MFSA: THE WIDER PICTURE

The Malta Financial Services Authority lifts the lid on the jurisdiction's evolving financial and regulatory landscape

Solvency II came into force on 1 January 2016 following a long period of preparation. Its phasing in stage is also drawing to an end with the publication of EIOPA's implementing technical standards and guidelines. This is indeed the dawn of the Solvency II era.

Unfolding scenario

Solvency II ushers in a new way of looking at risk focused on bringing the objectives of both regulators and operators into close alignment. This is a regulatory regime that is built on dialogue with market participants and that seeks to better understand business models, strategies and underlying risks in order to ensure stability, mitigate and pre-empt risk wherever possible. In the ORSA, insurers have a structured framework on which to develop strong risk management capabilities in the face of challenging economic and market conditions. It provides the background against which the industry will need to develop a strong risk culture that informs strategic business choices and the setting of business objectives.

Of the three main objectives of Solvency II, convergence in capital requirements, standards of disclosure and risk management processes, the latter is perhaps the hardest part to achieve. Nevertheless, the MFSA is confident that the message is coming across and that the Maltese insurance industry is able to meet the standards expected in all three areas.

Equally important is the "fourth dimension" of Solvency II. As the market starts to operate under the new regime, regulators must ensure a high degree of uniformity in the application of these standards in all 28 member states of the EU. This is why, as we go forward, regulators are becoming more deeply engaged in the process of supervisory convergence aimed at ensuring a level playing field and equal safeguards across the entire internal market.

However, there is a "fifth dimension" that, in a sense, lies beyond the scope of Solvency II and that has more to do with the ability to continue to innovate and develop new business strategies in an increasingly standardised regulatory environment. The question is even more pertinent from a Maltese perspective given that Malta has been able to develop a cluster of insurance and related service providers that have managed to establish a strong international and cross-border presence in the space of a few years. The simple answer to that is that EU regulation has never been a stumbling block to Malta's development; if anything it has helped the country achieve recognition.

MFSA
MALTA FINANCIAL SERVICES AUTHORITY

The **Malta Financial Services Authority** (MFSA) is the single regulator for financial services in Malta and was established as a fully autonomous public institution in 2002. It regulates and supervises all financial services activity including banking, securities and markets and insurance business. The MFSA also manages the registry of companies and has responsibility for consumer complaints.

The more complex answer is that innovation knows no boundaries but, as anything else in business, needs to be managed within regulatory parameters and comes with a strong denominator called reputation. On this score, there is no reason why insurers cannot continue to develop new products and innovative strategies under the new order. On their part the Maltese legislators and the MFSA will continue to improve on the tools and infrastructures that have contributed to the formation of this cluster and to promote more synergies with other types of financial service activities.

In this vein, the MFSA has recently been focusing its efforts on upgrading and enhancing the product structuring framework. One area that is receiving particular attention is securitisation, which also presents challenges and opportunities to insurers.

Product development

The Securitisation Act was an important piece of legislation when it was first introduced into Maltese law in 2006. It recognised the fact that financial innovation had long moved on from the established practices of raising capital using traditional methods of security. The capital market called for new legal tools beyond those offered by more conventional instruments. Fund managers and market providers welcomed this development as this would increase product diversity and flexibility in asset allocation, as well as add scope and depth to the financial market. Institutional investors, including insurance undertakings and pension funds, can also benefit from the more attractive investment opportunities that may be created as a result of these developments, particularly as the scope of Solvency II capital requirements is revisited to encourage the development of a sustainable securitisations market in the EU.

Over the last ten years, securitisation has provided local financial operators with the opportunity to create vehicles and issue financial instruments linked to specific assets or packaged risks. The Securitisation Act greatly improved the scope for structuring new investment products under Maltese law. This was followed by other important developments, including the setting up of the European Wholesale Securities Market (EWSM), which provided a new opportunity to list debt securities on a regulated market for wholesale investors in the EU.

As the new framework settled in, it was earmarked for further development aimed particularly at integrating securitisation into the financial services value chain and for the introduction of add-ons that would render it more amenable to specific types of products and give it an edge over comparable frameworks elsewhere.

The first of these initiatives was to explore ways in which the industry could meaningfully tap the ability to securitise risk provided by the Act.

Securitisation of risk

Given the synergies that may be obtained by combining the inroads made in alternative risk transfer and captive insurance structures with the new possibilities offered by securitisation law, the MFSA had picked out insurance-linked securities (ILS) for the next stage of development.

ILS are a type of financial instrument whose values are driven by insurance loss events. Typical ILS instruments are those linked to property losses due to natural catastrophes. For investors these represent a unique asset class, the return from which is uncorrelated to that of the broader financial market.

The extension of the legal framework in this direction involved a complex interplay between the provisions of company, insurance and securitisation law. The Reinsurance Special Purpose Vehicle Regulations, published at the beginning of 2014, were based on a careful assessment of these laws and came up with a dedicated framework for the licensing and regulation of these new types of specialised vehicles that were appearing on the international market.

The RSPV Regulations had the added advantage of being already aligned with EIOPA's advice for the development of Level 2 implementing measures on special purpose vehicles under Solvency II, allowing operators to position themselves in this market at an early stage. They have now been seamlessly integrated into the new Solvency II regime.

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The ability to purchase a securitised risk instrument (in the form of bonds, notes and possibly equity) helps insurers to transfer and hedge various types of risks. It is also possible to structure the product in different tranches based on proximity to the underlying risk thus making the product more attractive to investors.

Cell structures

The next logical step was to introduce the cell concept in the area of securitisation. The protected cell concept was already very well established in both law and practice when the Securitisation Cell Company (SCC) Regulations came into force at the end of 2014. Protected cell companies have in fact been a feature of Maltese insurance law for well over a decade and a number of insurance PCCs have already been operating successfully for a number of years. Investment schemes having multiple segregated sub-funds with different investment objectives have also been around for much longer than that.

The SCC is therefore founded on well-trodden ground. Similar to its counterparts in the insurance and investment sectors, it allows securitisation vehicles making use of multiple compartments to establish these within a legally entrenched framework that recognises and protects different sets of assets or risks placed in separate cells. Thus investors in instruments issued through one cell of an SCC are insulated from any possible claims arising from other creditors of the same SCC, both in respect of instruments issued through other cells, as well as the general creditors of the company.

Securitisation cell legislation therefore provides a fireproof ring around contractual arrangements and assets placed within separate cells of the same company. This may be replicated in other cells thus providing for unlimited scaling up of securitisation activity within a single special purpose vehicle. SCCs may be set up in preparation for the establishment of future cells, while cells will require individual authorisation from the MFSA based on the type of risk and the nature of the instrument involved.