

# Banking & Finance Law

**Lecture Title: Banking - A Highly Regulated Business**

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# Why are banks regulated?



# Why are banks regulated?

Professor David Llewellyn, in his paper *'The Economic Rationale for Financial Regulation'* (April 1999), identified a number of objectives for regulating and supervising banks and financial institutions. These include:

## (A) To sustain systemic stability

- Regulation for systemic reasons is warranted when the social costs of failure of banks and financial institutions exceed private costs. Banks are interconnected institutions. A failure of one institution, may have a domino effect on other institutions. Examples including the recent collapse of Silicon Valley Bank, Credit Suisse and the First Republic Bank.
- Although regulators cannot be expected to prevent the financial failure of banks and financial institutions, regulation aims to reduce the risk of failure (including through capital and internal control requirements). Where financial failure nonetheless does occur, regulation seeks to reduce the impact of that failure, and, in particular, attempt to isolate the risk to the failing institution.

## (B) The correction of market imperfections and failures

- There are many market imperfections or market failures in retail financial services which create a rationale for regulation, such as problems of inadequate information on the part of the consumer, problems of asymmetric information (consumers are less well informed than are suppliers of financial services), issues related to conflicts of interest, imprecise definitions of products and contracts and the inability of retail consumers to assess safety and soundness of banks and financial institutions.



# Why are banks regulated?

## **(C) The need for monitoring of banks and financial institutions and the economies of scale that exist**

- Due to the nature of financial contracts between banks and financial institutions and their customers, there is a need for continuous monitoring of the behaviour of these licensed entities. There are several characteristics of some financial products that require a continuous process of monitoring of the suppliers of products. In the absence of regulation and supervision by regulators, consumers are required to spend time, effort and resources investigating and monitoring institutions supplying financial services.

## **(D) Consumer confidence**

- The fourth rationale for regulating banks and financial institutions relates to questions of consumer confidence. The known existence of asymmetric information can, under certain circumstances, reduce consumer demand for services and contracts. An additional role of regulation, therefore, is to set minimum standards and thereby remove poor products from the market.



# Why are banks regulated?

- There is an ongoing debate as to the better approach to regulating financial services, namely between the so-called 'regulatory capitalism' championing increased regulation and the free market ideology.
- Regulation is sometimes perceived as obstructive because it hinders operators from carrying on their business. Others perceive regulation as empowering the honest and competent operator to achieve his goals with integrity, which when achieved, will benefit the whole of our society in many ways.
- Although many market players believe that regulation of financial services (including banks) is at best beneficial to the market and at worst a necessary evil, it is very important not to stifle business with over-regulation. Excessive regulation restricts competition and this could ultimately have a detrimental effect.



# Historical Evolution of Maltese Banking Regulation and Supervision



# Historical Evolution of Maltese Banking Regulation and Supervision

- The Central Bank of Malta Act (Cap. 204 of the laws of Malta) of 1968 was enacted shortly after Malta's independence in 1964. One of the functions of the Central Bank of Malta ("CBM") was to foster the development of a capital market and promote a sound financial infrastructure in Malta.
- The business of banking was regulated by the Banking Act, 1970 and this law provided that no business of banking could be provided in Malta except by a company which was in possession of a licence granted by the Minister responsible for finance, after consultation with the CBM. However, in practice, the Minister had the final and conclusive decision on the issuance of a license.



# Historical Evolution of Maltese Banking Regulation and Supervision

- During the period starting from 1970, the CBM was the only organisation which resembled a regulator within today's meaning of the word, acting as the sole regulator of Malta's banking system.
- Following a change of Government in 1987, the Maltese legislator adopted a more liberal and open economic policy after years of rigidity. The policies of the then new government favoured the launch of Malta as an offshore centre and the development of the financial sector. This resulted in a series of laws between 1988 and 1992 which suspended certain restrictive or onerous legislation and generally started to liberalise the financial market in Malta with the CBM at the helm.
- In 1988, the Malta International Business Authority (“MIBA”) was set up to develop Malta as an international financial centre.



# Historical Evolution of Maltese Banking Regulation and Supervision

- The year 1994 marks the point in time where Malta was catapulted into an international financial centre. A radical step was taken by the then Government to promote Malta as an offshore centre. Ministerial powers relating to licensing in the financial services sector started being replaced by powers vested in regulatory bodies. The MIBA was converted into the Malta Financial Services Centre (“**MFSC**”).
- A series of laws which updated Maltese legislation to European standards and introduced new sector-specific regulatory laws were enacted. The Banking Act of 1994 (Cap. 370 of the Laws of Malta) repealed the previous Banking Act, 1970 and put paid to the Minister’s power to issue licences.



# Historical Evolution of Maltese Banking Regulation and Supervision

- Although the MFSC was designed to eventually become an overall financial services regulator, the regulatory and supervisory function over banks (except for offshore banks which were always regulated by the MFSC) and financial institutions, remained within the remit of the CBM until the complete framework for a single regulator could be put in place.
- This framework was introduced in 2002, pursuant to which the regulation and supervision of banks and financial institutions passed from the CBM to the MFSC, which was later renamed the Malta Financial Services Authority (“**MFSA**”), in such a manner as to make the MFSA the single regulator for banking, investment services and insurance business.
- Malta became a full Member State of the European Union on 1 May 2004 and Malta was therefore required to comply with European Union directives and regulations. Once Malta joined the Eurozone in 2008, the CBM then took on the responsibility - as a Eurosystem member - to maintain price stability.
- To date, laws continue to be updated regularly so as to comply with European law and practice. Developments on a European level must be transposed into Maltese law, and the Government, together with the financial services industry, fine-tune our laws to maintain our legislation in line with international developments.



# THE MALTA FINANCIAL SERVICES AUTHORITY





# The Malta Financial Services Authority

- The MFSA is the single regulator vested with the responsibility to regulate, monitor and supervise financial services in Malta. The powers of the MFSA are broadly set out in the Malta Financial Services Authority Act (Cap. 330 of the Laws of Malta).
- The MFSA is a fully autonomous public institution. It is partly funded by the industry it regulates through statutory fee-raising powers and partly by Government through the Consolidated Fund. Notwithstanding, the Authority operates independently from the Government and aims to be fully self-funded in the medium term.

# The Malta Financial Services Authority

- The MFSA's current regulatory responsibilities include banks and financial institutions; investment services; insurance business; regulated markets; and trustees and fiduciaries. Most financial services laws do not refer to the MFSA by name, but rather make reference to the competent authority being appointed in terms of law.
- The MFSA also has the duty to promote financial market integrity and the legitimate expectations of consumers of financial services, to promote fair competition practices and consumer choice in financial services and to complement the Central Bank of Malta in its role to ensure the stability of the financial system.



# The Malta Financial Services Authority

- The main organs of the MFSA are *inter alia*: (i) the Board of Governors; and (ii) the Executive Committee.

## ***Board of Governors***

- The Board of Governors receives broad policy guidelines from the Government and determines the policy which will affect the way the industry will work on a more specific level. The Board of Governors consists of: (i) a chairman, who is appointed by the Prime Minister acting on the advice of the Cabinet of Ministers; (ii) the Chief Executive Officer; and (iii) five members or more appointed by the Prime Minister who have distinguished themselves in business, financial activities, the professions, the public services or academic affairs.

## ***Executive Committee***

- The Executive Committee is responsible for the implementation of the strategy and policies of the MFSA, for the approval of regulation, for the approval of and for the issuing of licences and other authorisations and for the monitoring and supervision of licence holders. The Executive Committee consists of the Chief Executive Officer, who chairs the meetings of the Committee, the General Counsel, being the Chief Officer leading the Directorate for Legal and International Relations, and of each of the Chief Officers responsible respectively for supervision, enforcement, corporate services, operations, strategy, policy and innovation.

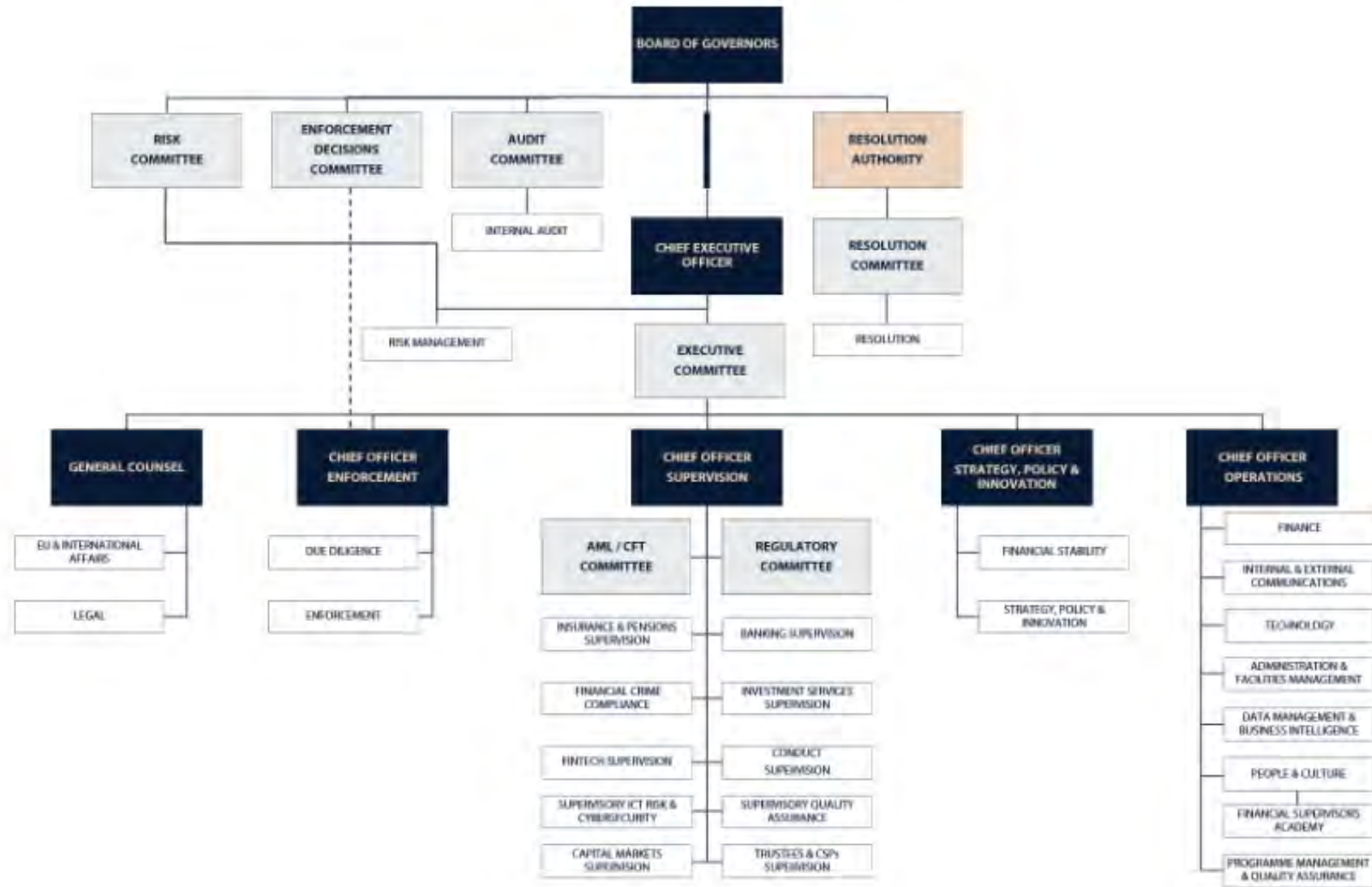


# The Malta Financial Services Authority

- The Executive Committee which is responsible for the authorisation and supervision of all persons and entities within the remit of the MFSA, has delegated to **the Chief Officer Supervision** the approval, monitoring and supervision of supervised natural persons and entities falling within the regulatory and supervisory remit of the MFSA. In turn, the Chief Officer Supervision has established the **Regulatory Committee (RegCo)** to co-ordinate effectively the approval and issuance of licenses and authorisations and to undertake supervision of all licensed persons. The Regulatory Committee is still required to obtain confirmation of approval from the Executive Committee prior to issuing licences to, amongst others, credit institutions.
- The Regulatory Committee (RegCo) is chaired by the Chief Officer Supervision and includes the heads of the respective supervisory functions and the authorisations function. The supervision unit responsible for oversight of licensed banking activities in Malta is the **Banking Supervision Unit**.







# LICENSING OF BANKS



# Licensing Trigger for Banks In Malta

- In terms of article 2A of the Banking Act (Cap. 371 of the Laws of Malta) (the “BA”), a person that is not a credit institution is prohibited from carrying on the business of taking deposits or other repayable funds from the public.
- Under the BA, a person shall be deemed to be accepting deposits of money as aforesaid as a regular feature of its business, if, whether as principal or as agent, it advertises or solicits for such deposits, without regard to the terms and conditions under which such deposits are solicited or received and without regard to whether certificates or other instruments are issued in respect of any such deposits.
- In addition, article 5(1) of the BA provides that no business of banking shall be transacted in or from Malta except by a company which is in possession of a license granted under the BA by the MFSA.



# Licensing Trigger for Banks In Malta

The '*business of banking*' is, in turn, defined as the business of a person who as set out in article 2A of the BA (referred to above) accepts deposits of money from the public withdrawable or repayable on demand or after a fixed period or after notice or who borrows or raises money from the public (including the borrowing or raising of money by the issue of debentures or debenture stock or other instruments creating or acknowledging indebtedness), in either case for the purpose of employing such money in whole or in part by lending to others or otherwise investing for the account and at the risk of the person accepting such money.



# Licensing Trigger for Banks In Malta

A licensed bank may also market, offer or provide additional services, including, amongst others, payment services. The full list of additional services is set out below:

- 1) Financial leasing;
- 2) Payment Services as defined in the Financial Institutions Act (Cap. 376 of the Laws of Malta);
- 3) Issuing and administering other means of payment (travellers' cheques, bankers' drafts and similar instruments) insofar as this activity is not covered by activity 2 above;
- 4) Guarantees and commitments;
- 5) Trading for own account or for account of customers in
  - a) money market instruments (cheques, bills, certificates of deposit, and similar instruments);
  - b) financial futures and options;
  - c) exchange and interest-rate instruments;
  - d) transferable securities.
- 6) Participation in securities issues and the provision of services related to such issues;
- 7) Advice to undertakings on capital structure, industrial strategy and related questions and advice as well as services relating to mergers and the purchase of undertakings;
- 8) Money broking;
- 9) Portfolio management and advice;
- 10) Safekeeping and administration of securities;
- 11) Credit reference services;
- 12) Safe custody services;
- 13) Issuing electronic money.



# Licensing Trigger for Banks In Malta

- The trigger point for a licensing requirement is whether the products/services are being delivered/performed *'in or from Malta'*. The MFSA has not issued any interpretative guidelines as to the meaning of the terms *'in or from Malta'* and this test is considered by the MFSA on a case-by-case basis.
- Please note that in the event of reasonable doubt as to whether the business of banking or of accepting deposits is or is not being transacted in or from Malta by any person, the MFSA has discretion to conclusively determine the matter.
- The licensing requirements and procedure for credit institutions in Malta are set out in the BA and the banking rules issued thereunder.



# Licensing Requirements and Process Under the BA

- Below is a broad overview of the licensing requirements set out in the BA.
- A company desirous of commencing the business of banking in Malta is required to:
  - (1) submit an application to the MFSA;
  - (2) have an initial capital amount of not less than €5,000,000. The initial capital amount is typically satisfied through initial share capital;
  - (3) have at least 2 individuals who effectively direct the business of the company (the four-eyes principle);
  - (4) notify the MFSA of the identities of the shareholders or members whether direct or indirect, that have qualifying holdings and of the amounts of those holdings or, where there are no qualifying holdings, of the twenty largest shareholders or members.
- The MFSA would also need to be satisfied that *inter alia*:
  - (5) controllers, shareholders and all individuals who will effectively direct the business of the credit institution (i.e. directors) are suitable persons (satisfying the fitness and properness test) to ensure its sound and prudent management;
  - (6) the credit institution has put in place robust governance arrangements which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, adequate internal control mechanisms including sound administrative and accounting procedures, and remuneration policies and practices that are consistent with and promote sound and effective risk management (we will focus on the internal governance requirements of credit institutions later on in our lecture).

# Licensing Requirements and Process Under the BA

- The MFSA is required to determine each application for a licence within 6 months of receipt of the application or if additional information is required, within 6 months of the furnishing of the information. In any event an application is to be determined within 12 months of its receipt. The MFSA may then either grant or refuse to grant a licence. If the MFSA refuses to grant a license, the applicant may appeal that decision in front of the Financial Services Tribunal.
- Credit institution licensed under the BA are required to provide the MFSA with particulars of any changes in the information provided under BA as soon as such credit institution becomes aware of such change.
- A credit institution licensed in terms of the BA is required to have its head office and its registered office in Malta.





# Licensing Requirements and Process Under the BA

- The MFSA will notify the European Banking Authority (“EBA”) of every licence issued to a credit institution.
- The granting of a licence is a concession and a revocable privilege, and no holder thereof is deemed to have acquired any vested rights therein or thereunder, and, therefore, the MFSA may revoke or impose restrictions on the licence provided to a credit institution. The burden of proving the licence holder’s qualifications to hold a licence, rests at all times on the licence holder.
- Article 12 of the BA restricts the use of the word ‘bank’, in names of companies, except by a credit institution licensed under the BA which must at all times use as part of its description or title the word ‘bank’.



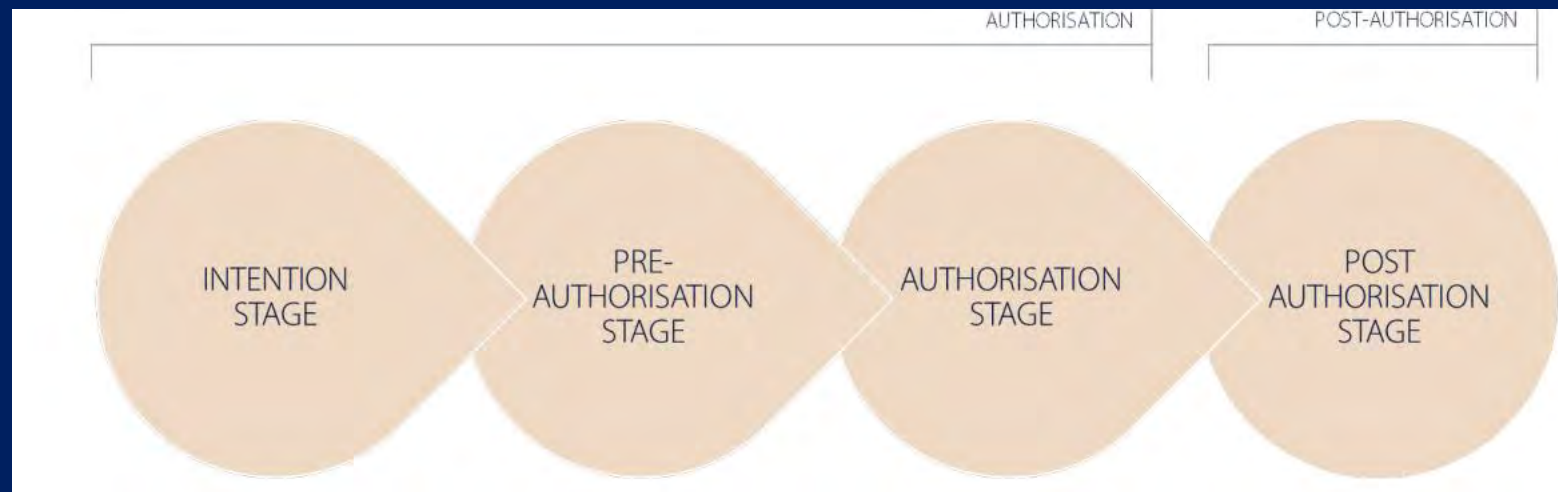
# The Application Procedure Under the Banking Rules and in Practice

- As set out in the previous slides, the BA is supplemented by banking rules. These banking rules are accessible through the MFSA website (Homepage > Our work > Credit institutions > Rules). Insofar as relevant for the purposes of this lecture, the banking rule which regulates the application procedures and requirements for authorisations of licences for banking activities, is Banking Rule BR/01.
- BR/01 provides, amongst others, that together with the application form, an applicant is required to submit to the MFSA: (i) a copy of the draft memorandum and articles of association; (ii) audited financial statements for the last 3 years (if any); (iii) a business plan; (iv) an overview of the internal organisation of the credit institution; (v) whistleblowing policy; (vi) conflicts of interest policy; (vii) complaints handling policy; (viii) market abuse policy; (ix) consumer protection policy; (x) remuneration policy; (xi) policies and procedures in relation to AML/CFT.



# The Application Procedure Under the Banking Rules and in Practice

The licensing process is divided into four stages: (i) intention stage; (ii) pre-authorisation stage; (iii) authorisation stage; and (iv) post-authorisation stage.



# The Application Procedure Under the Banking Rules and in Practice

## *The intention stage*

Prior to the submission of a complete application pack with the MFSA, the credit institution will draw up a statement of intent to the MFSA (in a form of a brief memo) which is a summary of *inter alia* who the shareholders, ultimate beneficial owners and directors will be; the committees intended to be set up by the credit institution; the proposed services to be provided by the credit institution in terms of the BA; the proposed organisation structure; the business model and strategy; whether the credit institution will utilise the right to provide services in the EU; details of the head office in Malta; and the branches to be established in Malta. A meeting will be set up with the Banking Supervision Unit whereby the promoters of the credit institution will present this information to the MFSA.



# The Application Procedure Under the Banking Rules and in Practice

## *Pre authorisation stage*

- Once the statement of intent is submitted to the MFSA and a meeting is held, the MFSA will give an indication to the applicant whether it is willing to accept the intended business plan. Once the MFSA is satisfied of the applicant's proposal, the applicant will submit the application with the MFSA (through the LH portal) and all ancillary documents to it such as the personal questionnaires of individuals who intend to be ultimate beneficial owners, shareholders, directors or holding a senior managerial role and corporate questionnaires in the case of legal persons. The documents set out earlier in the slides will also be submitted to the MFSA.
- Through the submission of personal questionnaires and corporate questionnaires, the MFSA will assess the fitness and properness of individuals and legal persons (as the case may be). This assessment is a rigorous due diligence process on the proposed appointees and the MFSA will assess the: (i) competence; (ii) reputation; (iii) conflicts of interest and independence of mind; and (iv) the time commitment, of the proposed appointees.



# The Application Procedure Under the Banking Rules and in Practice

## *Authorisation stage*

- If satisfied with the contents of the information received, the MFSA will issue an 'in principle' approval for the issue of the licence after any outstanding matters are finalised. The 'in principle' approval will be valid for specified period of time from the date of issue thereof during which the applicant will be required to finalise any outstanding matters, as indicated in the licence conditions. Signed copies of the application form, together with supporting documents in their final form, will then be submitted.

## *Post-authorisation stage*

- The MFSA may require certain post licensing matters to be satisfied prior to the issuance of the licence.
- In Malta, there are around 25 licenced credit institutions and branches of foreign banks. You can check whether an entity is licensed as a credit institution or is authorised to carry out any other licensable activity through the Financial Services Register on the MFSA's website (MFSA > Financial Services Register).





**Diploma in Law (Malta)**



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# SUPERVISION



# Supervision

Banking supervision falls under three main areas: (i) micro-prudential supervision; (ii) macro-prudential supervision; and (iii) conduct supervision.

## *Micro-prudential supervision*

- Micro supervision of banks refers to the regulatory oversight of individual banks and financial institutions. The objective of micro supervision is to ensure that individual banks operate in a safe and sound manner, comply with relevant laws and regulations, and maintain the financial strength necessary to meet the needs of their customers and the broader economy.



# Supervision

## *Macro-prudential supervision*

- Macro supervision of banks refers to the oversight and regulation of the banking system as a whole, rather than just individual banks. It involves monitoring and assessing the overall stability and health of the banking system, identifying systemic risks and vulnerabilities, and implementing policies and regulations to mitigate those risks and promote financial stability.
- Macro prudential supervision focuses on identifying and mitigating systemic risks, which are risks that can affect the stability of the financial system as a whole. Macro prudential supervision typically involves the use of tools such as capital requirements, loan-to-value ratios, and stress testing to ensure that the banking system as a whole is resilient to shocks and can withstand periods of stress.



# Supervision

## *Conduct supervision*

Complementing prudential supervision, conduct supervision focuses on the relevant institution's risk and compliance culture and consumer protection. Conduct supervision ensures that credit institutions develop policies and procedures internally and that these policies and procedures are in line with the applicable regulatory frameworks. Conduct supervision is usually conducted through on-site inspections and thematic reviews by the regulator.



# Supervision

## Supervisory authorities

- The Banking Supervision function of the MFSA is responsible for the oversight and supervision of all licensed banking activities in Malta. The ultimate objective of supervision is to ensure that licensed entities are compliant with both national and international frameworks.
- The MFSA, as a national competent authority (“**NCA**”), is in charge of supervising less significant institutions (“**LSIs**”) based in Malta (subject to the oversight of the ECB), while credit institutions classified as significant institutions (“**SIs**”) or other systemically important institutions (“**O-SIIs**”) fall under the direct supervision of the ECB via the Single Supervisory Mechanism (SSM) through Joint Supervisory Teams, which comprise staff from both NCAs and the ECB.

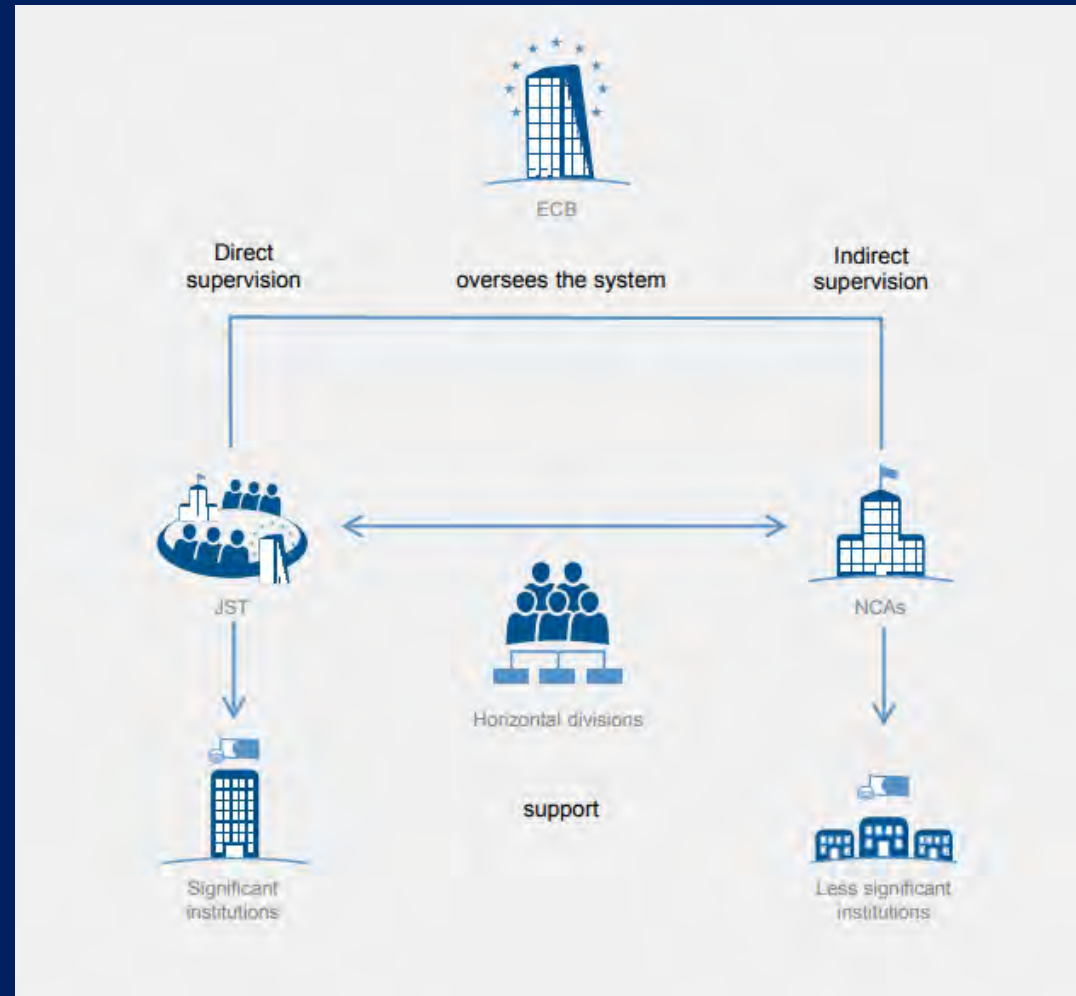


# Supervision

- Significant institutions are those institutions which, amongst others, satisfy any one of the following conditions: (i) the total value of their assets exceeds €30 billion; or (ii) the total value of their assets exceeds €5 billion and the ratio of its total assets over the GDP of the participating Member State of establishment exceeds 20%.
- In Malta, the following have been classified as O-SIIs: (i) Bank of Valletta plc; (ii) HSBC Bank Malta p.l.c.; (iii) MDB Group Limited, the parent company of MEDIRECT BANK (MALTA) PLC; and (iv) APS Bank plc.



# Supervision



# Supervision

In terms of article 17C of the BA as supplemented by Banking Rule BR/12, credit institutions are required to establish an internal capital adequacy assessment process ('ICAAP'). There are a number of supervisory requirements and powers set out in the BA and the banking rules issued thereunder, however, for the purposes of this lecture, we will focus on the internal governance of credit institutions, which is an essential component of a credit institution's ICAAP.





# Internal Governance



# Internal Governance

- The internal governance requirements of credit institutions licensed under the BA, are mainly regulated by Banking Rule BR/24 (“**BR/24**”), which was introduced in January 2022.
- The term ‘internal governance’ refers to the internal organisation of a credit institution and the way it conducts and manages its business and controls the risks it is exposed to. The internal governance framework includes the definition of the roles and responsibilities of the relevant persons, functions, and committees and how they cooperate.



# Internal Governance

## *Board of directors*

- The board of directors sit at the top of the hierarchy of internal governance of a credit institution. The board of directors have the overall responsibility for the credit institution and are required to oversee the implementation of the credit institution's strategic objectives, risk strategy and internal governance.
- In terms of BR/24, the board of directors of a credit institution is responsible for setting, approving and overseeing *inter alia* the implementation of the overall business strategy and key policies of the credit institution; the risk appetite and risk strategy of a credit institution; and the selection and appointment of key function holders (such as the risk manager and compliance officer).

# Internal Governance

## *Board of directors*

- The board of directors of a credit institution must comprise a healthy and appropriate mix of executive and non-executive directors; there is no minimum limit of the number of executive and non-executive directors that must be appointed. That said, the BA requires that the overall composition of the board of directors must reflect an adequately broad range of experiences and the directors must, in particular, possess adequate collective knowledge, skills and experience to be able to understand the credit institution's activities, including the main risks.



# Internal Governance

## *Executive directors*

Executive directors are those directors who engage actively in the business of a credit institution and are responsible for the implementation of the strategies set by the board of directors as a whole. One of the executive directors of a bank must be responsible for the implementation of AML/CFT policies and procedures. In practice, executive directors are those directors which represent the shareholders of the bank.



# Internal Governance

## *Non-Executive directors*

The role of non-executive directors sitting on the board includes the monitoring and constructively challenging the proposals and information provided by executive directors. Non-executive directors ought to include independent members which are not involved in the day-to-day functioning of the credit institution. In practice, independent members are senior directors that provide independent oversight and guidance to the bank's board of directors.



# Internal Governance

## *Chairperson of the board of directors*

- The chairperson of the board of directors leads the board and contributes to the efficient flow of information within the board of directors and between the board of directors and the committees thereof. In practice, the chairperson of the board of directors will have those powers as set out in the memorandum and articles of association of the bank and the Companies Act (Cap. 386 of the Laws of Malta).
- The chairperson of the board of directors must be a non-executive member of the board and is prohibited from exercising, simultaneously, the functions of a chief executive officer (CEO) within the same bank.



# Internal Governance

## *Chief executive officer (CEO)*

The CEO of a bank is responsible for overseeing the overall operations of the bank and setting the strategic direction for the institution. The CEO is typically the highest-ranking executive within the bank and directly reports to the board of directors.





# Internal Governance

## *Committees*

- All SIs (which include O-SIs) are required to establish risk, nomination and remuneration committees to advise the non-executive directors sitting on the board and to prepare the decisions to be taken by the non-executive directors. LSIs are not required to establish these committees.
- Where no risk or nomination committees are established, the non-executive directors ought to take on the roles of these committees.
- Each committee is to have a documented mandate. This typically takes the form of terms of reference which contain information on the minimum and maximum number of members of the relevant committee, the procedure of meetings and voting, the responsibilities and the conflict-of-interest procedure.
- All committees are to be chaired by a non-executive director sitting on the board of directors of the bank. Independent non-executive directors sitting on the board are required to be actively involved in committees.
- Committees are to be composed of at least 3 members. The risk and nomination committees are to be composed of non-executive directors of the board.



# Internal Governance

## *Risk Committee*

- The risk committee advises the board of directors on the credit institution's overall current and future risk appetite and strategy, taking into account all types of risks, to ensure that they are in line with the business strategy, objectives, corporate culture and values of the credit institution.
- One of the main functions of the risk committee is to review a number of possible scenarios such as stressed scenarios and to assess how the credit institution's risk profile would react to external and internal events.



# Internal Governance

## *Audit Committee*

- All credit institutions are required to establish an audit committee composed of non-executive directors with at least 3 members. The chairperson of the audit committee is required to be competent in accounting and/or auditing.
- One of the main functions of the audit committee is to inform the board of directors of the outcome of the statutory audit and explain how the statutory audit contributed to the integrity of financial reporting and present the yearly and (if applicable) half-yearly financial statements to the board of directors for approval.



# Internal Governance

## *Nomination Committee*

- In terms of BR/24, credit institutions which are significant are required to establish a nomination committee composed of directors sitting on the board who do not perform any executive function in the credit institution concerned.
- The nomination committee is required to identify and recommend, for the approval of the board of directors or for approval of the general meeting, candidates to fill vacancies of the board of directors, evaluate the balance of knowledge, skills, diversity and experience of the board of directors and prepare a description of the roles and capabilities for a particular appointment, and assess the time commitment expected.



# Internal Governance

- Banks in Malta, typically, establish other committees, depending on their size, nature and scale.
- Examples of other committees include:
  - **Credit Approval Committee** – which is a committee that is responsible for assessing credit facilities;
  - **Assets and Liabilities Committee (ALCO)** – which analyses financial information and assesses the impact that the various types of risks arising from changes in interest rates, exchange rates and the market, have on the profitability of a bank and the various other components of the financial statements. This Committee also monitors the commercial activity of a bank and reviews risks to liquidity and capital;
  - **Investments Committee** – the role of this committee is typically to discuss the investment strategy and specific investments for the Bank's proprietary portfolio.



# Internal Governance

## *Internal control functions*

The internal control functions of a credit institutions are required to include: (i) a risk management function ('RMF'); (ii) compliance function; and (iii) an internal audit function. The heads of internal control functions must be able to have access and report directly to the non-executive directors sitting on the board to raise concerns and warn the non-executive members.



# Internal Governance

## *Internal control functions*

- The responsibilities of the RMF includes the provision of relevant independent information, analyses and expert judgement on risk exposures, and advice on proposals and risk decisions made by business lines or internal units and must inform the board of directors as to whether they are consistent with the credit institution's risk appetite and strategy.
- The compliance function is to *inter alia* advise the board of directors on measures to be taken to ensure compliance with applicable laws, rules, regulations and standards, and must ensure that the bank is in line with its compliance monitoring programme (which sets out the compliance review of the institution for a particular year) and compliance policy.
- The internal audit's main function is to independently review and provide objective assurance of the compliance of all activities and units of a credit institution, including outsourced activities.



# PAYMENT SERVICES





# Payment services

- In the next couple of slides, we will briefly go through the main differences in respect of the licensing triggers and process applicable to credit institutions and financial institutions providing lending and/or payment services in Malta.

## *Licensing trigger*

- In terms of the Financial Institutions Act (Cap. 376 of the Laws of Malta, the “**FIA**”), no activities listed under the First Schedule of the FIA shall be transacted regularly or habitually, in or from Malta, except by a company licensed that is in possession of a license granted under the FIA by the Malta Financial Services Authority (the “**MFSA**”). The list of activities under the First Schedule include: (a) lending (including personal credits, mortgage credits, factoring with or without recourse, financing of commercial transactions including forfaiting); and (b) payment services. As set out above, the BA regulates the provision of the business of banking and other additional services.



# Payment services

- The notion of provision of services ‘regularly and or habitually’ is not defined at law; in the absence of said such definition, the terms ‘regularly and or habitually’ ought to be given a plain literal meaning, such that if services are not restricted to transactions undertaken on a purely one-off basis, this could trigger a licensing requirement under the FIA. The BA does not contemplate the concept of ‘regularly and or habitually’.
- The trigger point for a licensing requirement is whether the products/services are being delivered/performed ‘in or from Malta’. The MFSA has not issued any interpretative guidelines as to the meaning of the terms ‘in or from Malta’ and this test is considered by the MFSA on a case-by-case basis. The licensing trigger for credit institutions is the same.
- Credit institutions may provide payment services as an additional service, together with the business of banking. Whereas financial institutions are prohibited from providing the business of banking unless they are in possession of a banking license.



# Payment services

## *Rules and licensing process*

- Credit institutions are subject to *inter alia* the BA, the banking rules issued thereunder and the Central Bank of Malta Directives, insofar as local laws are concerned, whilst financial institutions are subject to the FIA, the financial institutions rules, the Central Bank of Malta Directives and certain banking rules (excluding BR/24).
- The licensing process for financial institutions, is broadly the same as that applicable to credit institutions. However, the licence application of a financial institution ought to be determined within a maximum period of 6 months, whilst the licence application ought to be determined by the MFSA within a maximum period 12 months. The initial capital requirements for financial institutions carrying payment services, varies between €20,000 to up to €350,000. Whilst the initial capital requirement for banks is €5,000,000.
- The MFSA is the competent authority for both credit institutions and financial institutions. However, in respect of banks, the banking supervision unit has the authorisation and supervision responsibility over banks, whilst in respect of financial institutions, it is the FinTech supervision unit.



# AML/CFT OBLIGATIONS FOR BANKS



# Relevant Legislation

## Prevention of Money Laundering and Funding of Terrorism Regulations

- Under Maltese law, any legal or natural person that carries out 'relevant financial business or activity' is deemed to be a 'subject person' and consequently subject to the Prevention of Money Laundering and Funding of Terrorism Regulations (S.L. 373.03) (the "**Regulations**"). The business of banking carried on by an entity licensed under the BA, is considered to be a relevant financial business or activity.
- Pursuant to the Regulations, subject persons have the duty to maintain risk-based measures relating to customer due diligence; record keeping; internal reporting; training; employee screening and procedures on internal control, risk assessment, risk management including customer acceptance policies, customer risk assessment procedures, internal controls, compliance management, communications, compliance management and communications.

## FIAU Implementing Procedures

- The Implementing Procedures provide an interpretation of the Regulations and their purpose is to guide and assist subject persons in understanding and fulfilling their obligations under the Regulations.
- The Implementing Procedures are binding on subject persons and failure to comply therewith is subject to an administrative penalty.

# Overview of key AML/CFT obligations under the Regulations and IPs



# Overview of key AML/CFT obligations under PMLFTR and IPs

## Ongoing Monitoring

- Transaction Monitoring;
- Ensuring CDD and data held is accurate & up-to-date

## Internal/External Reporting

- Appoint Money Laundering Reporting Officer
- Implement internal and external reporting channels when there is knowledge or suspicion of ML/FT to the FIAU
- Yearly submission of Risk Evaluation Questionnaire (**REQ**)
- Deliver AML/CFT Training to employees

## Record Keeping

- business relationships and occasional transactions (including, inter alia, CDD documents and details of all transactions);
- internal reports and external reports raised to the FIAU
- a record of the reasons for not forwarding an internal report to the FIAU
- a record of AML training provided / record of employee screening
- a record of any reliance & outsourcing agreements



**Diploma in Law (Malta)**



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