

CAPITAL MARKETS STRATEGY

TAKING OUR MARKETS TO THE NEXT LEVEL

CONSULTATION DOCUMENT

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Foreword



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MFSA's Vision 2021 announced that the MFSA is seeking to be a leading forward-looking financial services regulator, having the respect and trust of the industry and the general public, contributing towards a strong and dynamic financial sector. In furtherance of this, in the MFSA's Strategic Plan 2019-2021 the Authority indicated that work was underway on the formulation of the Authority's Capital Markets Strategy which would serve to create a more flexible and robust regulatory regime to cater for the local capital markets.

Capital Markets are vital to any modern economy. They facilitate the movement of capital and its allocation thereby fostering economic growth. The effects of the COVID-19 pandemic are testament to the need of a having a strong local capital market to assist businesses accessing funds to face the unprecedented challenges brought by this pandemic. On a general basis, companies have been required to reinvent their ways of doing business, including the need to restructure and invest in their business to strengthen their resilience.

The capital markets can be the ideal source of funding especially in the form of equity to provide companies with a more stable financial position and more working capital to survive the crisis. Efficient local capital markets are crucial, not only for a rapid economy recovery from COVID-19 but also to improve financial stability and maintain essential investment flows to the advantage of investors and businesses alike.

In June 2020 the High-Level Forum on capital markets union ('CMU') published its final report on the EU's capital markets union. This report clearly indicates that now, more than ever, the CMU is an essential part of the process of economic recovery for Europe. Valdis Dombrovskis, Executive Vice-President of the Commission and in charge of Financial Stability, Financial Services and Capital Markets Union stressed the importance of the CMU as *"a major element of our post-coronavirus recovery strategy. Savers and investors will play a vital role in getting the economy moving again and they need to have the confidence to invest through capital markets. And companies need to be able to access diversified sources of market-based financing anywhere in the EU."* The latter statement is substantiated by several issuances of equity securities by a diverse array of companies across Europe during the pandemic.

The Authority is mindful of the necessity of improving and growing a liquid local capital market through a framework which would cater for the ever-changing requirements of companies seeking access to finance. As the single supervisory authority for financial services in Malta, the Authority is also aware of the significant restrictions on banks and the de-risking of their portfolios in terms of various regulatory requirements. This too renders the capital markets an important avenue of funding for local small-to-medium enterprises.

The Authority is aware of the fact that there is room for growth in the local capital markets and that various novel proposals may not currently fall within the parameters which are generally deemed to be acceptable to the Authority. The Capital Markets Strategy aims to close these gaps and establish a landscape wherein such proposals as foreign issuers and innovative businesses would be considered favourably for admissibility to listing where they would satisfy certain criteria aimed at safeguarding investors and the integrity of the markets. The proposed Capital Markets Strategy encompasses all the players in the market and aims to create a holistic approach to the local capital markets eco-system. Although clear, modern rules are important, the strategy does not focus only on rules, but considers other aspects including risks, the role of the investors and intermediaries, such as the Sponsor to protect market integrity.

The Authority is also mindful of the various developments at a European level such as developments on the CMU and the European Commission's Digital Finance Strategy, the pertinent parts of which shall be factored into the Authority's Capital Markets Strategy. In this regard the Authority is currently working on the implementation of Regulation (EU) 2020/1503 of 7 October 2020 on European crowdfunding service providers for business which could create significant opportunities for local SMEs to raise up to €5 million over a period of 12 months in terms of the legal framework to be promulgated thereunder.

When discussing the local capital markets infrastructure, one cannot but mention the role of the Malta Stock Exchange (MSE) and the evolution thereof over the past few years. From trading of only Malta Government Stocks on a weekly basis in early 1992, to becoming a fully-fledged Regulated Market offering a structure for admission to trading of financial instruments, to also offering post-trading infrastructures, a wholesale securities market targeted at institutional investors and the Prospects Multilateral Trading Facility, to the MSE Institute, the MSE has adapted and developed areas of the Maltese Capital Markets according to the varying needs of its stakeholders. New initiatives of note by the MSE are its framework for Real Estate Investment Trusts (REITS) and its proposals on Green Bonds.

Another area which the Authority's Capital Markets Strategy shall target is increasing investor education. The MFSA strongly believes that the need for increased financial literacy of investors, enhanced transparency and better access to fair and high-quality professional advice, combined with empowering investors to make the right investment decisions will result in a more active capital markets landscape.

We look forward to receiving feedback from all stakeholders on our proposals in order to work together to creating a truly fluid and robust regulatory framework for the local capital markets.

Table of Abbreviations

CIS	Collective Investment Scheme
D2E	Debt to Equity
DSCR	Debt Service Coverage Ratio
EU	European Union
FATF	Financial Action Task Force
FDDR	Financial Due Diligence Report
FMA	Financial Markets Act
MFSA	Malta Financial Services Authority
OFAC	Office of Foreign Assets Control
REITS	Real Estate Investment Trusts
RMBS	Residential Mortgage-Backed Securities
STO	Security Token Offering
UBO	Ultimate Beneficial Owner
UN	United Nations
VFA	Virtual Financial Asset

Introduction

By definition, capital markets are venues where investors look for the best return to invest their savings and issuers look for the lowest finance cost to attain funding for their business prospects. The Malta Financial Services Authority ('MFSA' or the 'Authority') is the competent authority for the regulation of trading venues, market infrastructures and the prevention of financial markets abuse. The Authority's Board of Governors also currently acts as the Listing Authority. The proposed Capital Markets Strategy objective is to address the minimum quality of an issuer approaching the market with respect to financial soundness, corporate governance and transparency on one hand and educating investors on the other hand. Educating investors will empower investors to ask the right questions and to take positions in the market which can shape the market through the demand for certain issuers and securities.

The document, being published today by the MFSA, sets out a Strategy to take Malta's Capital Markets to the next level by: [i] establishing the Authority's risk appetite when considering applications for admissibility to listing; [ii] enhancing the legal framework to improve efficacy, efficiency and effectiveness; [iii] strengthening the Sponsors Regime; [iv] building supervisory capacity; and [v] setting out a strategy for investor education; with the aim of encouraging fair, efficient and transparent capital markets. The ultimate objectives of the strategy are [i] providing equal and fair opportunities to market players; [ii] safeguarding the stability and integrity of the financial markets; thereby enhancing investor confidence and sustainable growth; and [iii] protecting investors, by ensuring a minimum level of quality of issuers coming to the market.

The Listing Authority is established under the Financial Markets Act ('FMA') and performs the functions set out in Part III of the said Act.¹ In this respect, Article 11 states that it is the role of the Listing Authority:

- "(a) to authorise the admissibility of such financial instruments as it considers appropriate to any recognised list;*
- (b) to make Listing Rules for the better implementation and purposes of this Part of this Act;*
- (c) to ensure compliance with any requirements or conditions set out in Listing Rules for listed financial instruments to remain listed and to monitor the timely disclosure of information by issuers or any other person subject to the Listing Rules with the objective of ensuring effective and equal access to the public in Malta and in all Member States or EEA States where the transferable securities are traded;*
- (d) to act as the central competent administrative authority responsible for carrying out the obligations provided for in the Transparency Directive and for ensuring that the provisions adopted pursuant to this Directive are applied and to issue rules in furtherance of its responsibility under any provisions of the said Directive which rules shall be binding on issuers, shareholders and any other person as may be indicated in the said rules;*
- (e) to act as the authority competent to supervise bids for the purpose of the Listing Rules made or introduced pursuant to the Takeover Bids Directive;*
- (f) to cooperate with ESMA for the purposes of the Prospectus Directive, in accordance with Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010."*²

¹ Malta Financial Services Authority Act, Chapter 330 of the Laws of Malta, Article 7A

² Financial Markets Act, Chapter 345 of the Laws of Malta, Article 11

Article 14 of the Act then states that the Listing Authority may delegate any of its functions and powers to the MFSA's Executive Committee, acting as the Listing Committee.³ The Act also states that the MFSA's function responsible for Securities and Markets Supervision "*shall also assist and give advice to the Listing Committee on listing matters.*" To this effect, the Authority has set up a dedicated Capital Markets Team, within the Securities and Markets Supervision Function, which *inter alia* handles: [i] applications for listing; and [ii] supervision of the ongoing obligations of listed companies.

This document is composed of two chapters as follows:

- Chapter I provides an overview of Capital Markets in Malta, in order to provide the background for the Strategy being presented by the Authority through this document. This Chapter also details why a Capital Markets Strategy is required; and
- Chapter II then sets out the Authority's Capital Markets Strategy. It sets out the five pillars underpinning the Strategy, describing each pillar and what stakeholders can expect from the Authority.

In the concluding remarks, stakeholders are then invited to provide feedback/comments on any aspects of the strategy.

It should be noted that as part of the overarching Capital Markets Strategy being published today, the Authority has already issued a [Consultation Document and a Feedback Statement on Security Token Offerings](#) which seeks to address risks which may potentially arise from disruptive technology and innovative models.

Subsequent to the publication of this document the Authority intends to publish the Risk Appetite Statement of the Authority when considering applications for admissibility to listing. This includes the consideration of the most significant risks to which the Authority is exposed when authorising Applicants for admissibility to listing, with a specific focus on the financial soundness, corporate governance and transparency of the Applicants. This Risk Appetite Statement provides an outline of the approach to managing these risks.

³ Financial Markets Act, Chapter 345 of the Laws of Malta, Article 14(1)

Chapter 1



Capital Markets in Malta

The Maltese Capital Markets – Licensed Trading Venues

	2020		2019		2018	
	MSE	Prospects MTF	MSE	Prospects MTF	MSE	Prospects MTF
Market Capitalisation	€13.90b	€98.1m	€12.95b	€101.8m	€12.1b	€53.7m
Market Turnover	€324.02m	€3.69m	€487.6m	€3.35m	€392.7m	€1.2m
Deals	24,777	694	29,290	555	26,222	207
CSD Accounts	76,809		77,439		77,700	

By virtue of the provisions of the Financial Markets Act and the Investment Services Act, the MFSA is responsible for the regulation of trading venues⁴ operating in or from within Malta. At present there are three trading venues authorised by the Authority as follows:⁵

- i. Malta Stock Exchange plc (MSE) – a regulated market
- ii. Institutional Financial Securities Markets (IFSM) – a regulated market targeting the wholesale market
- iii. Prospects – a multilateral trading facility.

The MSE today is the market operator of three trading venues, namely the MSE Main Market, Prospects and the IFSM.

On 13 November 1990, the MSE was enacted through the Malta Stock Exchange Act (Cap. 345 of the Laws of Malta) as a *quasi* Self-Regulated Organisation, with the first equity listed in 1992 and trading commencing on the 8 January 1992. Ten years on, the Malta Financial Services Authority became the regulator of the MSE, following the legislative change in 2002 where the Malta Stock Exchange Act was amended and renamed the Financial Markets Act (Cap. 345 of the Laws of Malta).

Today the MSE has a market turnover of circa €328m, with over €13.9b in market capitalisation. The MSE main market is the largest contributor to such statistics, which is a regulated market in terms of MiFID II. However, the MSE has explored other areas of business for market participants locally. The MSE's Prospects multilateral trading facility has provided a rather novel route of access to financing for small and medium-sized enterprises, whilst the IFSM, the latest addition to the MSE's portfolio, is a regulated market which is specifically designed for institutional investors given that the minimum denomination of financial instruments which may quoted is of €100,000 per financial instrument.

Overleaf are some key figures that indicate the level of activity in the local markets:

⁴ The term trading venues encompasses [i] regulated markets; [ii] multilateral trading facilities ('MTFs'); and [iii] organised trading facilities ('OTFs')

⁵ This information is publicly available on the MFSA's Financial Services Register

	2020		2019		2018	
	Issues	Market Capitalisation	Issues	Market Capitalisation	Issues	Market Capitalisation
Equity	26	€4.16b	25	€4.73b	24	€4.41b
Corporate Bonds	72	€1.87b	70	€1.87b	62	€1.68b
Malta Government Bonds	46	€6.94b	43	€6.05b	46	€5.72b
Treasury Bills	38	€0.65b	19	€0.3b	20	€0.29b
Collective Investments Schemes	55	N/A	132	N/A	133	N/A

Formulating the Capital Markets Strategy

In line with the [MFSA Strategic Plan 2019-2021](#), the MFSA has formulated a Capital Markets Strategy which seeks to foster growth, enhance and future-proof the applicable regulatory framework whilst ensuring effective investor protection, market integrity and the soundness of the financial markets. The Authority has taken a holistic approach to formulate the Capital Markets Strategy and has based the proposed five pillars underpinning the strategy, which are explained in detail in Chapter 2, on different aspects which are fundamental to the whole capital markets ecosystem.

Another important step which is essential to the Capital Markets Strategy is establishing the Risk Appetite of the Authority in respect to applications for admissibility to listing. Presently the Listing Authority considers each application for admissibility to listing on a case-by-case basis and a default risk appetite has been established along the years. Although market players including Sponsors are aware of the Authority's position *vis-à-vis* certain types of applications, the publication of a Risk Appetite will surely help to clarify the expectations of the Authority in this area.

In this respect, the Authority has carried out a risk assessment in order to identify the risks which need to be managed and to ensure that the revision in the regulatory framework reflects the Risk Appetite of the Authority when it comes to considering applications for admissibility to listing.

During the past months, the Authority has also received several innovative proposals from stakeholders *vis-à-vis* capital markets. These include: [i] proposals relating to new types of issuers;⁶ [ii] applications for dual listings; [iii] security token offerings; [iv] proposals for Real Estate Investment Trusts ('REITS') and Residential Mortgage-Backed Securities ('RMBS'); and [v] applications for trading venues having innovative business models. The proposed Capital Markets Strategy takes into consideration these challenges.

The Authority considers the strategy as a comprehensive, long-term approach which will allow local capital markets to develop within an environment which fosters innovation whilst protecting investors and financial market integrity and stability. It will continue to promote fair competition and choice and ensure that markets participants have equal and fair opportunities.

⁶ These may include foreign companies (including Maltese registered companies with foreign operations), start-ups and specialist issuers (issuers whose business model centres around a specific industry e.g. shipping or aviation)

Chapter 2



Our Strategy

The Five Strategic Pillars

The Authority has set out the following five strategic pillars underpinning the Capital Markets Strategy.

- Pillar I – Establishing the Authority’s Risk Appetite in considering applications for admissibility to listing
- Pillar II – Revision of the Regulatory Framework
- Pillar III – Strengthening the Sponsors’ Regime
- Pillar IV – Building up supervisory capacity
- Pillar V – Educating Investors

Pillar I – Defining the Risk Appetite of the Authority when considering applications for admissibility to listing

As indicated in the preceding section, a risk assessment exercise was carried out prior to drawing up this strategy, in order to identify the risks inherent to Maltese capital markets, which have distinctive characteristics when compared to foreign capital markets. Cognisant of the particular characteristics and risks associated with the local markets, the objective of establishing a risk appetite of the Authority when it is considering applications for admissibility to listing is to ensure sustainable growth in the Maltese Capital Markets. This risk appetite of the Authority shall serve as the basis for the rest of the pillars underpinning the Capital Markets Strategy.

Applicants are stratified into three risk categories which will determine the extent to which additional application requirements are imposed on each applicant, together with the time, effort, resources and depth of assessment required. Additional requirements may *inter alia* include: [i] a Financial Due Diligence Report (‘FDDR’); [ii] an independent review of complex valuations; [iii] enhanced procedures to ascertain the good repute of the issuer’s officers; [iv] enhanced disclosure requirements; [v] additional governance related conditions in addition to the minimum requirements established by the Listing Rules/Capital Market Rules; [vi] the imposition of conditions on the issuer; [vii] requirements for issuances to be performed through finance vehicles whereby a trustee is appointed to represent debt holders; and [viii] a requirement for the issuer to establish a presence in Malta.

The following are the three risk categories:

- i) Applicants that exhibit strong positive characteristics – strong positive characteristics include issuances which are rated, or which can demonstrate an earnings capacity prior to the issuance of debt, sufficient to sustain a Debt Service Coverage Ratio (‘DSCR’) of 1.1 over the life coverage of the issuance and are: [i] established in Malta; or [ii] have similar securities listed on a Regulated Market (or equivalent) in a country with a better credit rating than Malta.

- ii) Applicants that exhibit characteristics for automatic refusal – this category would *inter alia* include: [i] applications from applicants connected with persons blacklisted by the FATF, with sanctions from the EU/UN/OFAC or are incorporated in jurisdictions having a low credit rating at date of issuance; [ii] applications from applicants incorporated in jurisdictions having ineffective justice systems; [iii] applications from applicants exhibiting weak financial soundness; [iv] applications from applicants whose officers do not meet qualities of propriety, particularly where such officers are found to have been associated with immoral or fraudulent behaviour, convicted of criminal offences of high seriousness, adjudicated bankrupt by a court or tribunal, or interdicted/incapacitated by a court order; and [v] applications from applicants who do not provide adequate disclosure of requested information.
- iii) Applicants that will only be authorised provided that the Authority implements safeguards - the Authority will only authorise issuances from applicants who do not exhibit any of the characteristics for refusal subject to certain safeguards. These safeguards will be directed to the areas of financial soundness, corporate governance and transparency.

Pillar II – Revisiting the Regulatory Framework

A sound regulatory framework is crucial for the proper functioning of capital markets and leads to investor confidence and, ultimately, economic growth. The MFSA is proposing to revise several aspects of the Maltese regulatory framework for Capital Markets, *inter alia* as follows:

- (i) Amending the Financial Markets Act to enhance the role of the Authority and its supervisory and investigatory powers in view of the requirements of the Prospectus Regulation.
- (ii) Revision of the Listing Rules - this will include: [i] revisions to align the listing rules with the risk assessment aforementioned; [ii] revision of the Conditions for admissibility to listing; [iii] a weighed checklist for the Authority's completion when reviewing applications for admissibility to listing; [iv] Corporate Governance Requirements; and [v] a revision of the Continuing Obligations.
- (iii) Implementation of the Prospectus Regulation – primarily through the designation of the MFSA as being the single competent administrative authority responsible for carrying out the duties resulting from said Regulation. This would also render the MFSA responsible for the scrutiny, review and approval of Prospectuses relating to an offer of securities to the public in addition to those required in conjunction with an application for admissibility to listing.
- (iv) New Rules, policies and guidelines on the ESEF reporting regime.

Pillar III – Strengthening the Sponsors’ Regime

Sponsors play a crucial role within the Maltese Capital Markets framework. Listing Rule 2.1 states that: *“an applicant applying for a primary listing of its Securities which requires the production of a Prospectus or equivalent document is required to appoint a Sponsor.”* The role of the Sponsor is to provide guidance to the applicant with respect to the applicable framework, and to act as a point of liaison between the applicant, its advisory team and the Authority.

The MFSA is seeking to revise the Sponsors regulatory regime extending their role and responsibilities. It may be argued that Sponsors may act as gatekeepers given that they are often one of the first points of contact for prospective issuers. In this respect, the proposed framework will ensure that Sponsors act as the first line of defence, preventing persons who are not fit and proper from accessing Maltese Capital Markets. The Authority is therefore proposing the adoption of a new regulatory framework similar to that for the VFA Agent under the VFA Framework.

The Authority is considering the introduction of a framework for Sponsors *inter alia* setting out rules for: [i] Sponsors to act as gatekeepers to Maltese capital markets; [ii] a role which is not limited to the application phase but one which is ongoing; [iii] their authorisation; [iv] appointment and approval of involved parties; [v] prudential requirements; [vi] corporate governance and organisational requirements; [vii] conduct of business obligations; [viii] client on-boarding, including fitness and properness assessments of such clients; and [ix] disclosures.

Pillar IV – Building Supervisory Capacity

As stated in the Authority’s [Strategic Plan](#) 2019-2021, the Capital Markets Strategy is mission-critical for the MFSA. In this respect, the Authority is committed to invest in human and technological resources to ensure its efficient and effective implementation, and that the Authority has the necessary expertise and technical competencies to carry out its functions.

The Authority will continue building its capacity and boost resources, in line with the projected inflow of work, particularly that relating to the assessment of applications for listing and for authorisation of trading venues. Furthermore, the Authority continuously provides its staff with training in order to ensure that they are kept abreast of ongoing developments in relevant areas.

Pillar V – Investor Education

Investor Education is one of the Pillars of the MFSA’s Strategic Plan. Educational and awareness campaigns are being planned on an annual basis to enhance consumer confidence in the financial market and raise consumer awareness. Educating investors, specifically retail investors on capital

markets, will raise awareness of the inherent risks and therefore ensure that investors are in a better position to make informed decisions about their investments.

The Authority is considering requiring authorised trading venues, in which retail investors can participate, to roll out educational programmes targeted at retail investors. The Authority should be involved in such programmes. The MFSA is already engaging in several educational programmes. These will be delivered with the support of the Conduct Supervisory function.

Concluding Remarks

The MFSA is seeking feedback from stakeholders on its Strategy for Capital Markets. In this respect, stakeholders may wish to submit any feedback, via email to cmsconsultation@mfsa.mt, by not later than 5 April 2021.

In line with the Authority's Vision to enhance stakeholder engagement, draft versions of any proposed amendments to policies or rules, will be issued for public consultation.

