MFSA MALTA FINANCIAL SERVICES AUTHORITY

SPECIAL EDITION

NewsHub

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contents

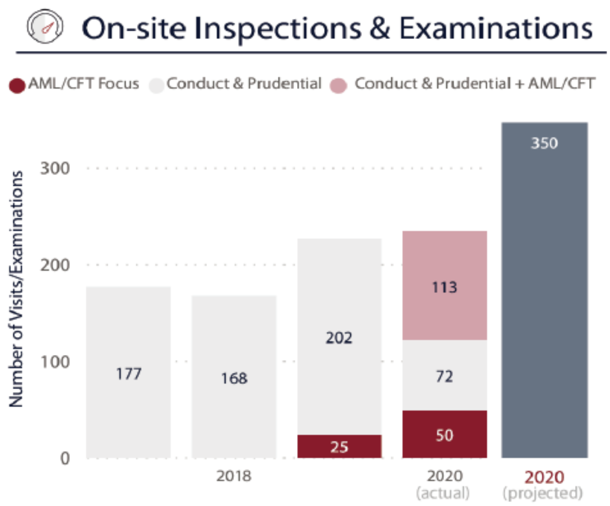
What will you be getting out of the Supervisory and Enforcement Effectiveness Dashboard?

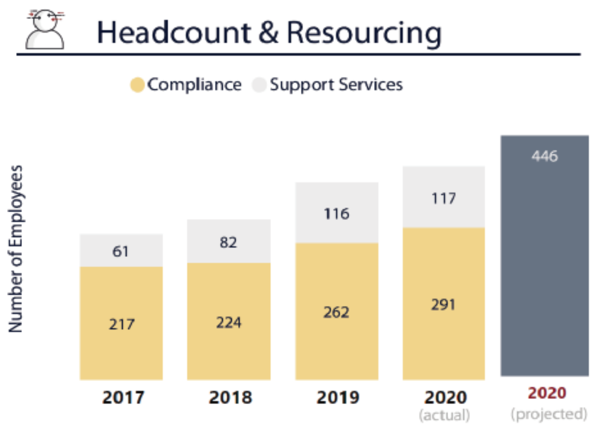
JOSEPH CUSCHIERI

CEO, MFSA

The **Supervisory and Enforcement Dashboard**, rolled out by the MFSA this year is another step in the right direction enhancing the MFSA's accountability and transparency. The Dashboard, which is updated monthly, highlights the key performance indicators with respect to regulatory oversight and enforcement effectiveness with a focus on the regulator's supervisory priorities.

In the following **video**, the MFSA CEO, Joseph Cuschieri looks at the key highlights of the May edition of the Dashboard within the context of the Authority's progress in reaching its strategic priorities.





How Malta's financial services tackled COVID-19 effects

RUDOLPH PSAILA

Chairman, FinanceMalta

> It is important that companies continue focusing on finding solutions to this complex scenario and to treat this as an opportunity to reposition their business

There is no doubt that the pandemic has hit the world in an unprecedented and forceful way. No country, no economy, no industry has escaped the clutches of its effect – the difference lies only in the extent or severity of the pandemic on the different sectors.

Malta's financial services industry has so far weathered the storm that has had a huge impact on the hospitality and tourism industries.

The Government has launched several initiatives to support the local economy and banks are playing a crucial role in this. The assistance, which local banks are providing to businesses in the light of the disruption caused by the COVID-19 pandemic, is imperative. To address the impact on banking, financial institutions must craft a strategic response across the immediate-, short- and medium-term, by adopting the appropriate digital technology enablers and innovations underpinned by agile delivery models.

It is also important that the capital markets continue functioning in an orderly manner by providing liquidity to the system and thereby continue enhancing market confidence. The prices of securities trading on the Malta Stock Exchange have fallen, and there are a number of investors who are actively trying to exit the market.

However, these are counter-balanced by a number of investors who are viewing the current market as an opportunity to invest in securities at discounted prices. Nevertheless, the drop in the prices of listed securities in Malta has been less than the drop registered in foreign markets. In such circumstances, the MFSA has acknowledged the fact that since the full implication of the COVID-19 pandemic on issuers' businesses may not be easy to predict, some company announcements may seem vague.

Furthermore, FinanceMalta appreciates the Regulator's reiteration that in uncertain times such as these, proper disclosures by issuers are an important way of providing investors sufficient information to help them make proper and informed decisions.

Auditors are consequently expected to pay more attention to the uncertainty surrounding events or conditions which may cast significant doubt upon a company's ability to continue as a going concern. In this regard, the COVID-19 pandemic may also impact publication schedules.

From an insurance perspective, Malta is witnessing a hardening of the insurance market particularly in financial lines and property and reductions in capacity for lines like cyber and professional indemnity markets.

This is partly attributable to certain insurers withdrawing operations completely or ceasing to underwrite certain lines of business and also due to insurers becoming much more prudent (and selective) with regard to where they deploy their capacity.

The uncertainty and economic pressures brought about by COVID-19 will, in all likelihood, further exacerbate the situation which includes an added restrictor at the level of companies and that is their requirement to have available cash to see them through this challenging time. This situation has resulted in an increase in enquiries for setting up captives in Malta; however we now need to see whether the capital restrictor could make this less attractive or delay this until the situation becomes clearer. It is probably also worth highlighting that as a domicile Malta has managed to establish itself as an onshore hub, not just for the captives but also for other types of niche underwriters.

These include companies operating in the run-off space who tend to thrive in this sort of environment because they would typically be on the lookout for distressed portfolios and companies.

FinanceMalta is pleased to note the Government of Malta's commitment and support towards the regeneration of the economy following the impact of COVID-19 on the country.

On 8 June, Prime Minister Dr Robert Abela announced the fourth financial package aimed at reducing business costs, enhancing domestic demand, and supporting employment, which, together with the lifting of restrictions, is expected to achieve positive results.

Nevertheless, it is important that companies continue focusing on finding solutions to this complex scenario and to treat this as an opportunity to reposition their business and to focus on innovation to revamp, if necessary, their existing models to adapt to the new norms.

Capital Markets should remain open in time of crisis

CARMINE DI NOIA

Commissioner, Commissione Nazionale per le Società e la Borsa (CONSOB)

When the wind of crisis beats hard on the windows of financial markets, with double-digit daily losses marking equity markets all over the world, there are very few things a securities market supervisor can do to stop indices from falling. No magic potions to give, no silver bullets to shoot. But there is at least one thing it must not do: shut down the market.

Closing stock markets in a time of crisis is an issue that goes a long way back. Handbooks of finance recall very few precedents in history, mostly due to logistic factors (London, 1987 (1 day), NYSE/NASDAQ, 2001 (4 days), NYSE/NASDAQ, 2012 (2 days), Athens, 2015 (5 weeks)), and scholars' findings on the point outline several potential drawbacks of such a measure (spill-over effect from equity to sovereign bonds markets, freezing of liquidity for both retail/SMEs and institutional investors, the market overreaction when re-opening). Nevertheless, the cries of those demanding a shutdown have always been loud. During the COVID-19 pandemic, these voices came even stronger from both political and institutional rooms. At CONSOB (the Italian Securities and Exchange Commission), we carefully listened to that request, we deeply analysed the situation and, finally, we firmly refrained from taking such a drastic decision.

As the European Securities and Markets Authority (ESMA) clearly stated, maintaining open and orderly markets "allow(s) the process of adjusting prices to new information to continue, and they provide liquidity to the benefit of investors by allowing them to rebalance portfolios and meet contractual obligations". The International Organisation of Securities Commissions (IOSCO) was of the same opinion.

The COVID-19 crisis, furthermore, is showing another reason to advocate for the non-closing case. Figures of the current crisis are definitely abnormal in both the downside and the upside trend.

In March the equity market dramatically collapsed at a pace never seen in former crises: S&P500 took only 19 days to reach a 30% loss compared to 31 days in the Great Financial Crisis and 152 days in the Dotcom crisis. Volatility too reached all-time highs, when the VIX index recorded a shocking peak of 82.7 (80.8 during the Great Financial Crisis). But what happened from mid-March on is of no less remarkable significance.

All main equity indices pulled off terrific rebounds in a range of 25%-40%, pairing most of the previous loss in less than two months. In the aftermath of the Great Financial Crisis, the best performer (S&P500) took more than one year to reach the same result. To cut a long story short, an unprecedented market shock followed by an unprecedented market reaction. In between, unprecedented monetary and fiscal stimulus packages.

According to McKinsey analysis, Governments' economic responses alone are worth more than USD 10 trillion, which is three times more than the response to the 2008–09 financial crisis.

Moving back to the markets open/markets closed debate, we can easily say that such a historical – and coordinated - response would not have been implemented if governments and central banks had not had the measure of the unparalleled severity of the crisis. People against markets shut-downs are used to saying that forcing a stock market to close would be like "getting rid of the thermometer when it signals a fever".

Expanding on this metaphor, we could say that when your illness is so severe that you need to take antibiotics, you must have a thermometer marking very high values to convince the doctor to prescribe them.

Strongly supporting the thesis of keeping capital markets open even during the strongest crisis does not mean doing nothing to prevent markets from free-falling. In order to preserve the orderly functioning of markets, reinforce market confidence and stop potential bearish speculation, CONSOB took a resolution to impose a ban on the creation of net short positions and on the increase of existing net short positions on 17 March.

Simplistically viewed as a mere short-selling ban, this measure has been criticised by those who, among market operators and scholars, are strictly convinced that a short-selling ban has proven so far useless if not even detrimental for liquidity and price discovery.

CONSOB resolution presents, however, innovative elements deserving attention. Firstly, it overcame the classic naked/covered sales dichotomy to embrace a quite larger scope of operations, including the use of (short) derivatives and other bearish strategies and the reference to (the creation of or the increase in) net short position. Secondly, it was not properly a CONSOB measure, having been adopted simultaneously by six other National Competent Authorities (NCAS) under the coordination of ESMA.

From this perspective, it can be seen as one of the most significant forms of supervisory convergence ever deployed in Europe and a benchmark for future cooperation. Finally, acting as the first actual stress test for the EU short-selling Regulation, it denounced its limits paving the way for a potential overhaul of the rules. It is obviously too early to collect evidence of how successful this action – simultaneously terminated by all authorities on 18 May – was.

> “The winds of crisis seem to have faded momentarily”

We do know, however, that this experience will make it easier to quickly adopt measures again in the case of a second wave.

The winds of crisis seem to have faded momentarily, and we all do hope that we will be facing a quiet autumn. Meanwhile, we can meditate on the two lessons we have learned in these tumultuous weeks.

Firstly, we saw that extremely hard times deserve extremely effective actions. These necessarily have the nature of fiscal and monetary responses, but such measures, in turn, need a liquid, transparent and continuously working capital market in order to fully unlock their potential.

Secondly, European markets terrifically enjoyed the spirit of greater coordination deployed by EU Institutions; hopes of a quick recovery of European economies rely on the revolutionary project of so far unknown cooperation among the Member States. Securities market supervision must take the same route.

It's time for an unprecedented shift towards a new dimension of regulatory and supervisory convergence suitable to empower the Union of real crisis management tools and resources.

What the experts had to say about the MFSA's performance in 2019

MARJORIE CHRISTIAN

Acting Deputy Chief of Mission, US Embassy in Malta

The United States is committed to partnership with Malta – we work closely with the MFSA, the Government of Malta, and the private sector. We have deepened our collaboration on several fronts to counter transnational financial threats, money laundering and terrorism finance, improve cybersecurity, and share best practices on FinTech. Since 2019, various U.S. experts from agencies like the Commodity Futures Trading Commission, Internal Revenue Service, Federal Bureau of Investigation, Department of Justice, and Treasury Department have partnered with Maltese financial authorities to share experience and expertise.

Thoughtful 21st century regulatory approaches together with international cooperation is a must to successfully combat financial crime. Digital innovations, like blockchain, have potential to unleash new levels of transparency - they can also be exploited by bad actors. The integrity of our global financial system requires strong partnerships now more than ever. We remain committed to the fight against money laundering and finance threats to strengthen rule of law in Malta. Through close collaborations like the Financial Integrity Forum, we continue to confront some of the region's crucial challenges, together.

JP FABRI

Partner, Seed Consultancy

As an island economy, Malta has embodied the concept of legislative and regulatory innovation since Independence carving out niche economic sectors on the basis of strong regulations, including financial services.

In order to remain competitive and attractive, Malta needs to ensure that such regulation-based sectors continuously transform themselves and the ecosystem they form remains robust. The MFSA is currently undergoing a complete transformation and the vision it has launched for itself and the sector clearly underlines the ambition to position Malta as a regional future-focused financial services hub. Regulatory innovation coupled with digital transformation and capacity building from a supervisory point of view are central tenets of regulated ecosystems and the MFSA is definitely on the path to set new standards. The Annual Report for 2019 shows that this transformational journey is well under way and I am confident that this will serve as an important catalyst for both the industry and the economy.

Financial services remain a backbone of Malta's economy and the MFSA remains a key player in the broader ecosystem. The transformation that it has embarked on and already started will play a key role in enhancing Malta's international investment attractiveness.

DANA FARRUGIA

Chief Executive Officer, Tech.mt

The MFSA's restructuring and investment in technology to ensure a more efficient, cost-effective and structured function to improve governance is highly commended by Tech.mt. With Tech.mt's constant drive for digitalisation, we are aligned with the MFSA's transformational journey. MFSA's investment in technology affirms Malta's pledge on good governance and the fight against corruption. Going down this route is the first phase of remodelling the credibility that Malta deserves to keep leading in terms of regulation and enforcement. We applaud the MFSA's revamp of its technology strategy and its commitment towards complete digitisation and digitalisation of its business processes.

At Tech.mt we strongly believe that technology can swiftly identify illicit behaviour by mapping strings of transactions and through AI applications pin point immediately any strange behaviour. We would also like one day to see a convergence of systems between the private sector and the Government, where financial transactions can be jointly tracked and from where in future taxation can be automatically calculated, whether it is per sale or per transaction.

As a country we need to have the right policies, the right mechanisms and the right commitment in place to truly embrace this new digital era.

JOSEPH FALZON

Professor - Department of Banking and Finance, University of Malta & Director, Malta Stock Exchange

Over the last two years, the MFSA has undergone a silent revolution. Under the leadership of the Chairman, Prof. John Mamo, and the CEO, Joseph Cushieri, the MFSA has restructured itself to emerge as a modern regulatory body of our financial services sector that inspires confidence and trust from all stakeholders.

The MFSA has a mammoth task because it is the regulator not only of the financial services sector, but also of the banking and insurance sectors. It also has to keep abreast of the vast legislation coming from Europe and to be ready to implement this legislation into the local sectors.

The Annual Report of 2019 clearly shows the huge steps that the MFSA has taken in all of its areas and all the progress that it is implementing. One hopes that the MFSA will continue to engage more with the private financial sector so that together, Malta will be able to continue to develop further this crucial sector in its economy.

ROSANNE BONNICI

Partner, Fenech & Fenech

The MFSA has taken several steps over the past months in pursuit of delivering to an increasingly higher standard in terms of its role in the licensing and ongoing supervision of financial services providers.

At present, time-to-market remains all-important, this being a, if not the single, most important jurisdictional advantage that Malta can leverage going forward.

This requires a focused commitment to, and continuous uncompromising investment in, organisational capacity and operational efficiency on the Authority's part. Recent steps taken by the MFSA augur well in this regard.

WILLIAM PORTELLI

President, Malta Union of Bank Employees (MUBE)

Malta's strong reputation of being traditionally a stable and reliable finance hub where the banking and finance industry prospers, strives to not only recover but to renew platform. As a jurisdiction, Malta is experiencing a transitionary phase where regaining credibility to support holistic effective recovery is a priority. Very relevant is how the institutions conduct business and are able to show integrity, accountability and responsibility at all levels. The MFSA, being the regulator and a firm driver of the process, cannot accept anything short of the highest of standards as it is the only way our nation can recover its former long-time good reputation that directly supports all those who work in the finance industry.

As the world gradually heads into a gig economy that is practically an evolution of the digitalised era with its already trendy flexible practices, Malta has to avoid self-inflicted reputational damage as it seriously poses potential unwarranted risks to the country's future wellbeing which rises above party politics. The fact that Government has officially pledged to implement all 58 recommendations of the EU Council's MONEYVAL report should leave no room for complacency.

Whilst improvement has been registered, standardisation of mandatory practices conducted by qualified personnel will help consolidate what has already been achieved in support of consistency and credibility.

Download the MFSA 2019 Annual Report

Risk Management transformation within the MFSA

The MFSA recognises that it is imperative to monitor and mitigate risks. During 2019, the MFSA continued to focus on enhancing its resource capabilities to maintain residual supervisory and operational risks at acceptable levels. The MFSA's Risk Management function was established as a separate function within the Authority reporting directly to the Risk Committee as an independent committee of the Board of Governors.

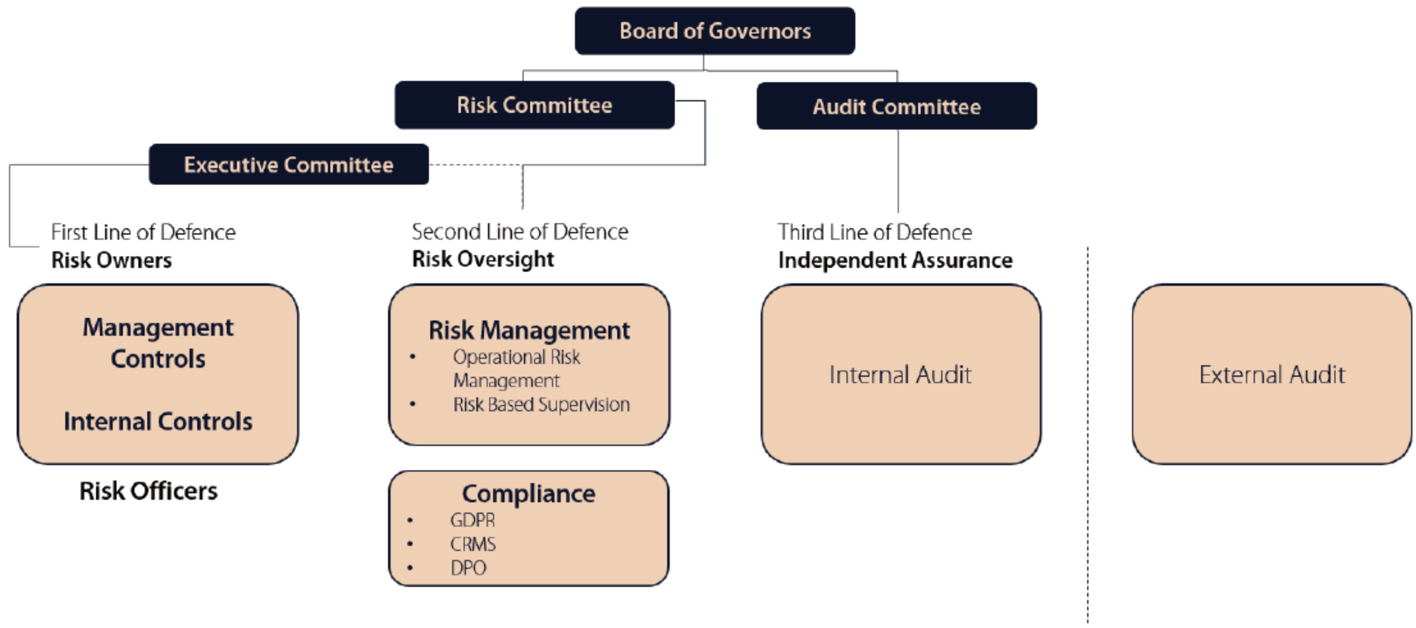
The first step undertaken towards the transformation process was the establishment of a Risk Management Framework, developed as a practical model in alignment with the MFSA's strategies and priorities.

The three lines of defence concept is the basis for promoting clear accountability for risk taking, oversight and independent assurance within the MFSA.

The first line of defence within the MFSA is provided by the business, support and operational functions, such as Supervision, Technology, Data Management and People & Culture. They "own" the risks associated with their activities and are responsible for assessing risks and taking action to address them. At the MFSA, we have appointed Risk Officers within each of these functions to act as the central point of contact for all related risk subjects and to assist in the promotion and awareness of the Authority's risk culture.

> "The three lines of defence concept is the basis for promoting clear accountability for risk taking, oversight and independent assurance within the MFSA"

MFSA - Three lines of Defence Methodology



Our Risk Management Function is responsible for the MFSA's internal risk analysis and mitigation. It acts as the second line of defence and is responsible for keeping the risk control framework of the Authority under review whilst providing strategic input and direction regarding the Authority's risk appetite. The team is also responsible for the organisation and development of work processes for the identification, management and reporting of risk within the Authority.

Internal Audit provides the third level of defence. This function provides a level of independent assurance that the risk management and internal control framework is working as designed.

During its first year in operation, the MFSA's Risk Management Function carried out the following activities:

➔Identified and assessed known risks and emerging issues.

➔Developed the MFSA's **Risk Appetite Statement** which documented the most significant risks to which the Authority is exposed and provides an outline of the approach to managing these risks.

➔Drafted the MFSA's **Risk Culture Statement** which describes the set of shared attitudes, values and behaviours that characterise how the Authority and its staff consider risk in their day-to-day activities.

➔Provided guidance on risk management processes.

➔Assisted in strengthening the supervisory risk-based approach by carrying out a sectoral risk analysis that identified licensable sectors that expose the MFSA to the highest of risk.

The Risk Management team also worked towards enhancing and strengthening the risk methodology and models underpinning the Authority's supervisory activity. The **Risk-Based Supervision** document which has been recently published outlines the work conducted in this regard. It clarifies how the Authority's supervisory risk models have been enhanced to incorporate financial crime risks into the risk assessment processes, and how these risks are now positioned at the heart of it.

Adopting a risk-based supervisory approach enables the MFSA to better allocate its resources, supervisory plans and procedures based on the unique risk profile of each firm under its supervision.

Non-bank financial intermediation in Malta

An academic paper, titled "Non-bank financial intermediation in Malta", penned by the MFSA Chief Officer Supervision, Christopher Buttigieg, and MFSA Analysts within the Financial Stability Function, Mariana Gkoutse and Theresa Fenech, has been published in the Law and Financial Markets Review Journal. The paper presents a first estimate of the size of non-bank financial intermediation (NBFI) in Malta as well as the regulatory implications for its monitoring.

Based on extensive research and analysis of information from various reports, articles, websites and other sources referenced throughout the paper, it transpires that NBFI in Malta is not only small, but also subject to significant EU and national regulation. Given the benefits that the real economy could gain from NBFI, the main challenge for the regulators is to strike a balance between the optimisation of their benefits and the minimisation of potential losses due to the build-up of risks emanating from this sector.

The assessment is based on the narrowing down approach introduced by the Financial Stability Board. The paper also provides an extensive review of the EU and national regulatory framework within which NBFI entities operate, listing also the challenges arising from this sector.

Users subscribed to the academic journal can view the full paper **here**

How have technological advancements helped the Company Secretary?

JOHN SAMMUT
Head - Internal Audit, MFSA

"An increasingly automated world could assist both in improving governance as well as the role itself"

Steve Jobs once said: "Technology is nothing. What's important is that you have faith in people, that they're basically good and smart, and if you give them tools, they'll do wonderful things with them." Against the backdrop of the difficulties created by COVID-19, the Company Secretary has the opportunity to consider how an increasingly automated world through various technological advancements such as robotics and artificial intelligence, could assist both in improving governance as well as the role itself.

In many instances, the Company Secretary consumes a significant amount of time in allocated administrative responsibilities such as compiling notices, registers, compliance returns, agendas and taking down minutes during meetings of the company and of its board of directors. Such administrative responsibilities do reduce the capability of the Company Secretary to focus on other important areas such as strategy, research, problem-solving, representation, co-ordination and management of information systems.

For this reason, the Company Secretary cannot ignore the openings presented by technological advancements which offer the opportunity to manage the ever-increasing governance challenges and complex compliance requirements faced today by all organisations. Through "E-transformation", the Company Secretary can do away with traditional office work mechanism and implement "e-services" such as e-ipo, e-dividend, e-filing and e-groups.

Changes to legislation and regulations together with the latest news, updates, case laws and judgements can nowadays all be obtained through the click of a button.

Communication advancements also present the Company Secretary with the opportunity to facilitate more efficient board meetings. Video conference facilities can replace the traditional board meetings where all members have to be physically present at the organisation's boardroom to discuss and decide on agenda items.

Besides, such facilities do reduce travel costs and time, particularly when international board members or subsidiaries of organisations are involved or located in different countries.

A board portal software could save Company Secretaries' and directors' time, to allow for more strategic work through electronic voting tools, submission of agenda, meeting minutes and messaging features.

Such facilities offer better security and also reduce time consumed in filing and retrieving the Company Secretary's documentation and also space and costs involved in storage facilities. Better document management systems ensure the possibility of paperless company secretarial documents, easier trace of documents and less storage space required.

The Company Secretary must keep abreast of digital skills by undertaking appropriate training and assists board members and other stakeholders to engage with the opportunities provided by technological advancements.

Such training is to include not only hands-on experience for board members on how to operate innovative IT systems but also increase their awareness of IT risks such as cybersecurity.

The ever-increasing cyber-related threats as a result of digitalisation can expose the Company Secretary's custodian role of a large volume of sensitive information and records. A robust data and business recovery plan need to be in place to counteract the eventuality of a loss of data through breaches in information security governance.

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