

Banking & Finance Law

Lecture Title: History & Legislative Landscape

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Date: 17 April 2024



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A. What is a bank?



An institution which raises funds and grants the same as loans or credit.



Banks offer a wide range of financial services which overlap with possibly other kinds of licensed and non-licensed services.

Types of Banks (non-exhaustive)

- Retail and commercial/merchant banks: these offer banking services to the general public and maybe small business, i.e. personal banking services. Retail banks give the general public the opportunity to deposit and manage their money, and obtain credit. Commercial banks may also provide banking services to larger corporates too.



Types of Banks (non-exhaustive)(cont'd)

- Investment banks: these generally take on the role of intermediators in larger transactions involving the raising of capital, or transactions relating to mergers and acquisitions;
- Payment institutions: these generally manage payments for their customers but do not necessarily grant credit (or grant credit only within a payment transaction);



The Banking Act (Cap. 370) defines the business of banking as follows:

"business of banking" means the business of a person who as set out in article 2A 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.



Services contemplated by the Banking Act

1. Financial leasing;
2. Payment Services as defined in the Financial Institutions Act;
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) foreign exchange;
 - (c) financial futures and options;
 - (d) exchange and interest-rate instruments;
 - (e) transferable securities.

cont'd

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*



Banks' role in Modern Society

- At the very core of a bank's function is a role of economic intermediary.
- But their relevance goes beyond the intermediation function. Banks (and other financial institutions) provide means of electronic payment, moving away from the traditional cash settlement systems.



B. History to Present Day

- Banks derive their concept from deposits / store of value. Originally, valuables were held in temples with priests etc. The temples themselves were repositories of these valuables.
- The temples offered a form of security to safeguard the objects deposited therewith.
- It is therefore at this time that the earliest known form of banking – understood limitedly for this case as safeguarding of deposits – took place

Roman Era

- The role of the bank was in some ways extricated from that of the temple (which however still retained a depositing role), and in some ways institutionalised into separate entities.



- The Argentarii –

whilst they had a role as repositories of value, they are more akin to modern day exchange bureaus whereby people exchanged non-roman currency with roman currency. They did however also provide credit for transactions (within the context of auctions, generally), generally to the lower spectrum of the population;

- The Mensarii –

whilst also carrying out work similar to that of the argentarii, these (generally a five-man commission) were actually appointed by the state to deal with time periods of economic hardship, and their role was that of providing liquidity to the poorer parts of the population;

- The Nummularii –

the aforementioned two made way for the Nummularii, who appeared towards the 2nd century B.C. Their role was that of providing loans, exchanging currency and operating early forms of bank accounts.



- The loans took various forms, with or without interest, and with or without collateral. Loans connected with trade activities also evidenced forms of factoring within it.
- Whilst generally the forms of loans and certain financial activities seem in principle similar (early forms) to what takes place nowadays, the consequences of non-payment were rather extreme in that the defaulting borrower could be subject to (amongst others), enslavement or mutilation.



An aerial photograph of the Florence Cathedral (Duomo) in Italy, showing its massive red-tiled dome and the surrounding city of Florence. The cathedral's facade is white with green and red marble accents. The city below is a dense collection of terracotta-roofed buildings.

Renaissance

1. Banking takes new life in the renaissance.
2. Renaissance Italy is regarded as the cradle of modern banking.
3. What really emerged during the renaissance is that merchants started making use of banks in international trading transactions.
4. There were three types of lending institutions / banks during Renaissance Italy, namely pawnbrokers, merchant banks and deposit banks.

Pawnbrokers –

these lent money to individuals, generally smaller amounts, who in turn would pawn / pledge an item of private property as security for the repayment of such debt. These kinds of loans generally attracted an interest rate – which at the time was questionable, at least in terms of the prevailing religious beliefs.

Merchant Bank –

this was the main development at the time, lending larger sums of money and extending credit across borders to facilitate trade. The Medici family for instance, had five bank branches in Italy and four in northern Europe. Merchant Banks also had significant profits made from foreign exchange transactions entered into through Bill of Exchange transactions. Bills circumvented the interest rate prohibition by making a profit through the different value in currencies. Renaissance also brought about new accounting methods as for instance the double entry accounting.



Deposit Banks –

similarly to the origins of banking institutions, renaissance banks still retained a store of value / repository of valuables element. Such banks typically also exchanged currency / coins at the time, and acted as a payment intermediary. The joint outcome of the first and third activity (deposit and payment intermediary) resulted in banks settling amounts due between creditor and debtor (who would both be depositors) through a book-entry rather than the physical movement of cash. This freed additional cash for lending, which is a critical characteristic of banking nowadays.



18th- 19th Century Europe

- John Consiglio states that banks at the time were structured mainly in two groupings,
 - banks based in large towns financing both local and international trade; and
 - smaller banks spread around the country intended to finance agricultural activity but also local craftsmen, goldsmiths.

Eventually through competition in the banking industry, the smaller players started being bought out.



Present Day

- Banks nowadays have a critical role in modern society. Indeed, they have evolved over the years in such a way which requires additional regulatory attention over banks (which will be discussed in later lectures), but also requires banks to offer certain basic services.
- This may in principle jar with a more common understanding of the way a business works.
- Take a restaurant for instance, the owner of a restaurant is by no means obliged to accept this or that patron. This is not always necessarily so with banks.



It suffices to mention that the EU has imposed upon banks, through **Directive 2014/92/EU**, the obligation to recognise the right to a basic bank account across the EU. What this means is that banks can only refuse the opening of a bank account when it runs counter to anti-money laundering obligations.

Such an account would have the following characteristics, at the very least:

- making deposits
- withdrawing cash
- receiving and carrying out payments (for example direct debits and card purchases)

C. History of Banking in Malta

The Order of St. John



The Order of St. John had what was referred to as the *Comun Tesoro*. This was the Order's consolidated fund, with its management receiving funds from various sources (landowning, piracy etc) and making payments from the same.

Through its officers, the *Comun Tesoro* gave financial advice, but it also decided on rates of exchange between the Order's currency and the Genoese *lira*.



Local banking historians opine that a predominantly rural population on the two islands with a very limited export / import activity, and the kind of political, economic, educational and social conditions of the time hardly were conducive to the growth of a banking industry which was in sync with that of mainland Europe.

It is with this in mind that it is generally perceived that lending, borrowing and similar activities were largely carried out in a private manner by individuals or certain institutions known as “Monte” or “Monti”.



Monte di Pieta'

Origins...

It is a charitable institution for the poor and for those who had fallen upon hard times through personal misfortune, to free themselves from usury.

It also served as a central fund for pious organisations and investors.

Eventually, the Monte di Pieta' also allowed for pledging of movable assets, generally gold or silver, but eventually also fabric, opening up to potential pledges by merchants.

Similarly, there was the *Monte della Redenzione degli Schiavi*, which was eventually merged into the Monte di Pieta'.



Massa Frumentaria

This also originated during the time of the Order of St. John, and its relevance to us when mapping out the history of banking in Malta is that it served as a repository of public funds raised through the issue of bonds.

The funds raised by the Massa Frumentaria were used for the acquisition and stocking of essential commodities, largely grain.



Again this is not a bank as we would understand it today, and indeed it did not fashion itself as such, but it did partake in one of the main banking operations.

The Presence of Banks in Malta

- Banks and trade prosper in tandem. Indeed, in the initial years of British rule, particularly up until 1815 or thereabout, the Islands were going through rapid economic growth.
- The first proper bank as we know it today, which also used the term *Bank* in its name was set up in 1809 as the Anglo-Maltese Bank. A second bank – the Banco Maltese - was recorded as having started in 1811



The Anglo-Maltese Bank

- It's capital was that of around GBP100,000, a quarter of which was paid up, with the remaining amount being unpaid but callable. The bank at the time provided a number of services:

- (a) Issue sight bills of exchange up to an amount which does not exceed the bank's issued share capital;
- (b) Discounting bills of exchange (short term, three month payment);
- (c) Short term deposit of precious metals with a fee of 0.25%;
- (d) Lending, with a 0.5% monthly interest;
- (e) Free of charge payments, but also come up with the types of promissory notes which in turn could be said to have been the first types of bank notes used in Malta.





- The interesting element here is that whilst intrinsically these bank notes carried no value whatsoever, the population started seeing them as a means of payment based on the trust they had in the institutions issuing them (to note however that the government did not accept such bank notes as means of payment).

- Clearly the bank had a medium-to-short credit policy; it even had (at least based on its original intentions) a medium-to-short life expectancy as also evidenced through its memorandum and articles of association, with their existing planned on lapsing after three years unless extended.

B. Tagliaferro e Figli (1812) (and others)

- Biagio Tagliaferro was essentially and primarily a merchant, ship-chandler, real estate and grain merchant. His merchant activities led him to set up what is probably the first merchant bank in Malta in 1812; a bank which had longer term policies (as opposed to the short term lending and deposit taking of the Angle-Maltese Bank and the Banco Maltese [which we will see in the next slides]).
- Another foray by private entrepreneurs into banking was that of Marquis Giuseppe Scicluna – Scicluna’s Bank, whose bank in Malta introduced current accounts operated through cheques – this was then corrupted into *cisk*, which became the trailblazing beer brand of the family business shortly thereafter.
- Both these banks were eventually incorporated into the National Bank of Malta Group.



There were other so-called “banks” at the time, though historians who have looked at this period in some detail state that the word bank was somewhat loosely used with “randomness and impunity”.

For instance, historians reference “Turnbull Junior and Somerville” who at the time described themselves as bankers. As part of their services they provided:

- Letters of credit;
- Current and deposit accounts;

Both of which are services which are nowadays provided by licensed credit institutions.





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Banco Maltese per I Risparmi

- We fast-forward to 1833 and 1834 when a Government Savings Bank was first launched in Malta.
- Effectively, the *Banco per I Risparmi* used the funds deposited with it to lend the funds to the individuals who had pawned their gold/silver etc with the Monte di Pieta'. The different sides of deposit taking and granting of credit were being carried out by the different institutions in unison.
- Eventually the *Banco per I Risparmi* introduced a new service; the bearer passbook for savings and fixed deposit accounts – i.e. accounts whose title vested in whoever carried the passbook relative to it, with no names, nor particulars recorded anywhere.



This bank also introduced (much later in time) an important concept of government guarantee on the repayment of deposits, following the promulgation of Ordinance XXV of 1 September 1961.

In many ways, this mechanism pre-dated the depositor compensation scheme which was established across the EU in the wake of a 1986 (at the time) EC Community Directive (in the aftermath of *the Savings & Investment Bank (Isle of Man)* debacle, which we will go through later in this session).



The Anglo-Egyptian Bank

- Opened a branch in Malta in the late 1800s. At the time, it had offices in London, Paris, Gibraltar, Alexandria and Cairo (together with Malta). This bank was eventually acquired by Barclays, which therefore established a presence in Malta.
- In its post war era in Malta, Barclays started decentralising its presence from Valletta to major towns in Malta including Hamrun, Birkirkara and Mosta.
- The bank grew substantially in post war Malta, and eventually also started extending credit to industrial, touristic and property development fields through Barclays Financial Corporation (Malta) Ltd. This was ground breaking in Malta; eventually however, after being acquired by Mid-Med Bank, the latter was spurred to share this business with its competitors in the 1970s through its ownership in the Lohombus Corporation (*loans for homes and businesses*).



Banco di Malta

- Founded in 1809, the list of original shareholders shows around 107 names, of these around 33 were Maltese holding around 27% of the entire share capital. The rest was held between English and Italian merchants.
- Eventually by 1946, the Anglo-Maltese Bank (referred to earlier) and the Banco di Malta (renamed Bank of Malta) merged to become the National Bank of Malta.
- A few years later, a third bank – Sciclunas bank - became affiliated with the National Bank of Malta. By 1969, 90% of the shareholding of the other remaining private bank was acquired by the National Bank of Malta.



The conglomerate of these three banks (together with Scicluna as an affiliate) grew with a pace comparable to that of the Anglo-Egyptian Bank (later, Barclays, Mid-Med and finally HSBC).

The National Bank of Malta later in the day becomes nationalised (and changes its name to Bank of Valletta) with a lot of concerns being raised on how the nationalisation took place (whether effectively it was at the time, a form of expropriation).



Banco di Roma

- Opened in Malta in the early 1900s as bankers in Rome believed in Malta's banking potential through its international trade and religious orders.
- This bank did significantly well up until Italy started suffering from sanctions imposed upon it in the wake of Italy's pre-World War II expansionist plans. Aside from there being a run-on deposits, around 1935, the local bank manager was arrested by the British and accused of treason. He was sent back to his country.
- The bank closed during the Second World War, and whilst there had been discussions for it to be reopened following the war, it ended up never reopening (even though the parties had undertaken extensive negotiations).



Post-Independence

By the early 1970s, banking services were practically available across the country to all layers of the population, with the two major banks being Barclays and the National Bank of Malta.

By mid-1970, a new Bank had been formed by the then government of the day to take over all of the assets and liabilities (effectively the business) from Barclays Bank. Mid-Med Bank was thereby created. The bank was eventually sold to HSBC late in the 1990s.



1970s & 1980s

- A dichotomy of two large banks, Mid-Med and Bank of Valletta, and two smaller banks, Lombard Bank and APS Bank prevailed during these days.

Lombard Bank was set up in 1969 by its parent, Lombard Bank Limited, a UK Company, which was eventually acquired by NatWest. At this point the parent's name changed to Lombard North Central.

By 1975, the Government had acquired 25% of the equity in Lombard Bank Malta. In 1981, government exercised an option to acquire an additional 35%, thereby becoming the majority owner in the bank.

In the 1990s, the Government announced a plan to reduce its shareholding in banks, including Lombard.



The second “smaller” bank – at least at the time –was APS. Its origins are deeply connected with religion. Indeed, its name is an acronym for “Apostleship of Prayer Savings Bank”. Its origins (started by the Jesuit community in Malta) were one of a *Cassa di Risparmio* – i.e. an institution which encourages savings. Following World War II, the Jesuits passed this on to Curia.

Today both Lombard and more recently, APS are publicly listed companies.



1990s & Noughties

1990s saw an internationalisation of the local banking context, with a lot of foreign banks (mainly Austrian and Turkish) setting up shop in Malta, in terms of the 1994 Banking Act.

Additional banks join the fray, foremost amongst which MeDirect (formerly, Mediterranean Bank), which has today, together with Bank of Valletta, HSBC, APS (formerly a “small” bank) become a systemically important bank which requires a heightened degree of supervision.

The logo for MeDirect, featuring the word "me" in a rounded rectangle followed by "direct".

me direct

The logo for Izola Bank, featuring a stylized "iB" icon followed by the text "izola Bank".

izola Bank

The logo for BNFBANK, featuring a stylized "B" icon followed by the text "BNFBANK".

BNFBANK



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D. Failure Leading to Regulation

As mentioned earlier in the slides, banks' critical role has led to a heightened regulatory environment around them.

A number of corner stone elements of today's banking system emerged in response to banking crisis taking place in the 1980s and 1990s. Taking a few of them in turn / chronologically:



1980s: The Savings & Investment Bank (Isle of Man)

SIB was a bank established and licensed in the Isle of Man.

By way of background, the Isle of Man is a self-governing British Crown dependency in the Irish Sea between England and Ireland. Its status does not make it part of the UK. Indeed, the Isle of Man has its own directly elected legislative assembly, administrative, fiscal and legal system and its own courts of law.

SIB however had business which was not strictly restricted with its own jurisdiction of incorporation, but covered the United Kingdom, and had interests in Malta too.

At face value the bank seemed to be solid but when in July 1982 an approximate statement of affairs was prepared for a creditors' meeting, it was disclosed that the asset side of the bank's balance sheet had loans and advances over £40 million.



In a statement presented to Twynwald Court (which is the legislative branch of the Isle of Man), the Chairman of the Finance Board disclosed that following a meeting with the auditors and the Board of the Bank, it was obvious that these very large loans were granted to a relatively small group of companies, and were probably irrecoverable at this stage.

This is a risk banks deal with on a daily basis within parameters set out by the EU (at least in Europe). The concept here is that of preventing as much as possible, any one institution from incurring disproportionately large losses as a result of the failure of an individual client or group of connected clients. We will deal with large exposures in a later lecture.

Upon the collapse of the bank, the Lieutenant Governor of the Isle of Man (effectively, a high ranking official within the governing bodies of the island), commissioned an examination of banking supervision in the Isle of Man by officials seconded from the Bank of England.



The investigation had established that the supervision was minimal and that government officials were unlawfully steering business towards the bank. As a result of the outcry, a new Financial Supervision Commission was established, inclusive of a specific Banking Supervision Unit which was a novelty at the time.

The losses were substantial and deposit holders eventually received around 29p in the pound which was finalised after 23 years (the liquidation was concluded in 2005!).

The Isle of Man Governor made additional *ex gratia* payments of 50p in the pound to certain depositors on the first £10,000 of their deposits. This effectively triggered an early form of Depositor Compensation Scheme.



The Bank of Credit & Commerce International (BCCI)

Originally licensed in Luxembourg, the bank operated extensively in the UK. The bank was found to have facilitated international money laundering, and was eventually shut down by the Bank of England.

The Bank of England however came under intense criticism for its supervisory shortcomings when it came to BCCI. Indeed, it was even questioned whether the Bank of England should remain as the main regulator of banks in England. The BCCI coupled by another failure which took place a few years later – Barings Bank – led to the stripping off of the supervisory function from the Bank of England and the taking on of such role by the Financial Services Authority (as indeed, we know it today).



Brief background on Barings Bank, this was one of the oldest and most respected banks in the United Kingdom.

The Bank collapsed in the mid-1990s due to fraudulent investments made by its head of derivatives trading Nick Leeson, through its Singapore offices. In a nutshell, Leeson was meant to be seeking profits through future contracts using client funds (i.e. on behalf of clients).

However, rather than doing it on behalf of clients with client funds, he had used the bank's own funds. Whilst he had been making losses, he falsified records to show profits. Losses had totalled GBP827million.



Banco Ambrosiano

Set up in 1896, the bank was generally known as a Catholic bank, with a very prudent approach towards business.

In the 1970s, Roberto Calvi become its chairman. When the Banca d'Italia starting investigating the bank's position early in the 1980s, it found extensive dealing with off shore companies owned by the same bank, to which (amongst other things) loans were granted. In some instances, these some off-share companies used the loans to acquire shares in the bank itself.

Within this narrative, one needs to bare in mind the added complexities brought about by the involvement of a masonic lodge (of which Calvi formed part), the *Istituto per le opere di religione*, which is an organ within the Vatican which was the main shareholder in Banco Ambrosiano, the Italian mafia, high profile Italian politicians and Calvi's mysterious death (he was found hanging off Black Friar's bridge in London).





E. A Complex Web of Laws

Banks are regulated by a substantial amount of laws, and whilst this course cannot reasonably cover all aspects of banking laws and regulations, we will attempt in this first lecture to provide you with a summary of what is relevant, and briefly why it is relevant.



The Banking Act

Chapter 371 of the laws of Malta as first enacted in 1994 is intended to *regulate the business of banking*.

In so doing it establishes a core principle in that banking is an activity which require authorisation to be lawfully carried out in or from Malta.

In turn, it also establishes the Malta Financial Services Authority as the competent authority which is at law, authorised to issue licences and supervise banks in their business. The Banking Act sets out key matters which banks may not do in the carrying out of their functions as licensed credit institutions, such as for instance - holding any immovable property or any right thereon except as may be reasonably necessary for the purpose of conducting its business or housing or providing amenities for its staff.

The Banking Act also regulates the ownership structures in Banks, which may in-turn having an impact on the licensed status of the credit institution.



The Companies Act

Nowhere is it specifically provided for (indeed, the business of banking may be carried out by “persons”), but in practical terms, banks are structured as limited liabilities companies established in terms of the Companies Act, Chapter 386 of the laws of Malta.

As products of the Companies Act, banks (as companies) need to be established, governed and liquidated in line with the provisions thereof. Banks are subject to the same filings as other companies are with the Malta Business Registry.



The Civil Code

Chapter 16 of the laws of Malta, aside from dealing with purely legal / technical matters such as prescription on contractual matters and liability in tort, which have a bearing on any person regulated by Maltese law, it also contains various provisions which have a bearing on the day-to-day operations of banks.

The Civil Code regulates the granting of loans, interest, compounding of interest, the provision of collateral and similar matters which banks continuously deal with.



The Malta Financial Services Authority Act

The MFSA (Chapter 330 of the laws of Malta) regulates the activity of the main supervisory body of credit institutions. Indeed, the Malta Financial Services Authority through its banking supervision unit, is responsible for the prudential supervision of banks, whilst the resolution authority - through the resolution committee is the authority responsible for resolution of banks.

Following on the aforesaid, within it, the law allows for the creation of separate organs, such as the Resolution Committee which have a significant role to play within a context where banks are to undergo a recovery process, or be subject to a resolution.

The Act also contains provisions for the creation of the depositor compensation scheme.



The Recovery and Resolution Regulations

The Recovery and Resolution Regulations are intended to implement the Bank Recovery and Resolution Directive into Maltese law. The Bank Recovery and Resolution Directive (and by extension the Recovery and Resolution Regulations) was adopted in order to provide national competent authorities and national resolution authorities of different EU member states with: (a) *comprehensive and effective arrangements to deal with failing banks at national level; and (b) Cooperation arrangements to tackle cross-border banking failures.*

The Recovery and Resolution Regulations are structured on the basis of several pillars which are intrinsically linked to bank, including:

- (a) Recovery planning and early intervention (pre-insolvency);
- (b) Resolution planning;
- (c) Preparation and conditions for taking resolution action;
- (d) Resolution tools;
- (e) Resolution financing; and
- (f) Judicial review



It is worth noting that the winding up of credit institutions is also regulated by a few other laws such the Controlled Companies (Procedure for Liquidation) Act (Cap. 383 of the Laws of Malta); the Credit Institutions (Reorganisation and Winding-Up) Regulations (S.L. 371.12); and the Residual Balances Fund Act (Cap. 618 of the Laws of Malta).



Investment Services Act

The Investment Services Act (Chapter 370) is relevant to banks where they offer – as part of their business – any one or more of the investment services and activities listed in Schedule 2 of the Act, in connection with the instruments set out in the second schedule.



Consumer Protection Legislation

Retail banks in particular are exposed to a highly sensitive and safeguarded cohort of clientele, namely consumers (i.e. any person who does not enter in a transaction further to his own business, trade, craft or profession).

The Consumer Affairs Act (Chapter 378) and legislation issued as subsidiary thereto is intended to create an environment where the average consumer has all the information easily available to make informed decisions on which products to obtain from banks.



AML / CFT Laws, and others

As subject persons, banks are required to ensure that checks are carried out on their clients and transactions in line with the risk appetite of the bank.

Banks however are also subject to Sanctions monitoring.

Banks are also subject to professional secrecy laws, data protection laws, and employment laws





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