MFSA MALTA FINANCIAL SERVICES AUTHORITY

Policy Paper

24 June 2020

Shareholding Policy for Credit Institutions and Insurance Companies

Background

Following the global financial crisis that hit the financial services sector in 2008, international regulatory standard-setters have placed increased emphasis on internal governance, with one of the main objectives being that of addressing poor internal governance practices, as identified during the said crisis. In 2012, the Malta Financial Services Authority ('the Authority' or 'MFSA') had, at the time, issued two Policy Papers concerning the licensing of credit institutions and insurance companies. These Policy Papers were issued on 13 February 2012 and 16 May 2012.

Purpose of new Policy

Since the issue of the Policy Papers, various regulatory developments took place, that have imposed more stringent requirements, regulating numerous aspects of the credit institutions and insurance companies' businesses. Effective efforts have also been made with regard to the harmonisation of the legal framework for the regulation and supervision of financial services at European level, which aims at ensuring a level-playing field across the European banking and insurance sector. Within this context, the Authority has carefully re-assessed the requirements set out within the Policy Papers.

This Policy repeals and supersedes the Policy dated 13 February 2012 applicable to 'Applicants for authorisation as Credit Institutions and Insurance Companies'.[1]

Furthermore, as further explained in the following sections, the purpose of this Policy is to provide an **overview of the MFSA's assessment process of shareholding structures of credit institutions and** insurance companies, and also to communicate the **Authority's** risk appetite, in relation to the assessment of shareholding structures of these institutions.

[1] With reference to the May 2012 Policy, which essentially relates to a Contingency Contribution requirement applicable to certain applicant credit institutions, the MFSA is taking the position that, going forward, this requirement shall not be applicable, and accordingly, this Policy shall no longer apply.

Credit institutions which are currently subject to a Contingency Contribution requirement (in terms of the May 2012 Policy), shall continue to be subject thereto, until notified otherwise. With reference to these institutions, the Authority is, however, conducting an assessment and reviewing the position of such banks. Further communication shall be issued by the Authority in this respect, at a later date.

The MFSA is of the view that good governance plays a key role in protecting licence holders, the market and ultimately stakeholders and customers. The Authority takes a long-term view of the critical role played by the governance framework in ensuring the stability of institutions on an ongoing basis and firmly believes that the compliance culture of a licence holder is shaped by its shareholders, management and employees holistically. Within this context, the Authority must be satisfied that all the required conditions are in place, as from the authorisation stage.

Assessment of Shareholding Structures

In assessing the shareholding structure of prospective credit institutions and/or insurance companies, as part of the overall governance arrangements of an entity, the MFSA follows and applies the relevant European, as well the national regulatory framework, which transposes and reflects European Directives.

The MFSA considers that the overall governance structure, soundness and resilience of an institution may be undermined if the shareholding structure of the relevant institution is not sufficiently diversified and may result in the following key risks:

- increased possible risk of dominance by a single beneficial owner/shareholder, both at board level as well as within the executive management of an institution;
- increased possible dependence on one/few shareholder/s in case of any requirement for capital injections, which may increase the risk of not having sufficient funding being made available.

In this respect, with reference to the assessment of shareholding structures of credit institutions and insurance companies, prospective applicants for such licences are advised that the MFSA has no risk appetite for limited shareholding structures that may adversely impact the overall governance, financial soundness and resilience of a licence holder. The same applies for existing licence holders, considering changes to their shareholding structure.

The Authority expects that the proposed shareholding structure of such entities to be reasonably diversified and balanced, in order to limit any potential shareholder dominance and ensure wider availability of funding, should capital injection(s) be required.

Qualifying shareholding structures of Credit Institutions

With the establishment of the Single Supervisory Mechanism ('SSM') Regulatory Framework in 2014, the ECB has the power to grant authorisations, impose withdrawals and approve changes to qualifying shareholding structures of any credit institution. This is done jointly with the MFSA being the National Competent Authority ('NCA'). The ECB also must ensure compliance with EU banking rules and the EBA Regulation as well as the application of the single rulebook. Where appropriate, it may also consider imposing additional prudential requirements on credit institutions to safeguard financial stability.

Therefore, the requirements applicable to shareholding structures of credit institutions are fully reflective of the Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019, amending Directive 2013/36/EU ('CRD V'), its delegated Regulation EU/575/2013 ('CRR'), as well as incorporating guidelines issued by the European Supervisory Authorities[2].

The Authority emphasises the importance of the assessment of any proposed qualifying shareholder[3], considering the vital role they play in shaping business strategies and the organisational frameworks to deliver them. Through their choices and controlling powers they determine the composition of the Board and influence the compliance culture of the institution and sustainability of the business model.

As detailed above, in assessing the shareholding structure of a credit institution, the Authority seeks assurance of the capacity of shareholders to support the institution and that there is an element of diversification in the proposed structure, to limit the risks of dependency and dominance. Such assessment forms part of the pre-application process assessment in line with the ECB methodology, the CRD and Acquisitions Directive requirement.

Qualifying shareholders of a credit institution must be suitable in order to carry out their responsibilities and contribute to the effective governance of a credit institution and its balanced decision-making. This will have an impact not only on the safety and soundness of the institution itself but also on the wider banking sector, as it will reinforce the trust of the public at large. Accordingly, the Authority's assessment of a proposed qualifying shareholder is carried out in compliance with the applicable European framework, and reference is made to:

- the "Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector" issued by The European Securities and Markets Authority (ESMA), The European Banking Authority (EBA) and The European Insurance and Occupational Pensions Authority (EIOPA) which became applicable as from 1 October 2017, which *inter alia* identify the criteria according to which the assessment of any proposed qualifying shareholder shall be carried out; and

- the "Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU" (EBA/GL/2017/12, 26 September 2017), with respect to the fitness and properness assessment of a proposed qualifying shareholder, on an individual as well as a collective basis.

[2] European Banking Authority Guidelines on internal governance under Directive 2013/36/EU [EBA/GL/2017/11, 26 September 2017]

[3] Article 2(1) of the Banking Act defines "qualifying holding" or "qualifying shareholding" by making a cross-reference to point (36) of Article 4(1) of the CRR which defines such terms as "a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking."

Therefore, the suitability of qualifying shareholders of a credit institution is assessed on the basis of each of the following assessment criteria:

(i) the reputation of the proposed qualifying shareholder(s);

(ii) the reputation, knowledge, skills and experience of persons who will direct the business of the credit institution and who have been appointed by, or following a nomination from the shareholders of the credit institution;

(iii) the financial soundness of the proposed qualifying shareholder(s), in particular, in relation to the type of business to be carried out by the credit institution;

(iv) whether the credit institution will be able to comply and continue to comply with the prudential requirements applicable to credit institutions; and

(v) the person`s financial or business reasons and foreseeable intentions for acquiring a qualifying shareholding in a credit institution must be explained in detail to the satisfaction of the MFSA. In this regard, an assessment will be made as to whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, money laundering or terrorist financing within the meaning of Article 1 of Directive (EU) 2015/849 is being, or has been committed or attempted, or that the proposed acquisition could increase the risk thereof.

With respect to criterion (iii), the proposed qualifying shareholder(s) need to demonstrate that they are capable of adequately financially support the applicant on an ongoing basis. The information required by the MFSA for the assessment of financial soundness of the proposed qualifying shareholder will depend on its status i.e. whether it is a financial institution that is subject to prudential supervision, a legal entity other than a financial institution or a natural person.

The proposed qualifying shareholders are assessed on their satisfactory past performance or expertise in the nature of the business being conducted and that they are in possession of an appropriate range of skills and experience to understand the licensable activities that the applicant credit institution intends to carry out.

The prudential assessment of the proposed qualifying shareholders is to cover their capacity to support adequate organisation of the entity with the aim of having in place transparent and robust corporate governance arrangements including adequate internal controls, risk management, AML/CFT and compliance structures.

The above is without prejudice to any further criteria which the MFSA may additionally require to complement the above assessment. Provided that nothing in this Policy shall affect the powers of the Authority to refuse authorisation to commence the activity of a credit institution if, taking into account the need to ensure the sound and prudent management of a credit institution, it is not satisfied as to the suitability of the shareholders or members in accordance with the criteria set out above.

Qualifying shareholding structures of Insurance Companies

Qualifying shareholdings[4] of prospective insurance undertakings applying for a licence or licensed undertakings amending their shareholding structures, will continue to be fully assessed in accordance with the requirements detailed in the MFSA Insurance Rules under the Insurance Business Act, with particular reference to Chapter 2, 3 and 6 of the mentioned Rules.

The MFSA Insurance Rules incorporate the assessment criteria set out in the already mentioned "Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector" issued by the ESMA, EBA and EIOPA. Accordingly, the suitability of qualifying shareholders of insurance companies is assessed on the basis of each of the following assessment criteria:

(i) the reputation of the proposed qualifying shareholder(s);

(ii) the reputation and experience of persons who will direct the business of the insurance undertaking as a result of the proposed acquisition;

(iii) the financial soundness of the proposed qualifying shareholder(s), in particular, in relation to the type of business to be carried out by the insurance undertaking;

(iv) whether the insurance undertaking will be able to comply and continue to comply with the applicable prudential requirements; and

(v) the person`s financial or business reasons and foreseeable intentions for acquiring a qualifying shareholding in an insurance undertaking must be explained in detail to the satisfaction of the MFSA. In this regard, an assessment will be made as to whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, money laundering or terrorist financing within the meaning of Article 1 of Directive (EU) 2015/849 is being or has been committed or attempted, or that the proposed acquisition could increase the risk thereof.

With respect to criteria (i) and (ii), the assessment of the reputation of the proposed acquirer covers two elements, namely integrity; and professional competence. It is to be noted that while the MFSA shall always assess the integrity of the proposed acquirers; the assessment of the professional competence may be reduced for proposed acquirers who are not in a position to exercise any influence over the insurance undertaking.

With respect to criterion (iii), the proposed qualifying shareholder(s) need to demonstrate that they are capable of adequately financially supporting the undertaking on an ongoing basis. The information required by the MFSA for the assessment of financial soundness of the proposed qualifying shareholder will depend on its status i.e. whether it is an institution subject to prudential supervision, a legal entity not subject to prudential supervision or a natural person.

[4] Article 2(1) of the Insurance Business Act defines "qualifying shareholding" as "a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights […] or which makes it possible to exercise a significant influence over the management of that undertaking."

The prudential assessment of the proposed qualifying shareholders is to cover their capacity to support adequate organisation of the undertaking with the aim of having in place transparent and robust corporate governance arrangements including adequate internal controls, risk management, AML/CFT and compliance structures.

The above is without prejudice to any further criteria which the MFSA may additionally require to complement the above assessment. Provided that nothing in this Policy shall affect the powers of the Authority to refuse authorisation to commence the activity of an insurance company if, taking into account the need to ensure the sound and prudent management of the undertaking, it is not satisfied as to the suitability of the shareholders or members in accordance with the criteria set out above.