>responses following the examination should be considered “subsequent events” and should not result in substantial re-evaluation of examination results unless significant misunderstanding is evident. <i>Reference to the ICAAP-SREP interaction process highlighted in various instances above, should also be made.</i></p> <ul style="list-style-type: none"> • [3] Substantially <i>inaccurate reporting</i> of classified assets and therefore provisioning, earnings and capital, based on the results of an examination, if and when they occur, should represent a serious violation of law. The supervisor should use the law, citing a violation, in these cases. It should also require restatement of regulatory reports and, if necessary, should also require republishing of annual financial statements. This also should have implications, if pertinent, on the external audit process and the auditors themselves. • [4] The supervisor should have some form of <i>written formal agreements</i> or memorandum of understanding in the case of significant problems, not necessarily exclusively based on capital impairment. These documents could provide the documented basis for more severe supervisory responses in the future if not complied.(EC 2) • [5] The <i>penalties</i> for specified breaches of law should be revisited. The level of the penalties should have a higher ceiling. Furthermore, penalties for breaches of banking law and rules should be set (more independently) by law. <p><u>2010 update</u></p> <p>The practice of moral suasion had been demonstrated to work reasonably well in the Maltese context; especially given the risk of reputational damage to an institution should a sanction imposed by the MFSA be publicly disclosed. However, officials agreed that a formal policy for initiating corrective measures and regulatory enforcement actions would be beneficial going forward. For optimal benefit, the policy should link the form and content of a regulatory response to objective, measurable criteria regarding the nature and severity of condition and operations, e.g. capital adequacy, violations of laws or rules, unsafe or unsound banking practices, mismanagement. The policy also should provide for progressively more restrictive requirements as risk increases. Notwithstanding the value of prescriptive "if-then" guidelines, the policy should be sufficiently flexible to allow for judgment and discretion so that responses can be tailored to unique circumstances.</p>
Principle 24. [formerly CP 20]	Consolidated supervision. An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.
Description	<p>Essential Criteria:</p> <p>Maltese banks do not have complex consolidated structures to date. Banks are not allowed to deal in general insurance and can only own up to a maximum of 25% of an insurance company’s equity. Banks do have <i>life assurance</i> affiliates, through common holding company ownership, and these are, for purposes of EU and MFSA Rules, subject to consolidated supervision. Banks are allowed to own or deal in investment services and stock brokerage companies; however, none has overseas operations or is owned by corporate entities. The legal framework is in place to address the consolidated company, and the MFSA is the sole regulator.</p> <p>The BA gives the MFSA the power to supervise the banking group including subsidiaries, and controllers of the license holder. BA Art. 25 also provides the MFSA the authority to cooperate with overseas supervisory agencies, which is particularly pertinent in the case of the international branches, subsidiaries, and offices located in Malta.</p>

	<p>Qualitative review of the consolidated whole consists of several aspects. The MFSA collects periodic statements showing assets, liabilities and profit and loss position on an individual and on a consolidated basis. Both capital and management of the consolidated whole are particularly closely evaluated. Intra-company transactions are reviewed on the basis of the BA Art. 15 and the Large Exposures Rule BR/02. If the supervisor deems it necessary, the Rule provides the authority for it to request additional information from either up or downstream related entities. Results of insurance and capital markets related examinations performed by the MFSA are shared internally. The conduct of consolidated supervision is overseen and monitored by the MFSA's Supervisory Council.</p> <p>Unless with the written consent of the MFSA, no domestic credit institution may open a new branch, agency or office or set up or acquire any subsidiary outside Malta.</p> <p>Additional Criteria: The MFSA does not allow corporate ownership of banking companies nor does it allow banks to own non-financial companies. BA Art. 20 and 22 empower the supervisor to examine also holding companies, subsidiaries, connected persons etc.</p>
Assessment	2002/3 – Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: (no comments)</p> <p><u>2010 update</u> Except for cases relating to the utilization of European rights of freedom to provide services or establishment, and except with written consent of the MFSA, no domestic credit institution may open a new branch, agency or office or set up or acquire any subsidiary outside Malta.</p>
Principle 25. [formerly CP 24 and 25]	Home-host relationships. Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.
Description	<p>Essential Criteria: The right to exchange information with foreign supervisory authorities is laid down in BA Art. 25(1) BA, 25A and 25B. It allows for information sharing arrangements with the foreign supervisor on an informal, formal and “ad hoc” basis.</p> <p>The same procedures would be put in place should Maltese credit institutions seek to establish cross-border establishments (see BA Art. 11(2) and BR/01 (Licensing)).</p> <p>The law does not explicitly foresee that the supervisor can prohibit banks from establishing operations in countries with secrecy laws or other regulations prohibiting flows of information deemed necessary for adequate supervision. However, BA Art. 11(2) and BR/01 Art. 23 give the supervisor the power to do this.</p> <p>Additional Criteria: BA Art. 9, 6 explicitly provide that the supervisor, who takes consequential action on the basis of information received from another supervisor, consult with that supervisor beforehand. Even for small overseas operations, the supervisors exchange information.</p>

	<p><u>2010 update</u> Actions taken by the MFSA since 2003, particularly as regards information-sharing and regulatory cooperation agreements, have addressed concerns raised previously.</p>
Assessment	2002/3 FSAP – Largely Compliant; 2010 Independent Assessment – Compliant
Comments	<p>2003: While Maltese banks currently have no significant operations abroad (only representative offices to date), the legal framework allows information sharing on the performance of subject bank operations. Also, the MFSA is continually in process of negotiating MOUs with other pertinent supervisory agencies abroad. The supervisor conveyed that in practice it would not allow banks to establish operations in countries with problematic secrecy laws. However, the law does not explicitly prohibit banks or their affiliates from establishing operations in countries with secrecy laws or other regulations prohibiting flows of information deemed necessary for adequate supervision. (EC 2) As the legal framework continues to be amended and refined, a specific provision addressing such could be included. The MFSA should continue to build its operational capacity to allow foreign supervisors to place reasonable confidence in its oversight abilities.</p> <p><u>2010 update</u> It is being proposed also that BA Art. 11 will be amended in Sept-2010 to explicitly prohibit a credit institution licensed in Malta from opening a branch, subsidiary or representative office in a third country (a non-EU country) where the secrecy laws or other regulations of that country prohibit the information flows deemed necessary for adequate consolidated supervision.</p>

Chapter 3: Implementation of the IOSCO Objectives and Principles of Securities Regulation

3.0 General

A joint International Monetary Fund and World Bank mission visited Malta during the period October 15—24, 2002 and January 27—January 31, 2003 as part of the Financial Sector Assessment Program (FSAP). The aim was to assess the soundness of market structure and intermediaries, and the effectiveness of securities regulation, including observance of the *IOSCO Objectives and Principles of Securities Regulation*. Paula Perttunen and Elizabeth Sherwood from the World Bank conducted the IOSCO assessment.

2010 Update

An independent assessment to update of the 2002/3 FSAP assessment was conducted during July 27-31 and September 6-7, 2010 by Piero Ugolini - former Assistant Director /IMF and mission chief of the IMF/WB team that conducted the 2002/3 FSAP exercise .The primary counterparts in conducting this assessment were the MFSA, Investment Services Unit (here forth referred to as MFSA) and the Malta Stock Exchange (MSE). The responses to the IOSCO Questionnaire and Methodologies were prepared by the MFSA and the MSE.

2010 Update

The independent assessment was based on a self-assessment performed by the newly established (January 2010) Securities and Markets Supervision Unit (SMSU).

3.1 Information and methodology used for assessment

2002/3 FSAP: The analysis contained in this assessment is based on information collected through extensive discussions with the MFSA, the MSE, numerous market participants, and institutions including industry associations including the College of Stockbrokers, College of Investment Services Providers, and a number individual private financial institutions. In particular, the discussions with the MFSA involved Board of Management, Members of Supervisory Council, the Director and Senior Managers of Investment Services Unit and line officers. The assessment further relies on analysis of the pertinent legislation including:

- the Malta Financial Services Authority Act, amended and renamed the MFSA Act on July 23, 2002 from Malta Financial Services Centre Act of 1994;
- the Investment Services Act, 1994, revised on July 23, 2002 and enacted October 1, 2002; Regulations and the Investment Services Guidelines revised and issued there under, including the Standard License Conditions for Investment Services License Holders; and Directives and notices issued by the Competent Authority;
- the Financial Markets Act, issued and renamed on July 23, 2002 and coming to force October 1, 2002 replacing the MSE Act of 1990,
- the Insider Dealing and Market Abuse Offences Act; and

- the Malta Stock Exchange's By-Laws.

2010 Update

The 2003 IOSCO Methodology was used for this exercise. The assessment benefitted from extensive discussions with MFSA officials: the Chairman, Director General, Supervisory Council, Securities and Markets Supervision Unit, Legal Unit, Authorization Unit, and Regulatory development Unit. Meetings were held with Ministry of Finance, Central Bank of Malta, FIAU, Malta Stock Exchange; financial sector representatives: PSA Insurance Ltd, Valletta Fund Management, Oceanwood, BAWAG, Mediterranean bank and Calamatta, Cuschieri & Company Ltd; and the Malta Institute of Accountants.

The 2010 team would like to thank all the participants of the independent assessment for their full collaboration and openness and full disclosure of the relevant information.

The following is an updated list of relevant Maltese Legislation:

Malta Financial Services Authority Act
Financial Conglomerates Regulations, 2004 - LN 521 of 2004
Investment Services Act, 1994
Investment Services Act (Capital Adequacy) Regulations - L.N. 87 of 2008
Investment Services Act (License and other Fees) Regulations - L. N. 359 of 2008
Investment Services Act (Tied Agents) Regulations - L.N. 327 of 2007
European Passport Rights for persons operating multilateral trading facilities Regulations - L.N. 326 of 2007
European Passport Rights for Investment Firms Regulations - L.N. 325 of 2007
Investor Compensation Scheme Regulations - L.N. 368 of 2003
Investment Services Act (Control of Assets) Regulations - L.N. 240 of 1998
Introduction to the Investment Services Rules for Investment Services Providers
Investment Services Act (Exemption) (Amendment) Regulations 2010 - LN 59 of 2010
Investment Services Act (Investment Advertisements and Prospectus Exemption) Regulations - L.N. 250 of 2008
Investment Services Act (License and other Fees) Regulations - L. N. 359 of 2008

Investment Services Act (Exemption) Regulations - L. N. 329 of 2007
Investment Services Act (Performance Fees) Regulations - L.N. 329 of 2006
Companies Act (Investment Companies with variable share capital) Regulations 2006 - L.N. 241 of 2006 as amended
Investment Services Act (Prospectus of Collective Investment Schemes) Regulations - L.N. 392 of 2005
Undertakings for collective investment in transferable securities and management companies regulations - L.N. 207 of 2004
Investment Services Act (Recognition of Private Collective Investment Schemes) Regulations
Guidance Notes to the Investment Services Rules for Investment Services Providers
Guidance Notes on Risk Management and Internal Capital Adequacy for Investment Services License Holders, Regulated Markets and Central Securities Depositories
Guidance notes on the computation of the Annual Supervisory Fees for investment services license holders - L.N. 353 of 2002

Financial Markets Act, 1990
Financial Markets Act (Authorization Requirements) Regulations, 2007 – L.N. 333 of 2007
Financial Markets Act (Membership and Access) Regulations, 2007 – L.N. 331 of 2007
Financial Markets Act (Off-Market Deals) Regulations, 2007 - L.N. 332 of 2007
Financial Markets Act (Transparency) Regulations, 2007 – L.N. 336 of 2007
European Rights for Regulated Markets Regulations, 2007 – L.N. 330 of 2007
Financial Markets Act (Transfer of Listed Securities) Regulations, 2004 (DVP) – L.N. 287 of 2004 as amended by LN 335 of 2007
Central Securities Depository (Authorization Requirements) Regulations, 2009 – L.N. 138 of 2009

Designated Financial Instruments Regulations, 2009 (Clarity on the holding of registers) – L.N. 140 of 2009
Central Securities Depository (Control of Assets) Regulations, 2009 – L.N. 139 of 2009
Regulated Markets and Central Securities Depositories (Fees) Regulations, 2009 - L.N. 360 of 2008
MFSA - Financial Market Rules for Regulated Markets - Stipulating notification requirements
MFSA - Financial Market Rules stipulating financial resources and financial reporting requirements applicable to Regulated Markets and Central Securities Depositories
MFSA - Listing Rules

Prevention of Financial Markets Abuse Act, 2005
Prevention of Financial Markets Abuse (Fair Presentation of Investment Recommendations and Disclosure of Conflicts of Interest) Regulations, 2005 – L.N. 106 of 2005
Prevention of Financial Markets Abuse (Market Practices and Manipulative Behaviour) Regulations, 2005 – L.N. 107 of 2005 as amended by L.N. 252 of 2008
Prevention of Financial Market Abuse (Disclosure and Notification) Regulations, 2005 – L.N. 108 of 2005, As amended – <i>inter alia</i> – L.N. 322 of 2005, L.N. 328 of 2008, & L.N. 294 of 2010
MFSA - Prevention of Financial Market Abuse Guidance Notes

Prevention of Money Laundering Act
Prevention of Money Laundering and Funding of Terrorism (Amendment) Regulations, 2009 L.N. 328 of 2009

2002/3 FSAP: The assessment of a comprehensive set of laws, regulations, and regulatory practices was somewhat complicated by the FSAP process coinciding with the simultaneous ongoing transition from one regulatory regime to another. The relevant laws came to force less than two weeks before the first mission, and the consequent amendments to the secondary legislation were issued just prior to the concluding mission. As a result, there are no established regulatory and supervisory practices or, for that matter, experience from the

conduct of such responsibilities as regards the new areas of regulatory responsibility for the MFSA. These new areas are primarily related to regulation and supervision of RIE's. Still, the MFSA is an experienced securities regulator with a good track record from its past areas of responsibility. To reflect the situation fairly the assessors have therefore applied a policy whereby the principle has been deemed 'implemented' with a comment that regulatory practice has not yet been tested where the regulatory framework is in place but there is no established track record from regulatory conduct.

3.2 Institutional and macro prudential setting, market structure

2002/3 FSAP: Institutional and macro prudential setting

The Malta Stock Exchange (MSE) has, till October 2002, been the exclusive market place for listed securities in Malta and was regulated as a statutory government owned market-place by the MSE Act, 1990 (Cap. 345 of the Laws of Malta) [hereinafter referred to as the 'MSE Act'] of November 13, 1990 and the MSE by-laws (hereinafter referred to as the 'By-laws') issued by the MSE Council there under. Under the past regime, the MSE had a status of a regulator—regulating stockbrokers, dematerialization of listed securities and issuers of listed securities—under the oversight of the CBM.

Under the MSE Act, the Council of the MSE has issued by-laws that had under the past regime a status of binding secondary legislation. The by-laws provided for the licensing of stockbrokers and approval of accredited representatives and financial intermediaries, the Stockbroker's Code of Conduct, the approval of stock-broking firms, trading and settlement procedures, the dematerialization of the listed securities, the Central Securities Depository (CSD), the listing requirements for admission to official listing on the Exchange, the Compensation Fund, amalgamation of listed companies, the listing requirements applying to collective investment schemes, the listing requirements for admission to the Alternative Companies List and the listing requirements for admission to listing of Overseas Companies.

The Malta Financial Services Centre, MFSC was the Competent Authority under the Investment Services Act, 1994 and as such responsible for the licensing and regulation of investment services providers and collective investment schemes operating in or from Malta. It should be noted that the MSE and its various functions (including the CSD and the CSS) and market conduct did not fall under MFSC's regulation or supervision in the past regime.

The Maltese Parliament substantially amended the MSE Act, and renamed the law as the Financial Markets Act. It entered into force on October 1, 2002 and seeks to incorporate and reflect the following principal objectives:

- a. to transfer regulatory competence for regulation and supervision of capital markets in Malta to the MFSA;
- b. to remove exclusivity of the *Borża* as the market place for trading of securities in Malta;
- c. to rationalize licensing, investigation and sanctioning;
- d. to merge the jurisdictions of the MSE Tribunal and the Financial Services Tribunal; and

- e. to provide a clearly defined right of appeal to an independent and impartial tribunal.

In line with the policy adopted by the government to create a single financial services regulator, the issuance of the Financial Market Act removes all regulatory functions from the MSE changing its status to a Recognized Investment Exchange (RIE) that is licensed, regulated and supervised by the MFSA. Hence, with the provisions of the Financial Market Act as well as the amendments to the Investment Services Act (hereinafter referred to as ISA), the MFSA is—in addition to its past responsibilities—also assuming regulatory competence for stockbrokers, RIEs, listed entities and market conduct.

Whereas the “*BORZA*” (or Malta Stock Exchange) was the focus of the MSE Act, the change in policy now calls for the introduction of “*Recognized Investment Exchanges*” *RIEs*. The MSE will in terms of law be a RIE with the law grand-fathering it a license to operate as such, and will thus be an operator without exclusivity in the trading of securities. As an operator, the MSE will be regulated by the MFSA. The shedding of the regulatory competence by the MSE as well as the removal of its exclusivity as a forum for the trading of securities will open the possibility for the existence of multiple exchanges.

2010 Update

In 2007 the Investment Services Act, 1994 and the Financial Markets Act, 1990 (‘FMA’), the regulations and the rules made thereunder were subject to significant amendments for the purpose of transposing and implementing the Markets in Financial Instruments Directive (‘MiFID’). As part of this process, the term recognized investment exchange was replaced with EU based terminology *Regulated Market*. As part of this process new forms of trading platforms were introduced within the local regulatory framework, these being multilateral trading facilities (‘MTFs’) and Systematic Internalisers.

In 2007 the FMA was also amended to include a specific section for the regulation of central securities depositaries. This addressed a principal weakness, which was identified during the 2002/3 FSAP as indicated in the comments under Principle 3, namely the lack of a clear legal basis for the regulation and supervision of the CSD. As of the date of coming into force of these amendments, persons wanting to operate a CSD in Malta are required to apply to the MFSA for an authorization under the FMA. The services of a CSD are regulated in terms of specific regulations and rules as detailed in section 1 above. In order to review the state of compliance by the Malta CSD with the applicable legislation, on the 25th May, 2010 the MFSA sent a self-assessment questionnaire to the Malta Stock Exchange. The questionnaire covers the requirements of the Central Securities Depositary (Authorization Requirements) Regulations [L.N. 138 of 2009] and Central Securities Depositary (Control of Assets) Regulations [L.N. 139 of 2009]. A copy of the self-assessment questionnaire is available upon request.

Furthermore, Article 34 of the CBM Act, which was last amended in 2007, sets out the CBM’s role as overseer and regulator of payments systems, including securities settlement systems. This addresses the comments made in the 2002/3 FSAP under Principle 3 regarding the lack of legal certainty concerning the supervision of clearing and settlement systems (CSS), apart from the CSD.

The MFSA has issued the relevant secondary regulation as regards operations of RIEs. These regulations apply to the MSE and any future RIEs that may be licensed. The MSE has also redrafting its by-laws to reflect the changes in legislation and its changed status and has submitted them for approval to the MFSA, as required by the Financial Markets Act. Whereas under the MSE Act the MSE By-laws had a status of binding secondary legislation, it is somewhat unclear what their legal standing is going forward given that their existence is tied to a license that has been issued—and hence also can be cancelled—by the competent authority.

2010 Update

As a consequence of the Government of Malta's announcement that the Malta Stock Exchange was to be privatized, legislative changes were made to the FMA to remove the stock exchange from the Act. In this regard, as from the 1st November, 2007, the Malta Stock Exchange plc (a company established in Malta) took over the personality of the Malta Stock Exchange. On the same date, the MFSA issued a license to this company to operate a regulated market and a central securities depository. The Malta Stock Exchange plc is currently a company fully owned by the Government of Malta.

Given the change in the status of the Exchange, its bye-laws are not any more considered as being binding secondary legislation.

Under the new legislation, there are serious concerns as regards the legal foundations for the actual dematerialization of the securities, as well as institutional, regulatory, and supervisory arrangements for the CSD and CSS functions. Under the past regime, the dematerialization and the clearing and settlement of securities traded in the MSE had its legal foundations largely in the MSE by-laws. In the new regime, the Financial Market Act—Section 24 subsection (4) (c), (d) and (e)—lists as authorities of MSE providing facilities for the maintenance of a central securities depository; performing all other functions as are customarily performed by a recognized investment exchange; and doing all such things as may be necessary or incidental for the proper functioning of the Exchange. The legislation does not provide any definition of an RIE, nor does it provide clarification as to nature of functions allowed to be conducted by an RIE. Further, more detailed discussion on the CSD/CSS related legal and regulatory issues can be found in section on the CPSS/IOSCO Assessment.

2010 Update

As indicated in the update to section 8 above, the FMA was amended to include provisions which deal with the regulation of central securities depositories. The FMA was also amended to include provisions which ensure that there is legal certainty as to the title to and rights in respect of *designated* financial instruments, the register of which is maintained in a central securities depository. In terms of article 28 of the FMA, the title to and rights in respect of designated financial instruments, the register of which is maintained in a central securities depository, may be created and, or transferred by an entry on the register maintained in a central securities depository and no instrument in writing shall be required for this purpose. The instruments which fall within the category of designated financial instruments are spelt out in Designated Financial Instruments Regulations, 2009 [L.N. 140 of 2009].

Regarding the failure of the Act to define the term RIE, as indicated in the update to section 8 above, the term RIE was in 2007 replaced with the EU terminology *Regulated Market*. In terms of the FMA a regulated market is defined ‘as a means a multilateral system operated by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments in the system within the meaning of the Directive. For the purposes of this definition, "buying and selling interests" includes orders, quotes and indications of interest’

The possibility of multiple exchanges calls for a potential duplication of functions in the listing procedure, with an application first being made to the Listing Authority and subsequently to the RIE. Under the new regime, it is envisaged that the Listing Authority is charged with the function of pass porting a security as authorized for admissibility to listing. Once this authorization is issued, the prospective issuer of a security is free to apply to a recognized investment exchange for its security to be “listed and traded.”

2010 Update

Since the date of the above statement, the MFSA was appointed as Listing Authority and is now responsible for all matters relating to the admissibility to listing of a security on a regulated market.

Regulatory competence in respect of the issuers of listed securities has been transferred to the MFSA. The Financial Markets Act contemplates the establishment of a Listing Authority. Transitional arrangements have been put in place whereby till the MFSA has issued the Listing Requirements the MSE by-laws will apply and MSE Council will support the work of the competent Listing Authority till it is ready to take over. This process is designed to ensure continuity and is not expected to disrupt prospective listings during the transitory period. The relevant regulations as regards listing authorizations, related processes, and actual listings by the RIEs are presently being drafted by the MFSA.

2010 Update

Since the date of the above statement, the Listing Authority issued its Listing Rules which apply to companies seeking to obtain admissibility to listing and to all companies which have been admitted to listing. Additional requirements applicable to companies, which have been admitted to listing, apply in terms of chapter 6 of the Malta Stock Exchange plc by-laws.

The Financial Markets Act also contemplates a procedure under which a RIE is obliged to report a suspicion of insider dealing or market abuse to the Competent Authority, which may, either on its own initiative or subsequent to the reporting of a suspicion by a RIE, appoint an inspector. Moreover, the Financial Markets Act reads alongside the renamed Insider Dealing and Market Abuse Offences Act to reflect the amendments catering for the introduction of new market abuse offences.

2010 Update

In 2005 through the adoption of the Prevention of Markets Abuse Act, Malta transposed and implemented the Market Abuse Directive. The Act grants various monitoring, supervisory, investigatory and enforcement powers to the Malta Financial

Services Authority which is responsible for monitoring the market and investigating any suspicious transactions. In terms of Act, operators on the market are required to report to the MFSA any suspicious transactions. Moreover, the Act also provides for various disclosure and transparency requirements.

In view of the desire to streamline local financial services adjudication procedures, the MSE Tribunal statute under the MSE Act has been abolished and its functions taken over by the Financial Services Tribunal. The Financial Markets Act and the revised Investment Services Act—alongside the MFSA Act—further cater for the exchange of information between domestic regulatory authorities as well as new provisions on the co-operation with overseas regulatory authorities.

2002/3 FSAP: Market structure

The Maltese domestic capital market consists of local equities and corporate and government bonds, all of which are listed and traded on the MSE, which was established in 1992. Market capitalization of outstanding securities at end June 2002 totaled Lm 1,565 million (92 percent of GDP) (Table 10), of which just over half was government bonds, followed by equities (16 listed companies; 39 percent of market capitalization), and corporate bonds (16 corporate bonds; 7 percent of market capitalization). There are no securitized instruments or derivative products traded on the market. The MSE lists collective investment schemes, but these are not traded on the exchange, with the exception of one closed-ended scheme. Share prices rose in tandem with the global demand for equities until 2000, and since then have fallen in line with international developments. The capital market is dominated by government bonds, reflecting long-standing weak interest of Maltese companies in public share ownership and, over the past year poor performance of equities, which resulted in equities losing half their value. Market intermediaries in the local capital markets consist of 20 stockbrokers and stock broking agencies. MSE by-laws prohibit trading on their own account except in the case of CBM dealing in government securities; consequently, there are no dealers or market makers on the MSE.

2010 Update

For the latest statistics and information on the Maltese market, you may wish to refer to the web-site of the Malta Stock Exchange plc www.borzamalta.com.mt In particular, the relevant section of this web-page dedicated to Statistics and Publications.

The MSE and the MFSA have during the last two years exchanged views/correspondence on the possible introduction of market makers on the local market. This is an on-going project and currently there is no time-frame within which this is to be implemented. The official correspondence between the Authority and the MSE on this project is available upon request.

The mutual fund business in Malta is made up of 57 ‘locally-based schemes’ and 300 ‘foreign-based schemes’. Of the 50 CIS with a primary listing on the MSE, about two thirds are managed by a fund manager directly associated with a bank (HSBC, Bank of Valletta, and Lombard Bank). Fourteen are denominated in Maltese lira, although several of those invest outside of Malta as well. Locally-managed CIS control approximately 10 percent of the total market capitalization of the MSE. The legal framework for the licensing of CIS was established in 1994 under the Investment Services Act. Between 1998 and 2002 there was an increase in CIS with a primary listing on the MSE from 12 to 50, and an increase in the net

asset value of such schemes from Lm 138 million to Lm 218 million. The latter figure is, however, a steep drop from the end-2000 figure of Lm 331million.

2010 Update

For the latest statistics and information on CISs licensed in Malta, you may wish to refer to the MFSA's web-page www.mfsa.com.mt – section Securities/Collective Investment Schemes/License holders. The data on the CISs which are listed on the Malta Stock Exchange is available on the web-site of the Malta Stock Exchange www.borzamalta.com.mt

Table 3.1: Malta: Selected Capital Market Indicators

Market capitalization (in EURO million) for the period 1998 to 2002 values displayed are based on the rate of €1 = Lm0.429300								
	1998	1999	2000	2001	Jun02	2008	2009	Jun10
Equities	689	1,840	2,055	1,421	1,297	2,567	2,844	2,787
Corporate bonds	61	96	247	252	321	536	760	848
Government bonds	1,558	1,780	7,420	1,987	2,027	3,256	3,476	3,708
Treasury Bills	0	0	0	0	0	343	473	553
Total	2,308	3,715	9,722	3,659	3,645	6,702	7,553	7,896

Market capitalisation/GDP (in per cent)							
	1998	1999	2000	2001	Jun02	2008 *	2009 *
Equities	21.8	54.3	56.5	37.5	32.6	45.2	49.7
Corporate bonds	1.9	2.8	6.8	6.6	8.1	9.4	13.3
Government bonds	49.1	52.5	47.5	52.4	50.9	57.3	60.8
Treasury Bills	0	0	0	0	0	6.0	8.3
Total	72.8	109.6	110.8	96.5	91.6	117.9	132.1

*Computation based on the Annual Nominal/ Current GDP

Turnover/Market capitalisation (in per cent)								
	1998	1999	2000	2001	Jun02	2008	2009	Jun10
Equities	26.5	12.8	9.2	3.4	2.6	1.9	0.9	0.67
Corporate bonds	5.8	5.1	4.2	13.9	4.1	4.7	4.5	1.73
Government bonds	16.8	6.6	8.5	15.7	1.9	8.2	7.4	3.9
Treasury Bills	0	0	0	0	0	43	49.8	18.4
Total	49.1	24.5	21.9	33	8.6	57.8	62.6	24.70

Sources: Central Bank of Malta and the Malta Stock Exchange

2010 Update

The latest statistics and information on the Maltese market, are available on the web-site of the Malta Stock Exchange plc www.borzamalta.com.mt and the web-site of the Central Bank of Malta www.centralbankmalta.org Annual reports of these institutions are also available on the websites.

General preconditions for effective securities regulation 2002/2003

The Maltese market regulation is in the process of being fully adjusted to the EU Directives as part of the EU accession process. The adopted regulatory policy will potentially have a positive developmental impact on the structure and the sophistication of the Maltese securities market. To a large extent, Maltese regulations have adopted the European standards and, consequently, the barriers to entry and exit have been largely abolished. Given the pertinent regulations in the Financial Markets Act that CSD services are provided by the Malta Stock Exchange, there is a need to clarify any entry barriers in providing both CSD and CSS services in Malta.

2010 Update

Since 2004, the Maltese financial market has been fully adjusted to comply with EU law in the field of the regulation of financial services, including the regulation of securities business.

To encourage equity listings by corporate on the MSE, the Malta Stock Exchange Act (now the Financial Markets Act) allows companies listing on the MSE the following temporary tax benefits:

- tax rate is reduced by 2 percentage points if between 20 and 30 per cent of its issued voting share capital is offered to the public as a listed security;
- tax rate is reduced by 3.5 percentage points if between 30 and 40 per cent of its issued voting share capital is offered to the public as a listed security; and
- tax rate is reduced by 5 percentage points if 40 percent of the company's issued voting share capital is offered to the public as a listed security.

The reduction in the tax rate was applicable the year of listing and the following two years. If the company increased the percentage of issued voting share capital available to the public, the benefit was increased for the remaining time allowed.

Investment in securities has similarly been encouraged by favorable tax-treatment.

3.3 Principle-by-principle assessment

A Principle is considered ***implemented*** whenever all assessment criteria are generally met without any material deficiencies. The Principles acknowledge that there are often several ways for countries to implement the Principles. A Principle is considered to be ***broadly implemented*** whenever only minor shortcomings are found, which do not raise major concerns and when corrective actions to achieve full implementation with the Principle are schedules and realistically achievable within a short period of time. A Principle is considered ***partly implemented*** whenever significant shortcomings are found, and the authorities have not implemented one or more assessment criteria. The difference between ***implemented*** and ***partially implemented*** may in part depend upon the improvements needed and on doubts as to the authorities' ability to implement within a reasonable time-frame. A Principle is considered ***non-implemented*** whenever major and material shortcomings are found in adhering with the assessment criteria. A Principle is considered ***not applicable*** whenever it does not apply given the structural and institutional conditions.

Principles Relating to the Regulator	
Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>The Maltese laws for financial markets, provision of investment services and their supervision have been fundamentally overhauled in July 2002 as Malta is adapting its legislation to the EU Directives as part of the country's integration with European Union. Consequently, the laws are very comprehensive, modern and appropriate for the functioning of financial markets today. As part of this legislative overhaul Malta has created a single supervisory authority (Malta Financial Services Authority, MFSA) for financial services, and provided this designated competent authority with comprehensive powers to regulate, investigate and enforce the laws applicable to provision of financial services in Malta.</p> <p>The responsibilities of the Malta Financial Services Authority as the sole regulator and supervisor of the provision of financial services are stated in the MFSA Act, Section 4 as regards the overall functions of the competent authority; in the Investment Services Act Section 6(3) as regards to objectives when considering licensing; and Financial Markets Act Section 11 as regards the authority's responsibilities as the Listing Authority. Together these statutes spell out clearly and without prejudice the objectives and the responsibilities of the MFSA as the competent authority responsible for the supervision of provision of investment services and the functioning of the capital markets in Malta.</p> <p>The general responsibilities of the MFSA, as stated in the MFSA Act, include</p> <ul style="list-style-type: none"> (a) regulating, monitoring and supervising financial services in Malta; (b) promoting general interests and legitimate expectations of consumers of financial services and promoting fair competition practices and consumers choice; (c) monitoring and keeping under review, trading and business practices related to supply of financial services;

	<p>(d) monitoring the working and enforcement of laws that directly or indirectly affect consumers of financial services;</p> <p>(e) investigating allegations of practices and activities detrimental to consumers of financial services;</p> <p>(f) ensuring high standards of conduct and management throughout the financial system;</p> <p>(g) advising the Government generally on the formulation of policies in the field of financial services; and</p> <p>(h) performing such other functions as may be assigned to it under any law.</p> <p><u>2010 Update</u></p> <p>As indicated above, the MFSA's responsibilities are primarily stipulated in the Malta Financial Services Authority Act. In the field of securities regulation these are further specified in the Investment Services Act, 1994 and the Financial Markets Act, 1990. Since the last financial sector assessment program, these Acts and the regulations and rules made there-under have been amended to transpose and implement the following EU legislation:</p> <p>[a] Markets in Financial Instruments Directive [including the relevant implementing measures]</p> <p>[b] Capital Requirements Directive</p> <p>[c] Prospectus Directive [including the relevant implementing measures]</p> <p>[d] Transparency Directive [including the relevant implementing measures]</p> <p>[e] Takeover bids Directive</p> <p>[f] Shareholders Rights Directive</p> <p>[g] UCITS III Directive [including the relevant implementing measures]</p> <p>Also of relevance to the securities regulatory framework is the Prevention of Financial Market Abuse Act which transposes the EU Prevention of Market Abuse Directive [including the relevant implementing measures].</p> <p>The responsibilities of the MFSA qua regulator responsible for securities business have been updated to cater for all new responsibilities emanating from the above mentioned EU legislation. The MFSA has also taken on the responsibility for the regulation of central securities depositaries. In this regard, the new responsibilities of the MFSA have been included in the Financial Markets Act, 1990.</p>
Assessment	2002/3 FSAP – Implemented; 2010 Independent Assessment – Implemented
Comments	No comments

Principle 2.	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	<p>MFSA Act Section 3(2) establishes MFSA as an authority that is a body corporate having a distinct legal personality capable of, inter alia, suing and being sued. The organization and the respective functions, appointment and removal process and powers of the stipulated Board of Governors, The Coordination Committee, the Supervisory Council, the Board of Management and Resources and the Legal office are clearly established in the law (MFSA Act Section 5 through 12).</p> <p>The Board of Governors of the MFSA, in determining the policies to be pursued by the Authority, shall follow any policy guidelines that may be set out by Government (Section 6 of the MFSA Act). However, regulatory decisions affecting licensed financial institutions or applicants for licenses are taken by the Supervisory Council of the MFSA independently of any other agency or government authority. The MFSA's Supervisory Council is the single regulator in the implementation of the powers vested in the competent authority by financial services primary and secondary legislation, including the Investment Services Act, the Financial Markets Act and any Regulations issued there under.</p> <p>The competent authority's powers are stipulated in the MFSA Act, Section 16, and its ability to share information explicitly spelled out in Sections 17 and 18. The authority reports to the House (Parliament) in accordance of Section 28; is funded through collection of fees, rents from property (Section 22); is audited annually (Section 27) and its bodies, officers and employees are exempted from liability in the discharge of its functions unless done in bad faith according to section 29. The Authority is thus subject to parliamentary scrutiny and its representatives meet on an annual basis with the Parliamentary Public Accounts Committee to discuss the performance of the Authority. The Act provides that the Authority shall, as soon as may be but not later than three months after the close of each financial year, transmit to the House of Representatives, through the Minister of Finance, a copy of its annual accounts certified by the auditors together with a report on its activities during the previous year.</p> <p>Finally, the MFSA Act Section 21 provides the supervisory subjects with an appeal procedure on MFSA decision or actions to the stipulated Financial Services Tribunal that is appointed by the Minister of Finance. The Financial Services Tribunal's sittings are generally to be held public, and the decisions of the Tribunal are always to be delivered in public. The Tribunal's decisions can be further appealed the Court of Appeals.</p> <p><u>2010 Update</u></p> <p>The above is still relevant</p>
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented

Comments	No comments
Principle 3.	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	<p>The general powers of the MFSA to perform its function are stipulated in the MFSA Act, Section 16; in the Investment Services Act Sections 6 through 7 as regards licensing; ISA Sections 12 through 16 and Financial Markets Act Sections 4 through 8, 11 through 21, 24 through 25, 27, 32 through 34A as regards the authority's regulatory, investigative and enforcement powers.</p> <p>The legal foundations for regulatory, investigative and enforcement powers placed with the MFSA as the competent authority for the most part are solid, and provide for extensive powers in these regards. To that end, <i>the</i> MFSA has the power:</p> <ol style="list-style-type: none"> to require information from the supervised entity or any parties related to it or any other person, to take copies of documents provided and use any information provided as evidence (except in relation to documents/information privileged in terms of the Criminal Code); to appoint inspectors for conduct of more in-depth investigations that may be required; to issue directives both generally and in specific circumstances; to enter premises of persons on whom a notice of investigation has been served for the purposes of obtaining information. <p>Up until end September 2002, the MFSA Investment Services Unit regulated and supervised all investment services providers licensed under the Investment Services Act. The Unit's resources (Director plus 12 staff, of which 4 are part time in the compliance office) appear to have been adequate for the task under the past regime; the Investment Services Guidelines were appropriate given the nature and scope of the business conducted by supervisees, and both onsite and offsite supervision seems to have commenced to fitting extent.</p> <p>The new regime that came to force October 1, 2002 gives the MFSA significant new responsibilities through making it the sole competent authority regulating the capital market, and bringing the marketplaces, market conduct, domestic securities intermediation, the securities depository (CSD) and clearing and settlement (CSS) arrangements as part of MSE operations, and all listed entities under its regulatory domain—many of these functions having in the past been the responsibility of the MSE. The Malta Stock Exchange has a Supervisory Unit that consists of 5 staff who is expected to stay with the MSE to continue performing the day-to-day market surveillance function.</p> <p>Having to date regulated primarily investment advisory and CIS activities, the MFSA appears to be presently short of skills required for the regulation and supervision of market places, market conduct, and securities depository (CSD) and clearing and settlement (CSS) arrangements. MFSA staff is planned to receive onsite training at the MSE and attend training courses provided by MFSA's counterparts abroad, such as U.K. FSA and U.S. SEC. The MFSA has presently no plans to increase its staffing</p>

even in light of its new areas of responsibility.

2010 Update

Since 1st January, 2010 the Securities and Markets Unit is responsible for the full spectrum of securities regulation in Malta.

Remit

The following is the remit of the Unit as approved by the MFSA's Board of Governors:

“The remit of the Securities and Markets Supervision Unit consists of the following core duties:

1. Securities Supervision including the regulation and supervision of persons licensed, recognised or registered as applicable, under the Investment Services Act. These persons comprise:

- *Licensed Investment Services Providers (four categories of licence holders)*
- *Recognised Fund Administrators*
- *Registered Tied Agents*
- *Recognised Private Collective Investment Schemes*
- *Licensed Collective Investment Schemes:*
 - *Retail non-UCITS schemes*
 - *UCITS schemes*
 - *Professional Investor Funds (currently three categories)*

2. Markets Supervision including the following primary functions under the Financial Markets Act [FMA] and the Prevention of Financial Markets Abuse Act [PFMAA]:

- *Monitoring and supervision of Regulated Markets and Central Securities Depositories [CSDs] in terms of the FMA.;*
- *General oversight of financial markets including monitoring compliance with the relevant provisions of the PFMAA. This includes:*
 - *Market surveillance comprising the review of trades in securities listed on the Malta Stock Exchange with a view to identifying any suspected market abuse (insider dealing and market manipulation). In particular, trades prior to price sensitive Company Announcements are reviewed in some detail;*
 - *Monitoring compliance by Intermediaries, the Malta Stock Exchange and persons discharging managerial responsibilities within an Issuer, with their respective obligations under the PFMAA, including submission by listed companies of the list of insiders and of the trades undertaken by persons discharging managerial responsibilities within an Issuer;*
 - *Investigation of suspicions of market abuse.*
- *Processing of applications for the admissibility to listing of securities on the Malta Stock Exchange, and monitoring of listed companies' compliance with their continuing obligations under the Listing Rules. This includes:*
 - *Reviewing the terms of reference and composition of the Audit Committees of Listed Companies;*

	<ul style="list-style-type: none"> ➤ <i>Reviewing all company announcements, circulars sent to shareholders and changes to the Memorandum & Articles of Association of an Issuer;</i> ➤ <i>Ensuring that Issuers comply with their reporting requirements, including the financial reporting requirements and Corporate Governance Statements in their Annual Financial Statements.</i> <p><i>3. Supervision of authorised trustees and fiduciaries in terms of the Trusts and Trustees Act, as well as supervising nominee companies having a warrant to act as shareholder in terms of the MFSC Act until the phasing out of the category.</i></p> <p><i>In carrying out the above duties, the Unit will be involved in the following tasks:</i></p> <p><i>(a) Prudential regulation and conduct of business regulation with a view to monitoring compliance with the relevant provisions of the Investment Services Act, the Financial Markets Act, the Trusts and Trustees Act, the Prevention of Money Laundering Act, and the Regulations and Rules issued there under. This will include both off-site and on-site supervision and will comprise the following principal duties:</i></p> <ul style="list-style-type: none"> - <i>reviewing financial returns, audited financial statements, auditors' reports to the MFSA and auditors' management letters, and following up with licence holders on issues that arise there from, such as breaches of minimum financial resources requirements, investment restrictions, or reporting deadlines;</i> - <i>validation of internal models which may be used by investment services licence holders utilising the IRB approach in the CRD whilst referring to the CEBS Guidelines for guidance in this regard;</i> - <i>oversight of the CRD Pillar II process involving review of the Investment Services Licence Holder's Risk Management and Internal Capital Adequacy Assessment Process and evaluation of the extent to which the Licence Holder has arrangements, strategies, processes and mechanisms in place which ensure a sound management and coverage of all material risks;</i> - <i>monitoring investment advertisements in the media and adherence to disclosure requirements set out in the Investment Services Rules and Listing rules;</i> - <i>conducting on-site compliance visits and inspections involving pre-visit preparatory work and post-visit reporting and follow up of the issues which need to be addressed;</i> <p><i>(b) Investigations of suspected breaches identified during off-site or on-site monitoring or as result of consumer complaints and drawing up of recommendations to the Supervisory Council for sanctioning licence holders in the case of breaches of licence conditions or authorisation requirements following liaison with the Legal & International Affairs Unit.</i></p> <p><i>(c) Acting as agent of the FIAU in monitoring compliance by the relevant</i></p>
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subject persons with the Prevention of Money Laundering Act and Regulations issued there under.

(d) Coordinating with the Authorisation Unit on an on-going basis particularly prior the authorisation of any changes in the scope of licences or authorisations granted.

(e) Initiating any proposed new legislation/rules, the review of existing legislation/rules and the transposition of EU legislation in the securities, markets and trusts area. The Unit shall coordinate the drafting, review and vetting of this work with the Regulatory Development Unit and with the Legal and International Affairs Unit, as appropriate.

The Securities and Markets Supervision Unit shall take into account both the micro and the macro prudential aspects in carrying out the supervisory functions and shall assist the Supervisory Council to fulfil the co-ordination efforts with the Central Bank.

The Securities and Markets Supervision Unit will participate at relevant EU and local as well as international regulatory committees, in particular IOSCO.”

Resources

In order to achieve the above objectives, the Unit Director currently has a staff complement of around 17 officials (2 of whom are support staff). The Unit is in the process of recruiting an additional 2 officials who will be contributing to the Unit’s regulatory work. The Unit’s staff is divided into two main teams: one team is mainly responsible for all off-site compliance duties, and the other is responsible for compliance visits and the processing of applications for admissibility to listing. Moreover in so far as the work in relation to listings is concerned (i.e. processing of applications for admissibility to listing on the MSE and monitoring of compliance of listed companies with the MFSA Listing Rules), the Unit refers to a separate Listing Committee composed of 5 persons appointed by the MFSA as Listing Authority.

In view of the expansion of the financial sector since the 2002/3 FSAP the Unit requires additional resources.

A circular by the Office of the Prime Minister (OPM) -OPM No 14/2005 of April 25, 2005 has introduced a process for recruitment in the Public Sector Organizations. Under this process, a recruitment in the MFSA has to follow these procedures. The intent of the OPM circular was to “ ensure a more efficient and effective Public Service and Public Sector”

Training

The identification of training needs and ensuring that staff have proper knowledge and obtain the necessary experience in order to be in a position to fulfil their duties diligently is considered fundamental for the Securities and

	<p>Markets Supervision Unit. In this regard, the Director takes an active role to identify training opportunities for the staff of the Unit. Since the Financial Sector Assessment Programme, members of staff have attended various training opportunities organized both locally by local training institutes, and abroad by IOSCO, the US SEC, CESR and other organizations, particularly in the field of markets and market monitoring. Staff involved in market surveillance and the regulation of the Malta Stock Exchange have also received training on its trading system. Two of the Unit's staff will later on this year, be undertaking a two week secondment with the MFSA's Luxembourg counterpart - the CSSF, focussing on the supervision of collective investment schemes.</p>
Assessment	2002/3 FSAP- Partially implemented ; 2010 Independent Assessment – Broadly implemented
Comments	<p>The legal foundations for the regulatory, supervisory, investigative, and enforcement powers vested with the MFSA are solid, and the powers wide and comprehensive. Some clarification, however, would be in order as regards the regulation and supervision of the CSD and CSS functions and the related institutional arrangements.</p> <p>The CSS and CSD functions within the MSE appear to fall under the MFSA regulation and supervision although the relevant laws do not explicitly spell out the statutory institutional arrangements nor the supervisory and regulatory responsibilities related to these key market functions. The role of the CBM in the regulation and supervision of CSD and CSS is also not explicitly stated, which represents a significant weakness for ensuring smooth and credible operations of these functions. To provide for proper institutional, regulatory and supervisory arrangements for the CSD and CSS the legal foundations need to be carefully re-examined. While such review is on-going, it is recommended—as a temporary solution—that the MFSA and CBM address this short-coming in their planned Memorandum of Understanding, and agree on joint regulatory and supervisory approach.</p> <p>Given the already disproportionately high number of regulatory subjects relative to the MFSA Investment Services Unit staff capacity, the new regime is likely to put a serious strain on the MFSA staff resources, both in terms of numbers and specialty skills required. Of particular concern are the regulation and supervision of the recognized investment exchanges (RIEs), market conduct, listing authorizations, and the CSD and the CSS arrangements.</p> <p>The MFSA, as the competent authority, and the MSE, as a RIE, are working together to try to alleviate these resource constraints. They are discussing how to explicitly spell out the responsibilities, applied procedures and required lines of reporting to avoid duplication and ascertain coverage with no surveillance or enforcement gaps. This process will take time despite the obvious collaborative spirit of these discussions.</p> <p>Particular attention should be given to optimizing the use of resources in regulation, supervision and operations of the CSD and CSS functions. Given the legislative shortcomings in this field, the complexity of the both legal and technical issues involved, and the need for a tripartite effort involving – not only MFSA and MSE – but</p>

pertinently also the CBM, this should become an important area of focus and cooperation.

2010 Update

The MFSA has addressed one of the main shortcomings noted in the original assessment. As of January 1, 2010, the Securities and Markets Unit of the MFSA is responsible for all the securities regulation in Malta. The MOU between MFSA and CBM in May 2003 clarifies the role of the two institutions. In 2007 the FMA was amended to include *inter alia* a specific section for the regulation of the CSD and address the lack of a clear legal basis for the regulation and supervision of CSD (see paragraph 10 of Institutional and macro prudential setting).

The MFSA has undertaken a correct policy of recruiting and training staffs to meet new challenges in the supervision of the financial sector- However, the on-going growth of the financial sector has put some strain on the MFSA staff resources and it will be important to continue and intensify such a policy to meet present and future challenges. Additional staff is being recruited in the Securities and Markets Supervision Unit. However, the 2005 OPM Circular has delayed considerably the time needed for recruiting staff in the MFSA. As a result of the cumbersome process and administrative layers under which the MFSA has to operate the recruitment process could take several months and impact on the workload of the MFSA staff.

The following is a more detailed update regarding the changes adopted with respect to the regulation of clearing and settlement:

Oversight of securities settlement systems is the responsibility of the Central Bank of Malta in terms of article 34 of the Central Bank of Malta Act, which authorises the CBM to issue regulations and directives covering the settlement of securities. The reference to “securities settlement” within the definition of “payments system” referred to in this article (previously numbered article 36), was introduced in 2004, whilst reference to “securities clearing” was also introduced in this definition in 2007. In this regard, the CBM has issued a directive addressing legal and systemic risks associated with payment and securities settlement systems, amongst others. The MFSA is on the other hand the competent authority entrusted with the duty to authorise and regulate providers of CSD services operating in/ from Malta in terms of the Financial Markets Act (further details below). The MFSA and the CBM had signed a MoU on the 16th May, 2003 specifically covering the regulation, oversight and smooth running of payment and securities settlement systems for which the CBM is primarily responsible in terms of article 34 of the CBM Act. This represents an extension of the principal MoU between the two institutions signed on 4th February 2003.

In 2007, the Financial Markets Act, 1990 was amended to *inter alia* include a part on the authorisation and supervision of central securities depositaries. Article 26 of the Act defines the functions of a central securities depositary which include the provisions of clearing and settlement services. On the coming into force of

	<p>these amendments to the Financial Markets Act, 1990 – [1st November, 2007], the Malta Stock Exchange was granted authorisation by the MFSA in terms of the FMA to operate as a CSD in terms of the Act and to provide the following services:</p> <p>[a] provision of custody or depository facilities in respect of financial instruments;</p> <p>[b] maintenance of registers of members and holders of financial instruments and recording of transactions and holdings in financial instruments;</p> <p>[c] provision, management and administration of a securities clearing and settlement system in respect of financial instruments, including the provision of access and interoperable links between such a system and other securities clearing and settlement systems, central securities depositories, central counterparties and clearing houses, and other services ancillary to the above;</p> <p>[d] authentication of the register of members or holders of designated financial instruments or of any extract thereof; and</p> <p>[e] such other ancillary or consequential functions related to the above including any preparatory and other related corporate administrative services in relation to issues of financial instruments which are listed or to be listed.</p> <p>In 2008 the MFSA issued the Financial Market Rules stipulating Financial Resources and Financial Reporting Requirements applicable to Regulated Markets and Central Securities Depositories. These rules stipulate the accounting, auditing, financial reporting, recording keeping and financial resources requirements which must be satisfied by <i>inter alia</i> entities which have been authorized as CSDs under the Act. These requirements are based on the Pillar I and II of the CRD as applicable to investment firms which operate a multilateral trading facility. During the same year, the MFSA also issued the Guidance Notes on Risk Management and Internal Capital Adequacy Assessment for Investment Services Licence Holders, Regulated Markets and Central Securities Depositories. The purpose of these Guidance Notes is to afford Authorised Persons with best practice guidance on the manner in which they may comply with the applicable risk management requirements.</p> <p>In 2009 the MFSA proposed and the Minister of Finance adopted the following legal notices for the regulation of the activity of CSDs authorised in terms of the Act:</p> <p>Legal Notice 138 of 2009 – Central Securities Depository (Authorisation Requirements) Regulations, 2009. These regulations set out the authorisation requirements which shall be satisfied by an applicant requesting to qualify as a central securities depository and which shall be satisfied by any central securities depository on a continuing and on-going basis if such depository is to remain a central securities depository. This Legal notice stipulates requirements relating</p>
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	<p>to the governance, financial resources and operating systems of a CSD.</p> <p>Legal Notice 139 of 2009 – Central Securities Depository (Control of Assets) Regulations, 2009. These regulations <i>inter alia</i> stipulate the conditions, duties and functions which must be satisfied by a CSD with respect to its custody and depositary function i.e. the holding and controlling of assets.</p> <p>Legal Notice 140 of 2009 – Designated Financial Instruments Regulations, 2009 – These regulation stipulate the instruments with respect to which the register held by the MSE CSD is to be considered as the official register of share/bond holders, i.e. the authentic record of members and holders of financial instruments and of transactions and holdings in the said instruments.</p> <p>The Securities and Markets Supervision Unit, currently supervises the CSD mainly through off-site compliance related work by reviewing the financial returns submitted by the MSE and through self-assessment questionnaires. The MFSA intends to carry out a CSD focused visits at the office of the Exchange in the coming months.</p> <p>In order to fulfil its duties in this area the Unit has a ‘<i>markets</i>’ team which is <i>inter alia</i> responsible for supervision of the MSE CSD. This team is made up of two managers and is supervised by a Senior Manager who reports to the Director of the Unit. Our earlier comments regarding staff training and resources also refer.</p>
Principle 4.	The regulator should adopt clear and consistent regulatory processes.
Description	<p>The MFSA has, through issuance and application of its Investment Services Rules and Financial Market Rules over the past decade, established transparent, clear and consistent regulatory processes for the regulatory subjects under the past legislative regime. The regulator has a consultative and open approach to the process, and sees its role not only as regulator and supervisor, but takes also an advisory role in its dealings with the present and potential licensees. All investment services license holders under the Investment Services Act appear to be aware what the processes followed are and what the regulator expects of them. Reporting is timely, both offsite and onsite supervision functions and enforcement actions operate smoothly. While the required regulations to RIEs and needed revisions to the IS Guidelines have been issued, the regulatory processes are still being established.</p> <p><u>2010 Update</u></p> <p>The MFSA has since the Financial Stability Assessment Program, refined its regulatory process, with respect to:</p> <p>[a] Consultation with the public on new regulatory initiatives: All regulatory initiatives are subject to a consultation process for a period of not less than two weeks (the length of the consultation process depends on the detail of the</p>

	<p>proposed regulatory measure). Moreover, all consultation documents are uploaded on the MFSA web-page.</p> <p>[b] Publicly disclose its policies in important operational areas: MFSA Rules are all available on the MFSA's web-page.</p> <p>[c] Observe standards of procedural fairness: All applications for a licence are all processed by the same department, which has streamlined procedures in this regard. Moreover, all regulatory decisions are subject to approval of the MFSA's Supervisory Council, which <i>inter alia</i> ensures consistency in the application of the Law and the making of regulatory decisions.</p> <p>[d] Have regard to the cost of compliance with the regulation: The MFSA always attempts to regulate its service providers in a way which does not overburden the industry. A practical example in this regard are the financial returns which investment services licence holders and the MSE are required to complete and submit in satisfaction of the Authority's financial reporting requirements. These have been automated to the extent possible so as to calculate the risks of the particular firm automatically and therefore reduce the administrative burden relating to the completion of these returns.</p> <p>The Securities and Markets Supervision Unit seeks to keep the Stock Exchange and all licensed entities informed of developments in the field of securities regulation. The Unit has a good working relationship with all licensed entities and provides its assistance to the industry where this is required for the better application of the regulatory requirements. In this regard, several training seminars and one to one meetings were held with the industry with respect to the transposition of specific EU legislation such as the MiFID and the CRD.</p> <p>The Securities and Markets Supervision Unit is also active with respect to market monitoring and the investigation of suspicious transactions. In this regard, the Unit's Markets Team carries out daily market monitoring and reviews/investigates any serious suspicions of market misconduct. During 2009 the Unit closed an insider dealing investigation relating to three directors of a listing company. Further to a decision by supervisory council, these directors were subject to a fine by the Authority. The MFSA's decision in this regard, has been contested at the level of the financial services tribunal.</p> <p>The Securities and Markets Supervision Unit also has set practices with respect to the processing of applications for listing and the on-going compliance by listed entities with the continuing obligations emanating from the Listing Rules and the Prevention of Financial Markets Abuse Act, 2005. As indicated above, the Unit has the responsibility to support the Listing Committee in fulfilment of its responsibilities in terms of Listing Rule 1.4 i.e: [a] Scrutinising all applications for Admissibility to Listing of Securities; [b] Considering requests for the discontinuation or suspension of the listing of any securities; [c] forwarding recommendations to the Listing Authority for the authorisation of Admissibility to Listing of any securities as the Listing Authority may consider appropriate or for discontinuing or suspending the listing of any Securities from time to time;</p>
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	and [d] ensuring compliance with any requirements or conditions set out in the Listing Rules.
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	<p>While there clearly is an established practice as regards the regulation and supervision of CIS and licensed investment services providers, the practices related to the supervision of recognized investment exchanges RIEs, and related CSD and CSS functions, listed entities and market conduct are in the process of being established. Regardless, as the MFSA is an experienced securities regulator and has a good track record in its past areas of competence, it is expected that the widening of its supervisory responsibilities will be completed smoothly in a timely fashion.</p> <p><u>2010 Update</u></p> <p>All the practices listed above were established-</p>
Principle 5.	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	<p>Under the MFSA Act (Section 13) the employees of the agency are deemed to be public officers for the purposes of the Criminal Code and any provision of penal nature in any law, and thus subject to the requirements for the code of conduct applying to public officers.</p> <p>The confidentiality standards in the legislation are comprehensive. The MFSA Act, Section 17 obliges all employees of the authority to treat any information acquired in the discharge of their duties as confidential, and precludes them from directly or indirectly disclosing such information. The Financial Markets Act Section 38 (3) imposes the confidentiality of information and protection by the duty of professional secrecy in discharge of duties under provisions of the said Act to the staff of the competent authority, and Section 38 (1) extends the same provision to the staff of RIE's. Violation of this confidentiality code is a punishable offense, with penalties extending up to two years of imprisonment. Similar confidentiality provisions are found in the Investment Services Act Section 26.</p> <p>The MFSA staff is subject to the provisions of the MFSA Staff Handbook and is also particularly bound by the MFSA Act, Sections 11, 11a and 38 regarding confidentiality, as well as by the provisions of the Prevention of Financial Market Abuse Act, 2005. The Handbook includes provisions concerning conflicts of interest and guidelines regarding gifts and hospitality. The officials and employees have, since beginning of 2003, been required to disclose their financial interest related to supervised entities, and the disclosure records are kept in the staff personnel files. While the general insider information provisions naturally apply to the MFSA staff, there are no explicit restrictions on, for example, on short-term active trading in falling under MFSA supervision.</p> <p>As the regulation of investment services business was only introduced in 1994, relevant work experience in this area was not immediately available locally. To that end, the Investment Services Unit's first two Directors since the enactment of the Act</p>

	were expatriates. The current Director has been involved in investment services regulation since 1995. As for the rest of the staff, the majority have approximately 3 years directly relevant work experience at the MFSA, although prior joining the Authority, some have had useful experience in internal audit and banking. Any new recruits to be responsible for regulation of investment services providers are required to be qualified in a relevant discipline—preferably Finance, but also in Law, Accountancy or Banking. The standard of education of applicants for vacancies at the MFSA is very high, and a good number of applicants have post-graduate degrees.
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	<p>The MFSA may wish to consider introducing an explicit restriction on short-term trading in instruments that fall under the MFSA jurisdiction by staff directly involved in market surveillance, supervision of RIE's, market participants, CIS's and the CSD and CSS.</p> <p><u>2010 Update</u></p> <p>The above is still relevant</p>
Principles of Self-Regulation	
Principle 6.	The regulatory regime should make appropriate use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.
Description	
Assessment	2002/3 FSAP - Not applicable; 2010 Independent Assessment - Not applicable
Comments	There are no functioning or stipulated SROs in the Maltese capital markets.
Principle 7.	SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	
Assessment	2002/3 FSAP - Not applicable ; 2010 Independent Assessment- Not applicable
Comments	There are no functioning or stipulated SROs in the Maltese capital markets.
Principles for the Enforcement of Securities Regulation	
Principle 8.	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	The MFSA has quite comprehensive inspection, investigation, and enforcement powers. Sections 12 to 16 of the Investment Services Act, provide the MFSA with an array of regulatory and investigative powers ranging from the right to require information, the right to appoint inspectors, to issue directives, even including the right of entry and the right to impose administrative penalties. Similar regulations can be found in Financial Markets Act Sections 4-8 and 11 to 21 (now 4, 4B, 5 to 8, 11 to

	<p>21and 24, 25, 29, 31, 32 to 34 and 48).</p> <p>The Investment Services Act, Section 13 allows the competent authority (the MFSA) to request from license holders any of the following:</p> <ul style="list-style-type: none"> a) to furnish it, at such time and place and in such form as it may specify, such information and documentation as it may require with respect to any such service, scheme or advertisement; b) to furnish it with any information or documentation aforesaid verified in such manner as it may specify; and c) to attend before it, or a person appointed by it, at such time and place as it may specify, to answer questions and provide information and documentation with respect to any such service, scheme or advertisement. <p>These provisions do not apply to information or documentation which is privileged in accordance with the provisions of subsection (1) of section 642 of the Criminal Code.</p> <p>The laws go even as far as to empower any officer, employee or agent of the MFSA (on producing, if required, evidence of his authority) to enter premises occupied by a person on whom a notice has been served or whose affairs are being investigated, for the purpose of obtaining information or documents required, or otherwise for the purpose of the investigation. The MFSA may also request the assistance of the Commissioner of Police to carry out such actions.</p> <p>The MFSA powers are further enhanced in the Standard Licence Conditions, more specifically in SLC 8.02 (Part C.I of the IS Guidelines) (since changed to SLC 1.02 of Part B of the Investment Services Rules for Investment Services Providers) that requires license holders to cooperate in an open and honest manner with the MFSA and to inform it promptly of any relevant information. The license holder is further required to supply the MFSA with such information and returns as the MFSA requires. Similar provisions are set out in the Investment Services Rules for Retail Collective Investment Schemes, Professional Investor Funds and in the Financial Market Rules for Regulated Markets.</p> <p><u>2010 Update</u></p> <p>In 2005 the Prevention of Financial Markets Abuse Act came into force. The Act provides the MFSA with <i>inter alia</i> various inspection, investigation and surveillance powers, including the power to: [i] carrying out investigations into market abuse (article 13); [ii] demand access to documents and telephone records (article 14); [iii] demand information and assistance and to summon persons for hearing (article 15); [iv] appoint inspectors and to conduct onsite inspections (article 16); and [v] power to issues certain orders (article 17); [vi] power to issues administrative sanctions (article 22).</p> <p>The MFSA also has various investigative and enforcement powers which emanate from the MFSA Act, in particular from article 16 of the Act.</p>
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	No comments

Principle 9.	The regulator should have comprehensive enforcement powers.
Description	<p>Under the provisions of the Investment Services Act (Section 6(8); 7; 12-16) (current relevant articles are 7, 15, 16A, 21 and 25) and the Financial Markets Act (Sections 8; 17; 19; 21), (current relevant articles are 7, 8, 17, 19; 27, 29, 39, 39A and 41A) the MFSA may adopt a number of administrative and other measures against a license holders found to have breached relevant regulatory requirements. The principal provisions in this regard are the following:</p> <p>Investment Services Act</p> <p>Section 6 (renumbered 16A):</p> <ul style="list-style-type: none"> ▪ Enables the MFSA to impose an administrative penalty of up to Lm40,000 (now Euro 93,174.94) on a license holder who has contravened a license condition “<i>without recourse to a court hearing.</i>” In exercising this power, the MFSA would give license holders sufficient opportunity to make representations before enforcing this measure. In terms of the regulator to levy such penalties not only on the license holder, but also on its directors or other senior officers in their individual capacity. • The power to impose administrative penalties has been exercised several times. Penalties levied in 2000 amounted to approx. USD34,000; in 2001: USD17,000 and June 1-30, 2002: USD 3,800 <p>Section 7:</p> <ul style="list-style-type: none"> ▪ Enables the MFSA to cancel or suspend a license in certain serious circumstances, including if it considers it desirable to do so “for the protection of the public” or when it considers the license holder no longer ‘fit and proper’. • This power was availed of twice, in 2000 and 2001, in cases of an investment services licence and collective investment scheme licence respectively. It was also availed of once in 2007 when an Investment Services Licence was cancelled on regulatory grounds. <p>Section 15:</p> <ul style="list-style-type: none"> ▪ Allows the MFSA to issue directives to a license holder requiring the licensee to do or refrain from doing certain acts, including to cease operations or to remove a manager or employee. Such directives may also be made public by the regulator. ▪ This power was availed of once in 2000 and three times in 2001. <p>Section 21</p> <ul style="list-style-type: none"> ▪ Enables the MFSA to apply to the Court to give “such orders as it may deem appropriate” to restrain a contravention by a license holder. Of particular relevance to the investor protection objective, the Court may additionally order the license holder to make a payment by way of compensation to investors who may have suffered loss. • This power has not been availed in the past two years.

Section 25:

- Permits the MFSA to issue a public statement relating to ‘misconduct’ on the part of a license holder after giving him due notice thereof. Public statements need not be limited to situations of misconduct by license holders and may be availed of for the protection of investors, such as for example in cases of unauthorized providers of investment services.
- This power has not been availed of in the last two years.

With respect to RIEs (**Regulated Markets**), the Competent Authority may – should it appear that a recognised investment exchange (**Regulated Market**) has failed or is likely to fail to satisfy the requirements for recognition in or under the Financial Markets Act or has failed to comply with any other obligation imposed on it or under the Financial Markets Act – issue such directives as it deems appropriate in the circumstances. Moreover, in serious circumstances, the Competent Authority has even the right to revoke the recognition order (**authorisation**) which was issued to the Investment Exchange (**Regulated Market**) in question.

2010 Update

For a list of enforcement action taken by the Authority in terms of the Investment Services Act, please refer to the section of the MFSA web-site www.mfsa.com.mt dedicated to Announcements / Sanctions and Penalties. The List on the Authority’s web-site covers the last three years of operation. . From 2008 to mid-2010, a total of Euro 42,720 was levied by way of administrative penalties, not taking into account the penalties which are currently subject to on-going appeal proceedings.

The following are the articles in the FMA granting the authority enforcement powers:

Financial Markets Act

Article 7: Issuing of directives addressed to a Regulated Market

Article 8: Revocation of an authorisation to operate a Regulated Market

Article 17: Discontinuation or suspension from listing and trading

Article 19: Imposition of an administrative penalty on an Issuer of Financial Instruments (up to Euro 93,174.94).

Article 27: Revocation of an authorisation to operate a Central Securities Depository

Article 29: Refers to the applicability of (inter alia) article 7 mutatis mutandis in the case of Central Securities Depositories

Article 39: Competent Authority may apply to the Court to make certain orders

Article 39A: Imposition of an administrative penalty on a person who contravenes the Act, other than Part III thereof, the regulation or the rule (up to Euro 93,174.94).

Article 41A: Issue of public statements on a person who has contravened the FMA.

For a list of enforcement action taken by the Authority in terms of the Financial Markets Act, please refer to the section of the MFSA web-site www.mfsa.com.mt dedicated to Announcements / Sanctions and Penalties. The List on the Authority's web-site covers the last three years of operation.

2002/3 FSAP: The above-mentioned provisions are complemented by comprehensive investigation and inspection powers afforded to the regulator, as indicated in assessment of Principle 8. Remedial action by license holders is required within set time frames to rectify breaches of license conditions, including breaches of financial resources requirements.

Furthermore, in accordance with Section 22 of the ISA, a breach of a license condition may constitute a criminal offence. The maximum sanction is a fine of Euro 465,874.68 and a four year prison sentence. Similarly, the Criminal proceedings section in the Financial Markets Act provides that any person guilty of an offence under the provisions of the Act shall be liable on conviction to a fine not exceeding Euro 465,874.68 or a term of imprisonment not exceeding four years, or to both such fine and imprisonment. The Financial Markets Act also gives the Listing Authority the power to impose a fine or publish a statement censuring a person who has contravened the listing rules. Moreover, in terms of the same Act, the Listing Authority has the power to suspend temporarily the trading in a security or securities on any recognized investment exchange.

2010 Update

In addition to the above, please note the following powers of the Authority in terms of the PFMA:

Article 17 – Power to issue certain orders including an order requiring the cessation of any practice that is contrary to the provisions of the PFMA;

Article 18 – Power to apply to the Attorney General to apply to the Court to make attachment order

Article 19 – Power to apply to the Attorney General to apply to the Court to Freeze Funds

Article 22- Imposition of Administrative Sanctions

The MFSA also has various investigative and enforcement powers which emanate from the MFSA Act – please refer to article 16 of the Act.

For a list of enforcement action taken by the Authority in terms of the Prevention of Financial Markets Abuse Act, you may wish to refer to the section of the MFSA web-site www.mfsa.com.mt dedicated to Announcements / Sanctions and Penalties. The List on the Authority's web-site covers the last three years of operation.

Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	No comments
Principle 10.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	<p>The MFSA conducts both onsite and offsite monitoring work and compliance testing.</p> <p>Offsite supervision is carried out primarily through the analysis of financial returns and reports submitted by license holders and third parties, e.g. external/internal auditors, and ad-hoc meetings. Whilst both Investment Services license holders and licensed CIS are required to submit annual audited financial statements within four months of the accounting year end, all investment services license holders (with the exception of licence holders which are credit institutions licensed also under the Banking Act, 1994 which are therefore subject to the prudential requirements under the Banking Act, 1994) are required to submit annual financial returns approved by their auditors within the same time-frame. Retail CIS are also required to submit interim unaudited financial statements within two months from the end of the reporting period. Category 1, 2, 3 and 4 IS license holders are required to submit half-yearly/ quarterly/ monthly unaudited financial returns as applicable within one month of the end of the reporting period. The Malta Stock Exchange qua operator of a regulated market and a CSD is also required to submit financial documentation on a quarterly basis besides monthly operational reports.</p> <p>Compliance visits assist the MFSA in monitoring how closely license holders adhere to license conditions and to the standards required by law. An on-going compliance-testing program is in place. The purpose of these visits is three fold: to provide assistance to license holders; to identify issues which may give rise to regulatory concerns; and to ensure adherence to regulatory requirements. The following on site reviews were carried out over recent years:</p> <p>Year 2000: 32</p> <p>Year 2001: 64</p> <p>Year 2002 (up to end June): 27</p>

2010 Update: Updated information on compliance visits between 2007 and 2009

<i>Year</i>	<i>Number of compliance visits undertaken</i>
<i>2007</i>	<i>32 visits to investment intermediaries</i>
<i>2008</i>	<i>20 visits to investment intermediaries and regulated markets and 8 visits to Collective Investment Schemes (including sub-funds)</i>
<i>2009</i>	<i>20 visits to investment intermediaries</i>

Compliance visits are currently carried out to category 1 to 4 Investment Services Licensees, and to those licensed locally-based collective investment schemes that do not engage a third party fund manager. Although such visits are as a general rule undertaken on an annual basis, the frequency depends on a risk assessment exercise carried out at the end of each visit. The frequency of visits varies between a six month and smaller interval for high risk companies, up to eighteen months for medium risk and over eighteen months for license holders considered low risk. The risk assessment procedure which is used to determine the frequency of the visits—is based on a model used by the former U.K. Investment Management Regulatory Organization though tailored as appropriate for the local circumstances—assesses two risk areas: (1) inherent risk—the risk arising from the type and nature of the business being undertaken, and (2) control risk—the risk that management’s control systems does not identify and/ or rectify deficiencies.

2010 Update

The approach for determining the Unit’s visit schedule has recently been reassessed. **The above-mentioned risk assessment procedures are in fact highlighted in the ‘Securities Unit Compliance Team Procedures Manual’, dated 30 November 2007, which includes a risk assessment model so as to determine the frequency of compliance visits to be carried out on License Holders. The above-referred to frequency of visits which was subsequently changed to every 12 months for high risk firms, 24 months for medium risk firms and 36 months for low risk firms, was set at a time when the then Investment Services Unit’s remit was largely limited to the licensing and regulation of investment services providers and collective investment schemes in terms of the Investment Services Act, 1994. At the time, the Unit’s staff consisted of approximately 12 staff apart from the Director. Due to (1) the significant increase in applications for the issue of licences under the Investment Services Act over recent years which up to 1st January 2010 were processed by the Securities Unit (previously Investment Services Unit); (2) the wider remit of the Securities Unit (including market surveillance, investigation and enforcement in terms of the Prevention of Financial Markets Abuse Act as well as regulation of the Malta Stock Exchange and CSD under the Financial Markets Act) to that of its predecessor the**

Investment Services Unit; (3) the substantial EU-related work carried out by the Unit post EU accession in 2004 in so far as transposition and implementation of Directives (particularly MiFID, CAD/CRD, UCITS and MAD) and CESR Committee work is concerned (involving frequent travel, input to various questionnaires and reports etc.), the Unit has over recent years not been in a position to adhere to the set frequency of visits schedule. Another relevant factor in this regard is the fact that the Unit's staff complement is largely composed of relatively inexperienced Managers who are still being trained to enable more effective delegation by the more experienced staff members. Although following the internal MFSA restructuring, the Unit is no longer involved in processing applications for the issue of licences under the Investment Services Act, its remit as Securities & Markets Supervision Unit has been widened as further detailed under Principle 3 to include processing of applications for the admissibility to listing, oversight of listed entities and regulation of trustees and fiduciaries which in themselves require dedicated resources. The Unit's wider remit has also led to an increase in EU-related work given the large number of Directives which are relevant to the Unit's work (currently over 10). (As indicated in the 2010 Update to Principle, 3 the Unit Director currently has a staff complement of around 17 officials (2 of whom are support staff). The recruitment process for two additional Managers is underway and there are plans to augment the Unit's resources in due course.)

In this respect, senior management conducted a detailed review of the list of all license holders with a view to determine which license holders are to be subject for a *broad scope visit*. The latter aims to review the concerned investment services license holder's compliance with MiFID requirements in particular. Furthermore, senior management agreed to conduct *focused visits* to a selected number of license holders particularly those who are known to sell complex products and who actively market their services. These focused visits are expected to focus specifically on adherence to the suitability and appropriateness requirements as well as other areas, such as inducements and conflicts of interest. On a final note, senior management agreed to conduct visits to recently licensed investment services firms, which have so far never been subject to a compliance visit. There is however still the intention to build on the risk assessment model set out in the 2007 Procedures referred to above as the risk categorization of firms is regarded as a useful guide to prioritizing compliance visits.

2002/3 FSAP: Spot checks are also undertaken as needed, focusing on specific aspects of a license holders' business, e.g., compliance with the record-keeping and reconciliation requirements for clients' money and assets.

Investment Services Licence Holders: Compliance officers follow documented procedures and check-lists in undertaking such onsite compliance visits. These generally concentrate on:

1. Know Your Customer procedures;
2. Administration of the license holder's company, including dual control principle and risk management;
3. Compliance arrangements;

4. Complaints procedures;
5. Handling and safe-keeping of customers' assets and clients' money;
6. Book-keeping and record keeping;
7. Client relationships, including client agreements and procedures; and
8. Dealing, including timely transactions and conflicts of interest and accuracy of deals.

However, should circumstances so warrant, the focus can change to any particular area which is considered critical.

2010 Update

Compliance officers follow documented procedures and check-lists in undertaking such onsite compliance visits. In this regard, prior to undertaking a compliance visit, the Compliance Officers prepare a *documents checklist*. This checklist outlines the required documentation which should be collected or reviewed during the compliance visit. This procedure enables the Compliance officers to conduct a review (both during the visit as well as following the visit, during the compilation of the visit report) of the extent of the License Holder's compliance with Part B of the Investment Services Rules for Investment Services Providers as well as the relevant anti-money laundering rules. The under-mentioned list outlines the extent of documentation ordinarily reviewed by the Compliance Officers:

1. A selected sample of client files and all documentation pertaining to the Company's client portfolio;
2. Adverts' file;
3. Breaches log;
4. Business Continuity Plan and the documentation pertaining to its testing;
5. Complaints register;
6. Internal audit report (*if applicable*);
7. Internal organizational chart;
8. Relevant agreements (such as investment management, outsourcing and/or service agreements);
9. List of introducers;
10. List of staff authorized to promote and sell;
11. Review of Board of Directors' meetings;
12. Written procedures manual (including anti-money laundering procedures);
13. Documentation evidencing the reconciliation of clients' assets and clients' monies;
14. Reports provided to senior management (as prepared by the Compliance Officer);
15. RMICAAP (Risk Management Internal Capital Adequacy Assessment Process) report;
16. Investment Committee minutes and the relevant Terms of Reference of the Investment Committee;
17. Documentation distributed to retail clients such as Terms of Business document (including Nominee agreement), Conflicts of Interest policy, Inducements policy and order/best execution policy;
18. Other client related documentation – Client Fact Find, Order Form,

Contract Note and Statement of client instruments or client money.

2002/3 FSAP: Each license holder is required to have a formally appointed compliance officer approved by the MFSA. Prior to approving such appointment, the MFSA seeks to ensure that the person is of integrity and possesses the necessary competence to carry out the role professionally. In order to avoid conflicts of interest, the MFSA generally requires compliance officers not to be involved in front-office roles, such as trading. Moreover, the MFSA needs to be satisfied that the person appointed has sufficient resources and is of an appropriate senior rank and calibre to be influential in the firm. This serves to emphasize the importance of the compliance officer's responsibilities and to ensure these are understood and accepted by the person concerned. License holders are required to draw up compliance manuals for guidance to compliance staff, as well as staff procedures manuals, which are required to be kept up to date.

Prior to a compliance visit, a letter introducing the compliance officials (referred to as 'Pre-Visit letter') is sent to the license holder. This letter confirms the date of the visit and requests certain information to be prepared.

~~A questionnaire (two types of questionnaires are available, one for first time visits and another for repeat visits) is enclosed to be returned duly compiled before the start of the visit. The purpose of the questionnaire is to gain a better understanding of the company to be visited and to prepare for the visit accordingly. Further, in preparation for the visit, the correspondence file relating to the license holder as from the date of the last visit will be reviewed and salient features noted and summarized.~~

The above is no longer relevant.

2010 Update

In preparation for the visit, the Compliance officials compile a *Pre-Visit report*. The latter is divided in the following sections: Introduction; Objectives; Methodology; Background; Description of Business; Investment Services Licence Holders' Organisational Chart; Summary of Correspondence; Financial Resources and Clients' Money and Assets; Auditors' Management Letter and Breaches identified during the Last Compliance Visit. The main objectives of the Pre-Visit report are to assess the Licence Holder's level of implementation of the Investment Services Rules as well as to verify whether the Licence Holder is maintaining adequate procedures in place to comply with the applicable requirements of the Prevention of Financial Markets Abuse Act (2005) and the Prevention of Money Laundering act (1994). The Pre-Visit report aides the Compliance officials to gain an understanding of the operations and activities as undertaken by the Licence Holder. The Pre-Visit report also provides an overview of the management and administration of the Company. Moreover, the Pre-Visit report includes a summary of the salient points as featured in the correspondence file of the Licence Holder. Such correspondence dates back to the previous compliance visit that was undertaken. On a final note, the Pre-Visit report also features a review of the latest auditor's management letter as well as a review of the breaches identified during the last compliance visit. Any additional

issues which are deemed to be of a significant nature are also included. The report is reviewed and signed by senior management.

After the visit, the compliance officials compile a Visit Report which is reviewed by the Deputy Director and by the Director of the Securities & Markets Supervision Unit. The Visit Report presents a detailed overview of the MiFID findings in terms of a review of the written procedures as well as an assessment of the Licence Holder's records. Moreover findings concerning Capital Requirements Directive (CRD) issues (regarding the RMICAAP report) are also included. Anti-Money Laundering issues also feature in the Visit Report. By way of conclusion, the Outcome section of the Visit Report highlights the issues which the Licence Holder would need to rectify. Such issues are subsequently reflected in the Visit Letter.

As per above, a letter (*Visit Letter*) is subsequently sent to the Licence Holder outlining any observations, recommendations and requirements. Requirements are expected to be addressed by the Licence Holder by a specified date. If the need arises, such as where breaches/violations of licence conditions are identified, regulatory action is recommended by the Unit for consideration and approval or otherwise by the Authority's Supervisory Council which may lead to the imposition of an administrative penalty or other appropriate sanction and a follow-up visit is scheduled.

Compliance Visits undertaken to Professional Investor Funds (PIFs)

Compliance Officers perform the following principal checks:

- Check whether the Scheme has any borrowing and/or investment restrictions;
- Review the Investor Declaration Forms and whether there is evidence that the PIF was promoted to other investors;
- Check whether there is any evidence of changes in ownership of the founder shareholders of the PIF;
- Check whether the appointments and resignations of directors have been brought to the attention of the MFSA for its approval;
- Verify that the compliance arrangements outlined in the PIF's Standard Licensing Conditions are being maintained;
- Review of service agreements;
- Check whether any side letters have been utilised;

Compliance Visits undertaken to Retail CIS

During the above-mentioned visits, Compliance Officers review the Board of Directors minutes; the Investment Committee minutes and also check whether the Fund Manager has appropriate AML procedures in place.

~~In terms of the CIS compliance visit checklist the compliance officials from the MFSA have the responsibility to:~~

~~(1) — establish that the internal audit function is adequate and reporting lines are~~

	<p>directed to a very high level and that reports receive appropriate attention and are acted upon;</p> <p>(2) — confirm that internal audit are carried out regularly based on a risk-based system;</p> <p>(3) — confirm that internal audit regularly reviews the activities of the compliance function;</p> <p>(4) — establish that internal audit regularly tests the security of automated systems and the integrity of the information maintained in and produced by these systems;</p> <p>(5) — confirm that internal audit is involved in the development and implementation of all new systems to make sure adequate security and internal control procedures are incorporated into the design of such systems;</p> <p>(6) — confirm that internal audit provides periodic reports and also meets with the CIS Board of Directors to report on audit findings and on the responsiveness of management to remedy weaknesses identified.</p> <p>(7) — confirm that internal audit follow up their recommendations.</p> <p>Further, in terms of the same compliance visit checklist the compliance officials are also obliged to:</p> <p>(1) — establish the lines of authority of the compliance officer.</p> <p>(2) — establish how the compliance officer monitors and evaluates reports generated by compliance routines built into all operating systems;</p> <p>(3) — confirm that breaches are identified by the routines and that procedures are in place to ensure that action to regularize is timely and appropriate.</p> <p>The above information has been included in other sections of the report.</p> <p>With respect to IS license holders the compliance officers are required to check whether:</p> <p>(1) — compliance procedures are documented;</p> <p>(2) — these procedures are reviewed annually;</p> <p>(3) — reviews are documented;</p> <p>(4) — copies of procedures are available to staff;</p> <p>(5) — these copies of the procedures are up to date and followed in practice;</p>
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~~(6) — the reporting lines are adequate and whether there is an alternative reporting line in the event of disagreement or inaction and the relationship between compliance and internal audit;~~

~~(7) — there are adequate procedures for recording breaches of standard license conditions and a breaches log;~~

~~(8) — establish whether adequate training is given to ensure compliance procedures are followed;~~

~~(9) — the license holder's compliance function has adequate resources and whether it is well organized;~~

~~(10) the compliance officer has sufficient seniority and influence to carry out his or her functions.~~

The above information is already included in other sections of the report.

2002/3 FSAP: With the exception of the two largest banks and their subsidiary fund management companies as well a couple of medium sized financial services companies, which have an internal audit function, the size of current investment services license holders is very small (average number of employees approx. 6) and does not really justify a fully-fledged internal audit function. Reliance is in such case placed on the external auditor.

While no formal procedures have yet been established as regards to surveillance, enforcement, and assurance of compliance by RIE's and their operations under the Financial Markets Act, the MFSA and MSE are actively communicating and collaborating seeking to develop and put in place optimal procedures.

2010 Update

The SMSU now has a comprehensive framework for the compliance monitoring of regulated markets and central securities depositories. This includes both off-site and on-site supervision. A general description of this framework is outlined in the MFSA's public document entitled: *'The Framework for the Regulation Of Investment Services License Holders, Regulated Markets And Central Securities Depositories'* which is available on www.mfsa.com.mt under 'Securities'/ Guide to Regulation.

The detailed procedures for on-site and off-site compliance monitoring are included in the MFSA SMSU Compliance Manual. The manual contains the latest version of the checklists which are used by the MFSA in order to conduct supervision of entities which are providing securities business. The checklist for the carry out of on-site supervision of the Malta Stock Exchange is included as Appendix VII of the Manual. Please note that this particular checklist is in the process of being updated, as it needs to cater for recently adopted legislation such as the legislation on central securities depositories.

	<p>The manual also includes the procedure which applies with respect to the review of financial documentation. This is included in Part II of the Compliance Manual. The relevant section in this regard is entitled '<i>Review of financial documentation of IS License Holder</i>'. Please note that while this only refers to IS License Holders, the same procedures also apply to the review of the financial documentation submitted by the Malta Stock Exchange given that the financial resources and reporting requirements of the MSE are the same as those for Category 3 Investment Services License Holders with the exception being the frequency of reporting (quarterly for the MSE and monthly for Category 3 IS License Holders in line with the CRD).</p> <p>From an off-site supervisory perspective, the MFSA reviews the regular off-site compliance reports, which the MSE submits to the Authority. These include a monthly report on the operations of the MSE and quarterly financial returns, which indicate whether the MSE is satisfying the financial resources requirements. The MSE also submits to the Authority its annual audited financial statements. From an on-site monitoring point of view, the MFSA has carried out six compliance visits at the offices MSE since taking responsibility for the regulation of the MSE in 2003.</p>
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment– Implemented
Comments	<p>While there clearly is an established practice as regards the regulation and supervision of CIS and licensed investment services providers, the practices related to the supervision of recognized investment exchanges RIEs, and related CSD and CSS functions, listed entities and market conduct are in the process of being established. The MFSA and MSE are actively communicating and collaborating seeking to develop and put in place optimal procedures. Consequently and as the MFSA is an experienced securities regulator and has a good track record in its past areas of competence, it is expected that the widening of its supervisory responsibilities will be completed smoothly in a timely fashion.</p> <p><u>2010 Update</u></p> <p>Since taking over responsibility for the regulation of the Malta Stock Exchange in 2003, the MFSA has gained experience in the supervision and on-going monitoring of the Exchange, CSD, and listed entities in terms of the Financial Markets Act as well as market surveillance in terms of the Prevention of Financial Market Abuse Act. Please also refer to the above 2010 Update</p>
Principles for Cooperation in Regulation	
Principle 11.	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	Parliament approved in July 2002 amendments to both the MFSA Act (Sections 17 and 18), the ISA (Sections 17, and 26), and the Financial Markets Act (Sections 37, and 38) facilitating exchange of information with both foreign competent authorities or bodies carrying out similar functions as MFSA, and local bodies or authorities with regulatory, judicial or licensing functions. The new provisions came to force October

	<p>1, 2002. The powers thus vested with the MFSA are wide enabling the authority to use its investigative and enforcement powers to assist foreign authorities in pursuance of serious regulatory concerns or detection, prevention or prosecution of criminal offences. Section 17 of the Investment Services Act provides for cooperation with overseas regulatory authorities, granting the MFSA the power to communicate to overseas regulatory authority information which is in its possession, subject to certain considerations such as reciprocity, Malta's international commitments and signed Memoranda of Understanding.</p> <p>Exchange of Information is also being facilitated through the signing of Memoranda of Understanding (MoUs) with domestic and overseas regulators. The provisions contained in the aforementioned laws and the model Memorandum of Understanding applied by the MFSA enable the Authority to comply with the principle. The MFSA MoU template that is offered to jurisdictions willing to conclude an arrangement with Malta for the exchange of information and other collaboration is in line with the Principles.</p> <p><u>2010 Update</u></p> <p>Other relevant sections relating to exchange of information are articles 17A to 17B of the Investment Services Act and articles 37A to 37C of the Financial Markets Act. The following article of the Prevention of Financial Market Abuse Act is also relevant:</p> <p>Article 20 – Co-ordination with other Authorities</p>
Assessment	2003 - Implemented ; 2010 Independent Assessment – Implemented
Comments	No comments
Principle 12.	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	<p>Section 26 of the Investment Services Act has been amended to facilitate the exchange of information with both local and overseas authorities, including disclosure of information pursuant to a request arising under a MoU. The MFSA is in contact with its domestic counterparts on a regular basis, and is in discussions with the CBM on signing a MoU detailing their cooperation arrangements. Such MoU has in the meantime be signed (please refer to the 2010 Updated to comments in relation to Principle 3)</p> <p>As part of its due diligence work, the MFSA contacts its foreign counterparts when required to obtain information regarding applicants for licenses or proposed directors, senior managers etc., which are or have been regulated overseas. This occurs on a regular basis, and there have been numerous such requests over the past two years (approximately over 200). Moreover, there is no impediment to the MFSA providing information to its foreign counterparts when requested. This does not occur very frequently, given that most local license holders based in Malta do not themselves</p>

	<p>operate overseas.</p> <p>The Authority has a MoU with CONSOB (Italy), BVI and Turkey, as well as information sharing arrangements with Luxembourg. The Authority is in the process of seeking to expand the range of its MoUs or similar agreements with foreign regulators to facilitate timely two way communication as and when the need arises. Negotiations are under way for the establishment of MoUs, including Bermuda, Cayman Islands, Ireland, Gibraltar, Mauritius, Portugal, Guernsey and San Marino. <i>[Details of the MoUs which MFSA is currently a signatory to can be found on the Authority's web-site by selecting 'Memoranda of Understanding']</i></p> <p>In addition to the MFSA's cooperative arrangements, the MSE has MoUs signed by the London Stock Exchange plc. the Cairo & Alexandria Stock Exchanges, and MoUs establishing exchange of information with the Capital Markets Board of Turkey, the Cyprus Securities, and Exchange Commission and the Polish Securities and Exchange Commission.</p> <p><u>2010 Update :</u></p> <p>The above is still relevant</p>
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	No comments
Principle 13.	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>The Investment Services Act (Section 17) provides that the competent authority may exercise the following powers at the request of or for the purposes of assisting an overseas regulatory authority: (a) the power to impose, revoke or vary conditions on the grant of a license; (b) the power to cancel or suspend a license;(c) the powers of inquiry under the ISA Act; (d) the power to appoint inspectors; (e) the powers of intervention; (f) the powers of entry under the Act; (g) the power to communicate to the overseas regulatory authority information which is in the possession of the competent authority, whether or not as a result of the exercise of any of the above powers. The powers vested with the MFSA enable the authority to use its investigative and enforcement powers to assist foreign authorities in pursuance of serious regulatory concerns or detection, prevention or prosecution of criminal offences. The competent authority is to exercise powers by virtue of the abovementioned Investment Services Act Section.</p> <p>(a) where the assistance is requested by the overseas regulatory authority for the purposes of the exercise of one or more of its regulatory functions; or</p> <p>(b) where so required within the terms of Malta's international commitments; or</p> <p>(c) where so required within the terms of undertaking assumed in bilateral or multilateral agreements for the exchange of information and other forms of collaboration with overseas regulatory authorities including a request arising under a</p>

	Memorandum of Understanding concluded with the Competent Authority.
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	No comments
Principles for Issuers	
Principle 14.	There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.
Description	<p>Despite the regulatory competence having been transferred to the MFSA in the beginning of 2003, the listing requirements and the disclosure by listed companies of financial results and other events that are material to investors' decision are, as a transitory arrangement, still governed in Chapter 6 of the By-laws of the Malta Stock Exchange. Chapter 6 also includes requirements for financial disclosure of companies for initial listing.</p> <p>Section 6.05 sets out continuing listing obligations:</p> <p>Listed companies are obliged to provide the Exchange (for release to members) with any relevant information that would be "likely to materially affect the price of its securities," including, inter alia, any decision to declare or not declare a dividend or other distribution; any change in senior management; any notice of shareholdings of five per cent or more of the equity share capital of the company being acquired or being traded; any acquisition of shares of an unquoted company; any sale of shares in another company; or any proposed changes to the Memorandum and Articles of Association of the company. (6.05.04; 6.05.05)</p> <p>The by-laws include an exception to disclosure policy: "Without prejudice to anything contained in this bye-law, the Council may authorize the omission from the half-yearly report of certain information provided for in these By-laws if it decides that disclosure of such information would be contrary to the public interest or seriously detrimental to the company, provided that, in the latter, case, such omission would not be likely to mislead the public with regard to facts and circumstances, knowledge of which is essential for the assessment of the shares in question. The company or its representatives shall be responsible for the correctness and relevance of the facts on which any application for such exemption is based." (6.05.02).</p> <p>Listed companies are obliged to publish a half-yearly report on the activities and profits and losses for the first six months of each financial year, published within three months of the end of the period. The by-laws set out minimum information to be included in the report:</p> <ul style="list-style-type: none"> • net turnover; • profit or loss before taxation and extraordinary items; • taxation on profits; income tax and, if material, share of associated companies to be shown separately; • minority interest; • profit or loss attributable to shareholders, before extraordinary items; • extraordinary items net of taxation;

	<ul style="list-style-type: none"> • profit or loss attributable to shareholders; • rates of dividends paid and proposed and amount absorbed thereby; • earnings per share; • comparative figures for the previous period. <p>The above figures are to be prepared using the same accounting standards and policies as the annual accounts; auditing is not required, although if the company's half-yearly financials are audited, the auditor's report shall be reproduced in full.</p> <p>Annual reports and accounts have to be audited in accordance with International Auditing Guidelines and published within six months of the end of the period. The annual report must include a balance sheet, profit and loss account, and a statement of source and application of funds (all with comparative figures for the previous year), as well as:</p> <ul style="list-style-type: none"> • the auditors' report; • a statement showing the interest of each director of the company in the share of the company or any related company; • names of shareholders holding five per cent or more of the equity share capital; • the number of holders of each class of shares and the voting rights attaching to each class; and • a distribution of each class of shares, setting out the number of holders in. <p>Listing particulars at the time of listing or of issue of new securities must include information regarding the financial position of the company (or the group, where accounts are consolidated) for the previous three years and as specified in Chapter 6 of the MSE by-laws. Section 6.04 of the by-laws sets out the requirements for the above-mentioned accountants' reports, including the independence of accountants and auditors, and at a minimum the following information:</p> <ul style="list-style-type: none"> • Turnover or other operating income or revenue; • Depreciation and amortization; • Investment and other income; • Directors' remuneration; • Auditors' remuneration; • Interest payable and leasing or hire expenses; • Exceptional items; • Share of profits or losses of associated companies; • Profits/losses before taxation and extraordinary items; • Taxation, including share of associated companies; • Minority interest; • Amount absorbed by preferential dividends; • Profits/losses attributable to equity shareholders before extraordinary items; • Extraordinary items and related tax; • Profit attributable to equity shareholders; and • Movements of reserves of holding company. <p>In addition, listing particulars require: a "statement of the assets and liabilities of the company"; "the source and application of funds statements" a statement showing bank loans and overdrafts and other borrowings of the company or group; a note regarding principal accounting policies and any changes in policies; an opinion from the auditors</p>
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whether the statements represent a true and fair picture; whether there have been any qualifications. Although the figures provided in the listing particulars need to have been audited according to International Auditing Standards, presentation of financial statements in the offering memorandum does not appear to be required to follow particular standards. However, under the Companies Act, companies' financial statements are required to conform to International Accounting Standards, and auditors are required to report companies' compliance with IAS.

2010 Update

The Listing Authority adopted the Listing Rules in 2004. These Rules are divided in to 19 chapters as follows:

Chapter 1 – Outlines the powers of the Listing Authority.

Chapter 2: Stipulates requirements on the Sponsors and the Sponsor's responsibilities to the Issuer and the Listing Authority during the Listing process.

Chapter 3: Specifies the rules relating to the conditions for suitability for admissibility to Listing of a security, and the Listing Authority's scope of discretion.

Chapter 4: Stipulates the rules which apply with respect to the submission of an application for the securities to be Listed or Traded.

Chapter 5: Indicates what additional documents should be submitted with the Prospectus

Chapter 6: Stipulates rules on the content of the prospectus

Chapter 7: Describes the procedure for determination of the granting of authorisation to listing, as well as the procedures for applying and issuing notifications to the public

Chapter 8: Stipulates the continuing obligations applicable to Listed Companies

Chapter 9: Stipulates the financial information which must be prepared and published by Listed Companies

Chapter 10: Stipulates rules on documentation which does not require prior authorisation

Chapter 11: Stipulates rules regarding Circular and their issue

Chapter 12: Stipulates the procedures for the purchase by an issuer of its own securities

Chapter 13: Stipulates rules applicable to Overseas Companies

Chapter 14: Stipulates the rules applicable to Property Companies

	<p>Chapter 15: Sets the admissibility requirements applicable to collective investment schemes</p> <p>Chapter 16: Stipulates the Rules which apply to Public/State Sector Issuers Issuing Debt Securities</p> <p>Chapter 17: Sets the rules which are applicable to issuer which would like to list on the second tier market</p> <p>Chapter 18: Applies with respect to Takeover Bids</p> <p>Chapter 19: Stipulates requirements relating to shareholder rights</p> <p>For a detailed understanding of the requirements which emanate from the Listing Rules, its best to refer to the Rules, a copy of which is being attached for ease of reference. These Rules are in the process of being amended. Consultation documents in this regard were issued in January and April 2010. A copy of the amended version is available in the section of our web-page www.mfsa.com.mt entitled Listing Authority.</p> <p>The Listing Rules transpose the Consolidated Admission Requirements Directive ('CARD'); the Prospectus Directive; the Transparency Directive; the Shareholder Rights Directive; and the Takeover Bids Directive.</p>
Assessment	2002/3 FSAP - Partially implemented ; 2010 Independent Assessment – Implemented
Comments	<p>Regulatory competence in respect of the issuers of listed securities has been transferred to the MFSA. The Financial Markets Act contemplates the establishment of a Listing Authority. Transitional arrangements have been put in place whereby till the MFSA has issued the Listing Requirements the MSE by-laws will apply and MSE Council will support the work of the competent Listing Authority till it is ready to take over. In the context of this transition the following issues would need to be considered:</p> <ul style="list-style-type: none"> • The exceptions to the half-yearly disclosure requirement would need to be reconsidered. • The 6 month lag allowed for issuance of audited annual accounts is long by international standards. <p><u>2010 Update</u></p> <p>Since 2004 the Listing Authority is fully responsible for authorising the admissibility to listing on the Malta Stock Exchange. The Authority regulates listed companies in terms of the FMA and its Listing Rules.</p> <p>With respect to the disclosure of financial information, the Listing Rules transpose and implement the EU Transparency Directive. In terms of Listing Rules 9.54 and 9.55, the exemption from the required publication of the half-yearly report is only applicable to a restricted group of issuers. The following are relevant extracts from the Listing Rules:</p>

	<p>9.54 The obligation to draw up and make available to the public the annual financial report, the half-yearly financial report and the interim Directors' statement shall not apply to:</p> <p>9.54.1 a State, a regional or local authority of a State, a public international body of which at least one Member State is a member, the European Central Bank and Central Banks of EU or Member States whether or not they issue shares or other securities; and</p> <p>9.54.2 an Issuer exclusively of Debt Securities admitted to trading on a Regulated Market, the denomination per unit of which is at least €50, 000 or, in the case of Debt Securities denomination in a currency other than Lm, the value of such denomination per unit is, at the date of the issuer, equivalent to at least €50,000.</p> <p>9.55 The obligation to draw up and make available to the public the half-yearly financial report shall not apply to;</p> <p>9.55.1 Credit Institutions whose shares are not admitted to trading on a Regulated Market and which have, in a continuous or repeated manner, only issued Debt Securities provided that the total nominal amount of all such Debt Securities remains below €100,000,000 and that they have not published a Prospectus in terms of the Prospectus Directive;</p> <p>9.55.2 Issuers already existing at the date of the entry into force of the Prospectus Directive which exclusively issue Debt Securities unconditionally and irrevocably guaranteed by the Home Member State or by one of its regional or local authorities, on a Regulated Market.</p> <p>In terms of Listing Rule 9.37, issuers are required to publish their annual audited accounts within four months of their financial year end.</p> <p>All issues raised in the 2003 assessment have been satisfactorily addressed.</p>
Principle 15.	Holders of securities in a company should be treated in a fair and equitable manner.
Description	<p>Beyond the Company Act provisions that provide a modern and comprehensive framework for minority protection, the MSE by-laws provide further specificity as regards the companies listed on the exchange, primarily reflected in rules regarding disclosure to existing shareholders of changes in shareholding as well as other key corporate decisions and regarding offering and allocation of new shares to existing shareholders. In addition, the by-laws require disclosure of shareholding above a five per cent interest, and prohibit trading of shares by directors and others with non-public relevant information in some instances.</p> <p>Specific requirements MSE by-laws include:</p> <ul style="list-style-type: none"> • Offerings of equity securities must be first made to existing equity shareholders in proportion to their holdings, unless shareholders have approved otherwise, either as a statutory pre-emption not more than fifteen months prior to the issue, or as approval for the specific issue. (6.01.05 (xviii)) • When issuing new securities, the by-laws require that companies receive

	<p>approval of shareholders in the general meeting for any new issue that would transfer a controlling interest, or any issue of new shares over a period of twelve months greater than 10 per cent of the nominal value of shares at the start of the period (unless such shares are issued to ordinary shareholders on a pro-rata basis).</p> <ul style="list-style-type: none"> • Listing particulars must include a statement that no additional share offerings will be made within one year (except pro rata to shareholders) without prior approval in the general meeting. Listing particulars must also include a statement regarding any individual's interest in the share capital of the company above 5 per cent. • Shares or rights may not be issued to directors or other associated persons without the approval of the specific allotment by shareholders in a general meeting. Finally, employee share schemes have to be approved by shareholders in the general meeting. • Listing requirements set out in Chapter 6 of the MSE by-laws require that, where there is a corporate substantial shareholder (defined as entitled to exercise or control the exercise of 30 per cent or more of the voting power at general meetings or in a position to control the composition of a majority of the board of directors of the company), the Exchange may render the company subject to conditions in the interest of the general body of shareholders. (6.01.05 (x)) • Regarding trading by company insiders, the MSE by-laws establish rules regarding trading of share by directors of a company (or any employee who is in possession of unpublished price-sensitive information): Directors (and their spouses) may not deal directly or indirectly in securities of a company of which he is a director at any time when he is in possession of unpublished price-sensitive information or prior to the announcement of matters of a exceptional nature involving unpublished price-sensitive information. In addition, directors may not trade in the securities of his company in a period of two months preceding announcement of the company's yearly and half-yearly results. Directors are not allowed to trade securities of a company of which he is a director on any short-term notice without giving notice to the Chairman or other directors designated for this purpose. Companies have to maintain a written record of such notices. (6.05.08) <p><u>2010 Update</u></p> <p>The above-mentioned provisions safeguarding the rights of holders of securities which were included in the Bye-Laws, have been further enhanced in the MFSA Listing Rules which transpose the relevant EU Directives, including the Shareholders' Rights Directive, Transparency Directive, Takeover Bids Directive etc. Reference should be made to the following chapters of the Listing Rules in particular:</p> <p>Chapter 3 – Conditions for Admissibility</p> <p>Listing Rule 3.34 requiring shareholder approval by general meeting for any issue of equity if the nominal value of those securities when aggregated with the nominal value of any other securities of the same class issued in the previous 12 months, exceeds 10% of the nominal value of that same class of securities in issue</p>
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	<p>at the commencement of that period of 12 months unless the securities are issued to ordinary shareholders pro-rata.</p> <p>Chapter 4 – Methods of Bringing Securities to Listing and Trading</p> <p>Listing Rule 4.31 requires issues for cash of equity securities to be offered in the first place to existing shareholders in proportion to their holdings in accordance with the relevant Companies Act provisions unless shareholders have approved other specific proposals by extraordinary resolution.</p> <p>Listing Rule 4.37 requiring employee share schemes to be approved by shareholders in the general meeting.</p> <p>Chapter 8 - Continuing Obligations</p> <p>Listing Rules 8.45 to 8.55 regulate transactions by Directors and Senior Officers of Issuers and include prohibitions on dealing in the issuer's securities when in possession of unpublished price sensitive information.</p> <p>Listing Rule 8.110.1 requires disclosure of shareholdings above certain thresholds starting from 5%.</p> <p>Appendix 1 to Chapter 8 – Principle 9 of the Code of Principles of Good Corporate Governance dealing with relations with shareholders and with the market.</p> <p>A copy of the Listing Rules is available in the section of the Authority's web-page www.mfsa.com.mt entitled 'Listing Authority'.</p>
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	No comments
Principle 16.	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	<p>Accounting standards for all corporations are laid out in the Companies Act of 1995, which requires that companies prepare annual financial statements in accordance with International Accounting Standards. The Companies Act also requires companies to hire an independent auditor to undertake an audit of the financial statements and directors' report. The auditors' report is required to be drawn up in accordance with International Standards on Auditing and must state whether in the auditors' opinion the annual accounts have been properly prepared and whether a true and fair view is given.</p> <p><u>2010 Update</u></p> <p>In 2008 the Companies Act was amended to require companies to draw up their annual accounts in accordance with generally accepted accounting principles and practice as defined under the Accountancy Profession Act and regulations made there under. The Accountancy Profession (Accounting and Auditing Standards)</p>

	<p>Regulation 2009 then define generally accepted accounting principles and practice as meaning adherence to international accounting standards as adopted by the EU.</p> <p>The radical changes to the regulatory framework of the accountancy and auditing profession brought about by the EU 8th Council Directive on statutory audits of annual accounts and consolidated accounts resulted in the review and revisions to the legislation relating to the accounting profession in Malta to implement the requirements of the 8th Council Directive. The 8th Council Directive obliges EU member states to have an effective system of public oversight for statutory auditors and audit firms. To this end, the Accountancy Board in 2005 enacted directive 4, which deals with quality assurance. Within this Directive Malta delegated its responsibility for quality assurance to the Quality Assurance Oversight Committee (QAOC) set up in June 2006. The QAOC is the policy making body and regulator of the quality assurance function in the accountancy and auditing profession in Malta. The main objective of the QAOC is to ensure that audit firms maintain the highest professional standards. Quality review visits are carried out by the Quality Assurance Unit (QAU), which is the duly appointed agent of the QAOC. The QAU carries out quality assurance reviews on warrant holders in terms of the Accountancy Profession Act including carrying out on-site visits, monitoring compliance with the returns submitted as well as other issues impinging on audit quality.</p>
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	No comments
Principles for Collective Investment Schemes	
Principle 17.	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
Description	<p>Establishment and marketing of collective investment schemes (CIS) are legislated under the framework of the Investment Services Act and regulated by the MFSA (as the Competent Authority under the Investment Services Act). The Investment Services Guidelines (replaced by 'Rules'), published by the MFSA, establish the regulations under which CIS can be established and marketed. Locally established and marketed CIS are licensed and regulated in the same manner as CIS established in regulated markets outside of Malta but marketed to resident investors. CIS may not be marketed from or in Malta without a CIS license.</p> <p>The ISA and the Guidelines (Rules) require that separate Investment Service license holders carry out the functions of CIS Manager and of CIS Custodian and, if applicable, Advisor to the CIS; separate sections of the Guidelines (Rules) establish the criteria and licensing requirements for applicants for those functions (see Principles 21 through 24 for more information regarding standards for financial services providers). The Guidelines (Rules) also require the appointment of an auditor approved by the</p>

	<p>MFSA.</p> <p>The Guidelines (Rules) require that applicants for CIS licenses provide information regarding the legal framework of the CIS, the investment policy, the valuation of the fund and the calculation of units or shares for purchase and sale, the calculation and application of fees, contractual arrangements among the CIS manager, custodian, and advisor, as applicable, etc.</p> <p>The Guidelines (Rules) require periodic financial reporting and publication of the values of shares for purchase or redemption, require publication and availability of a prospectus, which is required to contain certain minimal information and is subject to MFSA approval, sets certain investment limitations (with respect to CIS asset concentration), etc.</p> <p><u>2010 Update</u></p> <p>The MFSA has fully transposed the requirements of the EU UCITS III Directive and is presently preparing for the transposition of UCITS IV.</p> <p>In 2007 the MFSA issued the following Rules books applicable to collective investment schemes:</p> <p>Investment Services Rules applicable to Retail Collective Investment Schemes [Section BII of these Rules transpose the UCITS III Directive].</p> <p>Investment Services Rules applicable to Professional Investor Funds</p>
Assessment	2002/3FSAP – Implemented; 2010 Independent Assessment – Implemented
Comments	<p>While the Maltese regulatory regime is compliant with the principle, some minor comments are warranted. An area where there is scope for enhancement concerns the regulation of potential conflicts of interest of fund operators, such as for example in respect of the use of affiliated brokers, soft commissions etc. The Guidelines provide for some general rules in this regard, but do not presently appear to make any specific reference to the conduct of such activities with affiliates. Hence, consideration needs to be given to the introduction of specific rules in this area.</p> <p>Lastly, while the Guidelines also require that investment services license holders be “fit and proper” the Guidelines do not set minimum standards for this definition. In practice, still, the MFSA appears diligent in reviewing personal, educational, and professional backgrounds of applicants.</p> <p><u>2010 Update</u></p> <p>Conflicts of Interest: In 2007 the Investment Services Rules for Investment Services Providers have replaced the Guidelines referred to in the original FSAP report. The rules must be complied with by locally licensed Fund Managers and Custodians of Collective Investment Schemes (Retail Schemes licensed by MFSA are ordinarily required to appoint a locally licensed Fund Management Company and Custodian) and include specific provisions on inducements and conflicts of interest – please refer to SLC 2.02 and SLCs 2.94 to 2.99 of Part B of these rules, a</p>

	<p>copy of which is available from the Authority’s web-site under ‘Securities’. These go beyond the general principles which were included in the Investment Services Guidelines and reflect the EU MiFID requirements in this area.</p> <p>Fit and proper: Part A of the Investment Services Rules for Investment Services Providers defines the meaning of fit and proper – please refer to Section 3 – Criteria which MFSA will apply in considering an application for a Licence. The rules provide that applicants and license holders need to be of integrity, competent, and solvent to satisfy the “fit and proper” test. In terms of solvency, there are minimum initial and on-going financial resources requirements set out in the Rules for CIS service providers holding an Investment Services Licence. The MFSA has also published details of (non-exhaustive) qualifications in satisfaction of the competence requirements. These are available on www.mfsa.com.mt under Training and Development/MFSA Training Policy & Approved Qualifications/ Securities Approved Qualifications”. As regards integrity, the MFSA requires applicants to have a clean police record and be of good-standing.</p>
Principle 18.	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	<p>Article 2 of the Investment Services Act defines provides a general definition of what constitutes a CIS, i.e., according to particular financial characteristics, but does not define their legal form. These details are included in the IS Guidelines (Rules) and the Companies Act 1995. Definitions of allowable legal forms of CIS are established in the Rules that state that a CIS may be established in various different legal forms.</p> <p>The IS Guidelines (Rules) acknowledge that CIS may be established in a variety of legal forms, including as SICAV (investment company with variable share capital i.e. open-ended fund), an investment company with fixed share capital (i.e. closed-ended fund); a unit trust constituted by a trust deed between a management company and a trustee, or as a mutual fund established by way of contract. The formation of SICAVs and closed-ended investment companies is ‘regulated’ by the Companies Act 1995 which also stipulates that companies in Malta have a distinct legal personality. CIS may also be established as umbrella funds, feeder funds or funds of funds, although the current policy of the Authority is not to entertain applications for feeder funds, except for Professional Investor Funds.</p> <p>The CIS standard license conditions in the IS Guidelines specify what the constitutional documents of a CIS should contain. Moreover, the Companies Act, 1995 contains specific provisions for corporate open-ended and closed-ended schemes and all Memoranda and Articles of Association of such schemes are vetted for compliance with the Companies Act by the Registry of Companies, besides being vetted by the MFSA’s Investment Services Unit (now Authorisation Unit), for compliance with the requirements of the IS Guidelines (Rules)</p> <p>The categories of CIS that may be licensed under the Act include:</p> <p>a. Retail Funds made available to the general public - are subject to the standard conditions for CIS and providers of services to CIS set out in Part C of the IS</p>

	<p>Guidelines (now Part B of the IS Rules for Retail CIS and Part B of the Investment Services Rules for Investment Services Providers, respectively).</p> <ul style="list-style-type: none"> b. <i>Non-Retail funds which are not to be made available to the general public but whose target investors do not qualify as professional investors (as defined in the MFSA’s Guide to Professional Investor Funds)</i>—will be subject to the standard conditions for CIS and providers of services to CIS set out in Part C of the IS Guidelines (as indicated above). However, the standard conditions will be varied according to the nature of the fund and the kind of investors to which it is to be marketed. MFSA exercises discretion in this regard. c. <i>Professional Investor Funds</i>—are not subject to any standard licence conditions prescribing for example, investment and borrowing restrictions. The main emphasis in this scenario is on the fitness and properness of the parties involved, as well as those management functions that remain the responsibility of the Directors of the CIS in the absence of an appointed Manager. [2010 Update: The standard licence conditions set out in Part B of the Investment Services Rules for Professional Investor Funds currently apply.] d. <i>Specialist Schemes</i>—will be subject to particular conditions. The MFSA will consider in each case the nature of these specialist CIS, the expertise of the manager, the prospectus contents, the investment and borrowing restrictions, and the marketing and reporting arrangements, to ensure that they are appropriate to the CIS, taking account of the nature of the potential investors. Guidelines specific for the regulation of Property Funds are currently being developed. [2010 Update: There is a Policy of the Board of the MFSA specifically relating to Property Funds setting certain leverage limits, amongst other requirements.] <p>The Investment Services Act (Control of Assets) Regulations, 1998, which were issued in terms of Section 12 of the ISA, constitute the principal statutory protection for clients’ assets controlled by investment services license holders or other authorized or exempt persons, including custodians of collective investment schemes. All assets belonging to a CIS must—in terms of the scheme’s license conditions, be entrusted to a custodian for safekeeping and control. ‘Control of assets’ is defined as the holding or control of assets (movables or immovable of any kind) belonging to, or on behalf of a customer, by a person acting in the course of rendering an investment service under the ISA, and includes custody of assets.</p> <p>The regulations further provide legal protection of investors’ assets controlled by investment services providers, against the possible claims of the latter’s creditors. This is particularly important in the event of insolvency or bankruptcy of the investment services provider. The clients’ assets are treated as a ‘distinct patrimony’ which is separate from the assets belonging to the investment services provider or from that of other customers whose assets are controlled by the same provider. Such principle applies irrespective of anything stated in the Civil Code (Section 1894) or in the client agreement or the fact that the customer’s assets are registered in the name and title of or are otherwise vested in the service provider. The regulations also stipulate that assets controlled by an investment services provider, shall be held “solely for and on behalf and in the interest of the customer” and that the customer enjoys the ‘right of ownership’ of such assets.</p> <p>Regulation 7 refers to the functions and duties of investment services providers</p>
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	<p>controlling clients' assets. These are supplemented by the Standard License Conditions in the Investment Services Guidelines, relating to customers' assets. These include the duty to:</p> <ul style="list-style-type: none"> • Safeguard such assets and the interest of the customer therein; • SLC 6.01 requires license holders to ensure that in respect of all assets belonging to customers, including instruments and documents evidencing title to instruments, adequate arrangements are maintained so that they and the customers' interests in them are safeguarded. • SLC 6.07 requires license holders to maintain adequate insurance arrangements to cover customers' assets which it, or its own nominee, hold. • SLC 6.08 requires license holders to obtain written confirmation from third parties (recognized custodians) to whom customers' assets may be entrusted with a view to ensuring such assets are safeguarded. This includes a confirmation that it will not attempt to enforce or execute, any charge, right of set-off or other claim against customers' assets. • Maintain proper and adequate records and accounts of all customers' assets held under its control. • SLC 6.09 requires regular physical counts and inspections of customers' assets as well as reconciliations at least twice a year. Discrepancies are to be immediately resolved and the regulator is to be notified in the case of untimely reconciliations or failure to reconcile. • Segregate in a proper manner—to every extent possible—the assets of every customer from assets belonging to the investment services provider and from the assets of other customers. • SLC 6.06 requires license holders to hold assets in a way which makes it clear that they do not belong to the license holder or to any party other than the customer concerned. Internal controls should be adequate to ensure proper segregation. <p><u>2010 Update</u></p> <p>The Investment Services Guidelines referred to above have been superseded by the issue of the Investment Services Rules for Investment Services Providers which largely transpose the EU MiFID requirements. The updated requirements are set in SLCs 2.86 to 2.93 of Part B of the Investment Services Rules for Investment Services Providers. These requirements are further supplemented by the Guidance set in section 2 [E] of the Guidance Notes – The Investment Services Rules For Investment Services Providers. Both the Rules and Guidance are available on the Authority's web-site under 'Securities/ Investment Services'.</p>
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	No comments
Principle 19.	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	The Investment Services Guidelines Standard Licensing Conditions for CIS require disclosure necessary to allow investors to evaluate the suitability and performance of a

	<p>CIS and be able to make informed investment decisions. More specifically, the SLCs:</p> <ul style="list-style-type: none"> i. require disclosure regarding charges and changes thereto [SLC3.10]; ii. require certain details to be included in the constitutional documents [SLC 3.31] and the Prospectus [SLC 3.32 - SLC 3.35, SLCs 3.52 - 3.56, 3.64] in particular. Changes to documents require prior approval of the MFSA [SLCs 3.08, 3.34]; iii. impose investment restrictions and borrowing limits depending on the type of CIS [3.38]; and iv. impose reporting requirements on the scheme through publication of annual and interim reports (contents of which are also prescribed in Appendices 5 and 6 of the IS Guidelines) and making these available, together with Prospectus, to investors free of charge <p>The Guidelines require that all CIS issue a prospectus that contains “sufficient information for investors to make an informed judgment about the investment proposed to them....” Minimum contents regarding such information is included in the Guidelines, including:</p> <p>“Description of the Scheme’s investment objectives, including its financial objectives (e.g., capital growth or income), investment policy (e.g., specialization in geographical or industrial sectors), any limitations on that investment policy, and an indication of any techniques and instruments which may be used for the purposes of efficient portfolio management, and of any borrowing powers which may be used in the management of the Scheme.”</p> <p>In addition, the Guidelines require that the CIS’s investment policy be clearly defined in the prospectus, and that “sufficient information ... be given to ensure that holders of Units are fully aware of the risks they are entering into.”</p> <p>Finally, the Guidelines require that advertisements contain a risk warning “appropriate to the nature of the investments involved,” including specific examples of where warnings are necessary, such as if there are disproportionate early charges for the investment or if the investment is denominated in a foreign currency.</p> <p>Reviewed samples of prospectuses and advertisements all had explicit disclosure regarding risks to investment.</p> <p><u>2010 Update</u></p> <p>Since the issue of the original report, the Authority has adopted and published the Investment Services Rules for Retail CISs and Professional Investment Funds [‘PIFs’]. These rules replace the original IS guidelines which applied with respect to CIS. The following is a general outline of the requirements referred to in the</p>
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	<p>relevant SLCs:</p> <p>Part B I of the ISRs for Malta-based Retail Non-UCITS CISs reflecting similar requirements to the above:</p> <ul style="list-style-type: none"> • Requirement i) which requires the disclosure regarding charges and changes thereto, is referred to in SLC 10.6; • Requirement ii) - requires that certain details to be included in the constitutional documents [SLC6.1 and 6.2 and Appendix III] and the Prospectus [SLC 5.1 to 5.9 and Appendix I] in particular. Changes to documents require prior approval of the MFSA [SLC 6.2] • Requirement iii) above - to impose investment restrictions and borrowing limits depending on the type of CIS [SLCs 4.1 to 4.28] • Requirement iv) above - to impose reporting requirements on the scheme through publication of annual and interim reports [SLC 10.7] and making these available, together with Prospectus which is provided to investors free of charge [SLC 5.1]. <p>Part B II of the ISRs for Malta-based Retail UCITS CISs reflecting similar requirements to the above:</p> <ul style="list-style-type: none"> • Requirement i) which requires the disclosure regarding charges and changes thereto, is referred to in SLC 12.7; • Requirement ii) - requires certain details to be included in the constitutional documents [SLC7.1 and 7.2 Appendix III] and the Prospectus [SLC 6.1 to 6.9 Appendix I] in particular. Changes to documents require prior approval of the MFSA [SLCs 7.2]; • Requirement iii) above - to impose investment restrictions and borrowing limits depending on the type of CIS [SLCs 5.1 to 5.52]; • Requirement iv) above - to impose reporting requirements on the scheme through publication of annual and interim reports [SLC12.8] and making these available, together with Prospectus which is provided to investors free of charge [SLC 6.1]. <p>Part B I: Professional Investor Funds targeting Experienced Investors reflecting similar requirements to the above:</p> <ul style="list-style-type: none"> • Requires that certain details to be included in the Offering Document [SLC 1.67 to 1.71 and Appendix II] in particular. Changes to the constitutional documents require prior approval of the MFSA [SLC 1.72]; • Investment restrictions and borrowing limits [SLCs 1.38 to 1.66]; • Requirement iv) above - to impose reporting requirements on the scheme
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	<p>through publication of annual reports [SLC 1.84 and 1.85] and making these available, together with Prospectus which is provided to investors free of charge [SLC 1.67]. The publication of interim reports is optional for PIFs.</p> <p>Part B II: Professional Investor Funds targeting Qualifying Investors:</p> <ul style="list-style-type: none"> • Requires that certain details to be included in the Offering Document [SLC 1.43 to 1.45 and Appendix II] in particular. Changes to the constitutional documents require prior approval of the MFSA [SLCs 1.46]; • Reporting requirements on the scheme through publication of annual reports [SLC 1.57] and making these available, together with Prospectus which is provided to investors free of charge [SLC 1.42]. The publication of interim reports is optional for PIFs <p>Part B III: Professional Investor Funds targeting Extraordinary Investors reflecting similar requirements to the above:</p> <ul style="list-style-type: none"> • Requires that certain details be included in the Offering or Marketing Document [SLC 1.44 to 1.45 and Appendix II]. Changes to the constitutional documents of the scheme require prior approval of the MFSA [SLCs 1.48]; • Reporting requirements on the scheme through publication of annual reports [SLC 1.59] and making these available, together with Prospectus which is provided to investors free of charge [SLC 1.42]. The publication of interim reports is optional for PIFs
Assessment	2002/3 FSAP – Implemented; 2010 Independent Assessment – Implemented
Comments	No comments
Principle 20.	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>The IS Guidelines (3.31) require that the constitutional documents of a CIS “define clearly the method of calculation of the assets of the scheme, which method shall have been approved by the [MFSA].” In addition, the constitutional documents are required to “provide that the Units of the Scheme shall be issued or sold at a price arrived at by dividing the net asset value of the Scheme calculated on the approved basis by the number of units outstanding. Such price may be increased by duties and charges.” The constitutional documents must similarly “provide that units shall be redeemed or repurchased at a price arrived at by dividing the net asset value of the Scheme calculated on the approved basis by the number of units outstanding. Such price may be decreased by duties and charges.” Finally, the Guidelines require that the constitutional documents “determine the frequency of the calculation of the issue and repurchase prices. This shall be at least twice each month. The prices shall be made available with similar frequency. The scheme shall be bound to repurchase its Units at</p>

	<p>the request of any unit holder.”</p> <p>Appendix 9, Section 3 of the IS Guidelines provides that the prospectus of the Collective Investment Scheme should disclose the method to be used for the determination of the creation, sale and issue prices and the repurchase, redemption and cancellation prices of Units, in particular, the method and frequency of the calculation of those prices, (this should be at least twice each month). The Guidelines require that the prospectus of a CIS similarly disclose</p> <ul style="list-style-type: none"> (i) rules for the valuation of assets; (ii) the method and frequency (at least twice each month) of the calculation of the prices for creation, sale and issue, repurchase, redemption and cancellation of units; (iii) details of where and when those prices will be published; (iv) information concerning the charges relating to the sale or issue and the repurchase or redemption of units; and (v) arrangements whereby holders of units and prospective holders of units may deal. <p>The accuracy of the valuation of the assets and unit price of a CIS is verified by the custodian. Onsite supervision of CIS custodians operating under investment services license category 4 also include checks on whether the pricing of units, including for transactions, are in accordance with the constitutional documents.</p> <p><u>2010 Update</u></p> <p>All collective investment schemes regulated in terms of the Investment Services Act are subject to a requirement to disclose in their prospectus/offering memorandum the method to be used for the determination of the creation, sale and issue prices and the repurchase, redemption and cancellation prices of Unit, including the method and frequency of the calculation of the net assets value. Please refer to paragraph 1.16 of Appendix I of Part B of the Investment Services Rules for Retail Collective Investment Schemes and paragraph 1.2 (xvii) of Appendix II to Part B of the Investment Services Rules for Professional Investor Funds. Additional disclosures are also required in terms of the Investment Services Rules applicable to collective investments schemes. The extent of the disclosure which is required in terms of the Rules depends on whether the Schemes are of retail or a professional nature. For a detailed outline of these rules, reference should be made to Appendix I of Part B of the Investment Services Rules for Retail Collective Investment Schemes and Appendix II to Part B of the Investment Services Rules for Professional Investor Funds. A copy of these appendices is available upon request or through the section of the MFSA web-page www.mfsa.com.mt dedicated to collective investment schemes under the folder ‘Securities’.</p>
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Assessment	2002/3 FSAP – Implemented; 2010 Independent Assessment– Implemented										
Comments	No comments										
Principles for Market Intermediaries											
Principle 21.	Regulation should provide for minimum entry standards for market intermediaries.										
Description	<p>The standard license conditions in the IS Guidelines, as well as the MFSA’s powers in terms of the Investment Services Act, provide the basis for the on-going supervision of investment services license holders and licensed CIS. Once a person is granted a license by the MFSA, such person is required to adhere to the Standard license conditions contained in the IS Guidelines issued by the MFSA. The said Guidelines have the purpose of regulating the activity of license holders.</p> <p>The permissible services as set out in Schedule 1 of the ISA are:</p> <ol style="list-style-type: none"> 1. Dealing as Principal or Agent 2. Arranging Deals 3. Management of Investments 4. Trustee, Custodian or Nominee Services 5. Investment Advice 6. Stock broking <p>The above Services may be provided in relation to a range of ‘Instruments’ as set out in Schedule 2 of the ISA. The five categories of investment services license holders are authorized. These are:</p> <table> <tr> <td>Category 1</td><td>License holders authorized to provide any investment service but not to hold or control clients’ money or customers’ assets, deal for their own account or underwrite. (This category does not include managers of Collective Investment Schemes.)</td></tr> <tr> <td>Category 2</td><td>License holders authorized to provide any investment service, and to hold or control clients’ money or customers’ assets, but not to deal for their own account or underwrite.</td></tr> <tr> <td>Category 3</td><td>License holders authorized to provide any investment service, to hold and control clients’ money or customers’ assets, and to deal for their own account or underwrite.</td></tr> <tr> <td>Category 4</td><td>License holders authorized to act as trustees or custodians of Collective Investment Schemes.</td></tr> <tr> <td>Category 5</td><td>License holders who are only authorized to sell unit linked products issued by a sole local insurance principal but not to hold or to control clients’ money or customers’ assets or to deal for their own account or to underwrite.</td></tr> </table>	Category 1	License holders authorized to provide any investment service but not to hold or control clients’ money or customers’ assets, deal for their own account or underwrite. (This category does not include managers of Collective Investment Schemes.)	Category 2	License holders authorized to provide any investment service, and to hold or control clients’ money or customers’ assets, but not to deal for their own account or underwrite.	Category 3	License holders authorized to provide any investment service, to hold and control clients’ money or customers’ assets, and to deal for their own account or underwrite.	Category 4	License holders authorized to act as trustees or custodians of Collective Investment Schemes.	Category 5	License holders who are only authorized to sell unit linked products issued by a sole local insurance principal but not to hold or to control clients’ money or customers’ assets or to deal for their own account or to underwrite.
Category 1	License holders authorized to provide any investment service but not to hold or control clients’ money or customers’ assets, deal for their own account or underwrite. (This category does not include managers of Collective Investment Schemes.)										
Category 2	License holders authorized to provide any investment service, and to hold or control clients’ money or customers’ assets, but not to deal for their own account or underwrite.										
Category 3	License holders authorized to provide any investment service, to hold and control clients’ money or customers’ assets, and to deal for their own account or underwrite.										
Category 4	License holders authorized to act as trustees or custodians of Collective Investment Schemes.										
Category 5	License holders who are only authorized to sell unit linked products issued by a sole local insurance principal but not to hold or to control clients’ money or customers’ assets or to deal for their own account or to underwrite.										

In accordance with Section 6 (1) (a) of the Investment Services Act, the MFSA shall not grant an investment services license unless it is satisfied that the ‘fit and proper’ criteria are met by the applicant. There are three essential criteria assessed: integrity; competence and solvency. The IS Guidelines (Part A) further explain these criteria. Applicants for licenses are required to undergo a due diligence process that aims to ensure they are of sound repute and have a clean track record. Applicants are also required to assure that they possess the required competence to provide a professional service, giving consideration to the applicant’s relevant experience, training and qualifications. The applicant’s resources—in terms of staff, know-how, systems etc., must also be appropriate to the proposed business. Lastly, applicants are required to satisfy set minimum financial resources requirements in terms of net tangible assets and liquidity to ensure their financial resources are adequate to meet their business commitments and the risks to which they may be exposed.

Precise statistics on the number of applications refused, or rather withdrawn are not available. The application process includes the fit and proper test, is thorough and it is usually the case that after having understood the requirements, potential applicants do not proceed with their applications or applicants withdraw their applications if these are not of the required standard. However this year, at least one application was stalled due to due diligence concerns, (the main promoters were unable to demonstrate a sound track record and competence for the proposed services.)

Under the recently approved amendments to the law, before applying for membership on a Recognized Investment Exchange the person would need to obtain an Investment Services License from the MFSA under the Investment Services Act. Currently, discussions are also underway with a view to amend the current Malta Stock Exchange by-laws so as to introduce the requirements which members of the Exchange (in their capacity as traders) must satisfy prior to becoming members.

2010 Update

The Investment Services Act, 1994 (“the ISA”) provides a statutory basis for regulating the provision of Investment Services (which included market intermediaries).

In terms of the ISA, licensable activity takes place when an investment service (as defined in Schedule I of the ISA) is offered in respect of an instrument (as listed in Schedule II of the ISA). It is an offence under the ISA to conduct licensable activity without a licence.

The ISA is supported, inter alia, by a set of Rules for Investment Services Providers and related Guidance Notes (“Rules for ISPs”).

In so far as Entry Requirements are concerned to note the following:

The First Schedule to the Act lists the following Services:

- i. Reception and Transmission of Orders in relation to one or more instruments.*

	<p> <i>ii. Execution of orders on behalf of other persons</i> <i>iii. Dealing on own account.</i> <i>iv. Management of Investments</i> <i>v. Trustee, Custodian or Nominee Services</i> c. Acting as trustee or custodian in relation to a collective investment scheme. <i>vi. Investment Advice</i> <i>vii. Underwriting of Instruments and, or placing of instruments on a firm commitment basis</i> <i>viii. Placing of Instruments without a firm commitment basis.</i> <i>ix. Operation of a Multilateral Trading Facility.</i> </p> <p>The above Services may be provided in relation to a range of ‘Instruments’ as set out in Schedule 2 of the ISA. The four categories of investment services license holders are authorized. These are:</p> <p> Category 1a License holders authorized to receive and transmit orders in relation to one or more instruments and, or provide investment advice and, or place instruments without a firm commitment basis but not to hold or control clients’ money or customers’ assets, deal for their own account or underwrite. (This category does not include managers of Collective Investment Schemes.) </p> <p> Category 1b Licence Holders authorised to receive and transmit orders, and, or provide investment advice in relation to one or more instrument and, or place instruments without a firm commitment basis solely for professional clients and, or eligible counterparties but not to hold or control Clients’ Money or Customers’ Assets. </p> <p> Category 2 License holders authorized to provide any investment service, and to hold or control clients’ money or customers’ assets, but not to deal for their own account or underwrite. </p> <p> Category 3 License holders authorized to provide any investment service, to hold and control clients’ money or customers’ assets, and to deal for their own account or underwrite. </p> <p> Category 4 License holders authorized to act as trustees or custodians of Collective Investment Schemes. </p>
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	<p>In accordance with Section 6 (1) (a) of the Investment Services Act, the MFSA shall not grant an investment services license unless it is satisfied that the ‘fit and proper’ criteria are met by the applicant. There are three essential criteria assessed: integrity; competence and solvency. The Rules for ISPs (Part A) further explain these criteria. Applicants for licenses are required to undergo a due diligence process that aims to ensure they are of sound repute and have a clean track record. Applicants are also required to assure that they possess the required competence to provide a professional service, giving consideration to the applicant’s relevant experience, training and qualifications. The applicant’s resources—in terms of staff, know-how, systems etc., must also be appropriate to the proposed business. Lastly, applicants are required to satisfy set minimum financial resources requirements in terms of net tangible assets and liquidity to ensure their financial resources are adequate to meet their business commitments and the risks to which they may be exposed.</p> <p>Precise statistics on the number of applications refused, or rather withdrawn are not available. The application process includes the fit and proper test, is thorough and it is usually the case that after having understood the requirements, potential applicants do not proceed with their applications or applicants withdraw their applications if these are not of the required standard. From the beginning of this year to date, at least one application was stalled due to national reputational concerns. Another two applications may also be stalled.</p> <p>Before applying for membership on a Recognized Investment Exchange the person would need to obtain an Investment Services License from the MFSA under the ISA. The Malta Stock Exchange by-laws also lay down the requirements which members of the Exchange (in their capacity as traders) must satisfy prior to becoming members.</p>
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	No comments
Principle 22.	There should be initial and on-going capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	Investment services license holders are required to satisfy minimum financial resources requirements in respect of net tangible assets and liquid capital both prior-licensing and post-licensing on an on-going basis. The license holders authorized to hold or control clients’ money and assets (Category 2) are subject to more onerous minimum financial resources requirements than those (Category 1) who provide investment services such as the provision of advice and the arranging of deals, but who do not hold or control clients’ money and assets. Similarly, firms dealing on their own account (Category 3) are subject to still higher financial resources requirements, whilst custodians appointed by collective investment schemes to hold and control the scheme’s assets (Category 4) are subject to the highest net tangible asset requirement. The four main categories of investment services licenses and their applicable minimum net tangible asset

requirement are the following.

License Category 1	Lm 20,000
License Category 2	Lm 50,000
License Category 3	Lm 300,000
License Category 4	Lm 2,000,000

Whilst the minimum net tangible asset requirement is fixed and varies according to category of Investment Services License, there are presently no risk-related on-going capital requirements. The minimum liquidity requirement is directly proportional to annual expenditure.

License holders are required to submit financial returns either on a quarterly or a half yearly basis. Moreover, all license holders are required to submit annual audited financial statements drawn up in accordance with International Accounting Standards, as well as annual financial returns approved by their auditors. The purpose of these requirements is to assess whether the said licensees are adequately satisfying the applicable financial resources requirements.

An exercise is currently underway to prepare for the implementation of the EU Capital Adequacy Directive requirements.

2010 Update

Before Malta's accession into the European Union on 1st May 2004, an exercise was undertaken by the MFSA in order to align the local prudential requirements with the provisions of the EU Capital Adequacy Directive (CAD).

On the 14th June 2006, the Council of the European Union and the European Parliament adopted the Capital Requirements Directive ('the CRD'), which required Member States to transpose and implement the CRD by 1st January 2007. The CRD applies more comprehensive capital requirements than the CAD did; in particular, it introduces the concept of 'operational risk'.

The CRD lays down the capital adequacy requirements that are applicable to investment firms and is primarily based on three pillars:

Pillar 1 indicates the calculation of the minimum financial resources requirement (including the initial capital requirement) that is applicable to investment firms, depending on the range and nature of investment services that are provided by investment firms and the risks that are faced by investment firms (in particular,

	<p>credit risk, market risk, foreign exchange risk, commodities risk, large exposures risk and operational risk).</p> <p>Pillar 2 requires investment firms to assess their risk exposures (in particular risks which are not covered within the Pillar 1 regime such as liquidity risk, reputational risk) and to determine the amount of internal capital that is needed in order to cover its risks (as a result of the risk assessment made by the investment firm). Pillar 2 also imposes an obligation on supervisors to review the adequacy of the risk assessment performed by investment firms.</p> <p>Pillar 3 requires investment firms to develop a set of disclosure requirements which will allow market participants to assess the key information about the firm's underlying risks, models, controls and capital position.</p> <p>The MFSA has transposed the requirements to implement Pillar 1, 2 and 3 of the CRD as they apply to investment firms. The requirements are now included in section 7 and Appendices I and II of Part B of the Investment Services Rules for Investment Services Providers. The MFSA has also issued Guidance Notes on Risk Management and Internal Capital Adequacy for investment services license holders to complement the requirements relating to Pillar II of the CRD. The above-mentioned Rules and Guidance Notes are available on www.mfsa.com.mt under 'Securities'/Investment Services.</p> <p>In line with the CRD's Pillar 1 requirements, initial capital requirements are as follows:</p> <p>IS License Category 1a: Euro 50,000</p> <p>IS License Category 1b: Euro 20,000 + Professional Indemnity Insurance Euro 50,000 without PII</p> <p>IS License Category 2: Euro 125,000</p> <p>IS License Category 3: Euro 730,000</p> <p>IS License Category 4: Euro 125,000</p> <p>The above License Holders are also subject to an on-going financial resources requirement calculated as the higher of initial capital and various risk based components details of which are set out in Appendix 1 to Part B of the Investment Services Rules for Investment Services Providers. All Investment Services License Holders (with the exception of those entities which are licensed credit institutions subject to the prudential requirements under the Banking Act, 1994) are required to submit financial returns to the MFSA to enable on-going monitoring of adherence to their financial resources requirements. The</p>
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	<p>frequency of submission of financial returns is as follows:</p> <p>Category 1 – six monthly</p> <p>Category 2 and 4 – quarterly</p> <p>Category 3 - monthly</p> <p>Regulated Markets ('RM') and Central Securities Depositories ('CSD')</p> <p>Although Regulated Markets and CSDs fall outside the scope of the CRD and there are no EU harmonized financial resources requirements for such entities, the MFSA has based its requirements for such entities on the CRD requirements (Pillar I and Pillar II) which apply to Category 3 Investment Services License Holders, with the difference that financial reporting is on a quarterly rather than monthly basis.</p>
Assessment	2002/3 FSAP - Partially implemented; 2010 Independent Assessment – Broadly implemented
Comments	<p>While the present arrangements may—for all practical purposes —have been adequate to ensure sufficient level of capital by the license holders given the relatively simple nature and limited extent of the business conducted, they do not meet the international standards and—as such—will need to be amended. The planned implementation of the EU Capital Adequacy Directive requirements would remedy this short-coming and render this principle fully compliant. As indicated in the CPSS /IOSCO assessment part of this report, the overall solvency arrangements of the entire market structure, including the MSE and—in particular—its CSD and CSS functions, should be reviewed and reconsidered. It is recommended that these exercises be conducted in coordination to ascertain that the solvency requirements of the individual market participants and market in general are not compromised, while taking into account the market's capacity to bear the cost.</p> <p><u>2010 Update</u></p> <p>The MFSA has transposed the requirements to implement Pillar 1, 2, and 3 of the EU/CRD- As previously indicated the CSD/CSS functions have been reviewed and satisfactorily finalized. These actions fully address the concerns and comments of the 2003 evaluation. However, in view of the tight capacity of human resources, the time for the review of the capital levels of market intermediaries is, at times, longer than normal. The authorities are addressing this shortcoming by recruiting additional staff.</p>
Principle 23.	Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.

Description	<p>The standard license conditions in the IS Guidelines, require an Investment Services License Holder to have “adequate operational, administrative and financial procedures and controls in respect of its own business and its customers' affairs to ensure compliance with regulatory requirements.” Moreover, given the nature and small size of the business conducted by most of the IS license holders, the importance of dual control in the conduct of a licensee’s business is emphasized and the SLCs require the licensee’s business to be conducted by a minimum of two persons on an on-going basis. An overview of the areas on which the MFSA expects license holders to have controls in place is included in the IS Guidelines. These include procedures to ensure staff does not act beyond their levels of competence and authorizations, and procedures to avoid and manage conflicts of interest etc. A number of mandatory reconciliation procedures for ensuring proper accounting of clients’ money and assets held/ controlled by license holders are also imposed, supervised in context of compliance visits and reported on by external auditors on an annual basis.</p> <p>The effectiveness of internal procedures and controls is reviewed during onsite compliance visits to license holders. Disaster recovery plans and procedures are also reviewed during such visits and licensees are required to maintain appropriate back-ups of data offsite.</p> <p>The legal framework for corporate governance in Malta is substantially contained in the Companies Act, 1995. With the exception of some minor issues, the Act is fully compliant with all EC Company Law Harmonization Directives.</p> <p>There is presently no guidance issued by the MFSA to the license holders as regards risk management. Similarly, no guidelines have yet been issued to the RIE’s on their internal organization, internal controls of risk management.</p> <p><u>2010 Update</u></p> <p>Internal organization and operational conduct</p> <p>The Investment Services firms are required - through the MFSA’s Investment Services Rules for Investment Services Providers (ISR for ISP) - to establish, implement and maintain decision-making procedures and an organizational structure which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities. The firm must also implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the firm. [Refer to SLC 1.17 to 1.22 of Part B of the Rules]</p> <p>The License Holder shall monitor and, on a regular basis evaluate, the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with SLCs 1.17 and 1.18 above and take appropriate measures to address any deficiencies.</p> <p>Ensuring proper management of risk</p> <p>In line with the EU MiFID Directive, the ISR for ISP further require the License</p>
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	<p>Holder to manage its risks by establishing, implementing and maintaining adequate risk management policies and procedures which identify the risks relating to the License Holder's activities, processes and systems, and where appropriate, set the level of risk tolerated by the License Holder, as well as establishing and maintaining a risk management function that operates independently and carries out a number of tasks, including the implementation of a number of policies and procedures. [SLC1.23 to 1.24].</p> <p>SLC 7.45 further requires License Holders to have in place sound, effective and complete strategies and processes to assess and maintain on an on-going basis the amounts, types and distribution of internal capital that it considers adequate to cover the nature and level of the risks to which it is or might be exposed, referred to as the License Holder's Internal Capital Adequacy Assessment Process. This requirement is based on the CRD Pillar II requirement referred to earlier in relation to Principle 22.</p> <p>Management Responsibilities</p> <p>When allocating functions internally, the License Holder shall ensure that senior management, and where appropriate, the supervisory function, are responsible for ensuring that the License Holder complies with its obligations under these Rules.</p> <p>In particular, senior management and where appropriate, the supervisory function shall be required to assess and periodically to review the effectiveness of the policies, arrangements and procedures put in place to comply with the obligations under these Rules and to take appropriate measures to address any deficiencies. [SLC 1.25 to 1.27].</p>
Assessment	2002/3 FSAP - Partially implemented; 2010 Independent Assessment – Broadly implemented
Comments	<p>The MFSA has recently issued guidance to license holders to include greater emphasis on risk management and the importance of business continuity plans. While these arrangements may, again for all practical purposes, be adequate to ensure appropriate level of risk management by the license holders given the relatively simple nature and limited extent of the business conducted, they will need to be amended further to meet international standards. Similar guidance should be issued to the RIEs, particularly as regards the CSD and CSS functions.</p> <p><u>2010 Update</u></p> <p>Investment Services Licence Holders, Regulated Markets and Central Securities Depositories [henceforth referred to as 'Authorised Persons'] are, in terms of the respective MFSA Rules, required to identify the risks relating to their activities, processes and systems, and to manage these risks effectively.</p> <hr/> <p>On September 28, 2008, the MFSA issued Guidance on Risk Management and Internal Capital Adequacy. The purpose of these Guidance Notes is to afford</p>

	<p>Authorised Persons with best practice guidance on the manner in which they may comply with the applicable risk management requirements. These Guidance Notes also have the purpose of implementing part of the Pillar II requirements of the EU Capital Requirements Directive. The Guidance Notes are divided into two parts: Part A explains the Risk Management and Internal Capital Adequacy Assessment Process ('RMICAAP') and outlines the manner in which an Authorised Person may compile a RMICAAP Report. Part B explains the technical criteria on the review and evaluation by the MFSA of an Authorised Person's RMICAAP.</p> <p>As in the case of Principle 22, the limited human resources, at times, cause some delays in the schedule of periodic evaluation of internal controls and of risk management processes implemented by the market intermediaries.</p>
Principle 24.	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	<p>There has been no failure of market intermediaries or license holders since the ISA was first enacted in 1994, and hence the relevant regulations and MFSA's actual ability to act in protection of investors in case of such failure has not been tested.</p> <p>Presently, the safeguards in place in various legislations and regulations are the following:</p> <p>The ISA (Control of Assets) Regulations, 1998 are aimed at minimizing the damage and loss to investors in the event of the failure of a market intermediary by providing legal protection of customers' assets. The Regulations provide legal protection for clients' assets held or controlled by investment services license holders, including custodians. Clients' assets are treated as a distinct legal patrimony and in the event of the license holder's insolvency; a liquidator cannot claim the right to such assets to pay the license holder's creditors.</p> <p>Another safeguard aimed at providing the Competent Authority with the power to ensure an orderly winding down of a license holder's business is provided in the Standard License Conditions of the IS Guidelines (now renamed IS Rules). SLC 8.15 (now SLC 1.14 of Part B of the Investment Services Rules for Investment Services Providers) applicable to investment services license holders stipulates that, if so required by the MFSA, the license holder shall do all in its power to delay the cessation of its investment services business, or the winding up of such business so as to comply with conditions imposed by the MFSA in order to protect the interests of customers. Similarly, SLC 3.26 (SLC 10.21 of Part B.I/ 12.21 of Part B.II of the Investment Services Rules for Retail Collective Investment Schemes) applicable to licensed CIS requires that in the event of a winding up of a scheme, where practicable, the prior approval of the MFSA shall be obtained for the approach to be adopted. If so requested by the MFSA, the scheme and its management company shall do all in their power to delay the winding-up of the scheme or to proceed with the winding-up in accordance with conditions imposed by the MFSA.</p> <p>Section 15(2) (e) provides the MFSA with the power to issue directives to an</p>

	<p>individual license holder, requiring such license holder to wind up its affairs, in accordance with procedures and directions as may be specified in the directive, which may provide for the appointment of a person to take possession and control of all documents, records, assets and property belonging to or in the possession or control of the license holder.</p> <p>Finally, Section 12(c) of the Investment Services Act enables the establishment of schemes or arrangements for the compensation of investors in cases where license holders are unable to satisfy claims in respect of any civil liability incurred by them in connection with their investment services. Regulations have been issued on January 3, 2003 in terms of the above section to establish an Investor Compensation Scheme based on the EU Directive 97/9/EC.</p>
Assessment	2002/3 FSAP - Partially implemented; 2010 Independent Assessment– Broadly implemented
Comments	<p>The issuance of the planned draft regulations to establish an Investor Compensation Scheme should be completed. Similarly, while MFSA appears to have the powers to deal with a market intermediary failure based on the legislation, IS guidelines and related SLCs, and through its power to issue specific directives to individual licensees, it should—in the context of revising its guidelines—establish more detailed principles and procedures for dealing with such failures. Completing these two actions would avail upgrading this principle to ‘implemented’.</p> <p><u>2010 Update</u></p> <p>The provisions mentioned above relating to the Investment Services Act, 1994 and the Investment Services Act, (Control of Assets) Regulations, are still in force. Moreover, the requirements within the Guidelines which were in place at the time of the FSAP, have been refined and enhanced to transpose EU legislation such as the Markets In Financial Instruments Directive and are now included in the Investment Services Rules for Investment Services Providers.</p> <p>Part V of the procedures manual of the Securities and Markets Unit sets out guidance on how the Regulator should deal with a possible failure of an investment services license holder. Moreover, guidelines on business continuity were issued to market intermediaries, as part of the Guidance Notes to the Investment Services Rules for Investment Services Providers, on the 1st November 2007. Lastly, Malta also has in place the Investor Compensation Scheme Regulations, which provide for a mechanism wherein investors may get compensation in case of failure of a licensed entity which results in the loss of their assets.</p> <hr/> <p>The supervisor authorities have addressed the two actions highlighted in the 2002/3 assessment and an upgrading of the assessment was granted. However, the authorities should accelerate the completion of the revision of their internal early warning system to better evaluate a potential default by market intermediaries,</p>

	address the problem, and take timely corrective actions.
Principles for the Secondary Market	
Principle 25.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>The past legislative regime did not allow establishment of additional exchanges or trading systems apart from the MSE, and the latter was in a monopoly situation insofar as listing and trading of securities in Malta was concerned. The trading system was subject to oversight by the CBM, though the extent of the oversight function appears to have been somewhat superficial. The legislative amendments approved on July 23 2002 (current Financial Markets Act) contemplate the possibility of having more than one exchange operating in/ from Malta and all such exchanges shall require ‘recognition’ from the Malta Financial Services Authority as the Competent Authority. The Financial Markets Act provides that any ‘person’ who intends to provide the services of an investment exchange in or from within Malta would in future require the approval of the Competent Authority. Under the recently approved legislation, the MFSA will exercise regulatory and investigative powers with respect to Investment Exchanges operating in Malta.</p> <p>The recognition requirements for an investment exchange will need to be satisfied on an on-going basis and not simply at application stage. Moreover, the Competent Authority has the power to issue notification directives. The notification directives include requirements for notification to the MFSA in respect of the following areas:</p> <ol style="list-style-type: none"> (1) Constitutional documents; (2) By-laws and default rules; (3) Capital and shareholding; (4) Officers; (5) Standing committees; (6) Arrangements for fulfilment of functions; (7) Financial information; (8) Fees and incentive schemes; (9) Complaints; (10) Dissolution and insolvency events; (11) Legal action; (12) Products, services and normal hours of operation; (13) Suspension of services and inability to operate facilities; (14) Information technology systems; (15) Inability to discharge functions; (16) Disciplinary functions; and

	<p>(17) Criminal offences and regulatory prohibitions.</p> <p>Apart from these notification directives, financial resources and financial reporting directives are also proposed to be issued under the Financial Markets Act. The MFSA will be assessing recognized investment exchanges' compliance with such requirement by way of Financial Returns and confirmations from auditors. Investment Exchanges will be required to complete these returns on a quarterly basis.</p> <p><u>2010 Update</u></p> <p>The Financial Market Rules stipulating Financial Resources and Financial Reporting Requirements applicable to Regulated Markets and Central Securities Depositories have been put in place since the last version of this report. An automated financial return is to be submitted by the Regulated Markets and Central Securities Depositories on a regular basis, (three quarterly interim returns, an annual financial return and an annual audited financial return.)The regulatory regime under the Investment Services Act, 1994 which transposes MiFID also caters for the regulation and oversight of operators of multilateral trading facilities although to date none have been authorized by the MFSA.</p>
Assessment	2002/3 FSAP – Implemented; 2010Independent Assessment – Implemented
Comments	No comments
Principle 26.	There should be on-going regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	<p>New regulations for RIEs, planned to be issued by the MFSA under the Financial Markets Act, are presently being drafted. These regulations are to be issued by the Minister and will contain the recognition requirements for exchanges operating in/ from Malta that have already been drafted but are yet to be published. The main requirements which the applicant must satisfy include:</p> <ol style="list-style-type: none"> (1) Financial Resources requirements; (2) Suitability requirements; (3) Constitution and Governance requirements; (4) Systems and controls requirements; (5) Safeguards for Investors requirements; (6) Having requirements in place to ensure adequate disclosure by issuers of securities; (7) Promotion and maintenance of standards requirements; (8) Rules, by-laws and consultation requirements; (9) Disciplinary requirements in respect of persons making use of its facilities;

- (10) Complaints-handling requirements;
- (11) Default rules in respect of market contracts requirements;
- (12) Notification requirements; and
- (13) Requirements for the Co-operation with other authorities.

It is envisaged that the MFSA, as Competent Authority, will need to ensure—by means of reviewing application documents, discussions with the promoters, onsite inspections, as well as reliance on third parties such as auditors—that the above-mentioned requirements have been satisfied by an exchange prior issuing a recognition order, as well as on an on-going bases once the recognition order has been issued.

Section 1.2 of the proposed Financial Resources and Financial Reporting Directives applicable to RIEs requires every investment exchange to meet at all times both the net tangible asset requirement and the expenditure based requirement. The proposed net tangible asset requirement is Lm 500,000 and the proposed liquid capital requirement is 50 per cent of relevant annual expenditure or pro-rated annualized expenditure. Recognized investment exchanges will be required to monitor these two requirements on a daily basis. In this regard, the MFSA will look in to the adequacy of staff, systems and reporting lines to senior management to ensure that resources are such as would enable the exchange to comply with such requirements, including the quarterly reporting requirement to which it would be subject.

The exchange's external auditors are expected have an important role to play in the prudential supervision of the exchange. It is proposed that external auditors of the Recognized Investment Exchange will be required to report to the MFSA annually as to whether in their opinion:

- (1) the Annual Financial Return together with the audited annual financial statements, are in agreement with the Exchange's accounting records;
- (2) the Annual Financial Return has been prepared in accordance with the MFSA's requirements and is consistent with the contents of the audited financial statements; and
- (3) the Exchange's Financial Resources have been properly calculated in accordance with the MFSA's requirements and exceed the Exchange's Financial Resources Requirements as at the Accounting Reference Date.

2010 Update

Since the last version of this document, new regulations have been issued in terms of the Financial Markets Act, including:

LN 140 of 2009 - Designated Financial Instruments Regulations, 2009

LN 139 of 2009 - Central Securities Depository (Control of Assets) Regulations,

	<p>2009</p> <p>LN 138 of 2009 - Central Securities Depository (Authorization Requirements) Regulations, 2009</p> <p>LN 360 of 2008 - Regulated Markets and Central Securities Depositories (Fees) Regulations, 2008</p> <p>LN 336 of 2007 - Financial Markets Act (Transparency) Regulations, 2007</p> <p>LN 331 of 2007 - Financial Markets Act (Membership and Access) Regulations</p> <p>LN 332 of 2007 - Financial Markets Act (Off-Market Deals) Regulations</p> <p>LN 333 of 2007 - Financial Markets Act (Authorization Requirements) Regulations, 2007 - covering the areas referred to above (1) o (13)</p> <p>LN 330 of 2007 - European Rights for Regulated Markets Regulations</p> <p>Moreover, the Financial Market Rules stipulating Financial Resources and Financial Reporting Requirements applicable to Regulated Markets and Central Securities Depositories, and the Guidance Notes on Risk Management and Internal Capital Adequacy for Investment Services License Holders, Regulated Markets and Central Securities Depositories have been issued.</p> <p>From a supervisory perspective, the MFSA reviews the regular off-site compliance reports (monthly operational reports and quarterly financial reports) which the MSE submits to the Authority. Moreover, the MFSA has carried out six compliance visits at the Stock Exchange during this period.</p> <p>The Initial Capital Requirement for RMs and CDSs, has now been set as follows and such entities are required to maintain on-going capital requirements equal to the higher of the initial capital and the total of a number of risk components:</p> <p>Regulated Markets - €730,000;</p> <p>Central Securities Depositories - €730,000;</p> <p>Regulated Markets and Central Securities Depositories - € 1,460,000.</p>
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	<p>While there clearly is an established practice as regards the regulation and supervision of CIS and licensed investment services providers, the practices related to the supervision of recognized investment exchanges RIEs, and related CSD and CSS functions, listed entities and market conduct admittedly are in the process of being established. Regardless, as the MFSA is an experienced securities regulator and has a good track record in its past areas of competence, it is expected that the widening of its supervisory responsibilities will be completed smoothly in a timely fashion. The detailed Directives on financial reporting by the RIE's should be issued imminently.</p>

	<p><u>2010 Update</u></p> <p>The MFSA has been responsible for the regulation of the Malta Stock Exchange for the last seven years. During this period the legislative framework and the supervisory practices in this area have been significantly developed and refined. The current framework reflects the legislative framework in the EU for Regulated Markets. For a list of applicable legislation in this area, you may wish to refer to the 2010 Updated to the section of this document entitled: <i>Information and methodology used for assessment</i>. Please also refer to the above 2010 Update which has been included in the ‘Description’ section.</p>
Principle 27.	Regulation should promote transparency of trading.
Description	Refer to principle 26.
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	<p>While there clearly is an established practice as regards the regulation and supervision of CIS and licensed investment services providers, the practices related to the supervision of recognized investment exchanges RIEs, and related CSD and CSS functions, listed entities and market conduct admittedly are in the process of being established. Regardless, as the MFSA is an experienced securities regulator and has a good track record in its past areas of competence, it is expected that the widening of its supervisory responsibilities will be completed smoothly in a timely fashion.</p> <p><u>2010 Update</u></p> <p>Transparency of trading on Regulated Markets is required in terms of a number of Regulations and Rules applicable to Regulated Markets in terms of the Financial Markets Act. In particular the Authority has issued L.N. 336 of 2007 Financial Markets Act (Transparency) Regulations, 2007, which provides for both pre-trade and post-trade requirement conditions for Regulated Markets.</p>
Principle 28.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	<p>Under the new legislation, the Recognized Investment Exchange must report any suspicion of insider dealing or market abuse to the Competent Authority (MFSA). In turn the Competent Authority, whether pursuant to a report as mentioned above or otherwise, is required to appoint an inspector or inspectors to carry out an investigation for the purpose of establishing whether or not any offence as detailed above, is being committed or is likely in the circumstance to be committed, and to report the results of the investigation to it. The Competent Authority in turn has an obligation to report the offence of insider dealing and market abuse to the Commissioner of the Police.</p> <p>Currently, the market surveillance continues to be undertaken by the Exchange’s Compliance Office that maintains a constant watch of the market to detect any unusual activity involving potential circumvention of market rules and practices. Market</p>

	<p>supervision is geared to identify anomalous movements on the floor that could suggest the need for intervention by the appropriate authority.</p> <p>To this effect, the Exchange has introduced both manual and computer generated programs which allow the Exchange to carry out full audit trails with regards to the trading, settlement and registration cycle thereby enabling the Exchange to detect any manipulation and other unfair trading practices. Besides contributing towards the increased market transparency which comes about as a result of the real time information which is available to all market participants, the Malta Automated Trading System (MATS) also includes the added advantage of being capable of producing detailed reports which can be closely analysed during the immediate post trading period in order to ascertain that trading is being conducted in a transparent, fair and orderly manner.</p> <p>The manner how MFSA's role as the competent authority will be implemented in practice is still under consideration. Till the relevant regulations are issued, and the procedures in place the MSE will continue to conduct the day-to-day market surveillance and report ad-hoc its findings and possible concerns to the MFSA.</p> <p><u>2010 Update</u></p> <p>Since 2005, the MFSA is responsible for monitoring the market and identifying suspicious transactions in terms of the Prevention of Financial Market Abuse Act which transposes the EU Market Abuse Directive. The Securities and Markets Supervision Unit is also active with respect to market monitoring and the investigation of suspicious transactions. In this regard, the Unit's Markets Team carries out daily market monitoring and reviews/investigates any serious suspicions of market misconduct. During 2009 the Unit closed an insider dealing investigation relating to three directors of a listing company. Further to a decision by MFSA's Supervisory Council, these directors were subject to a fine by the Authority. The MFSA's decision in this regard, has been contested at the level of the financial services tribunal. It is to be noted that in terms of the PFMA regulatory framework, financial intermediaries also have a legal obligation to report instances of suspected market abuse to the Authority besides the Malta Stock Exchange.</p>
Assessment	2002/3 FSAP – Implemented; 2010Independent Assessment – Implemented
Comments	<p>While there clearly is an established practice as regards the regulation and supervision of CIS and licensed investment services providers, the practices related to the supervision of recognised investment exchanges RIEs, and related CSD and CSS functions, listed entities and market conduct admittedly are in the process of being established. Regardless, as the MFSA is an experienced securities regulator and has a good track record in its past areas of competence, it is expected that the widening of its supervisory responsibilities will be completed smoothly in a timely fashion.</p>

	<p><u>2010 Update</u></p> <p>The MFSA has been responsible for the regulation of the Malta Stock Exchange for the last seven years. During this period the legislative framework and the supervisory practices in this area have been significantly developed and refined. The current framework reflects the legislative framework in the EU. From a supervisory perspective, the MFSA reviews the regular off-site compliance reports (monthly operational reports and quarterly financial reports) which the MSE submits to the Authority. Moreover, the MFSA has carried out six compliance visits at the Stock Exchange during this period.</p>
Principle 29.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	MSE Act Section 5; 16;17; MSE by-laws/ proposed requirements as per Principle 26
Assessment	2002/3 FSAP – Implemented ; 2010 Independent Assessment – Implemented
Comments	<p>While there clearly is an established practice as regards the regulation and supervision of CIS and licensed investment services providers, the practices related to the supervision of recognized investment exchanges RIEs, and related CSD and CSS functions, listed entities and market conduct admittedly are in the process of being established. Regardless, as the MFSA is an experienced securities regulator and has a good track record in its past areas of competence, it is expected that the widening of its supervisory responsibilities will be completed smoothly in a timely fashion.</p> <p><u>2010 Update</u></p> <p>Both Regulated Markets and CSDs are subject to the Financial Market Rules setting out Financial Resources and Reporting Requirements and are expected to adhere to the MFSA’s Guidance on Risk Management and Internal Capital Adequacy (as further detailed in the up-date to Principle 22). Please refer to the updated in relation to Principle 28. Malta’s regulatory regime for Regulated Markets is in line with the EU MiFID Directive requirements. The Regulated Markets (Authorization Requirements) Regulations 2007 which need to be satisfied by the Regulated Market on an on-going basis include requirements for ensuring that all the systems and controls used in the performance of the Regulated Market’s functions are adequate and appropriate. Section 3(2) of the Schedule to Legal Notice 333 of 2007 requires the regulated market to ensure that (inter alia):</p> <ul style="list-style-type: none"> • It has appropriate arrangements and systems to identify all significant risks to its operations and it has effective measures to mitigate those risks. • It has proper arrangements for the sound management of the technical operations of its systems, including the establishment of effective contingency

	<p>arrangements to cope with risks of disruption to these systems.</p> <p>Moreover, the Financial Market Rules which include the Notification Requirements for Regulated Markets include (in section 20 and 21), particular requirements for notifying the Authority in the event of any circumstances which create disruption to the market together with the remedial action the Regulated Market is taking or proposes to take.</p>
Principle 30.	Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	<p>Under the past regime, the dematerialization and the clearing and settlement of securities traded in the MSE had its legal foundations largely in the MSE Byelaws. In the new regime, the Financial Markets Act—Section 24 subsection (4) (c), (d) and (e)—list as part of the authorities of MSE (1) provision of facilities for the maintenance of a central securities depository; (2) performing all other functions as are customarily performed by a recognized investment exchange; and (3) doing all such things as may be necessary or incidental for the proper functioning of the Exchange. The legislation does not provide any definition of an RIE, nor does it provide clarification as to nature of functions allowed to be conducted by an RIE. As the above-mentioned Section 24 of the Financial Markets Act is the only reference in the legislation to the central depository, this leaves open serious questions as regards the legal foundations for the actual dematerialization of the securities, as well as the allowed or intended institutional, regulatory and supervisory arrangements for the CSD and CSS functions.</p> <p>The MFSA has issued regulations as regards operations of RIEs. These regulations apply not only to the MSE but also to any future RIEs that may be licensed. The MSE has redrafted its by-laws to reflect the changes in legislation and its changed status and submitted them for approval to the MFSA, as required by the Financial Markets Act. Whereas under the MSE Act the MSE by-laws had a status of binding secondary legislation, it is somewhat unclear what their legal standing is going forward given that their existence is tied to a license that has been issued—and hence also can be cancelled—by the Competent Authority.</p> <p><u>2010 Update:</u></p> <p>With reference to the lack of definition of ‘Recognized Investment Exchange’ (RIE) which had been reported in the FSAP, the term RIE was in 2007 replaced with the EU terminology <i>Regulated Market</i>. In terms of the Financial Markets Act a regulated market is defined in line with the definition in the MiFID Directive ‘as a means a multilateral system operated by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments in the system within the meaning of the Directive. For the purposes of this definition, "buying and selling interests" includes orders, quotes and indications of interest’</p>

	<p>In 2007 the FMA was amended to <i>inter alia</i> include a specific section for the regulation of central securities depositories. As of the date of the coming into force of these amendments persons wanting to operate a CSD in Malta are required to apply to the MFSA for an authorization under the FMA. The services of a CSD are regulated in terms of specific regulations issued under the Financial Markets Act (refer to 2010 Update to Principle 26). In order to review the state of compliance by the Malta CSD with the applicable legislation, on the 25th May, 2010 the MFSA sent a self-assessment questionnaire to the Malta Stock Exchange. The questionnaire covers the requirements of the Central Securities Depository (Authorization Requirements) Regulations [L.N. 138 of 2009] and Central Securities Depository (Control of Assets) Regulations [L.N. 139 of 2009]. A copy of the self-assessment questionnaire is available upon request.</p> <p>The FMA was also amended in 2007 to include an article (article 28) which, <i>inter alia</i>, specifically provides for the dematerialization of securities. The new provisions ensure that there is legal certainty regarding the ownership of dematerialized securities, i.e. that the title to and rights in respect of <i>designated</i> financial instruments, the register of which is maintained in a central securities depository, may be created and, or transferred by an entry on the register which is maintained in a central securities depository, and no instrument in writing shall be required for this purpose. The instruments which fall within the category of designated financial instruments are spelt out in Designated Financial Instruments Regulations, 2009 [L.N. 140 of 2009], which is currently in the process of being brought into effect.</p>
Assessment	2002/3 FSAP - Partially implemented; 2010 Independent Assessment - Implemented
Comments	<p>The present operational arrangements for Central Securities Depository, CSD and Clearing and Settlement of Securities, CSS functions within the MSE appear to be largely appropriate for the nature and size of the domestic market today. However, the legal foundations for the institutional arrangements, for their regulation and supervision, and for the dematerialization itself do not appear sufficiently solid. The recent amendments to the Financial Markets Act change the legal standing of the MSE by-laws, and it is unlikely that by-laws of a Recognized Investment Exchanges would suffice as ultimate proof-of-ownership in court as the recognition order can be cancelled by the MFSA. Similarly, the legislation does not explicitly establish the institutional arrangements for maintaining, regulating and supervising a CSD to meet the international standards. Hence, the government should consider specific legislation both for the dematerialization and the institutional infrastructure.</p> <p><u>2010 Update</u></p> <p>The amendments to the FMA, primarily the introduction of the new Part IV titled “Central Securities Depository”, have addressed the above mentioned weaknesses by clearly setting out the legislative foundation for the regulation of CSD services and for the dematerialization of securities so as to provide legal certainty as to the ownership of dematerialized securities the register of which is maintained by a CSD. The comments under the above 2010 Update to the “Description” also refer.</p>

3.4 Recommended actions and MFSA (Securities and Markets Supervisory Unit) response to the assessment

2002/3 FSAP- Recommended actions

The assessment of a comprehensive set of laws, regulations and regulatory practices is somewhat impeded by the FSAP process coinciding with the simultaneous ongoing transition from one regulatory regime to another. The relevant laws came to force less than two weeks before the first mission and the secondary legislation was finalized just before the second mission. Furthermore, as regards the new areas of regulatory responsibility for the MFSA, there are no established regulatory and supervisory practices or, for that matter, experience from the conduct of such responsibilities. There are, however, a few areas where the issuance of relevant secondary legislation will not suffice to rectify the short-comings. These are related, most notably, to the legal foundations for the dematerialization of securities traded, and the related regulatory, supervisory and institutional arrangements. Similar short-comings are found in the lack of risk-related capital adequacy requirements. Both these areas are very technical and complex in nature and thus require very thorough vetting. The areas are also inter-related given that the solvency arrangements for the CSD and the CSS, and the market participants together form the overall buffer against systemic market failure, and would therefore need to be addressed connectively. Moreover, the European policies on the regulation of the CSD and CSS functions are under-going reform. Hence, it is recommended that the Government, and the relevant agencies involved, take the time needed to do the changes properly. In the meantime, the planned Memorandum of Understanding between the MFSA and the CBM, CBM directives, enactment of Bill 165 and the secondary legislation for RIEs can be used as temporary rectification vehicles on the CSD and CSS related issues.

2010 Independent Assessment – Response

Principles Relating to the Regulator (CP 1–5): Whilst there are plans to segregate the CSD from the MSE and to establish a clearer legal and regulatory framework for the CSD, the oversight of securities settlement is being discussed with the CBM. Moreover, the MoU between MFSA and CBM, signed on February 4, 2003, refers to the CBM’s responsibility for the oversight of securities settlement.

2010 Update

The Financial Markets Act has been amended to provide a clear legal framework for the regulation of CSDs. Please refer to the 2010 Update in the comments section relating to Principle 3 for further details.

The standards which the MSE is required to adhere to as a Recognized Investment Exchange (“RIE”) are referred to in the RIE (Recognition Requirements) Regulations, 2003 which were issued in January, 2003 (since replaced with the Regulated Markets (Authorization Requirements) Regulations, 2007. Moreover, the detailed notification and financial resources and reporting requirements applicable to the MSE are included in Directives (now referred to as Financial Market Rules which are in force) which have been drafted by the MFSA and subject to final discussion with the MSE, are expected to be issued shortly. The MFSA and MSE are also engaged in on-going exchanges of correspondence and discussion to clarify respective responsibilities. These have now been clarified and tested.

Principles for Issuers (CP 14–16): By-law 6.05.06(i) (a) states that half-yearly reports are to be published within 3 months. Bye-law 6.05.06 (ii) gives a publication period of six months for annual reports. In practice, this period is always less than six months for companies to be able to comply with 6.05.05(I) “...the date fixed for any board meeting...” Nonetheless, the mission’s recommendation will be referred to the MFSA’s Listing Committee which is responsible for drawing up the MFSA’s new Listing Rules.

2010 Update

The above issues have since been addressed though the MFSA Listing Rules – refer to the 2010 Update in respect of Principle 14 for further detail Principles for Market Intermediaries (CP 21–24): Financial resources and reporting rules for investment services license holders in line with the EU CAD have been drafted and are scheduled for adoption in 2004. Moreover, the MSE’s financial resources are being monitored through the submission of regular Financial Returns. The MFSA will be considering what procedures for dealing with the failure of a market intermediary would be appropriate to introduce, and what guidelines on risk management for its regulatory subjects, would be appropriate for it to issue.

2010 Update

The above issues have since been addressed though the MFSA Listing Rules – refer to the 2010 Update in respect of Principle 22 to 24 for further detail Principles for the Secondary Market (CP 25–30): The recommended action will be considered as part of the developments underway in relation to the CSD and CSS (see comments under CP 1-5 above).

2010 Update

Action has been taken to address the weaknesses identified in the last FSAP – refer to the updates in respect of Principles 26 and 30 in particular for further details.

2010 Update - Recommended actions

Most of the recommendations made in 2003 were made during the period of transition from one regime to another and the relevant laws came to force during the FSAP evaluation. In several cases, the assessors considered ‘Implemented’ “several Principles based on the MFSA track record. In 2003 the assessors stated that MFSA is “an experienced securities regulator and has a good track record in past areas of competence, it is expected that the widening of its supervisory responsibilities will be completed smoothly in a timely fashion” .**The current independent assessment endorses the 2003 evaluation made as “Implemented” in all those cases.**

The entry of Malta in the EU has had a significant impact on addressing the remaining shortcomings signalled during the 2003 FSAP. The MFSA has been transposing and implementing all the relevant EU directives as listed in the introduction of this assessment. In addition to the secondary legislation, the MFSA, in coordination with the CBM and MSE has

addressed some of the main concerns related to the legal foundations for the dematerialization of securities traded, and the related, regulatory, supervisory, and institutional arrangements. The MFSA and CBM signed the MOU and the CSD – CSS issues raised in 2003 have been fully addressed.

As a result of the progress made since 2003 this independent assessment has concluded that the MFSA has “Implemented” twenty-four Principles (versus twenty-two in 2003) and has “Broadly Implemented” four Principles (versus six “Partially Implemented” in 2003). Two Principles remain “Not Applicable “(Table 3.2).

Table 3.2. Summary Observance of the IOSCO Objectives and Principles of Securities Regulation

2002/3 FSAP Assessment	Principles Grouped by Assessment Grade	
	Count	List
Implemented	22	1; 2; 4; 5; 8; 9; 10; 11; 12; 13; 15; 16; 17; 18; 19; 20; 21; 25; 26; 27; 28; 29;
Broadly Implemented	0	
Partially Implemented	6	3; 14; 22; 23; 24; 30
Non-Implemented	0	--
Not applicable	2	6, 7

<u>2010 Update</u>	Principles Grouped by Assessment Grade	
	Count	List
Implemented	24	1; 2; 4; 5; 6;7;8; 9; 10; 11; 12; 13;14; 15; 16; 17; 18; 19; 20; 21; 25; 26; 27; 28; 29;30
Broadly Implemented	4	3; 22; 23; 24
Partially Implemented	0	
Non-Implemented	0	--
Not applicable	2	6, 7

This internal assessment has highlighted the importance of recruiting and retaining qualified staff. In this context, the current policy of providing training from external sources should continue. It will be also very important to streamline and shorten the current cumbersome recruiting policy. Risk management and risk-based regulatory directives should be fully implemented and staff should be trained and dedicated to review capital adequacy and the early warning system should be finalized and implemented (Table 3.3).

Table 3.3 Recommended Plan of Actions to Improve Observance of the IOSCO Objectives and Principles of Securities Regulation

Reference Principle	Recommended Action
Principles Relating to the Regulator (CP 1–5)	<p>Clarification would be in order as regards the regulation and supervision of the CSD and CSS functions and the related institutional arrangements.</p> <p>The MFSA's and the MSE's responsibilities, applied procedures and required lines of reporting should be explicitly established to optimize use of scarce resources and ascertain coverage with no supervisory, surveillance or enforcement gaps.</p> <p>2010 Update: Appropriate action has been taken to address the above through legislative changes and enhancements to the local regulatory framework as further detailed in the Principle by Principle 2010 Update.</p> <p>The MFSA has to continue pursuing the policy of remaining update with new products offered in the financial sector. In view of the growing financial sector and new challenges, the MFSA has to continue its policy of recruiting and retaining qualified staff. Appropriate and continuous training for the MFSA staff and outside assistance from experienced officials in the financial sector area should continue. The recruitment process must be streamlined and shortened.</p>
Principles of Self-Regulation (CP 6–7)	No action required.
Principles for the Enforcement of Securities Regulation (CP 8–10)	
Principles for Cooperation in Regulation (CP11–13)	No action required.
Principles for Issuers (CP 14–16)	<p>Reconsider the exceptions to the half-yearly disclosure requirement.</p> <p>Reconsider the 6 month lag allowed for issuance of audited</p>

Reference Principle	Recommended Action
	<p>annual accounts as it is long by international standards.</p> <p><u>2010 Update:</u> The MFSA Listing Rules have addressed the above and are in line with relevant EU Directives in this area</p>
Principles for Collective Investment Schemes (CP 17–20)	No action required.
Principles for Market Intermediaries (CP 21–24)	<p>The planned implementation of the EU Capital Adequacy Directive requirements should be considered.</p> <p>The overall solvency arrangements of the entire market structure, including the MSE and—in particular—its CSD and CSS functions, should be reviewed and reconsidered. It is recommended that these exercises be conducted in coordination to ascertain that the solvency requirements of the individual market participants and market in general are not compromised, while taking into account the market’s capacity to bear the cost.</p> <p>The MFSA issue guidelines to the RIEs on risk management, particularly as regards the CSD and CSS functions.</p> <p>The MFSA should establish more detailed principles and procedures for dealing with failures of market intermediaries.</p> <p><u>2010 Update:</u> The EU Capital Requirements Directive (which replaced the CAD) has been transposed into the local regulatory framework and besides being applicable to investment firms, has also been used as a basis for the introduction of risk-based financial resources requirements for the Regulated Market and CSD.</p> <p>Risk Management guidance has also been issued and an internal procedure for dealing with the failure of an investment firm has been drawn up.</p> <p>Appropriate staff should be dedicated to review capital adequacy on a continuous basis and the early warning system should be formalized.</p>
Principles for the Secondary Market (CP 25–30)	<p>The Government should consider specific legislation both for the dematerialization of securities and the institutional infrastructure for CSD and CSS functions.</p> <p><u>2010 Update:</u> The above has been addressed through amendments to the Financial Markets Act and the issue of Regulations</p>

3.5 MFSA Response (Securities and Markets Supervisory Unit) to the 2010 Independent Assessment:

Principles Relating to the Regulator (CP 1-5): The MFSA recognises the importance of ensuring that its regulatory staff keep abreast with financial services industry developments. The Authority also recognises the need for recruiting and retaining appropriately qualified staff to enable it to carry out its supervisory duties effectively in the light of the growth in the number of licensed entities falling under its regulatory remit as well as in the light of the increasingly demanding regulatory standards (both European and international) which are expected of regulatory authorities. In this regard, a recruitment programme is currently underway to gradually augment the Securities & Markets Supervision Unit staff by recruiting graduates having some relevant industry experience and who can contribute to achieving the Unit's objectives. Moreover, since the 2002/3 FSAP assessment, besides continuous investment in training for regulatory staff, arrangements have been made for the secondment of Unit staff both with other more experienced regulatory authorities, as well as with the industry. The MFSA is committed to continue exposing its staff in such manner.

Principles for Market Intermediaries (CP 21-24): As indicated above, the staff resources available to the Securities & Markets Supervision Unit are being supplemented to enable it to better cope with its supervisory duties. These include the prudential regulation of investment services licence holders with a view to ensuring that they comply with the on-going requirements of the EU Capital Requirements Directive. In line with the recommendation made, the MFSA plans to enhance its internal procedure for dealing with the failure of a market intermediary which it has drawn up since the 2003/3 FSAP assessment, to include a formalised internal warning system to better evaluate a potential default by a market intermediary, address the problem, and take timely corrective action. In this context, the SMSU is monitoring discussions at the EU level on the proposed crisis management directive.

Chapter 4: Observance of Insurance Core Principles for Insurance and Pensions Supervision

4.0 Introduction

An independent assessment of the insurance regulatory and supervisory system in Malta was carried out during 27-31 July 2010 to update a joint International Monetary Fund and World Bank mission visited Malta during the period October 15—24, 2002 and January 27—January 31, 2003 as part of the Financial Sector Assessment Program (FSAP). Luc Cardinal from the World Bank carried out the assessment. **The independent assessment reviews the effectiveness of Malta insurance legislation in the context of current insurance supervisory best practices (the ICPs). It also examines the effectiveness of the supervisory body, which is the Malta Financial Services Authority (MFSA). The independent assessment was carried out by Michael Kehr (BaFin, Germany).**

This assessment has been based on the ICP of the International Association of Insurance Supervisors (IAIS) dated October 2003. Given the developed nature of the Maltese insurance market, this assessment comments on both the essential and advanced criteria underpinning each core principle. However, in accordance with Annex 2 of the Insurance Core Principles and Methodology, only essential criteria have been taken into account in assessing the overall level of observance of a core principle.

The assessment was based on the following information:

- The self-assessment prepared by the MFSA,
- The EU-Directives, national laws, rules and regulations,
- Procedures, checklists, files, off- and onsite reports and correspondence,
- Interviews with MFSA staff, undertakings under supervision and other stakeholders.

The assessment led to the following key recommendations:

- a) The MFSA's supervisory framework for internal audit functions needs to be tighter. Companies should be required to have internal audit functions. Supervision of internal audit functions should be strengthened.
- b) On-site inspections should be assigned the necessary staff and time resources. Work on enhanced planning procedures needs to be continued. Follow up actions should be stricter.

The market has undergone deep changes since the FSAP was conducted in 2003. With the accession procedures to the European Union completed in 2003/2004, Malta had to include the whole of the *Acquis communautaire* into its legislative framework, thereby setting a more competition-stimulating environment. Undertakings from all other EU/EEA Member States were able to make use of the EU passport system ("single licence") and offer their services to Maltese customers without having to obtain an extra licence. Domestic undertakings were vice versa able to offer their services to customers of all other Member states. As of January 1st, 2008, Malta acceded the Euro area, becoming its 16th member. Main effects were that currency exchange risks as well as

investment costs became considerably lower, if they were not eliminated. However, they retain some relevance mostly with regard to a few currencies, mainly the UK £ and US\$.

The Malta insurance market, initially rather insulated from global markets, has taken a rapid and fast-paced development in the last 10 years. Premiums multiplied by 40 compared to 1999 and tripled compared to 2005, the first year after EU accession. The market saw double-digit growth rates for many years. Property, liability and motor contributed most, and also life insurance has taken an overall exciting development. Only long-term classes took a dip in terms of premiums written during the recent financial crisis, but have since already recovered since then. This enormous growth is, to a part, owed to various factors, one of them being the EU single market with its regulatory framework. Numerous notifications were made into Malta, while some domestic Maltese insurers, probably due to their medium-sized nature, and perhaps due to their cautious business strategies, seem yet to be more reluctant to make use of these opportunities.

4.1 Information and Methodology

The IAIS Methodology approved in October 2003, together with an IMF Template based on this methodology, was employed in preparing the independent assessment. It was felt that a principle by principle update of the 2002/2003 FSAP would not be appropriate bearing in mind the all-embracing changes not only of the market environment and supervisory framework, but also of the Insurance Core Principles themselves in 2003 (the 2002/2003 FSAP was built on standards adopted in 2000).

The independent assessment was greatly facilitated by a detailed Self-Assessment and other information supplied by the Insurance and Pensions Supervision Unit at the MFSA as well as other participants from the public and private sector. The assessor would like to extend his gratitude for the substantial efforts, inputs, and time given by all stakeholders in facilitating the independent assessment. All the necessary information was provided without delay.

4.2 Principle by Principle Assessment

ICP 1	<p>Conditions for effective insurance supervision</p> <p>Insurance supervision relies upon</p> <ul style="list-style-type: none"> • a policy, institutional and legal framework for financial sector supervision • a well-developed and effective financial market infrastructure • efficient financial markets.
Description	<p>Financial sector policy framework:</p> <p>Undertakings in Malta operate within a legal and institutional framework which is publicly disclosed by the Government, and by the MFSA, as Insurance Rules and Guidance Notes are concerned. The MFSA is the single regulator for financial services activities in Malta. It regulates and supervises credit and financial institutions, investment, trust and insurance business, financial intermediaries, and also houses the Registry of Companies. It has assumed the regulatory and supervisory responsibilities</p>

	<p>previously shared between the MFSA, the Central Bank of Malta and the Malta Stock Exchange.</p> <p>Malta acceded the European Union as of 1 May, 2004, and had by that date to transpose all of the <i>Acquis communautaire</i> into national law. For the insurance sector, the most relevant elements are the EU Directives:</p> <ul style="list-style-type: none"> • Directive 2002/83/EC on Life assurance, • Directives 73/239/EEC and 92/49/EEC on Non-life insurance, together with a number of particular Directives on Non-life insurance classes (on the Solvency margin, 2002/13/ED; on Motor Insurance, 2009/103/EC; on Tourist assistance, 84/641/EEC; on Credit and Suretyship insurance, 87/343/EEC; on Legal expenses insurance, 87/344/EEC), • Directive 2005/68/EC on Reinsurance, • Directives 98/78/EC on insurance groups and 2002/87/EC on financial conglomerates, • Directives 91/674/EEC, 78/660/EEC, and 83/349/EEC on annual accounts of insurance undertakings, certain types of companies, and consolidated accounts, • Directives 2000/31/EC on e-commerce and 2002/65/EC on distance marketing of consumer financial services. • Directive 2001/17/EC on Reorganisation and winding up, • Directive 2002/92/EC on Insurance mediation, • Directive 2000/64/EC on the Exchange of information with third countries (meaning Non-EU/EEA countries). <p>The legal framework for insurance revolves around the MFSA Act and the two main pieces of legislation for the insurance sector (The Insurance Business Act (IBA) and the Insurance Intermediaries Act (IIA)). Laws and regulations as well as MFSA's Insurance Rules and Guidance Notes work out the details of the legal framework, which is, along with other information relevant for market participants, published on the MFSA website.</p> <p>Financial market infrastructure:</p> <p>Market participants in Malta operate within a constitutional and legal framework which provides legal certainty as well as access to courts and arbitration procedures. The level of provision of infrastructure is high and equals European standards. All of the financial sector participants have their own trade associations, each of which <i>inter alia</i> acts as a forum to discuss developments, take part in MFSA's public consultations, and make comments and recommendations to the MFSA.</p> <p>The courts are impartial and independent. Judges are appointed by the President of Malta. They may also only be dismissed by the President, and only in a case of proved misbehaviour or inability to perform the functions of his or her office upon address of the House of Representatives.</p> <p>The Malta Insurance Association provides its members with the opportunity to analyse and discuss external developments, also within its different subcommittees. Part of the Association's mission is to offer training initiatives and events targeting general and specialized lines of insurance business. It carries out studies, provides statistical information - which is also shared with MFSA – and sponsors university courses in insurance to improve the availability of educated employees on the local market. It also discusses with the Government and MFSA how best to mitigate possible large-scale catastrophe risks.</p> <p>The Malta Institute of Accountants was formed in 1942. It became a member of the International Federation of Accountants and the International Accounting Standards Committee in 1977, subsequently adopting International Accounting Standards and Auditing Guidelines (which are publicly available). The Institute is a full member of the <i>Federation des Experts Comptables Europeans</i>.</p>
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	<p>Local recognition of accountancy as a profession came about in 1979 with the enactment of the Accountancy Profession Act, 1979 which introduced the granting of warrant of Certified Public Accountant by the Minister of Finance. Under the Act the Institute gained statutory recognition - to date the Institute is the only body recognized under the said Act.</p> <p>The few actuaries that are resident permanently in Malta are employed with local insurance companies. Overseas external actuarial firms currently service the life insurance companies and relevant non-life insurance companies, while the MFSA use the services of the UK Government Actuaries Department for advice. The MFSA actively promotes courses for actuarial studies.</p> <p>Efficient financial markets:</p> <p>Money and securities markets have further been growing and developing since Malta acceded the European Union in 2004. Financial institutions could since then choose from a much wider portfolio of investment products.</p> <p>Securities are traded at the Malta Stock Exchange (MSE) which is authorised as a market operator by the MFSA under the Financial Markets Act.</p> <p>A number of local credit institutions as well as from other EU/EEA Member States provide financial services in Malta. The sector has proven to remain relatively stable and has continued to uphold its functions as a service provider for the insurance sector also during the recent financial crisis.</p> <p>Economic, financial and social statistics are freely available from the National Office of Statistics (NOS). The MFSA, the NOS and the Central Bank of Malta exchange information on a quarterly basis. The Central Bank regularly receives data from insurance undertakings for financial stability analyses. These data are also processed to the European Central Bank for further analysis.</p>
Assessment	Observed.
Comments	None.
ICP 2	<p>Supervisory objectives</p> <p>The principal objectives of insurance supervision are clearly defined.</p>
Description	<p>The key objectives of supervision can be summarised as follows (Art. 4 MFSA Act):</p> <ul style="list-style-type: none"> • To regulate, monitor and supervise financial services in Malta; • To promote the general interests and legitimate expectations of consumers of financial services, and to promote fair competition practices and consumer choice; • To advise the Government generally on the formulation of policies in the field of financial services; • To monitor and keep under review trading and business practices; • To monitor the working and enforcement of laws that directly or indirectly affect the financial services consumer in Malta; • To investigate allegations of practices and activities detrimental to investors. <p>With regard to authorisations of insurance undertakings, the MFSA should have regard to (Art. 4 (2) IBA:</p> <ul style="list-style-type: none"> • The protection of insured persons, policy holders and the general public; • The protection of the reputation of Malta, taking into account Malta's international commitments; • The promotion of competition and choice.

	The MFSA establishes a Strategic Plan which is updated every three years and communicated on the website. The current 2007 – 2009 plan identifies overall objectives for further development of the authority and its work on the grounds of the above-mentioned legal provisions.
Assessment	Observed.
Comments	The objectives as they have been verbalized in the law give wide leeway to the MFSA and do not account for a priority among themselves. It should be considered to expand the scope of Art. 4 (2) of the Insurance Business Act in a way that it is applicable also to ongoing supervision.
ICP 3	<p>Supervisory authority</p> <p>The supervisory authority:</p> <ul style="list-style-type: none"> • has adequate powers, legal protection and financial resources to exercise its functions and powers • is operationally independent and accountable in the exercise of its functions and powers • hires, trains and maintains sufficient staff with high professional standards • treats confidential information appropriately.
Description	<p>Adequate powers:</p> <p>Insurance business is regulated by two separate but complimentary laws (IBA and IIA). The two Acts govern all relevant operators in the sector. The MFSA is empowered under the Acts to issue Insurance Rules and Insurance Intermediaries Rules as may be required for the carrying into effect of any provisions of these Acts and of any rules or regulations. Regulations are issued by the Minister of Finance after consultation with the MFSA. Supervisory measures taken by MFSA are published on the website. Breaches will normally result in administrative penalties or, if more serious, in court penalties; administrative measures set out in the laws above apply independently thereof.</p> <p>The MFSA Act gives the MFSA power to issue rules for administrative means. Under Article 4(3) IBA, MFSA may make rules as may be required for carrying on into effect any of the provisions of the Act, and of any regulations made thereunder. In particular, MFSA may, according to Art. 28 – 31A IBA,</p> <ul style="list-style-type: none"> • issue binding decisions and directives, • enter and search the premises of undertakings under supervision, • carry out inspections at any time, • require undertakings to produce documentation and information, • remove managers/directors, • appoint a person to take charge of the assets of the company for the purposes of safeguarding the interests of policyholders, • appoint a person to assume control of the business of the company, • issue an order for the dissolution and winding up of the company and appoint a competent person to act as liquidator. <p>Legal protection:</p> <p>Bodies and employees of the authority are exempted from any liability according to Arts. 29 MFSA Act, 66 IBA, unless the act or omission is shown to have been done or omitted to be done, in bad faith. In the event of proceedings initiated by third parties, the MFSA has committed in its staff handbook to protect and support employees in contesting such proceedings.</p> <p>Financial resources:</p> <p>MFSA sets up its budget independently. It consists of annual fees, licensing fees and</p>

	<p>sanctions. Annual fees are revised every 5 years in such a way that expenses of MFSA can be fully covered and provisions for contingencies can be made. For insurers these fees are set out in the Insurance Business Fees Regulations (LN 139/1999), last amended in 2009, and account for fees to be paid according to gross premiums receivable.</p> <p>According to Art. 26 MFSA Act, MFSA has to submit the remainder of the surplus to the government.</p> <p>Independence and accountability:</p> <p>The main organs of the Authority are the Board of Governors, The Co-ordination Committee, the Supervisory Council, the Board of Management and resources, and the Legal Office (Art. 5 MFSA Act).</p> <p>The Chairman and six other members (together the Board of Governors, Art. 6 MFSA Act) are appointed by the Prime Minister. Reasons for dismissals as set out in Art. 6 MFSA Act ("... has ... otherwise conducted himself in such a manner as to cast doubt on his competence or soundness of judgement, ... or ... is otherwise not a fit and proper person...") do not always define the elements for dismissal precisely, but allow for a wide scope of judgment evaluation. The appointment of a new Board of Governors is published in the Government Gazette. Reasons for dismissal are not to be published.</p> <p>The Supervisory Council, headed by the Director General, is exclusively responsible for issuing licences and regulation and is composed of the Directors responsible for Banking, Securities and Markets, Insurance and Pensions, Authorisation, and Regulatory Development.. Every 2 years regulatory units undergo an internal audit which will measure the compliance with IOSCO, IAIS, BCP, and other relevant standards. A financial audit is carried out every year by external auditors, their report is laid before Parliament. Internal rules of promotion as well as matters of recruitment and payroll fall within the scope of the financial audit because of their financial impact.</p> <p>Rules of internal governance are mainly set out in the comprehensive staff handbook. It contains regulations on conflicts of interests, staff dealings including disclosure requirements, more detailed rules on confidentiality and the like. The handbook is maintained by the Human Resources Department and updated at least once a year.</p> <p>The MoF retains the following competences:</p> <ul style="list-style-type: none"> • to determine remuneration of board members, • to give approval to the MFSA to borrow or raise money for the purpose of carrying out its functions, • to make advances as he may consider to be required by the MFSA, • to receive a copy of the annual accounts, certified by the auditors. <p>Human resources:</p> <p>At the end of 2009 MFSA had a staff complement of over 146 specialist regulators, lawyers, accountants and support staff. 83 members of staff hold a first degree, 31 members of staff also hold a second degree while 39 hold a diploma in various studies. The MFSA encourages and facilitate access to further study by its own staff and in 2009 over 30 employees were engaged in study programmes for diploma or degrees. Staff receive training in specialized areas on a regular basis.</p> <p>The MFSA has hired outside experts, e.g. consultants, as necessary. For auditing annual submissions it also makes use of the help of the UK Government Actuary's Department.</p> <p>The IPSU is currently composed of fourteen members of staff. Staff leaving is within limits and has amounted to 1 – 2 educated staffs over the last 2 years.</p> <p>There are ongoing efforts to recruit eligible staff, e.g. qualified accountants and</p>
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	<p>actuaries, the latter are not easily available on the Maltese labor market. However, the procedure for recruitment had changed fundamentally after the 2003 FSAP. A Circular issued in 2005 by the Prime Minister (OPM 14/2005) set new rules for recruitment for the public sector which the MFSA is bound to follow (in contrast to the Central Bank of Malta).</p> <p>Confidentiality: MFSA employees are obliged to treat all records, information or documents strictly confidential. This obligation includes information relating to applicants and licence-holders as well as to any information relating to the Authority's own internal affairs, and continues to exist after termination of the employment (MFSA Act Artt. 14, 17; IBA Art. 59). Exceptions are allowed for the purposes of supervisory cooperation and information exchange. Information may also be disclosed to criminal courts or any other courts under the IBA (e.g. for the purposes of insolvency proceedings). However, information obtained from an overseas regulatory authority may only be disclosed to any other third party with the prior approval of the authority which had provided the information (i.e., subsect. 3). For a more comprehensive explanation, see ICP 5.</p>
Assessment	Largely observed.
Comments	<p>Reasons for dismissal of the Board of Governors give wide leeway to the Prime Minister. While this has not led to problems until now, the fact remains that these reasons are not to be publicly disclosed.</p> <p>It is difficult for MFSA, despite competitive salaries, to attract good qualified accountants and actuaries. There is a shortage of eligible staff on the labor market. MFSA and associations are working to mitigate the situation which did not pose an imminent threat to MFSA's functionality in the past. However, with more burdensome recruitment procedures in place, the MFSA's chances to attract good experienced experts in a competition with market participants and stakeholders for qualified staff are limited. New regulatory requirements and obligations resulting from coming changes in EU legislative frameworks – as the yet adopted Solvency II Directive (2009/138/EC) and subsequent implementing measures - will have various implications for staffing. This, along with the need to increase and intensify the frequency, scope, and depth of on-site inspections, particularly through SRP and ORSA, will require additional and qualified staff. However, the 2005 OPM Circular has delayed considerably the time needed for recruiting staff in the MFSA. As a result of the cumbersome process and administrative layers under which the MFSA has to operate the recruitment process could take several months and impact on the workload of the MFSA staff. The process should be streamlined and shortened.</p> <p>MFSA has to submit the remainder of the yearly surplus to the government. That could, in principle, create ambitions or pressure. However, amounts paid have been relatively low (€ 5m at the end of 2009) until now.</p>
ICP 4	<p>Supervisory process</p> <p>The supervisory authority conducts its functions in a transparent and accountable manner.</p>
Description	<p>Rules and procedures:</p> <p>The MFSA Act stipulates the functions and powers to be exercised by the MFSA in relation to financial services in Malta. Arts. 5 to 12 of the MFSA Act identify the main organs of the Authority (the Board of Governors, the Co-Ordination Committee, the</p>

	<p>Supervisory Council, the Board of Management and Resources and the Legal Office). The composition of the main bodies is clearly defined and regulatory and supervisory functions are assigned. Procedures are set out in laws, rules, and regulations in the staff handbook. Laws and regulations are published by the Ministry of Justice and Home Affairs on its website, Insurance Rules and Guidance Notes on the MFSA website.</p> <p>Transparency and consistency: It is up to the Supervisory Council, after receiving a briefing along with a recommendation for action, to make the relevant decisions. The officers in charge of direct supervision or the IPSU as such reviews the case on the merits and prepares the mentioned briefing. With competences centralized at a central body responsible for decision making, consistency over supervisory decisions is ensured. When preparing for or taking those decisions, the IPSU and the Supervisory Council takes into account the kind of business and risk profile of the undertakings concerned before applying measures, e.g. tightened reporting duties.</p> <p>Supervisory decisions: MFSA's decisions may be challenged before the Financial Services Tribunal (Art. 58 IBA), an independent body with the power to confirm, reverse or vary the decision of the MFSA (MFSA Act, Art 21). The Financial Services Tribunal is also empowered to give directions within its powers to the MFSA to implement its decision. The decisions of the Tribunal can be appealed to the Court of Appeal only on a question of law (MFSA Act Art 21 (14)). The members of the Tribunal are independent of the MFSA and are appointed by the Minister of Finance. An appeal to the Tribunal does not suspend the operation of any MFSA decision from which the appeal is made except in the case of an appeal from a decision to revoke an authorisation, in which case such decision is not operative until the expiration of the period within which an appeal may be made and if the appeal is made, the decision becomes operative on the date of the decision of the Tribunal or the date on which the appeal is abandoned. However, in the interim a licence can still be suspended.</p> <p>Information of the public: All legislation and subsequent regulations, general information, MFSA Annual Reports and MFSA Consumer Complaints Reports, consultations, sanctions, penalties and warnings as well as lists and databases of insurance undertakings, intermediaries and approved auditors are published on the MFSA website.</p>
Assessment	Observed.
Comments	None.
ICP 5	<p>Supervisory cooperation and information sharing The supervisory authority cooperates and shares information with other relevant supervisors subject to confidentiality requirements.</p>
Description	<p>The MFSA Act and IBA provide powers for the MFSA to share information and co-operate in its supervisory duties with other overseas regulatory authorities and some local authorities, one of them the Central Bank which processes financial information for financial stability purposes.</p> <p>EU/EEA multilateral agreements: Various multilateral agreements between EU Member States are in place. They govern in detail cooperation and coordination among the supervisory authorities across the EEA under the current directives. The following agreements are in place:</p> <ul style="list-style-type: none"> • General Protocol relating to the Collaboration of the Insurance Supervisory Authorities of the Member States of the European Union ("Revised Siena Protocol") of 31st August, 2008;

	<ul style="list-style-type: none"> • Protocol relating to the collaboration of the supervisory authorities of the Member States of the European Union with regard to the application of Directive 98/78/EC on the supplementary supervision of insurance undertakings in an insurance group ("Helsinki Protocol") of 11th May, 2000; • Protocol relating to the Collaboration of the Relevant Competent Authorities of the Member States of the European Union in Particular in the Application of the Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the Activities and Supervision of Institutions for Occupational Retirement Provision (IORPs) Operating Cross-Border ("Revised Budapest Protocol") of 5th November, 2009; • Protocol relating to the Cooperation of the Competent Authorities of the Member States of the European Union in Particular Concerning the Application of Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on Insurance Mediation ("Luxembourg Protocol") of 28th April, 2006; • Memorandum of Understanding on Cooperation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the European Union on Cross-Border Financial Stability of 1st June, 2008; • Memorandum of Understanding between the members and observers of CEIOPS and the Swiss Financial Market Supervisory Authority of 11th April, 2006. <p>International protocols and agreements: MFSA has concluded a number of bilateral agreements with supervisory authorities from across Europe and from other countries around the world, most of them cross-sectoral agreements, some of them limited to the area of insurance. MFSA is a signatory to the IOSCO Multilateral Memorandum of Understanding. The application to accede the IAIS Multilateral Memorandum of Understanding was still pending at the time of the audit. [The MFSA signed the IAIS Multilateral Memorandum of Understanding in October 2010] Having entered into those agreements, MFSA has a constant and ongoing dialogue with contract parties in special situations as well in day-to-day supervision, e.g. in the field of inbound/outbound EU passport notifications of insurance undertakings and intermediaries as well as fit and proper testing of directors and managers.</p> <p>Protection of confidential information: The confidentiality of information is protected under Art. 59 IBA and the PSA. A breach would not only lead to disciplinary consequences that include the possibility of being dismissed, but also to criminal investigations. Information obtained from an overseas regulatory authority may only be disclosed to any other third party with the prior approval of the authority which had provided the information (Art. 59(3) IBA). The MFSA understands that this provision will override a possible requirement to testify in court (i.e., subsect. 4). The interpretation has not yet been tested in court, but it is likely that courts will consider the importance of the agreements and the reputation of the MFSA in weighting to the respective interests of the parties concerned, or will at least consider evidence to be held in camera (Art. 9 PSA). When disclosing information to other supervisory authorities or otherwise authorised recipients, MFSA provides information only on condition that the information is kept confidential and not disseminated further without the written consent of the MFSA and is only being used for supervisory purposes.</p>
Assessment	Observed.
Comments	None.

ICP 6	<p>Licensing</p> <p>An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public.</p>
Description	<p>Definition of insurers:</p> <p>An Insurer is defined in Article as the party to a contract of insurance who agrees to pay a sum of money or other consideration on the happening of a specific event (Art. 2 IBA).</p> <p>According to the law no person is allowed to carry on the business of insurance unless authorised and the insurers' objects must be limited to the business of insurance and connected operations, to the exclusion of all other commercial business.</p> <p>Permissible legal form of insurers:</p> <p>Insurance companies in Malta are to be set up as limited liability companies. Non-EEA insurers authorised under the IBA may have a different legal form according to the applicable laws of their home state.</p> <p>Responsibility for issuing licences:</p> <p>As a result of recent restructuring measures licensing of insurance undertakings lies now with the newly established Authorisation Unit, which processes licensing applications across all financial sectors. It is equipped with 14 staff coming from different units of the MFSA. The Unit 's work also involves work that is covered by ICPs 7 (Suitability), 8 (Changes in Control), and 24 (Intermediaries). The IPSU is still consulted before submitting a proposal for decision to the Supervisory Council.</p> <p>Requirements for licensing of insurers:</p> <p>The most important requirements for direct insurers are:</p> <ul style="list-style-type: none"> • All qualifying shareholders, controllers and all persons who will effectively direct the business of insurance must be fit and proper (ICP 7). • The company must submit to the satisfaction of the competent authority a scheme of operations. • The company's own funds, whether in euro or in other currencies acceptable to the competent authority are, at all times, not less than such amount appropriate for the kind of business to be carried on. The applicant needs to prove to the MFSA that the funds are actually available. <p>Requirements for the scheme of operations are set out in IR 6/2007. This scheme has to describe the applicant's business strategy in detail and include financial projections with appropriate scenarios, including optimistic and pessimistic scenarios. A report of an auditor has to state the adequacy of the company's business plan and appropriateness of assumptions. For schemes including long term business a report on the adequacy of the company's policy of reserving has to be prepared by the company's actuary. An applicant has to submit mainly the following information on these categories:</p> <ul style="list-style-type: none"> • Background to the applicant and business planning: This includes a description of major risks or commitments which the company proposes to cover, and the classes of business to be underwritten. If the applicant is a member of an insurance group or financial conglomerate, a description of the group and information on the company's position in it is needed as well as a description of the significant activities of applicant and the group. • Marketing strategies: A description of the proposed sources of business of insurance (e.g. insurance brokers, agents, direct selling, tied insurance intermediaries and branch offices). • Financial projections and resources: Forecasts are to be attached to the

	<p>application including a P&L (i.e., expected premiums, investment returns, claims, expenses, taxation, dividends), a forecast balance sheet including a solvency statement, and, if applicable, detailed information on long term business.</p> <ul style="list-style-type: none"> • Investment strategy: • Personnel and internal controls, including proposed management structure, responsibilities and reporting lines as well as details of the controls over underwriting, reinsurance/or retrocession, claims, investments, IT, and details of committees to be established. • Business strategy • Outsourcing agreements • Reinsurance/Retrocession arrangements <p>European insurance undertakings are able to operate in Malta without the need of holding an authorisation under the IBA. In lieu of authorisation the MFSA receives a notification from the home supervisory authority with all relevant information. Carrying out unauthorised insurance business is a criminal offence. Apart from police investigations being initiated, the MFSA will publish warnings on its website in the local press.</p> <p>Companies must appoint external auditors and, to be able to run long-term business, also actuaries. Both must fulfill fit and proper requirements at all times. Accountants must be qualified to be an auditor in accordance with the Companies Act and must be registered with the MFSA. Approved actuaries must be a fellow of an institute of actuaries, or hold actuarial qualifications of similar standing of an institute of repute recognized for such purposes by the competent authority. S/he must also hold appropriate practical experience as an actuary; and be authorised by MFSA to act as actuary to a company authorised to carry on long term business.</p>
Assessment	Observed.
Comments	None.
ICP 7	<p>Suitability of persons</p> <p>The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfill their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications.</p>
Description	<p>All qualifying shareholders, controllers and all persons who will effectively direct the business of insurance must be fit and proper. This applies also to senior managers and controllers as compliance officers and money laundering reporting officers. Auditors and actuaries must also meet certain requirements. The affiliated tasks of assessing the fit and proper criteria have been shifted as of 1 January 2010 to the newly established Authorisation Unit (see ICP 6). In day-to-day work checklists are used to facilitate the assessment. Relevant guidance can be found in Art. 8 (1) (d) IBA and IR 2/2007 (plus IR 17/2010 for auditors); the schedule to IR 15/2008 contains the personal questionnaire that is to be filled in by applicant board members and other personnel. Fit and proper information from questionnaires is stored in a database maintained by the Authorisation Unit. The regulatory units (banking/insurance/securities supervision) have reading rights.</p> <p>The assessment itself is mainly based on a weighting of information. In general, the assessment of five criteria - integrity, competence, experience, qualifications and the requirement to be financially sound - feed into an overall assessment. There are only few hard criteria set out in the laws and relevant rules (e.g., No. 6 of the Schedule to IR 2/2007 makes references to bankruptcy and regulatory actions taken). The assessment rather relies on the experience and judgment of the persons responsible for decision making and their knowledge of human nature. In this context it has to be added that</p>

	<p>applicants ordinarily meet MFSA officials prior to the submission of an application or during the application process.</p> <p>External auditors: To act as an approved auditor, a person must hold such a warrant under the Accountancy Profession Act, must have suitable post-qualification experience in the insurance companies accounts and/or the audit of insurance companies accounts for not less than 3 years during the last 7 years or 5 years during the last 10 years; and must have successfully concluded a course on the insurance companies accounts and/or the audit of insurance companies accounts.</p> <p>Actuaries: An actuary would only deemed fit if s/he is a fellow of an institute or faculty of actuaries or holds actuarial qualifications of similar standing of an recognized institute of repute and holds appropriate practical experience as an actuary.</p> <p>Significant owners: Of the five assessment criteria set out in IR 29/2009, the following are mainly relevant for the fit and proper assessment of owners:</p> <ul style="list-style-type: none"> • The reputation of the proposed acquirer, • The reputation and experience of any person who will direct the business as a result of the acquisition, • The financial soundness of the proposed acquirer, • A positive outlook as to compliance to prudential requirements, including maintaining a sufficiently transparent group or conglomerate structure and viable information channels between the supervisory authorities involved. Information must be able to flow freely between the MFSA and the competent supervisory authority of the jurisdiction where the relevant acquirer is domiciled. • Nothing shall indicate that, in connection with the proposed acquisition, money laundering or terrorist financing has been committed or attempted. <p>Apart from these, all information from questionnaires (which need to be renewed if more than 5 years old), databases and background checks is taken into account. In practice MFSA runs extensive background checks to see if documents, certificates and other information from universities, former employers and any other institutions or facilities is actually valid. Channels for the exchange on fit and proper information with other national and overseas authorities are established and functional.</p> <p>There have been no removals of board members or senior staff in the area of insurance supervision (although 2 or 3 removals of intermediaries staff in the last few years).</p>
Assessment	Observed.
Comments	None.
ICP 8.	<p>Changes in control and portfolio transfers</p> <p>The supervisory authority approves or rejects proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer.</p> <p>The supervisory authority approves the portfolio transfer or merger of insurance business.</p>
Description	<p>Changes in control:</p> <p>According to Art. 2 IBA, "control", in relation to a body corporate, is the power to determine the financial and operating policies of the body. A 'qualifying shareholding' is defined as a 'direct or indirect holding in a company which represents ten percent or</p>

	<p>more of the share capital or of the voting rights, or which makes it possible to exercise a significant influence over the management of the company.</p> <p>The provisions of the IBA (Art. 38, 38 A) are closely modeled after the provisions of the EU insurance directives, namely 2002/83/EC, 92/49/EEC, 2005/68/EC and 2007/44/EC. The rationale behind these provisions is to trigger, under specified conditions, information obligations for undertakings and enable the MFSA to take action only if necessary. Undertakings have to notify the MFSA if they have decided to</p> <ul style="list-style-type: none"> • acquire, directly or indirectly, a qualifying shareholding in an authorised company; • increase, directly or indirectly, an existing shareholding which is not a qualifying shareholding so as to cause it to become a qualifying shareholding in an authorised company; or • further increase, directly or indirectly, such qualifying shareholding in an authorised company as a result of which the proportion of the voting rights or of the capital held would reach or exceed twenty per centum, thirty per centum or fifty per centum or so that the authorised company would become its subsidiary. <p>Taking any such action without prior notification to the MFSA may result, <i>inter alia</i>, in these actions being declared as void and of no effect.</p> <p>IR 29/2009 provides the assessment criteria due to which proposals to acquire or increase a significant interest in an insurer can be refused (in this respect, reference is made to the five criteria mentioned in ICP 7). Proposals for changes in control are processed by the MFSA's Authorisation Unit.</p> <p>Portfolio transfer:</p> <p>The MFSA is the competent authority to approve schemes which involve the transfer of all rights and obligations, or the transfer of the whole or part of long term business (sc. life, permanent health and related insurance classes as defined in the Second Schedule of the IBA) of an insurance undertaking. Criteria are set out in Art. 33 et seq. IBA and include that the transferee must be properly authorised and possess the required solvency margin. Although the issue of consumer protection is not mentioned explicitly in this context, the MFSA is committed to act in line with its supervisory goals set out in Art. 4 MFSA Act (see ICP 2).</p> <p>An obligation to obtain a permit is triggered with regard to general business, where a transfer of a portfolio affects all rights and obligations or general business of such descriptions as may be specified in the scheme (in a case where only part of the business of the company is being transferred (Art. 33 (1) IBA and in long-term business, where a transfer involves the whole or part of the portfolio (Art. 35 (1) IBA).</p> <p>The transferor of a portfolio is requested to announce the proposed scheme in advance in local newspapers (or newspapers of the country of commitment, if applicable) and inform every policyholder in writing of the particulars of the proposed transfer. A consent of policyholders is not required. Upon notification, policyholders may make written representations to the MFSA in the case of financial business and the Financial Services Tribunal in relation to any long term business.</p> <p>The MFSA dealt with 9 portfolio transfers since 2003. In 8 cases transfers were made to an undertaking domiciled in Malta; in 1 case a portfolio was transferred to an undertaking outside of Malta. All transfers included general business. No problems were observed during the process.</p> <p>Applications for portfolio transfers are handled by IPSU staff.</p>
Assessment	Observed.
Comments	None.
ICP 9	Corporate governance

	The corporate governance framework recognizes and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards.
Description	<p>Directors, controllers and managers are required to manage the company in a sound and prudent manner (Art. 8(1)(d), and 11(1)(d) IBA). This includes both maintaining adequate accounting and orderly records of its business, internal organisation; and maintaining adequate systems of control of its business and records (LN 158/1999).</p> <p>Board of directors: The MFSA has established guidelines that, <i>inter alia</i>, are meant to support good governance within the Maltese financial sector ("Corporate Governance Guidelines for Public Interest Companies"). A public interest company means, <i>inter alia</i>, regulated companies. According to the Guidelines, such regulated companies shall be companies authorised to provide a financial or a utility service, thus comprising insurance undertakings.</p> <p>The Guidelines cover topics as the responsibilities of the board collectively and those of the chairman and directors, and are currently respected on a best practice basis. No. 4.1, 4.2 provide that, while the board may delegate authority to management in an unequivocal manner, it remains responsible for monitoring effectively the implementation of strategy and policy by management.</p> <p>It is up to the board to define the company's strategy, policies, management performance criteria and business policies. It also has to continuously assess and monitor the company's present and future operations, opportunities, threats and risks (No. 4.4).</p> <p>No. 8 provides that conflicts of interest, as a general rule, should be avoided and, if they arise, be disclosed to the board in full and in time. No. 9 of the Guidelines stipulates adherence to good ethical standards. In addition, provisions of the Companies Act are applicable, of which art. 136A sets out general rules on conflicts of interest. Art. 144 CA states in particular that loans or guarantees of any kind to directors of a company are prohibited unless approved at a general meeting, as well as e.g. compensations to directors for loss of office.</p> <p>Special Committees: Only investment committees must be established (IR 6/2007, App. III) under Maltese law. Some of the supervised insurance undertakings have established other committees (audit committees, remuneration committees, compliance committees, risk management committees) without being obliged to do so. The existence of such committees must be indicated at application stage; changes are followed up during on-site inspections.</p> <p>Remuneration policy: Board minutes, internal policies, staff files and contracts of employment are subject to investigation during on-site visits. Remuneration issues are not materially addressed in the mentioned Guideline or other applicable rules and regulations.</p> <p>Compliance officers: Local insurers must appoint a compliance officer to oversee observance by the company and its staff with the laws and required standards of business conduct (IR 6/2007, App. I). Breaches in compliance must be brought to the attention of the board of directors, possibly also to the MFSA. Compliance officers must have a good reputation and profound experience and are subject to a routine suitability test.</p> <p>The above mentioned principles apply accordingly to money laundering reporting officers (IR 6/2007, App. II), who must be appointed by companies which run long term business or business of affiliated insurance. (Regulation 15 (3) Prevention of Money Laundering and Funding of Terrorism, 2008)</p>

	<p>Actuaries:</p> <p>Companies which run long-term insurance risks must appoint an approved actuary (Art. 23 IBA) who must have profound actuarial experience (see ICP 7). Actuaries file a report at the end of the financial year, which shall include a valuation of the liabilities of the company attributable to its long term business and a determination of any excess over those liabilities of the assets representing the fund or funds maintained by the company in respect of that business. Actuarial reports are also to be submitted on request of the MFSA.</p> <p>On the engagement of an appointed actuary, a declaration from the board and the actuary is obtained confirming that s/he shall have direct access to the board of directors so that s/he is in a position to advise them of any change of policy or action which may be necessary. The appointed actuary shall be consulted before the board makes any decision on the distribution of profits to policyholders or shareholders.</p> <p>In addition, if in the course of his/her duties an actuary becomes aware of any matters which may have a serious adverse effect on policyholders, the actuary should bring the matter to the attention of the company's management or if circumstances so warrant directly to the MFSA. It has only happened once in the last years that such information was revealed to the MFSA that way.</p>
Assessment	Largely observed.
Comments	<p>Regarding the setup of special committees, a company has no obligation to inform the authority of changes in the company setup once it has been authorised. Given the current intervals of on-site inspections (see ICP 13), the MFSA may not necessarily be aware of changes in companies' decision structures for a longer time.</p> <p>Regarding remuneration policies, no principles seem to have been established, e.g. in order to prompting companies to set incentives right, preferably in accordance with the G 20 resolutions and the subsequent FSB Principles for Sound Compensation Practices (and succeeding implementation standards) (April/Sept. 2009). The Corporate Governance Guidelines need to set, to some extent, qualitative standards.</p>
ICP 10	<p>Internal control</p> <p>The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations.</p>
Description	<p>Undertakings should have in place an appropriate and effective internal control environment to ensure that they are managed and controlled in a sound and prudent manner (IR 27/2009). The Rule, which updated IR 27/2005, sets out general guidance for the different components of a risk management system and for their interaction. The system affects the compliance function, risk identification/ evaluation/ management function, management information systems, human resources management/training, internal audit function, audit committees, business planning/strategy, continuity and contingency planning, accounting and record-keeping controls, segregation of duties, safeguarding controls, actuarial reports, and guidance on some further issues. The Rule is legally non-binding, but provides a guidance for the company in meeting the expectations of the Authority in directing its business and affairs (IR 27/2009, 3 (2)).</p> <p>Risk management system:</p> <p>The Rule also requires that each company should take steps to ensure that it has in place and applies internal controls in order to prudently manage and control the significant risks. The board of directors is responsible for establishing and reviewing of such controls. The system shall include controls for identifying, assessing and evaluating, on an on-going basis, the significant risks across all hierarchy levels, operational processes and functional areas and their probability and potential impact on the company. Risk assessment should include a quantitative assessment (e.g. stress tests etc.) for a range of</p>

	<p>adverse scenarios and qualitative analysis (see ICP 23 including comments). Each company needs to develop, maintain and utilise an effective comprehensive management information system as a part of a proper risk management in order that sufficient, timely and relevant information may be produced.</p> <p>For the purpose of managing and controlling the risks, appropriate controls relating to risk mitigation and risk transfer arrangements and the establishment of contingency plans are recommended. In particular, certain risk tolerances limits and resilience strategies are expected to be established and regularly reviewed.</p> <p>Internal audit: IR 27/2009 (Part E) recommends insurance undertakings to establish an internal audit mechanism. It is requested that internal audit shall include an examination of the compliance of the activities of the company with all its internal strategies, processes and reporting procedures and an evaluation of whether the internal control systems of the company remain sufficient and appropriate for its business. To achieve this, IR 27/2009 requests, <i>inter alia</i>, that internal audit units must have appropriate independence, access to all company units and outsourced functions, direct reporting lines to the board of directors, and be equipped with appropriately trained staff.</p> <p>External audit, actuarial and compliance functions: The external audit and actuarial functions are regulated by the IBA and IR 27/2009 and the compliance function is regulated by IR 27/2009. The IBA establishes the existence of an audit function for prudential purposes, namely to assess the financial statements of undertakings, and for the purpose of assessing compliance with the IBA and regulations and rules thereunder. The board of directors should assure that all concerns raised by external auditors are followed up by senior management (Schedule to IR 27/2009, Art. 5). A further joint between company and external auditor, although not obligatory, is an audit committee.</p> <p>An approved actuary who carries out the work (described under ICP 9) needs to properly understand the laws, regulations and internal control procedures and how they might influence his analysis. If a situation arises which would have a serious adverse effect upon insured or policyholders, s/he shall immediately inform the MFSA through the company's management, or directly, if necessary.</p> <p>Furthermore, IR 27/2009 requests that a compliance function, if established, shall be equipped with an appropriate number of competent staff who are sufficiently independent to perform their duties objectively. It shall be adequately resourced and shall have unrestricted access to the company's relevant records.</p>
Assessment	Partly observed.
Comments	<p>Recommendations and general guidance for the internal audit function have been established in 2005 and were last updated in 2009. IR 27/2009, Part E, in so far mirrors the requirements of ICP 10. However, an internal audit function is mandatory under ICP 10.</p> <p>Supervision of undertakings should be stronger with regard to their internal audit function. It should extend to the planning of internal audits and may use them as a possible starting point (time intervals, scope, units/functions that are subject to the audits). Internal audit should strictly focus on ensuring operability of the internal controls system. Supervision needs to honour this fact and, in addition, observe that internal audit units do not have to perform tasks that lie with units dealing with application development or business organisation.</p> <p>When deficiencies in the area of internal audits are stated (normally during on-site inspections), they need to be communicated consequently to the undertaking and be followed up in the wake of the inspection (see also ICP 13).</p> <p>The recommendations comprised in the Rule are often very general. This requires that supervision must be even stronger and intensive, mainly with regard to on-site inspections (see ICP 13).</p>

ICP 11	<p>Market analysis</p> <p>Making use of all available sources, the supervisory authority monitors and analyses all factors that may have an impact on insurers and insurance markets. It draws conclusions and takes action as appropriate.</p>
Description	<p>Regular analyses:</p> <p>Each authorised insurance undertaking must forward to the MFSA statements relating to its business on a regular basis. In principle, these statements are to be filed not later than six months from the end of the calendar year (Art. 32 IBA, Art. 6 IR 12/2007). Data collected from these statements as well as from quarterly reports is being processed by the IPSU, analysed, and then published in suitable form on an aggregated basis.</p> <p>The market analyses are carried out both quantitatively and qualitatively. A quantitative analysis of the market includes general market indicators (premiums, premium growth, claims, balance sheet totals and profitability, changes in asset allocation and solvency covers, new product developments and market share, distribution channels and use of reinsurance). The qualitative analysis includes reporting on general developments observed in the insurance sector, the key drivers of these developments, the main risks and challenges faced by the insurance market, legislative and regulatory developments, and possible other trends and phenomena observed in the market. Reports are published in aggregated form by the MFSA and also by the Malta Insurance Association. In addition, a qualitative report summarising the key trends in the insurance market is published in the annual report of the MFSA.</p> <p>Particular activities</p> <p>The MFSA follows particular developments on the local, European and international market and requests particular reports from undertakings as necessary or orders them to file normal reports in full or in part, as maybe necessary, more often than on a quarterly basis.</p> <p>A comprehensive set of data available from insurance undertakings is regularly collected and processed by the Central Bank for the purpose of financial stability analyses (also by the ECB). This data is also used by the MFSA for supervisory purposes. It enables the authority e.g. to analyse risk exposures broken down to asset classes or debtor countries.</p> <p>A database containing data from all financial sectors has been developed and was being fed with data under the auspices of the Regulatory Development Unit at the time of the audit. It is envisaged to be phased into operation during 2011. This database would allow MFSA to react more quickly and to carry out more ambitious analyses over the different financial sectors.</p> <p>Furthermore, the MFSA and Maltese insurance undertakings have participated in the comprehensive set of studies processed by CEIOPS in preparation for the EU Solvency II Project.</p>
Assessment	Observed.
Comments	None.
ICP 12	<p>Reporting to supervisors and off-site monitoring</p> <p>The supervisory authority receives necessary information to conduct effective off-site monitoring and to evaluate the condition of each insurer as well as the insurance market.</p>
Description	<p>The MFSA has the right to request information and documentation with respect to the business or with respect to any person with whom the supervised undertaking has close links with, and may access or enter premises and offices for this purpose (Art. 29, Art. 8 IBA; Art. 16 MFSA Act). Apart from this, the following sources of information are</p>

	<p>available to the authority by way of regular reporting:</p> <p>Annual accounts: Annual externally-audited accounts are to be submitted to the MFSA within six months after the end of the financial year and will be published (Art. 20 IBA). Together with this, regular actuarial reports from insurers writing long-term business is required (Art. 23 IBA).</p> <p>Insurance business statements: The insurance business statements supplement information from annual accounts by adding a comprehensive set of statistical data. They are to be filed not later than six months from the end of the calendar year (Art. 32 IBA, Art. 6 IR 12/2007) and provide a good part of data used for off-site analysis (see ICP 11). Reported are all kinds of figures necessary for supervisory analysis, including gross and net premiums according to insurance classes and by source of business, claims incurred, claims paid, analyses of premiums, claims and expenses broken down to classes; analyses of provisions according to classes, plus a number of technical parameters necessary for a more in depth analysis of long term business, furthermore tables displaying capital and reserves, own funds and solvency margin calculations for general, long term, and reinsurance business; eventually forms displaying the assets, their composition and valuation, counterparty and concentration exposures. With regard to insurance activities carried out abroad, premiums, claims and commissions are reported broken down to countries, classes, and whether they relate to business generated under the freedom of services or under the right of establishment.</p> <p>Quarterly management accounts: Management accounts are to be submitted to the MFSA, normally on a quarterly basis. They are accompanied by a margin of solvency computation together with a breakdown of the assets covering the technical reserves and also disclose the percentage exposure of each asset to the business amount compared with the maximum exposure allowed by regulations (LN 286/2007). The Statements include information about financial condition and performance of insurers and reinsurers on both a solo and a group-wide basis (LN 287/2007). Most important, parent undertaking solvency margins are to be included (LN 287/2007, Art. 5), along with information on any remedial action taken or planned, if the necessity arises.</p>
Assessment	Observed.
Comments	None.
ICP 13	<p>On-site inspection</p> <p>The supervisory authority carries out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.</p>
Description	<p>Legal framework: The MFSA may appoint one or more inspectors to examine the affairs of an authorised company at any time (Art. 30 IBA). An insurance undertaking is required to provide whatever information is needed in respect to its authorised business or on details of persons with close links (Art. 29 IBA).</p> <p>Inspection methodology: At the end of the year the MFSA sets up an annual plan for the audits in the upcoming year. There are routine inspections and focused inspections which answer to particular developments in supervised entities. In general, the MFSA plans to visit insurance undertakings every 2 – 3 years. Inspections are conducted using own resources and no external specialists. Future planning of on-site inspections will more systematically take into account the risks supervised entities face. The MFSA intends to assign supervisory resources</p>

	<p>according to an own risk assessment of undertakings instead of using a fixed inspection schedule. A system that will produce the internal ratings required to setup such improved inspection methodology is currently in the making.</p> <p>While these steps taken are much appreciated, the assigned rating still reflects the state of transmission until this system has become operable.</p>
Assessment	Partly observed.
Comments	<p>While the legal framework is comprehensive and the MFSA has already taken significant steps to implement more sophisticated techniques of inspection planning, a sample of files and reports of recent inspections led to the conclusion that more resources should be assigned to on-site inspections to make them effective. Reports revealed that few man hours were actually spent on-site, mainly interviewing members of the board. Where the reports stated serious shortcomings, they were not always communicated to the undertaking and followed up properly. Other sometimes crucial shortcomings were communicated, but not followed up.</p> <p>Statements of undertakings suggested that there were sometimes far longer time intervals between inspections than 2 – 3 years.</p> <p>Inspections need to focus and set clear priorities. Inspection reports did not always show these preconditions were observed to a sufficient degree. For instance, the role and tasks of internal audit units often need to be monitored more closely, taking account of their planning and inspection process, their setup, and the fact that their tasks should be separated from tasks of other units to make their work effective and efficient.</p> <p>Rules and guidelines often leave much leeway for undertakings. Only inspections will bring about a clearer picture how undertakings use their scope and what the risks inherent to their approach are. E.g., inspectors not only need to make sure "that procedures exist for the safekeeping and protection of the company's assets" (Art. 7K to the Schedule to IR 27), but also if these procedures suffice as to the substance of Art. 7K.</p> <p>See also ICP 18.</p>
ICP 14	<p>Preventive and corrective measures</p> <p>The supervisory authority takes preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of insurance supervision.</p>
Description	<p>The MFSA is empowered to choose from a comprehensive list of measures, according to the seriousness of a compliance failure of a supervised company. It may, <i>inter alia</i> (Art. 28 IBA),</p> <ul style="list-style-type: none"> • require the company to take such steps as it considers necessary to remedy the matter, • suspend or revoke an authorisation (IBA Art 26), • appoint a person to take charge of the assets of the company to safeguard the interests of policyholders, • appoint a person to assume control of the business of the company, • issue an order for the dissolution and winding up of the company, • appoint a competent person to act as liquidator • require the company to submit a financial recovery plan to ensure a stable financial solvency position. <p>Legislation does not explicitly provide for a progressive escalation of action. However, the MFSA has in practice given proof of its ability to apply the appropriate measures. Practical cases included e.g. a request to file a recovery plan, a decision to have a company file monthly instead of quarterly reports as to their financial position, a freeze of assets, or a revocation of a license.</p> <p>The MFSA also initiates and provides training to employees of insurers. Courses covering a variety of topics (compliance, company law, corporate governance, risk management etc.) are regularly held. The MFSA uses the opportunity to inform participants from the industry about supervisory measures as well as expectations and</p>

	administrative practice of the MFSA This strategy may help to prevent persons committing breaches of legal or supervisory requirements.
Assessment	Observed.
Comments	None.
ICP 15	Enforcement or sanctions The supervisory authority enforces corrective action and, where needed, imposes sanctions based on clear and objective criteria that are publicly disclosed.
Description	<p>The MFSA has a whole range of regulatory powers available, including issuing directions which are appropriate to the particular circumstances (Art. 31A IBA). This power would include the power to ask the insurer to desist from taking certain actions. Compliance to all applicable laws and regulations is checked on an ongoing basis through monitoring of annual accounts, quarterly management accounts, and on-site inspections.</p> <p>Besides, a failure to comply with a formal direction brings a first level administrative penalty.</p> <p>Particular actions:</p> <ul style="list-style-type: none"> • Art. 28 (1) (i) IBA is a general clause and allows to prevent an insurer from issuing new policies. Furthermore, insurers short of the required solvency position are barred from accepting new risks of any kind (Art. 15 IBA). • A transfer of obligations of an insurer could be achieved using the above-mentioned sweeping clause or appoint a person who assumes control of the business and who would bring about the transfer. • An insurer falling short of the required solvency margin must notify the competent authority and correct the deficiency without delay and within 15 days at maximum (Art. 15 IBA). During that time the MFSA may, restrict or prohibit the disposal of the company's assets. • Where the ownership or activities of a subsidiary may jeopardize the financial situation of the insurer, the MFSA may exercise its powers through the regulated parent. An insurer is not considered as conducting its business in a sound and prudent manner if it fails to supervise the activities of a subsidiary undertaking (which may not necessarily be a regulated undertaking) with due care and diligence and without detriment to the company's business. The MFSA may impose a first level administrative penalty and/or suspend or revoke the insurance undertaking's authorisation according to circumstances. • Directors can be disqualified (Art. 320 CA) by the court upon application of the Attorney General, in particular for offences under the CA other than an offence punishable only with a fine, or if the company has become insolvent during their term of service, or if the court finds them to be unfit. Such disqualification order would remain valid for a term from 1 to 15 years and will be delivered to the Registrar of Companies (Art. 400 CA). Applicants must also inform the MFSA of such facts in the case of their (re-)application. Further, directors, senior managers, managing directors or chief executives can be removed from office by serving a notice of objection on the company, which may make representations within one month (Art. 7 of IR 15/2008). • Appropriate supervisory measures shall be taken if a valuation of assets suggests that the solvency position of a subsidiary insurer with head office in Malta of a holding company is jeopardized. If the MFSA is not provided with proper and sufficient information for calculating the parent undertaking solvency margin, the book value of that undertaking in the participating undertaking shall be deducted from the elements eligible for the calculation. Unrealised gains connected with such participation shall not be allowed as an element eligible for the calculation (LN 287, Art. 6).

	<p>Sanctions:</p> <p>There are penalties which are enforceable by prosecution in the courts in Malta and which include monetary fines and imprisonment, and there are administrative penalties which can be imposed by the MFSA without a court hearing (LN 100/2000, Art. 3). The MFSA may fine both individuals and/or companies for breaches set out in regulations (LN 100/2000). Administrative fines reach from € 116.47 (minimum for a Level 1 penalty) to € 93,174.94 (maximum for a Level 3 penalty). Offences are assigned to one of three levels, according to the severity of a breach. In the same way a daily penalty is added for each day during which the infringement continues (Level 1 daily penalty: min. € 11.65; Level 3 daily penalty: max. € 116.47). E.g., a failure of company to maintain a sufficient solvency margin, or also a failure to notify the MFSA of an undertaking falling short of the solvency margin would result in a penalty between € 2,329.37 and € 93,174.94, plus a daily penalty between € 46.59 and € 116.47. On the other hand, a failure of a person to comply with and otherwise give effect to any directive imposed by the MFSA would be a Level 1 penalty (min.: € 116.47; max.: € 582,34, plus a daily penalty between € 11.65 and € 34.94. Final decisions will be made by the Supervisory Council to ensure consistency across all possible cases. Persons affected by administrative sanctions may appeal to the Financial Services Tribunal against the decision.</p> <p>Courts may, for more serious offences, apply sanctions including fines up to € 116,468.67 and imprisonment up to 2 years. Such serious Level 3 Court penalties are e.g. applied in the case of carrying on insurance business where the required authorisation was suspended or revoked.</p> <p>Persons withholding information from the MFSA or providing misleading or wrong information, or providing information not in a timely manner, will also face sanctions ranging from a Level 1 administrative penalty to a Level 3 court penalty.</p> <p>In the last 4 years, the MFSA applied fines against two insurance undertakings (and against several intermediaries). Administrative penalties are published on the MFSA's website, including the names of persons or undertakings concerned, and including the subject of proceedings.</p>
Assessment	Observed.
Comments	Where the law does not provide a particular legal basis, the MFSA would have to fall back on the general clause laid down in Art. 31A IBA (i.e. the right to issue such directives as the MFSA may deem appropriate in the circumstances; any person to whom or to which the notice is given shall obey, comply with and otherwise give effect to any such directive). As the scope well includes all kinds of situations, including those of more serious nature, a Level 1 administrative penalty seems not eligible as a deterrent. The arrangement of sanctions needs to be monitored, and, if practical cases arise, a review might be reasonable.
ICP 16	<p>Winding-up and exit from the market</p> <p>The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines insolvency and establishes the criteria and procedure for dealing with insolvency. In the event of winding-up proceedings, the legal framework gives priority to the protection of policyholders.</p>
Description	<p>Legal framework:</p> <p>An insurer's license is automatically revoked if he is declared bankrupt, goes into liquidation, makes a composition with its creditors or is otherwise dissolved (Art. 25 IBA).</p> <p>The same provision allows the MFSA to revoke a license at its discretion if an insurer</p> <ul style="list-style-type: none"> • suspends payment or is about to suspend payment, • no longer possesses the required own funds

	<ul style="list-style-type: none"> • is likely to become unable to meet its obligations or can no longer be relied upon to fulfil or satisfy its obligations towards insureds, policyholders, creditors or other interested persons <p>Under the Commercial Code, every trader who suspends payment of his debts is in a state of bankruptcy (Art. 477 CC). Every creditor may file for insolvency proceedings. In this case a civil court will appoint one or more curators who will in the end liquidate the business. The revocation of an authorisation shall not prevent persons entrusted by the court from carrying on some of the Maltese insurance undertaking's activities in so far as that is necessary or appropriate for the purposes of winding up. Such activities shall be carried on with the consent and under the supervision of the MFSA (Art. 13 of LN 208/2004). According to that, the MFSA can take all necessary steps to preserve the rights of policyholders, in particular</p> <ul style="list-style-type: none"> • appoint a person to take charge of the assets of the company, for the purposes of safeguarding the interests of policyholders, creditors, shareholders and other interested persons (Art. 28 (I) IBA), • appoint a person to assume control of the business of the company to carry on business or to carry out as the MFSA may direct. • prohibit the free disposal of the assets, if an insurer is likely to dissolve and wind up (Art. 41 II IBA). <p>Besides, an insurer may not assume any new risk of any kind while its margin of solvency is less than required (Art. 15 IBA).</p> <p>Insolvency and winding-up procedures: Maltese proceedings (LN 208/2004) are modelled on European law (Directive 2001/17/EC). The rationale behind the Directive is to avoid an undertaking and its business in other EEA countries being wound up separately and to ensure that claims are treated equally, regardless where the interested persons are domiciled. Consequently, reorganisation measures (i.e. measures intended to preserve or restore the financial situation of an insurance undertaking; CA Art. 327 et seq.) taken by the responsible authority are valid in any EEA country. The most important features for the protection of policyholders and insureds are: Assets of which are prohibited to be freely disposed of shall be available only for meeting the liabilities of the insurance undertaking attributable to its business, and insurance claims shall rank before any other claim against such assets (Art. 11 (I) of LN 208/2004). Together with Art. 41 IBA, laws provide for a privileged ranking for debts and other liabilities arising out of insurance contracts.</p>
Assessment	Observed.
Comments	None.
ICP 17	Group-wide supervision The supervisory authority supervises its insurers on a solo and a group-wide basis.
Description	Regulations in Malta on affiliation with an insurance group or a financial conglomerate are modeled on European law (EU Directives 98/78/EC and 2002/87/EC). Notwithstanding the requirements stated in these Directives, supervisory requirements for solo undertakings prevail. Art. 2 of LN 287/2007 defines the terms relevant for supplementary supervision as follows: <ul style="list-style-type: none"> • An insurance group means an insurance parent undertaking and its related undertakings that are insurance undertakings, reinsurance undertakings, or insurance holding companies. • An insurance holding company means a parent undertaking, the main business of which is to acquire and hold participations in subsidiary undertakings, where those subsidiary undertakings are exclusively or mainly insurers, EEA insurers,

	<p>pure reinsurers, EEA pure reinsurers, non-EEA insurers or non-EEA pure reinsurers, at least one of such subsidiary undertakings being an insurer or a pure reinsurer and which is not a mixed financial holding company in terms of the Financial Conglomerates Regulations (LN 521/2004);</p> <ul style="list-style-type: none"> • A parent undertaking" in relation to an insurer, an EEA insurer, a pure reinsurer or an EEA pure reinsurer, is a parent undertaking of that insurer, EEA insurer, pure reinsurer or EEA pure reinsurer which is either itself an insurance undertaking, a reinsurance undertaking or an insurance holding company. <p>Effective and efficient group-wide supervision is achieved through cooperation in the framework of the Helsinki Protocol and the various Memoranda of Understanding the MFSA has entered into (see ICP 5). The scope of group supervision, in essence, extends to the calculation of an adjusted solvency margin (as described in LN 287/2007, Art. 5 (7) and LN 286/2007, Art. 78, 79) and to the supervision of intra-group transactions according to LN 287/2007. For that purpose, certain activities of insurers domiciled in Malta are to be reported and are monitored by the MFSA, such as loans, guarantees and off-balance-sheet transactions, investments, reinsurance operations, and cost sharing agreements, between members of the group. As to supervision of the group structure, the MFSA requests from an insurer domiciled in Malta information on the relationships with each other member of the insurance group, including the amounts and descriptions of holdings of share capital and voting rights regarding every member of the insurance group.</p> <p>Art. 2 of LN 521/2004 governs affiliation to a financial conglomerate. At least one of the entities in a group must be within the insurance sector and at least one within the banking or investment services sectors. The aggregated activities of the entities within the different financial sectors must be significant as defined by the regulation. A coordinator is appointed by the MFSA and the other involved competent authorities. The coordinator will be responsible for coordination and exercise of supplementary supervision under the mentioned regulation. In particular, the following tasks lie with the coordinator (LN 521/2004, Art. 11):</p> <ul style="list-style-type: none"> • coordination of the gathering and dissemination of relevant or essential information • supervisory overview and assessment of the financial situation of the financial conglomerate and assessment of compliance with the rules on capital adequacy and of risk concentration and intra-group transactions • assessment of its structure, organisation and internal control system • planning and coordination of supervisory activities in ongoing supervision as well as in crisis situations. <p>A regulated entity authorised in Malta identified as forming part of a financial conglomerate must have, adequate risk management processes and internal control mechanisms at the level of the financial conglomerate, including sound administrative and accounting procedures. Such undertakings must also maintain own funds at the level of the financial conglomerate. For the calculation, the multiple use of elements eligible for the calculation of own funds at the level of the financial conglomerate as well as any inappropriate intra-group creation of own funds is not permissible (LN 521/2004, No. I (2) of the First Schedule).</p>
Assessment	Observed.
Comments	<p>One insurance group underwent a process of restructuring and was in a process of dissolving its group structure at the time of the audit. Apart from that, the MFSA is not a lead supervisor in terms of paragraph 2.2, subparagraph 8 of the "Helsinki Protocol" of 11th May, 2000 (see ICP 5), not the authority responsible for supplementary supervision in terms of Art. 4 (I) of the EU Directive 98/78/EC for any other insurance group, and not a coordinator under the Directive 2002/87/EC. On the other hand,</p>

	various undertakings belonging to insurance or financial groups domiciled outside Malta and in the EEA or elsewhere are active on the local market.
ICP 18	Risk assessment and management The supervisory authority requires insurers to recognize the range of risks that they face and to assess and manage them effectively.
Description	<p>Laws, regulations and rules require that insurers apply internal controls in order to prudently manage and control the significant risks to which the company is exposed. The significant business activities in which the company is engaged must commensurate with the nature, scale and complexity of its business (Schedule to IR 27/2009, Art. 7B). Risks insurers usually face (underwriting risk, market risk, credit risk, operational risk, liquidity risk, concentration risk) are explicitly mentioned and explained (IR 6/2007, Art. 5B8).</p> <p>Risks must be identified and managed by undertakings. The most relevant regulations on risk management are:</p> <ul style="list-style-type: none"> • LN 158/1999 ("Criteria of sound and prudent management") • IR 6/2007 ("Schemes of Operations"), in particular B.8 • IR 27/2009 ("Insurers' Internal Controls") and in particular its Schedule, • The "Corporate Governance Guidelines for Public Interest Companies" issued by the MFSA. <p>These general regulations and guidelines leave a wide scope for undertakings to fill. They almost do not establish hard criteria (however, there are some limits for assets, e.g. regarding counterparty exposures (Schedule 7 to LN 286/2007)). The MFSA is mainly involved when a scheme of operations is submitted for approval, and in the context of on-site inspections (see ICP 13).</p> <p>Some undertakings have voluntarily started to use more sophisticated tools of risk assessment, like scenario calculations and yearly stress tests. Life undertakings also participated in the Solvency II Project QIS 4 study, which included catastrophic risk scenarios.</p>
Assessment	Largely observed.
Comments	The MFSA and most market participants have started to move from a compliance oriented view and supervision to a more risk based approach. Although encouraging steps have been taken in undertakings and at the MFSA, the Authority will need probably 1 – 2 years more time to reach a sufficient degree of sophistication in supervision of risk assessment and management of insurance undertakings. At present, there are few tools that allow for consistent quantitative measurements of the most relevant risks, e.g. of the assets of an undertaking, during the financial year. In combination with the fact that on-site inspections yet need to be deepened and broadened, there may arise an information gap that could, on a marketplace with participants showing more risk appetite and applying more aggressive investment policies, lead to unpleasant situations. The fact that market participants seem to act with great caution regarding investments, e.g. derivatives, but also with a view to the lines of business they underwrite and products that they offer (this revealed from contacts with market players) may be comforting for the time being.
ICP 19	Insurance activity Since insurance is a risk taking activity, the supervisory authority requires insurers to evaluate and manage the risks that they underwrite, in particular through reinsurance, and to have the tools to establish an adequate level of premiums.
Description	Insurers file a scheme of operations at application stage which must establish

	<p>appropriate business strategies, including underwriting, general pricing and market penetration (IR 6/2007, Art. 5A.A. (a)). The declarations to the application form for authorisation of insurance companies require insurers to inform the MFSA of any material changes to the application.</p> <p>In addition, the routine on-site inspection programme includes the review of rating and underwriting guidelines and practices, proposal forms, policy documents and renewal notices as well as interviews with managers and directors. Claims Managers are interviewed about claims handling, reserving, settling, and repudiating; Financial Controllers about claims related expenses. To see if premiums are set appropriately, the MFSA may review rating methodologies on the grounds of information delivered to it under article 29 IBA. For long-term business, actuaries have to include in their report a statement based on reasonable actuarial assumptions that premiums for new business are sufficient (LN 286/2007, Art. 65 (2)).</p> <p>Risk mitigation:</p> <p>Regarding reinsurance, comprehensive information on the proposed programme is to be submitted, including:</p> <ul style="list-style-type: none"> • details of the applicant's maximum retention per risk or event after all reinsurance (or retrocession) ceded • details of the principal reinsurers • the description relating the reinsurance back to the original business being carried on by the applicant • where a significant proportion of the programme is to be ceded to a single reinsurance company (or retrocessionaires) or group, additional information should be given as to why this is considered to be appropriate, including details of the security provided and the financial adequacy • any statistics or risk profiles showing the maximum catastrophe exposure for the applicant and the net retained exposure. <p>Undertakings are required, <i>inter alia</i>, to manage prudently their accumulated credit exposures to individual reinsurers (IR 6/2007, Annex A paragraph A4 to Appendix III). A good rating (S&P/AM Best: A-) is expected from reinsurance companies with which direct insurers contract, otherwise such an arrangement would not be taken into consideration for solvency purposes. This practice has already been applied from time to time, but is – after commencement of the Directive 2005/68/EC on Reinsurance - no longer applicable to reinsurance companies domiciled within the EU.</p> <p>After application, MFSA checks the conduct of the reinsurance programme and cash flows between direct insurance and reinsurance undertakings for abnormalities. Prior to reinsurance renewals, the MFSA checks for changes in reinsurance strategy and requests details together with risk profiles and catastrophe PML evaluations as the case may be. Undertakings are to submit an extract of the relevant board minutes showing the board's approval of the reinsurance programme. These investigations are carried out off-site, together with analyses of reported figures (Forms 1A – 4B (Outward Reinsurance Business) of Part I Part 1 of IR 12/2007), and verified during on-site inspections.</p> <p>The forms allow for analysis of ceded premiums; debts, reserves, and IBNR claims for general and long-term business, and for proportional as well as non-proportional types of reinsurance contracts.</p>
Assessment	Observed.
Comments	<p>The effectiveness of these steps depends to a large degree on inspections on-site which produce the necessary information and findings. See ICP 13.</p> <p>The obligation "to inform the MFSA of any material changes" in the wake of the authorisation process may pose a legal uncertainty for undertakings in terms of what is considered to be material.</p>

ICP 20	<p>Liabilities</p> <p>The supervisory authority requires insurers to comply with standards for establishing adequate technical provisions and other liabilities, and making allowance for reinsurance recoverables. The supervisory authority has both the authority and the ability to assess the adequacy of the technical provisions and to require that these provisions be increased, if necessary.</p>
Description	<p>Insurers are required to establish and maintain adequate technical provisions, including mathematical provisions (Art. 17 (1) IBA). The amount of liabilities of an insurer shall be determined in accordance with generally accepted accounting concepts, bases and policies. All contingent and prospective liabilities shall be taken into account (LN 286/2007, Art. 58 (2)). The amount of technical provisions must at all times be sufficient to cover any liabilities arising out of contracts of insurance as far as can reasonably be foreseen. The following kinds of provisions are particularly mentioned and explained, along with standards for establishing technical provisions and other liabilities (First Schedule to LN 103/2000):</p> <ul style="list-style-type: none"> • Provision for unearned premiums: comprises the amount representing that part of gross premiums written which is estimated to be earned in the following financial year or in subsequent financial years. • Provision for unexpired risks: Shall be computed on the basis of claims and administrative expenses likely to arise after the end of the financial year from contracts concluded before that date, in so far as their estimated value exceeds the provision for unearned premiums and any premiums receivable under those contracts. • Long term business provision: This item shall comprise the actuarially estimated value of the company's liabilities, including bonuses already declared and after deducting the actuarial value of future premiums. Computations shall be made annually by an approved actuary, on the basis of recognized actuarial methods. The determination of the amount of long term liabilities shall make proper provision for all liabilities on prudent assumptions that shall include appropriate margins for adverse deviation of the relevant factors (LN 286/2007, Art. 63 (1)). • Provision for bonuses and rebates: Amounts intended for policyholders or contract beneficiaries by way of bonuses and rebates to the extent that such amounts have not been credited to policyholders. Includes all amounts paid or payable to policyholders or provided for their benefit, including amounts used to increase technical provisions or applied to the reduction of future premiums, to the extent that such amounts represent an allocation of surplus. Rebates shall comprise such amounts to the extent that they represent a partial refund of premiums resulting from the experience of individual contracts. • Provisions for claims outstanding (General business): Total estimated ultimate cost to the company of settling all claims arising from events which have occurred up to the end of the financial year (including, in the case of general business, IBNR claims) less amounts already paid in respect of such claims. All claims settlement costs (whether direct or indirect) shall be included in the calculation of the provision. • Equalization reserves: The amount required to be set aside by the company to equalize fluctuations in loss ratios in future years or to provide for special risks. <p>Other provisions may be established as well.</p> <p>All technical provisions must be sufficient and are, in long-term business, under scrutiny of the appointed actuary. The MFSA has the powers to issue specific directives if an insurer needs to increase its technical provisions (Art. 31A IBA).</p> <p>Methods and assumptions for assessing technical provisions are provided, e.g. the use of statistical methods instead of a separate computation for each contract. or the use of</p>

	<p>implicit discounting or deductions (No. 42 – 50 of the First Schedule of LN 103/2000). The adequacy of technical provisions is monitored through viewing random selections of files during on-site inspections and through both the internal and external auditors of the insurance companies.</p> <p>Regulations requires that Reinsurance amounts shall comprise the actual or estimated amounts which, under contractual reinsurance arrangements, are deducted from the gross amounts of technical provisions (Note 12 to article 15 of the First Schedule to LN 103/2000). The value of any rights of the insurer under a contract of reinsurance shall be the amount which can reasonably be expected to be recovered (LN 286/2007, Art. 45(5)). Accounts must be drawn up according to IFRS rules.</p> <p>Some of the market participants make use of stress tests to evaluate the development of key operating figures in adverse scenarios (see ICP 18, 23).</p>
Assessment	Observed.
Comments	None.
ICP 21	<p>Investments</p> <p>The supervisory authority requires insurers to comply with standards on investment activities. These standards include requirements on investment policy, asset mix, valuation, diversification, asset-liability matching, and risk management.</p>
Description	<p>An insurer must hold at all times unencumbered assets equal to the value of its technical provisions and after making adequate provision for all its other liabilities (Art. 17 (2) IBA).</p> <p>In 2007, the MFSA changed the applicable regulations so that valuation and asset exposure rules will apply solely to assets covering technical provisions in line with EU Directives. The previous rules applied to valuation and asset exposure rules on a total balance sheet basis.</p> <p>General strategy:</p> <p>On application, undertakings must submit a description of their proposed investment strategy, including details of the diversification, currency and types of investments which are expected to represent the insurance or reinsurance funds, the estimated proportion which will be represented by each type of investment and the arrangements for the maintenance of adequate liquidity. This representation should provide reasons for the chosen investment methodology with full details of any proposed use of derivatives or other nonstandard investments. Undertakings must inform the MFSA of any material changes of that strategy and other relevant arrangements (see ICP 19).</p> <p>Governance:</p> <p>Every authorised company shall have an investment committee. It forms the company's investment policy and issues guidelines to management. The committee ensures that investments are made according to the standards of safety, yield and marketability, and that they are sufficiently diversified and adequately spread in accordance with applicable regulations. It shall from time to time consider the determination of the strategic asset allocation, the establishment of assets by geographical area, markets, sectors, counterparties and currencies. The committee must include at least one independent non-executive person with adequate qualifications and experience in investment management.</p> <p>However, ultimate responsibility remains with the Board of Directors (see ICP 10). In order to be able to assume its responsibility, the Board should receive investment reports at an appropriate frequency with appropriate details as to the investment activities and reports (Appendix III, Paragraph 12 to IR 6/2007).</p> <p>To establish good governance within the investment department and according to the nature, scale and complexity of its business, an undertaking must have in place effective</p>

	<p>internal controls respecting the segregation of duties (Art. 7J of the Schedule of IR 27/2009), also with a view to the work of front and back office.</p> <p>Limitations: There are some concrete limitations in terms of mixture and diversification of assets in Maltese Rules and Regulations:</p> <ul style="list-style-type: none"> • Where an undertaking's liabilities in any particular currency exceed 5% of its total liabilities, the insurer shall hold sufficient assets in that currency to cover at least 80% of the insurer's liabilities in that currency (LN 286/2007, Art. 18 (1)). • The permitted counterparty exposure is, according to the legal nature of the counterparty, limited to 5%, 10%, 15%, or 30% (No. 4 of the Seventh Schedule of LN 286/2007). Calculation methods are likewise provided. A number of further limits is provided (Part II of the Seventh Schedule). • For instance, in general business investments in real estate are limited to 20%, in long-term business to 30%. - All debts due or to become due from an approved credit institution must not exceed 30%. • The amount by which the insurer is exposed to assets in excess of the permitted limit for assets of that description will not be taken in account for solvency purposes (LN 286/2007, Art. 54). <p>Safekeeping of assets: Internal controls must enable the undertaking to verify that assets are safeguarded (Art. 3(1)(iii) of IR 27/2009). There are procedures required for the safekeeping and protection of the company's assets and those of its customers or other parties held in physical custody or on a book based system of the company (Art. 7K to the Schedule to IR 27/2009). These very general requirements are subject to investigation during on-site inspections (see ICP 13).</p> <p>Audit functions: Undertakings must appoint an external auditor whose duty is to report on the financial statements of the company examined by him and on the financial statements prepared by the company (Art. 21 IBA). The external auditor is bound to report on whether the authorised company has complied with all applicable laws, rules and regulations. Consequently, the audit includes compliance of investment policies with rules and regulations, compliance with limits, valuation of assets, and in this context the accurateness of calculations. An undertaking should have an internal audit function which would also embrace audits of the investment functions and cooperation of responsible units within the entity (in particular, management, investment committee, board, and, if applicable, audit committee) (see ICP 10). The efficiency of these functions and their cooperation is subject to on-site investigations of and this requirement (and subsidiary requirements – e.g. effective communications, reactions of the Board of Directors by inspecting minutes) is checked during the on-site inspections. See also ICP 10, 12.</p>
Assessment	Largely observed.
Comments	<p>The requirements on safekeeping of assets are very thin and do not provide much guidance at all as to what arrangements may be considered sufficient by the MFSA. In view of the presently limited effectiveness of on-site inspections and of the fact that in a serious situation policyholders may suffer from the limited scope of the Protection and Compensation Fund (see ICP 25), a certain risk that could materialize in an economically adverse situation could not be denied.</p> <p>Considering that the ICP Principles and Methodology, October 2003, only state in general that requirements regarding investment management must address the</p>

	<p>safekeeping of assets (ICP 21, essential criteria – (a)), and further mention that risk management systems shall include the risk of "failure in safe keeping of assets (including the risk of inadequate custodial agreements" (l.c., (d)), supervisors are called on to fill this range and develop sufficiently detailed requirements for market participants, also in order to establish more legal certainty. Such requirements might, for instance, stipulate that:</p> <p>Assets being held separately:</p> <ul style="list-style-type: none"> • assets (other than cash) should be kept separate and distinct from the assets of the Custodian, • the Custodian's books of account must identify these assets clearly, <p>Custodian's governance is flawless:</p> <ul style="list-style-type: none"> • undertakings shall have a demonstrable process implemented to monitor and assess the performance of the Custodian on an on-going basis, • undertakings shall regularly check and seek information from the Custodian as to its internal controls, organisation, staffing capabilities, administrative resources and arrangements for holding the assets. <p>Financial position:</p> <ul style="list-style-type: none"> • undertakings satisfy themselves that Custodians have financial strength to fully and in a timely manner meet their liabilities. In considering the Custodian's financial strength, undertakings should consider insurance or guarantee arrangements, and / or capital.
ICP 22	<p>Derivatives and similar commitments</p> <p>The supervisory authority requires insurers to comply with standards on the use of derivatives and similar commitments. These standards address restrictions in their use and disclosure requirements, as well as internal controls and monitoring of the related positions.</p>
Description	<p>Supervisory requirements:</p> <p>General rules set a framework for the use of derivatives which relates first and foremost to risk management and investment policy. Both the authorised company and its investment managers shall implement controls over derivatives and other complex investment instruments adequate to ensure that risks are properly assessed, regularly reviewed in the light of changing market conditions and experience and consistent with the overall investment strategy (Paragraph 10 to Annex III of IR 6/2007 and No. 1.c., Annex C). Directors must satisfy themselves, <i>inter alia</i>, that managers:</p> <ul style="list-style-type: none"> • are suitably qualified and competent to manage the range and type of transactions being undertaken and understand the nature of the exposure, including both counterparty and market risk, • have documented clearly the objectives and policies for the use of derivatives contracts and monitor, to ensure that their use is in line with those objectives and policies, • new types of instruments must not be dealt in without due prior consideration, • define appropriate limits on exposures or volumes. <p>Tighter management requirements are established by the Rule with a view to the potentially increased risk. The Rule calls for systems adequate to prevent exposure to unacceptable exceptional volatile risks, and which trigger a strategy to hedge or close out a transaction whenever adverse developments threaten the company's solvency position.</p> <p>There is no legal limitation in laws, regulations and rules as to the purpose for which derivatives may be used (although Art. 52 (2) of LN 286/2007 explicitly mentions the purposes of reduction of investment risks or efficient portfolio management), neither are there absolute limits for investment in derivatives and other instruments.</p>

	<p>Reporting: Valuation and accounting rules for financial instruments are set out in Art. 52, 53 of LN 286/2007 for listed and unlisted instruments and Art. 41A, 41B, 41C of LN 103/2000. Both regulations were introduced or materially updated several times after the 2003 audit (last amended in 2008). Derivatives and financial instruments are shown in quarterly management accounts.</p>
Assessment	Observed.
Comments	<p>For the time being, market participants have adopted a very cautious and conservative investment strategy, and make very little or no use of derivatives and financial instruments. This is in line with most companies' limited appetite for more complex risks like longevity and long-ranging obligations to pay guaranteed interests. Taking on such risks to a significant amount would imply sophisticated systems of risk management and – as a part of this – an asset liability management system including appropriate strategies for hedging.</p> <p>With Malta acceding the Euro area, the demand to hedge currency risks has disappeared to a large part.</p>
ICP 23	<p>Capital adequacy and solvency The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses.</p>
Description	<p>The solvency framework in Malta is closely modeled on EU requirements (Directive 2002/83/EC, 92/49/EEC, 73/239 EEC and 98/78/EC). A number of important features for solvency supervision is addressed by Maltese legislation in the same way:</p> <p>Liabilities and technical provisions: The Regulations provide for the determination and reporting of insurance liabilities so as to ensure that the accounted and reported technical provisions are adequate, complete and not underestimated. The regulations provide for detailed methods to calculate the several components of technical provisions with specific provisions for long term business liabilities particularly with respect to mathematical reserves and the role of actuaries (See also ICP 20).</p> <p>Capital adequacy and its supervision: The very concept of solvency margin as computed in terms of Schedules 1 to 4 of the Insurance Business (Assets and Liabilities) Regulations, 2007 is geared towards ensuring that insurance undertakings have some level of protection against unexpected losses. Expected/foreseeable losses are accounted for in technical provisions. As well as maintaining the EU capital adequacy requirements outlined in the foregoing paragraphs, the MFSA requires a buffer of 50% in excess of the required margin of solvency except when the required margin of solvency is the minimum guarantee fund. This requirement is not enshrined in the law but is applied by way of practice.</p> <p>Control levels: The MFSA, where responsible for prudential supervision, monitors the solvency margin. In the case of an undertaking domiciled outside Malta and authorised by the MFSA, the Malta solvency margin or the EEA solvency margin must be maintained (Art. 14 IBA). The two latter positions refer to the assets and liabilities of the business carried on in Malta or in the EU/EEA.</p> <p>The solvency margin is monitored and reviewed through quarterly management accounts. When the solvency margin comes close to the minimum required or/and a situation that raises concern arises, the submission requirement may be tightened and trigger monthly reporting. These measures have already been applied in supervision.</p>

	<p>The company must submit to the MFSA a financial restoration plan and give effect to the plan immediately once it has been approved.</p> <p>In case of a shortfall of the minimum solvency margin the undertaking must notify the MFSA and remedy this situation without delay and at maximum fifteen days from the day of such notification. The shortfall will impact the company's business:</p> <ul style="list-style-type: none"> • During this time it may not assume any new risks. • Free disposal of the assets may be restricted or prohibited (only of the assets in Malta if the company is authorised outside Malta). • Solvency certificates – precondition for taking up business in other EU/EEA Member States – will not be issued. <p>A minimum guarantee fund under Art. 16 IBA must be kept according to the Fourth Schedule to LN 286/2007. The fund available for long-term insurers shall be € 3.5m (€ 2.3m or € 3.5m for general business, depending on whether classes 10 – 15 are included). Numerous exceptions exist, e.g. for small mutuals and similar undertakings ("non-directive insurers"), where the guarantee fund may be, depending on the kind of business, as low as € 200k. All in all, regulations for the guarantee fund exceed considerably the requirements set by the EU Directive 2002/83/EC.</p> <p>Inflation of capital:</p> <p>Methods for elimination of multiple use of solvency margin elements on solo level or of creation of capital in a group solvency calculation have been provided for (LN 286/2007, Art. 10 (7); First Schedule of LN 521/2004, which provides methods that may be applied with the approval of the MFSA).</p> <p>Forward looking analyses:</p> <p>Risk assessments should include a quantitative assessment (e.g. stress tests etc.) for a range of adverse scenarios and qualitative analysis (Art. 7B (a) of the Schedule to IR 27/2009). The provision leaves it to the companies to determine for what purposes and to what extent such stress tests shall be conducted, and whether they should include the asset side to assess the sensitivity of an investment portfolio, or whether they should (also) include the liability side to monitor how future obligations develop under adverse scenarios, or both. See also ICP 18.</p>
Assessment	Observed.
Comments	<p>On average, undertakings maintain sufficiently high solvency levels at present.</p> <p>The use of stress tests is becoming more common over time, locally and internationally. A supervisory policy fostering a more risk oriented culture would see to it that such tools are generally applied and set scenarios and standards for this purpose. See also ICP 20 and 21.</p>
ICP 24	<p>Intermediaries</p> <p>The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries.</p>
Description	<p>Intermediaries (insurance brokers, insurance agents and insurance managers) are required to be registered or enrolled (Art. 13 IIA). Tied insurance intermediaries are required to be registered (Art. 37 IIA).</p> <p>Intermediaries domiciled outside Malta, but within the EU/EEA area, benefit from facilitations under the IMD and may offer services in Malta under the right of establishment or freedom of services. LN 35/2005 reflects the passporting procedures under the IMD.</p> <p>The MFSA carries out direct (and indirect) supervision over intermediaries and applies the supervisory framework for insurance undertakings, <i>mutatis mutandis</i>, in the same way. The Authorisation Unit issues licences, runs fit and proper tests, and takes care of notifications under the IMD. The IPSU is responsible for off-site supervision, and</p>

	<p>performs on-site inspections of intermediaries as well.</p> <p>Qualification: Intermediaries must be of good repute and have experience in the business of insurance and/or insurance intermediation, e.g. have carried on intermediaries activities for a period of not less than seven years during the last ten years (IIR 9/2007, Art. 5 (2) (b)) or comparable experience. Tied intermediaries domiciled in Malta must, <i>inter alia</i>, prove that they have successfully completed a course organised by an institution or by a company concerned for tied insurance intermediaries according to IIR 17/2007, Art. 5.</p> <p>Sanctions: The MFSA has the power to apply direct sanctions and, if necessary, strike off the name of an intermediary from the register or list (Arts 15 – 19 and 40 – 41 IIA). The system of sanctions for insurance undertakings applies in a similar way (see ICP 15). Sanctions are published on the website of the Authority. In 2010 (as of 1 September), 3 penalties were imposed on insurance intermediaries in 2010 and 6 penalties were applied in 2009, however all of them being as low as € 116.47 or € 232.94.</p> <p>Safeguards for consumers: Legal safeguards are in place to ensure that consumers are protected during the process of insurance intermediation, including the debit of premiums. Monies held by an insurance intermediary in a fiduciary capacity must be kept in separate accounts (IIR 13/2007, IIR 7/2007). No person shall access these accounts in respect of a claim or right against an enrolled person until all proper claims arising out of insurance intermediaries activities against those monies have been satisfied, even in the event of bankruptcy of the individual or insolvency of the company. Insurance monies received by tied insurance intermediaries from a client are treated as having been paid to the insurer on whose behalf the tied insurance intermediary is acting. On the other hand, insurance monies paid by the insurer to the tied insurance intermediary and intended to the policyholder shall not be treated as having been paid to the policyholder until actually received. Further, insurance brokers, agents and managers must hold a fidelity bond in a specified form as collateral. The amount of the bond depends on the gross premiums receivable. If the person holds own funds in excess of the required own funds, the amount of the bond may be reduced or even dropped. The purpose of the fidelity bond is for a sum of money to become available if the intermediary fails to meet his or its financial obligations.</p> <p>Market conduct: Insurance brokers, agents and managers must inform a prospective policyholder of, <i>inter alia</i>: <ul style="list-style-type: none"> • applicable complaints procedures • any close connection between intermediary and the insurance undertaking (as more precisely defined in IIR 3/2007, Art. 4). An intermediary shall also provide information on whether he/it is under a contractual obligation to carry out insurance intermediaries activities exclusively with one or more undertakings, and give its/their name. A tied insurance intermediary shall provide the prospective policyholder with information on whether he has a holding, direct or indirect, representing more than 10% of the voting rights or of the capital in an authorised company; and whether an authorised company or parent undertaking of a given authorised company has a holding, direct or indirect, representing more than 10% of the voting rights or of the capital in the tied insurance intermediary.</p>
Assessment	Observed.

Comments	<p>The high number of intermediaries (local and from abroad), together with the demanding tasks and procedures of direct supervision, places a high administrative burden on the MFSA and feeds on the IPSU's and Authorisation Department's resources.</p> <p>Although the range for penalties is exactly the same as in insurance supervision (see ICP 15), all of the penalties applied since 2006 were as low as € 116.47 or € 232.94 and therefore seem hardly to be of any deterring effect.</p>
ICP 25	<p>Consumer protection</p> <p>The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied.</p>
Description	<p>Proper market conduct:</p> <p>Integrity, due care, diligence and the professional skills appropriate to the nature and scale of its activities are requested for the insurance business to carry out. A company shall not be regarded as conducting its business in a sound and prudent manner and shall be held accountable by the MFSA if, <i>inter alia</i>, it fails to supervise the activities of any of its tied insurance intermediaries (No. 5 (e) of the Schedule to LN 158/1999). E.g., where a tied intermediary is a bank, it shall, when in the process of granting credit, not exert undue pressure on customers to take out an insurance policy with the company it represents. Other requirements of good conduct involve, e.g (IIR 7/2007, 4/2007):</p> <ul style="list-style-type: none"> • not to make unsolicited calls at an inappropriate time, • not to attempt to persuade a prospective policyholder to surrender or cancel any existing policies, • not to talk badly of other insurance companies and intermediaries or talk down their products. <p>Similar requirements apply for agents, brokers, and managers.</p> <p>The MFSA supervises compliance to the above mainly through on-site inspections of insurance companies (see ICP 13) and through follow-up procedures with the company or intermediary in case of incoming complaints.</p> <p>To improve market conduct via enhanced expertise and professional competence, the MFSA actively supports a specialized education and training programme at the University of Malta which includes consumer protection areas.</p> <p>Information duties and transparency:</p> <p>Agents, brokers and managers have to assess a client's demands and needs and have to seek relevant information to identify the client's requirements and the facts that would affect the type of insurance recommended (Art. 4 (7) of IIR 3/2007, similar provision for tied intermediaries in Art. 2(d) of the First Schedule of IIR 7/2007). There are information duties for intermediaries and for insurance companies. The latter relate to the products and contracts and are broken down to whether long-term business or general business is affected and whether a contract has been concluded or is yet to be concluded (IR 3/2007), mirroring the requirements of Annex III to the EU Directive 2002/83/EC and Art. 31 of EU Directive 92/49/EEC. In carrying out its supervisory tasks, the MFSA criticized during an on-site inspection e.g. the illustration of bonus rates not in line with the current economic climate.</p> <p>Furthermore, any promotional activity which may mislead or deceive any prospective policyholder, or the insurance sector in general, or the general public with respect to a the assets of a company, its corporate structure or financial standing or authorisation, or any other material respect, is forbidden.</p>

	<p>The MFSA issues warnings on its website about threats for consumers. This includes, if necessary, warnings of unsupervised companies attracting business.</p> <p>The MFSA also has in place regulations for distant selling.</p> <p>Complaints procedures and handling:</p> <p>The MFSA may investigate complaints which relate to its supervisory functions and which could not be resolved. The Office of the Consumer Complaints Manager handles all financial services types of complaints and provides information about insurance and complaints procedures via a helpline and a website.</p> <p>Cases are referred to the Supervisory Council as necessary for its consideration. However, the Office may not give advice on any particular matter or act on policyholder's behalf in any dispute with a licensed person before any court or tribunal.</p> <p>Complaints registers are checked during on-site inspections. The IPSU, in preparation for its inspections, checks back with the Complaints Unit and, if necessary, follows up on matters while at the premises of the company.</p> <p>The Office of the Consumer Complaints Manager draws up extra annual reports comprising trends and complaints figures as well as legislative updates and further information, as a FAQ section. At present, the Unit has 4 staff. It may act independently from the MFSA's regulatory and supervisory structures and is directly responsible to the Board of Governors.</p> <p>Protection and Compensation Fund:</p> <p>Claims against a company which remain unpaid by reason of insolvency may be settled by the PCF. In case of such an insolvency, the Fund will satisfy claims out of general business and long-term business. In addition, it compensates victims of road traffic accidents under the EU motor directives.</p> <p>The scope of the Fund is limited:</p> <ul style="list-style-type: none"> • The Fund pays compensation. Contracts will be terminated and policyholders lose insurance cover. • Claims must relate to risks situated in Malta. • Malta must be the country of the commitment. • Not all insurance classes are covered (Exempted are: credit, surety ship, railway stock, aircraft, ships, goods in transit, aircraft and ships liability; and in long-term business: linked long-term, tontines, capital redemption operations, collective insurance). • The means collected by the Fund amount to only ~ € 2.3m for general business and for long-term business, although the Fund may collect a limited extra contribution to cover any shortfall. • Payments for each case are subject to a ceiling of ~ € 2.3m altogether and, for the individual contract, of ~ € 23k. <p>All companies with a head office in Malta writing risks situated in Malta must contribute to the Fund; branches of EU/EEA insurers are obliged to do so where there is no scheme in the home jurisdiction which offers similar protection.</p>
Assessment	Observed.
Comments	<p>While every effort undertaken to protect policyholders is to be appreciated and ICP 25 does not call for any guarantee scheme, the Fund may be found of very limited effectiveness once a situation arises. Considering the fact that, to a good part, private savings for old age provisions are fed into insurance contracts, many people depend on these monies being actually available when they retire. Low ceilings for compensations together with the fact that supervision of the safekeeping of assets can be improved should give rise to reconsider the arrangements for policyholders compensation.</p>
ICP 26	Information, disclosure & transparency towards the market

	The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed.
Description	<p>Insurance companies and captives are required to submit a copy of their audited financial statements to the MFSA no later than six months from the closing of their financial year. Insurance companies must exhibit copies in a conspicuous position in each office, agency and branch during the following year. Insurance companies are also required to provide a copy of their audited financial statements to any person applying for such copy.</p> <p>Insurance companies under supervision are required to publish their audited financial statements in abridged form (as set out in Art. 7 of LN 103/2000) in at least two local daily newspapers (with the exception of companies carrying on business restricted to risks situated outside Malta or commitments where Malta is not the country of commitment, Art. 20 IBA).</p> <p>No. 15, 18 of LN 103/2000 set out in detail the positions to be shown in the annual reports. They include the company's assets, liabilities, financial position and profit and loss. The approved auditor's report shall include a statement as to whether the various requirements of the IBA, any regulations and insurance rule have been complied with (Art. 21 (3) IBA), thus providing a "stamp of credence" to the report.</p> <p>Under the CA, companies are to draw up their accounts in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and with the requirements of the IBA and CA to ensure that financial statements provide a true and fair view of the state of the audited company.</p>
Assessment	Observed.
Comments	None.
ICP 27	<p>Fraud</p> <p>The supervisory authority requires that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.</p>
Description	<p>The MFSA may investigate allegations of practices and activities detrimental to consumers of financial services, and take measures to suppress and prevent unfair, harmful or detrimental practices, which would include fraud (Art. 4 MFSA Act).</p> <p>For the better performance of its functions, the MFSA shall collaborate with other local and foreign bodies, Government departments, international organisations and other entities which exercise regulatory, supervisory or licensing powers under any law in Malta or abroad.</p> <p>Insurance fraud is a crime in Malta. Article 295 of the Criminal Code states that anyone, with intent to obtain claims under an insurance policy, destroys, disperses or deteriorates goods belonging to him may be liable to imprisonment up to 3 years.</p> <p>The risk of fraud falls under the umbrella of operational risks (paragraph 5B8 (2)(d) of IR 6/2007) and needs to be addressed by a company's risk management strategy already at application stage. IR 27/2009 requires insurers to identify areas of operations which are susceptible to errors, illegal acts or fraudulent activities and ensure that sufficient and effective preventive and detective control mechanisms are in place to safeguard the assets of the company and its clients.</p> <p>The MFSA follows up on implementation of those strategies during on-site inspections.</p>
Assessment	Observed.
Comments	None.
ICP 28	<p>Anti-money laundering, combating the financing of terrorism (AML/CFT)</p> <p>The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related</p>

	insurance, to take effective measures to deter, detect and report money laundering and the financing of terrorism consistent with the Recommendations of the Financial Action Task Force on Money Laundering (FATF).
Description	<p>As the latest MONEYVAL report ((2008)41REV1) has it, the AML/CFT Regime in Malta has undergone a major overhaul since the last assessment. The Prevention of Money Laundering and Funding of Terrorism Regulations have been radically amended in 2006 to further align and harmonize them with the FATF 40 Recommendations. A new set of regulations was introduced in July 2008, mainly for transposing EU Directives 2005/60/EC and 2006/70/EC into Maltese law. The new regulations further broadened the scope of the AML/CFT regime in Malta and continued to implement those MONEYVAL recommendations which had until then not been addressed. The Regulations were last amended in 2009.</p> <p>Legal framework:</p> <p>The PMLA establishes money laundering as a criminal offence and provides for the penalties and investigation procedures and measures. According to Art. 12 PMLA, the MoF may introduce provisions for the regulation and control of banks, credit and other financial institutions to provide <i>inter alia</i> for procedures and systems for training, identification, record-keeping, internal reporting and reporting to supervisory authorities for the prevention of money laundering and funding of terrorism. Such implementation regulations are established in LN 180/2008. – The PMLA also provides regulations for the setup of the FIAU, its organisation and functions, staffing, financial resources, and its competences, namely the right to request information from supervisory authorities, and to carry out on-site inspections (Art. 27 PMLA).</p> <p>The implementing regulations in LN 180/2008 set out in detail the structure of AML/CFT legislation. A business relationship must not be established and a transaction not performed until customer due diligence measures, record-keeping procedures, and internal reporting procedures are in place (Art. 4 of LN 180/2008).</p> <ul style="list-style-type: none"> • Customer due diligence measures include: <ul style="list-style-type: none"> ○ Proper identification: Companies shall verify the identity of the applicant or the beneficial owner for business on the basis of reliable information. Where an applicant for business appears to be acting otherwise than as principal, in addition to the identification and the verification of the identity of the applicant for business, subject persons shall, <i>inter alia</i> establish and verify the identity of the person on whose behalf the applicant for business is acting. Anonymous accounts or accounts in fictitious names must not be kept. All these measures shall be applied to all new customers and, at appropriate times, to existing customers on a risk-sensitive basis. This approach also provides for alleviations e.g. for licensed entities domiciled in reputable jurisdictions. ○ Suspicious transactions: Due diligence procedures shall require to refrain from carry out transactions, not to establish the business relationship or even terminate it and to consider making a suspicious transaction report to the FIAU where identification procedures about any involved person cannot be successfully completed. ○ Large transaction: Subject persons must examine with special attention, and to the extent possible, the background and purpose of any complex or large transactions, including unusual patterns of transactions, which have no apparent economic or visible lawful purpose, and any other transactions which are particularly likely, by their nature, to be related to money laundering or the funding of terrorism, establish their findings in writing, and make such findings available to the Financial Intelligence Analysis

	<p>Unit and to the MFSA.</p> <ul style="list-style-type: none"> • Record-keeping procedures involve: <ul style="list-style-type: none"> ○ Full business and transaction records, including records giving proof of the due diligence measures applied, must be kept for a minimum of 5 years. Further requirements as to these records are also set out in Art. 13 of LN 180/2008. • Internal reporting procedures require: <ul style="list-style-type: none"> ○ Subject persons shall develop and establish effective customer acceptance policies and procedures that are not restrictive in allowing the provision of financial and other services to the public in general but that are conducive to determine, on a risk based approach, whether an applicant for business is a politically exposed person and that, as a minimum, include a description of the type of customer that is likely to pose higher than average risk, the identification of risk indicators such as the customer background, country of origin, business activities, products and the like, and the requirement for an enhanced customer due diligence for higher risk customers as defined in the regulation. ○ Subject persons are required to apply measures in branches and majority owned subsidiaries that are equivalent to those under the regulations regarding customer due diligence and record keeping. <p>The MFSA had issued Guidance Notes in 2005 which are currently under review.</p> <p>Supervisory measures: Where a proposed acquisition could at least increase a risk for money laundering or terrorist financing, the MFSA may refuse a proposal to acquire a significant interest (See ICP 8). Besides, the full range of regular supervisory measures is applicable (see ICP 15).</p> <p>Supervisory practice and co-operation: Long-term insurers, captive insurers and Protected Cell Companies appoint a Money Laundering Reporting Officer to ensure compliance with AML/CFT requirements at company level. The MFSA checks during on-site inspections the procedures established by the Officer and views company files. The MFSA co-operates closely with the Financial Intelligence Analysis Unit (“FIAU”) which is responsible for the monitoring and enforcement of AML requirements. During normal on-site inspections, the MFSA acts as FIAU’s agent when it comes to the audit of AML/CFT procedures (Art. 27 (3) (b) PMLA). The MFSA reports to the FIAU on its findings and the FIAU then takes any necessary action. If circumstances demand, the FIAU makes use of its authority to perform on-site inspection itself. In this case a targeted on-site inspection at a specific licenceholder will follow. For its preparation, the FIAU receives in advance MFSA’s yearly on-site inspection schedules. In the last 1,5 years 7 on-site inspections were conducted in cooperation with the MFSA and 3 focused inspections by FIAU staff alone. For pursuing additional professional qualifications, joint training sessions are held together with MFSA officers. The MFSA may as well co-operate with other supervisory authorities in the framework of the IAIS MMoU, assuming that the respective authority also has a competence in AML/CFT supervision.</p>
Assessment	Observed.

Comments	None.
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Table 4.1: Summary Observances of IAIS Insurance Core Principles [2010 Independent Assessment]

Assessment Grade	Count	Principles Grouped by Assessment Grade
Observed	22	1,2,4,5,6,7,8,11,12,14,15,16,17,19,20,22,23,24,25,26,27,28
Largely observed	4	3, 9,18,21
Partly observed	2	10,13
Non-observed	0	0
Not applicable	0	0

As the number of ICPs has since the 2002/2003 FSAP increased from 17 to 28, (Table 4.1) it is very difficult to carry out a principle by principle review. However, the observance resulting from the 2002/2003 FSAP is reproduced in Table 4.2 for comparative purposes.

Table 4.2. Summary Observance of IAIS Insurance Core Principles [2002/2003 FSAP]

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Observed	12	1, 2, 3, 4, 7, 10, 11, 13, 14, 15, 16, 17
Broadly observed	3	8, 9, 12
Materially non-observed	2	5, 6
Non-observed		
Not applicable		

4.3 Recommended Action Plan and response to the assessment

The recommendations are summarized in the following table.

Table 4.3: Recommended Action Plan to Improve Observance of IAIS Insurance Core Principles

Reference Principle	Recommended Action
CP 2 – Supervisory objectives	Although this principle was assessed as "observed", the MFSA should consider to expand the scope of Art. 4 (2) IBA in a way that it is applicable also to ongoing supervision, thereby arranging the

	objectives of insurance supervision to be more specific.
CP 3 – Supervisory authority	<p>Legislation should foresee that, in case of dismissal of a board member, the reasons shall be publicly disclosed.</p> <p>Cumbersome staff recruitment processes complicate MFSA's endeavours to hire qualified staff. Without enough well qualified staff, the MFSA would fall behind, could no longer discuss developments with the industry on eye-to-eye-level effectively, and could after all not cope with the challenges lying ahead in insurance supervision. These challenges are not to be underestimated as they mean, Europe-wide, a total paradigm shift in insurance supervision.</p>
CP 9 – Corporate governance	<p>Clarify that the setup of special committees means a material change to the layout of an insurance undertaking so that the MFSA needs to be notified. The Authority needs to be aware of the existence and setup of all relevant committees.</p> <p>Regarding remuneration policies, no principles have been established, e.g. in order to prompting companies to set incentives right, preferably in accordance with the G 20 resolutions and the subsequent FSB Principles for Sound Compensation Practices (and succeeding implementation standards) (April/Sept. 2009). The Corporate Governance Guidelines need to be amended specifically. The MFSA should ensure that these standards are actually being complied with.</p>
CP 10 – Internal control	<p>Recommendations and general guidance for the internal audit function have been established in 2005 and updated in 2009. The establishment of an internal audit function should be made mandatory.</p> <p>Supervision of internal audit functions should include planning and procedures of internal audit (time intervals, scope, units/functions that are subject to the audits). Attention should be paid to the separation of duties (internal audit units should not be charged with other tasks, i.e. to avoid from the outset a possible conflict of interest) and to the risk orientation of audit planning and conduct.</p>
CP 13 – On-site inspection	<p>The supervisory framework covers multiple aspects in a way of providing general guidance and principles.</p> <p>It is up to undertakings to fill this scope and find the appropriate procedures within this framework. It lies with the MFSA to check for the appropriateness and sufficiency of the procedures implemented by undertakings. While a part of this may be visible by means of off-site supervision, the largest part remains for investigation during on-site inspections:</p> <p>Sufficient resources, in terms of staff and time, should be dedicated to inspections.</p> <p>Inspections should focus and set clear priorities. The most relevant areas should be given necessary attention. When inspecting procedures established by undertakings, the Authority might want to see how procedures which insurers claim to have implemented</p>

	<p>actually work in practice, and trace the flow of information and reporting lines.</p> <p>Findings should be communicated consequently in all cases to undertakings with the proper emphasis and be followed up in the same way in the wake of inspections.</p>
CP 15 – Enforcement or sanctions	<p>Although this principle was assessed as "observed", the arrangements made for sanctions should be re-considered. As the scope of the general clause laid down in Art. 31A IBA well includes all kinds of situations, including those of more serious nature, a Level 1 administrative penalty seems not eligible as a deterrent.</p>
CP 18 – Risk assessment and management	<p>The MFSA and most market participants have started to move from a compliance oriented view and supervision to a more risk based approach. These efforts need to continue and systems shall be further developed.</p> <p>The MFSA should make sure that advanced tools of risk measurement and quantitative analysis are actually operative at company level. Such stress tests and scenario calculations should extend to both sides of the balance sheet.</p> <p>It seems recommendable to provide a framework and some guidance for market participants.</p> <p>Monitoring of the market should continue and take into account particularly that taking on a significant amount of more complex risks would imply sophisticated systems of risk management and probably – as a part of this – an asset liability management system including appropriate strategies for hedging.</p>
CP 19 – Insurance activity	<p>Notwithstanding the overall "observed" compliance rating for this principle, the MFSA should consider to remove legal uncertainties for undertakings in terms of what is considered to be a "material change " in terms of information duties in the wake of the authorisation process.</p>
CP 21 – Investments	<p>Sufficiently detailed requirements for the safekeeping of assets should be developed, also in order to establish more legal certainty for market participants.</p> <p>Such requirements might, for instance, stipulate that:</p> <p>Assets being held separately:</p> <ul style="list-style-type: none"> • assets (other than cash) should be kept separate and distinct from the assets of the Custodian, • the Custodian's books of account must identify these assets clearly, <p>Custodian's governance is flawless:</p> <ul style="list-style-type: none"> • undertakings shall have a demonstrable process implemented to monitor and assess the performance of the Custodian on an on-going basis, • undertakings shall regularly check and seek information from the Custodian as to its internal controls, organisation, staffing capabilities, administrative resources and arrangements for holding the assets.

	<p>Financial position:</p> <ul style="list-style-type: none"> undertakings satisfy themselves that Custodians have financial strength to fully and in a timely manner meet their liabilities. In considering the Custodian's financial strength, undertakings should consider insurance or guarantee arrangements, and / or capital.
CP 22 – Derivatives and similar commitments	Although this principle was assessed as "observed", the MFSA should review, from time to time, whether there is an increased use of derivatives and financial instruments in the market that calls for further development of rules and regulations for improved supervisory monitoring tools.
CP 24 – Intermediaries	Notwithstanding the overall "observed" rating for this principle, the MFSA should more use the full range of penalties available when imposing sanctions on supervised persons and entities, and see to it that they serve as a deterrent in the case considered.
CP 25 – Consumer protection	Although this principle was assessed as "observed", the MFSA might want to re-consider the arrangements made for the purpose of policyholder protection. With a particular view to long-term business, the low ceilings for compensation from the PCF almost render the purpose of the institution useless.

4.4 MFSA Response (Insurance and Pensions Supervision Unit) to the 2010 Independent Assessment

Reference Principle	Authority's response
CP 2 – Supervisory objectives	The recommendation will be discussed with the Legal and International Affairs Unit.
CP 3 – Supervisory authority	The assessor's comments regarding the dismissal of a board member and the staff recruitment processes will be brought to the attention of the Board of Governors.
CP 9 – Corporate governance	<p><u>Special Committees</u></p> <p>Comments of are noted, however, it should be highlighted that Article 43(1) of the IBA imposes a requirement on a licence holder to notify the Authority of any material changes in the documentation submitted at application stage and other documents submitted thereafter. It is to be noted that Insurance Rule 6 of 2007 requires the applicant to provide the MFSA, as part of the application information, with details of internal committees and their proposed terms of reference. Therefore, pursuant to article 43 of the Act any changes in these committees, as well as in their terms of reference, are to be notified to the MFSA.</p>
CP 10 – Internal control	The comments and the recommendations have been noted. Indeed, the internal audit function is also mandatory under

	<p>Solvency II.</p> <p>In this respect, the IPSU will certainly require the internal audit function to be made mandatory. However, , it should be noted that out of the 45 authorised companies, 31 companies already have an internal audit function in place..</p> <p>It is being proposed that this requirement is brought in line with the requirements of ICP 10 with the transposition of the Solvency II Directive.</p> <p>Please refer to our comments for CP 13 with respect to the supervision of the internal audit function.</p>
CP 13 – On-site inspection	<p>The majority of licenseholders in the Maltese market are small undertakings with only two falling under the QIS 5 category of medium undertakings.</p> <p>Despite the limited resources available for on-site inspections the compliance visits, which are not targeted inspections, cover all the key areas of the operations of the entity being inspected. This also involves a careful review of the organizational structure, segregation of duties and reporting lines. In addition, officials perform a walkthrough of all systems relating to underwriting, claims handling, reinsurance and accounting with the relevant personnel. This includes a review of records, reports and software systems.</p> <p>With regard to the findings, the IPSU would like to point out that minor issues are not normally taken up with the entity in the circumstances when other more important issues have been identified during the same on-site visit. In these cases the Authority would not wish to detract attention from more important and substantive issues by raising issues which are considered to be of a non-substantive nature.</p> <p>Issues are always given due importance and followed up until a satisfactory resolution is achieved. The two on-site inspection reports reviewed by the independent assessor were followed up by correspondence with the respective entities and issues are constantly followed up. This correspondence is kept in separate files from the on-site report file and it may be the case that the relevant follow-up correspondence was not filed in the files that the reviewed by the independent assessor.</p> <p>.</p>
CP 15 – Enforcement or sanctions	<p>Comments are noted. The IPSU will consider a revision in the level of penalties subject to the limits imposed by the IBA in Art. 67(6).</p>
CP 18 – Risk assessment and management	<p>Comments are noted. As rightly noted in the comments, the MFSA and most market participants have started to move</p>

	<p>from a compliance oriented view and supervision to a more risk based approach.</p> <p>There is always room for improvement and the IPSU will endeavor to provide a formal framework and guidance for market participants.</p>
CP 19 – Insurance activity	The recommendation will be discussed.. It should be clarified that during the licensing process and on-site visits as well as during presentations made to Compliance Officers, the Authority explains that it expects any changes to the information submitted during or subsequent to the application stage to be notified so that the Authority is kept informed of changes on an ongoing basis.
CP 21 – Investments	The IPSU is currently studying the recommendation.
CP 22 – Derivatives and similar commitments	Comments have been noted. As explained during the independent assessment, all insurance companies are required to submit detailed management accounts including a detailed solvency computation, and a detailed schedule of assets, broken down by individual asset, indicating their balance sheet value and their value as computed in accordance with the requirements of the Insurance Business (Assets and Liabilities) Regulations, 2007.
CP 24 – Intermediaries	Comment has been noted.
CP 25 – Consumer protection	Comment has been noted.