ACHIEVING EFFECTIVE CAPITAL MARKETS IN MALTA –

THE LEGAL AND REGULATORY FRAMEWORK, RECENT DEVELOPMENTS

AND SUGGESTIONS FOR POTENTIAL REFORM

Author: Doreanne Caruana

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Faculty of Laws, University of Malta

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ABSTRACT

Capital markets provide an important channel in financing the real economy, allocating risk, supporting economic growth and sustaining financial stability. Nonetheless, these objectives cannot be achieved in a vacuum but can only be aspired to when capital markets are allowed to operate effectively. This dissertation highlights the importance of an appropriate legal and regulatory framework which is key to enable capital markets to effectively intermediate capital and contribute to investor confidence.

This thesis reviews the current situation of the local capital markets and their respective challenges, particularly those prevailing due to a somewhat rigid regulatory framework (based on EU Regulation and Directives, together with other locally-enacted legislative acts and rules), its size (which impacts liquidity and limits the value of the new issues coming to market) and the high proportion of unsophisticated retail investors. The author makes a number of suggestions for potential reform in the local capital markets with a view of making it effective for the local economy. These include, primarily, adopting an approach to EU legislation which does not go beyond the minimum requirements (unless this is beneficial to the economy) and develop capital markets that are less onerous and more cost-effective for small and medium sized companies in Malta.

Other measures such as the introduction of market makers and the openness to foreign investors could also contribute to an improved effectiveness of the local capital markets. At the same time, Malta also needs to work towards improving financial literacy, by not

only improving the knowledge of existing investors but to also enlighten future generations.

Whilst the author appreciates the development of Malta's capital markets since their inception in 1990, further efforts are required to continue improving the local capital markets in order to truly achieve a level of effectiveness that will benefit the economy at large as well as issuers and investors alike.

KEYWORDS

Capital markets; prospectus; trading venues; securities regulation; listings.

DEDICATION

To my TM from your PHD

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Investment Services Act, Chapter 370 of the Laws of Malta

Malta Financial Services Authority Act, Chapter 330 of the Laws of Malta

Malta Stock Exchange Act, 1990, Act XXXIII of 1990 of the Laws of Malta

Securitisation Act, Chapter 484 of the Laws of Malta

Prevention of Financial Markets Abuse Act, Chapter 476 of the Laws of Malta

Rules

Capital Market Rules *(as revised on 6 December 2021)*

Conduct of Business Rulebook, MFSA *(revision version of 29 July 2022)*

MFSA Listing Policies *(as revised 13 August 2021)*

MSE Bye-Laws *(as revised in October 2021)*

Prospects MTF Rules *(as revised in October 2021)*

European Union Legislation

EU Directives

Transparency Directive

Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC [2004] OJ L 390 31.12.2004, p. 38

MiFID

Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance (recast) [2014] OJ L 173, 12.6.2014, p. 349–496

Market Abuse Directive

Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse [2014] OJ L 173, 12.6.2014, p. 179–189

Takeover Directive

Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (Text with EEA relevance) [2004] OJ L 142, 30.4.2004, p. 12–23

Short Selling

Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps Text with EEA relevance [2012] OJ L 86, 24.3.2012, p. 1–24

EU Regulation

Prospectus Regulation

Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC Text with EEA relevance [2017] OJ L 168, 30.6.2017, p. 12–82

MiFIR

Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 Text with EEA relevance [2014] OJ L 173, 12.6.2014, p. 84–148

Market Abuse Regulation

Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC,

2003/125/EC and 2004/72/EC Text with EEA relevance [2014] OJ L 173, 12.6.2014, p. 1–61

Securitisation Regulation

Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 [2017] OJ L 347, 28.12.2017, p. 35–80

Capital Requirements Regulation

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance OJ L 176, 27.6.2013, p. 1–337

Solvency II

Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast) (Text with EEA relevance) OJ L 335, 17.12.2009

Commission Delegated Regulation

Re: Prospectus Regulation

Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation (EU) 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No 809/2004 (Text with EEA relevance) [2019] OJ L 166, 21.6.2019, p. 26–176

Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation (EU) 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No 809/2004 (Text with EEA relevance) [2019] OJ L 166, 21.6.2019

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LIST OF ABBREVIATIONS

ACL	Alternative Companies List
CMR	Capital Market Rule
CMSU	Capital Markets Supervision Unit
CMU	Capital Markets Union
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
IFSM	Institutional Financial Securities Market
MAR	Market Abuse Regulation
MFSA	Malta Financial Services Authority
MSE	Malta Stock Exchange
MTF	Multilateral Trading Facility
SME	Small and medium enterprises
XBRL	eXtensible Business Reporting Language (XBRL) is an international standard for the exchange of financial and non-financial information in digital form. It simplifies the delivery of digital reports to various parties and enables better access of information for analyses and benchmarking purposes

CHAPTER 1 GENERAL OVERVIEW OF CAPITAL MARKETS IN THE ECONOMY

1.1 Introduction

Financing is an important element for every business to consider as having the appropriate amount and type of funding to continue to run and grow a sustainable business operation is fundamental to every company that seeks to survive and thrive, especially in today's challenging economic conditions. The avenues that companies have in order to raise such funding may be split in four: i) organic (from own funds previously generated through operations); ii) banks and similar credit institutions; iii) private investment (new private partners or existing shareholders); and iv) the capital markets.

This study will focus on the latter option, particularly looking at how the local capital markets are structured to be the enablers of this financing avenue, by bringing together two principal stakeholders – the investors and those raising the funds.

1.2 The Economic Aspect of Capital Markets

> "*Across the globe, the financial markets have been a long-standing determinant in the overall economic growth of any country. Stable and mature capital markets, both primary and secondary, create efficient capital rising opportunities for companies and also assist in channelising domestic savings towards capital formation – fuelling a nation's economic growth*."[1]

[1] The Boston Consulting Group, 'Deepening of Capital Markets, Enabling Faster Economic Growth' (2012) <https://web-assets.bcg.com/img-src/Deepening-Capital-Markets-Dec-2012-India_tcm9-28830.pdf> accessed 10 June 2022.

While the use of capital markets by companies is aimed at fostering growth to the issuing company (through the issuance of bonds or the offer of new shares in a company) or provide liquidity to the offerors of the securities, the resultant effect may also be beneficial to the economy of a country. Banjeree and Shah (2012)[2] identify four key attributes of capital markets to the macro economy:

i) higher economic growth;

ii) higher productivity and capital growth;

iii) higher employment; and

iv) a better developed financial sector,

while also contributing to the micro economy by instilling wealth creation for private investors, more flexible financing for companies, improved governance structures that allow for greater transparency and improved confidence in the company, driving entrepreneurial behaviour, and higher cross-border merger and acquisition powers, as companies listed on exchanges become more 'visible' to the market(s) in general.

In a World Bank report, Levine (1996)[3] sought to explain the relationship between the capital markets and the development of the economy. It focuses on the importance of the aspect of liquidity that capital markets offer to investors, which benefits companies but which ultimately also benefits the economy. He argues that investments often require long-term commitment of capital, while investors may not necessarily wish to stay tied up in a long-term investment. Capital markets provide an avenue for liquidity of an investment through trading

[2] The Boston Consulting Group, 'Deepening of Capital Markets, Enabling Faster Economic Growth' (2012) <https://web-assets.bcg.com/img-src/Deepening-Capital-Markets-Dec-2012-India_tcm9-28830.pdf> accessed 10 June 2022.

[3] Ross Levine, 'Stock Markets: A Spur to Economic Growth' (1996), IMF <https://www.imf.org/external/pubs/ft/fandd/1996/03/pdf/levine.pdf> accessed 10 June 2022.

venues, where one may trade in and out of an investment more easily than they can do so in a private untradeable investment, providing a sense of control over the investment and creates an element of confidence for investors.

Well-functioning capital markets, as such, are an important contributor to economic growth. But what makes a 'well-functioning' and effective capital market? While it is beyond the full scope of this dissertation to engage in determining the aspects that make a capital market geared up for promoting economic growth by making it 'well-functioning', this dissertation will seek to reflect on the developments made in the local scene, also touching on the European sphere since most regulations come through our full membership of the European Union, and how these have been enablers or can be enablers of effective capital markets.

In the World Bank article, Levine (1996) [4] lists the aspects that influence the development of capital markets:

i) legal and regulatory;
ii) accounting;
iii) fiscal measures; and
iv) supervisory systems.

While the article is relatively old, and since then a number of economic events helped shape up markets in a different manner and / or at a faster pace than would have been expected, the author believes that these aspects are appropriate yardsticks to assess how far and how developed capital markets have become, if we were to take the local scenario as a case study. What the author considers important to add to the list above is the element of regulatory

[4] Ross Levine, 'Stock Markets: A Spur to Economic Growth' (1996), IMF <https://www.imf.org/external/pubs/ft/fandd/1996/03/pdf/levine.pdf> accessed 10 June 2022.

innovation by Member States – the fact that European regulation does not apply proportionality, countries like Malta, which may be hampered by size, need to be proactive and innovative.

1.3 The Importance of Capital Markets for Companies and the Investing Public

Capital markets provide an infrastructure for companies to raise finance from an investor base rather than from one institution, such as bank borrowing. The type of financing that they may require can be in the form of bonds (debt instruments) or shares (equity holding in companies), or a hybrid of the two. Capital markets provide the platforms needed by companies to allow a number of investors to invest in their securities. Such investment would then allow these companies to finance the intended projects or plans, but it will also allow investors to channel their savings into opportunities that provide them with the ability to increase the yield therefrom when compared to 'traditional' financial products (such as bank savings accounts).

Some companies, however, require more than just financing, particularly family businesses that are going through generation succession. In her book 'The Maltese Family Business: Getting Organised', Dr Roberta Fenech indicates that "*only about 30% of family businesses survive into the second generation and only around 10% reach the third generation".*[5] The capital markets may also serve the purpose of succession planning of family businesses, by providing the platform to seek new investors, strengthen governance structures and make it possible for future generations to exit the business without the need of dissolving, dividing it

[5] Dr Roberta Fenech, 'The Maltese Family Business: Getting Organised' (APS) p.59.

or merging it into other businesses. This is particularly important in Malta, where family businesses represent the majority of the companies and most of these are small and medium sized enterprises (SME), which seek a plan but not one where they necessarily divest of the business, but rather aim to attain a continuation thereof. Capital markets are often considered as the ideal platform for succession planning that may also contribute to sustainable growth opportunities for companies because of the access it would have to new pools of investors and the resulting prestige once it acquires a listed company status. This concept of succession planning will be dealt with in later chapters of this dissertation since it contributes to the effectiveness of capital markets and benefits to the national economy.

Another important factor that was identified earlier on in this chapter is improved governance structures. Companies that seek to list their securities are expected to improve their corporate governance structures, in line with accepted principles, which typically include supplementing boards with independent, non-executive directors, having committees in place to scrutinise transactions, have policies on the engagement of new directors and remuneration thereof, and other governance matters in place that are there to instil confidence to the market. Each jurisdiction would have their own corporate governance codes, although there are several familiarities between the codes in terms of principles applicable. The importance of these codes, how they differ globally and how they contribute to making a market more effective in terms of promoting transparency and therefore confidence for investors will be looked at in more detail in later parts of this dissertation.

Another aspect that promotes confidence in the market and therefore, provides confidence to the investing public, is transparency. The obligations on companies that seek a listing of their securities on European capital markets in respect of transparency obligations emanate

from the Transparency Directive (Directive 2004/109/EC of the European Council and of the Council of 15 December 2004, as amended).[6] The importance of transparency to the markets is summarised perfectly well in recital 1 of the said directive, which states:

> *"The disclosure of accurate, comprehensive and timely information about security issuers builds sustained investor confidence and allows an informed assessment of their business performance and assets. This enhances both investor protection and market efficiency."*

Transparency enhances also the profile of the companies that tap the capital market with the issue of securities. While private companies are not required to provide information to the market to the same extent as public companies do, this makes them less 'visible' to companies seeking to grow through mergers and acquisitions. When a company provides timely and effective information to the market, and such disclosures become enshrined in the corporate culture, the company benefits from enhanced visibility in the market, which may attract new significant investors, business partnership opportunities as well as vertical and horizontal integration opportunities.

1.4 Contribution to the National Economy

Well-functioning capital markets are a source of higher economic growth, higher productivity and capital growth, improved employment levels and a better developed financial sector in general. This theory was also examined by US Chief Economist at Goldman Sachs in 2004,

[6] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (OJ L 390 31.12.2004, p. 38).

William C. Dudley[7], who found out how the distribution of capital, and therefore risk, across the US economy led to an enhanced stability of the US banking system, while assisting companies to better raise funds required. Such conclusions were also evident when Dudley examined the UK markets.

Through the ascendancy of capital markets, it was also observed that employment levels improved, while the development of capital markets also contributed to more jobs and higher salaries to the average citizens as productivity increased.

While the list of action plans that the EU is expected to follow through in its Capital Markets Union plans will be looked into in more detail in later parts of this dissertation, it is important to highlight how the EU is pushing banks to use securitisation as a means of lightening their balance sheets and be able to lend more to the real economy through the shifting of risk off balance sheet towards the capital markets in a structured manner. Securitisation allows banks to package mortgages and similar credits and offer them as securities on the capital markets. This benefits an economy as it will allow it to grow further as banks will have the capacity to increase their lending appetite without the need to increase its own capital. Most especially, in economies like Malta, banks tend to be highly exposed to the same geographical and sectorial exposures, particularly to property, both from a commercial loans' perspective and residential mortgages. Retaining all exposures on balance sheet would necessitate an increase in capital buffers to meet regulatory ratios comfortably, which, however, comes at a cost. Securitisation could be a solution that banks in Malta are yet to venture into.

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[7] William C. Dudley and R. Glenn Hubbard, 2004. '*How Capital Markets Enhance Economic Performance and Facilitate Job Creation'* [eBook] Goldman Sachs. Available at: <https://www0.gsb.columbia.edu/faculty/ghubbard/Articles%20for%20Web%20Site/How%20Capital%20Markets%20Enhance%20Economic%20Performance%20and%20Facilit.pdf#:~:text=By%20raising%20the%20productivity%20growth%20rate%2C%20the%20development,acted%20to%20reduce%20the%20volatility%20of%20the%20economy.> Accessed 5 May 2022.

1.5 What Makes Capital Markets Effective?

The fact that capital markets are important and vital for economic growth purposes, such markets need to be set up in an environment that enables them to be effective in order to achieve these objectives. Having the appropriate legal and regulatory framework is key to enable capital markets to effectively intermediate capital and contribute to investor confidence. It is also important to ensure that capital markets are enabled to grow, innovate and be sustainable in the long-term for all stakeholders alike.

This dissertation will focus on precisely that when assessing the characteristics of the local capital markets. While their attractiveness has improved over the more recent years, the local markets still lack depth which is important to generate interest and, as a result, further growth.

1.6 The Research

The nature of this study is not a scientific one. It does not envisage to create a new theory but is one that relies on information obtained from the analysis of rules, regulation, articles and personal experiences, and assessing how the current structures and processes could be reformed or improved in order to make the Maltese capital market more effective, more mature and one which provides better options to the economy in terms of capital employment. This is also done through the comparison of the same processes and enablers of capital markets in other jurisdictions. Furthermore, it needs to be acknowledged that studies on the local capital markets are limited. The professionals that are active in this area are restricted (by choice) to a handful of law firms, an equivalent amount of financial advisers

and a few professionals from investment services firms that are key persons acting as sponsors in terms of chapter 2 of the Capital Market Rules.

1.7 Concluding Remarks

Since becoming a member of the European Union, Malta no longer operates in a vacuum or has a *carte blanche* on its regulations. Over the next chapters, the author shall delve into more detail on the three areas that this dissertation seeks to analyse: i) the legal and regulatory framework (Chapter 2); ii) recent developments (Chapter 3); and iii) suggestions for potential reforms (Chapter 4). The analysis will not be limited to the local markets but will also look beyond our shores to see what other jurisdictions did, particularly those in Europe which are subject to the same regulation, in order to identify potential reforms or changes to our national capital markets' strategy to improve further on the existing structures and make the local capital markets more effective in intermediating funds, creating investment opportunities and generate growth, both to the local economy and to the companies that seek to make offers to the public of their securities and offer a listing venue for these securities to be traded on.

CHAPTER 2 THE LEGAL & REGULATORY FRAMEWORK

2.1 Historic Introduction to Malta's Regulatory Framework

In 1988, the Maltese Parliament of the time passed the Malta International Business Activities Act (also referred to as the MIBA Act).[8] Such law put in place the necessary framework for offshore financial activities in Malta, establishing an autonomous regulatory authority that was responsible with the licensing and supervision of such activities.[9] The offshore regime ended in 1996, two years after the coming into existence of the Malta Financial Services Centre in 1994 – the centre that was developed out of MIBA following a number of regulatory changes to the MIBA Act and which was aimed at offering a "*one-stop shop to foreign investors in establishing and conducting their financial operations in Malta*".[10] 1994 was also a critically important year for Malta because it brought along new financial services legislation that regulated banking and investment services, amongst others.

This historical introduction is necessary because it lays down the foundations of the development of capital markets in Malta (amongst other key financial services as we know them today). As it progresses, this chapter will delve into the legal and regulatory framework that shaped and continues to shape the financial services sector in Malta, with particular focus on the capital markets. National regulation and rules together with European regulation and

[8] The Malta International Business Activities Act, Chapter 34 of the Laws of Malta.

[9] Fabri, David, and Godfrey Baldacchino. *The Malta Financial Services Centre: A Study in Micro-state Dependency Management?* (1999).

[10] Ibid.

directives all play an important role in the development of the capital markets, as they regulate what is permissible and how capital markets are operated.

2.2 Background to European Legislation

Malta is a member of the European Union and as such, regulations issued by the European Union become applicable without the need to transpose these to local legislation. This is why regulation coming out of the European Union "*…reduce the possibility of divergent measures being taken at national level, and should ensure a consistent approach, greater legal certainty and prevent such significant impediments".*[11]

When it comes to directives issued by the European Union, as is the case with other Member States, these would need to be transposed to local rules or legislation in the manner necessary to achieve the goals set out in the respective directives. Directives (rather than regulation) are issued when the EU recognises the importance of providing room for flexibility to the application of certain rules in different markets. In such instances, each Member State has the freedom to adopt domestic laws which implement the minimum requirements of the directives. There are instances where Member States opt to go beyond the minimum requirements, however, this could create unnecessary legislative burdens and could also place the Member State at a competitive disadvantage. Nevertheless, there are instances where it is justifiable for a country to go beyond the minimum requirement. This would

[11] Recital 5 of the Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC Text with EEA relevance. *OJ L 168, 30.6.2017, p. 12–82.*

typically be done where it would be deemed to serve to safeguard the interest of the domestic economy or markets.

2.2.1 Historic Context of European Financial Services Legislation

European financial services legislation is structured in a manner that was originally "designed" by Alexandre Lamfalussy – a Hungarian born, Belgian economist and central banker who between 2000 and 2001 headed the Committee of Wise Men on the Regulation of European Securities Markets. This committee oversaw the creation of the Lamfalussy Process of regulation in Europe, which is still applicable today. The structure of the Lamfalussy Process consists of four levels:

- Level 1 – the legislation is adopted by the European Parliament and the Council of Europe, which would establish the core values of the law;
- Level 2 – sector-specific committees would be tasked to advise on technical details of the law, which is approved by Member States' representatives;
- Level 3 – at this level, national regulators coordinate the regulations with other Member State regulators; and
- Level 4 – this level involves compliance and enforcement of the new laws and rules thereunder.

The *raison d'etre* of the Lamfalussy Process back in 2001 was to achieve a higher degree of harmonisation across the various Member States. Furthermore, following the financial crisis, there was a significant shift towards a regulatory approach (rather than a directive approach) which led to more harmonisation across the European Member States.

The *de Larosière* report,[12] commissioned by Jose Manuel Barroso, as president of the European Commission in October 2008, is a landmark report that has led to an overhaul of the financial regulatory architecture in Europe following the financial crisis of 2008. The said crisis highlighted some key deficiencies in financial structures across Europe (and elsewhere globally), including the way regulation and supervision were implemented.

The 'High-Level Group' authoring the *de Larosière* report laid down a framework aimed at "*taking the European Union forward"* based on three pillars:

i. a new regulatory agenda;

ii. coordinated supervision; and

iii. effective crisis management procedures.

At the core of these three pillars, supervision was key, with the report highlighting the importance of "*closing the gaps in regulation*" and how "*an efficient single market should have a harmonised set of core rules*".[13] It was argued that the financial crisis was the result of deregulation (Guynn)[14] and what came out of the *de Larosière* report was the need to re-regulate and centralise supervision. Since then, we have seen the EU focusing on establishing a Banking Union for the banking sector. This was and is being achieved through a strategic shift from directives to regulation, thereby promoting a convergent supervisory regime

[12] Jacques de Larosière, 'The High-Level Group Of Financial Supervision In The EU' (2009) <https://www.esrb.europa.eu/shared/pdf/de_larosiere_report_en.pdf?351e1b35ec1ca5e855d2e465383a311f> accessed 9 December 2021.

[13] Ibid.

[14] Randall D. Guynn, 'The Financial Panic Of 2008 And Financial Regulatory Reform' <https://corpgov.law.harvard.edu/2010/11/20/the-financial-panic-of-2008-and-financial-regulatory-reform/> accessed 15 April 2022.

focused on a more harmonised supervision approach – the Single Supervisory Mechanism, through a single rulebook applicable to all banks in Europe.

The relevance of this to capital markets is such that, since 2014, the European Commission, initially under former president Jean-Claude Junker, has been targeting the setting up of a Capital Markets Union to operate in a similar way as the Banking Union. The aim of the European Commission was to tackle the different problems surrounding capital markets in Europe, including the reduction of market fragmentation, diversification of financial sources, cross-border capital flows, with a special attention given to small and medium-sized enterprises (SMEs).[15]

The 2015 action plan of the European Commission for a Capital Markets Union (CMU) highlighted the importance that capital markets have for European economies at large as well as the investing public, identifying the importance of "*increasing the variety of financing sources available for all businesses, in particular SMEs and small mid-caps, from smaller or larger financial markets, including high-growth potential and innovative SMEs, and building on successful solutions for connecting them to a wider basis of prospective investors".*[16] In its statement of conclusions on the Commission Action Plan on building the CMU, the Council indicated several times the importance of common rules and streamlined approaches that would reduce cross-border barriers to investments and access to funding.

This notwithstanding, the CMU is yet to be implemented, but not before there is more harmonisation of rules applicable to the various capital markets across the Member States.

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[15] Lucia Quaglia, David Howarth and Moritz Liebe, 'The Political Economy Of European Capital Markets Union' (2016) 54 JCMS: Journal of Common Market Studies.

[16] European Bank, 'EU Banking Law' (*European Central Bank - Banking supervision*, 2022) <https://www.bankingsupervision.europa.eu/legalframework/regulatory/html/index.en.html?msclkid=2c271007b25611ecacb424431381f2d1> accessed 15 April 2022.

Reviews and updates have been made to the plan over the years, in order to be more aligned with current economic circumstances. Meanwhile, consultation papers were issued, led by ESMA, focusing on specific areas within the CMU. The CMU and the EU's action plan therefor will be discussed in the next chapter of this dissertation.

2.2.2 The European Legislative Framework for the Capital Markets

The main European legislative pieces that are key to the capital markets sphere are the following:

- Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market[17] (the "**Prospectus Regulation**") which built upon and replaced the prospectus directive (Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC – repealed, the "**Prospectus Directive**");
- the **Transparency Directive** (Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the

[17] Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC Text with EEA relevance. *OJ L 168, 30.6.2017, p. 12–82* ("**Prospectus Regulation**").

Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC Text with EEA relevance);

- The second directive on markets in financial instruments - **MiFID II**[18] - provides a legal framework for securities markets, investment intermediaries and trading venues; and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments[19] (also commonly referred to as "**MiFIR**");
- Regulation (EU) No 596/2014 of European Parliament and of the Council of 16 April 2014 on market abuse (also commonly referred to as "**MAR**"); [20]
- **Shareholder Rights Directives** – (Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies) and (Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement), commonly referred to as "**SRD**"; as well as

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[18] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance (recast) *OJ L 173, 12.6.2014, p. 349–496* ("**MiFID**").

[19] Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 Text with EEA relevance *OJ L 173, 12.6.2014, p. 84–148* ("**MiFIR**").

[20] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC Text with EEA relevance *OJ L 173, 12.6.2014, p. 1–61* ("**Market Abuse Regulation**" or "**MAR**").

- the **Takeover Directive** (Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement).

In addition to the above legislative acts, the European Commission also issues a number of delegated regulations and technical standards that supplement existing legislative acts, which are also supported by guidelines and Q&A documents, issued through ESMA.

2.2.3 The Prospectus Regulation

This regulation is considered to be "*an essential step towards the completion of the Capital Markets Union as set out in the Communication of the Commission of 30 September 2015, entitled 'Action Plan on Building a Capital Markets Union'*".[21]

The purpose of the Prospectus Regulation "*is to ensure investor protection and market efficiency, while enhancing the internal market for capital. The provision of information which, according to the nature of the issuer and of the securities, is necessary to enable investors to make an informed investment decision ensures, together with rules on the conduct of business, the protection of investors. Moreover, such information provides an effective means of increasing confidence in securities and thus of contributing to the proper functioning and development of securities markets*."[22] Prospectuses are disclosure documents issued by a company that makes an offer of securities to the public or intends to list securities on a capital market, which provide information about the company and the group it forms part of, as well

[21] Recital 1 of the Prospectus Regulation.
[22] Recital 7 of the Prospectus Regulation.

as the offer of securities, if there is one, or the securities for which an application for admissibility to listing has been made.

The Prospectus Regulation came into full effect by 2019, replacing the Prospectus Directive, and includes the minimum information that a prospectus document ought to include, the disclosures that need to be made as well as structure of the document. A prospectus document is typically split in three parts (whether physically or in terms of context):

- a part that discloses details about the issuing company (frequently referred to as the issuer) and other parties to the transaction (such as guarantors or security providers), business overview, trends, information about material contracts, the officers of the company as well as financial information. This part is known as the 'Registration Document';
- another section focuses on the disclosures related to the securities being issued, characteristics, rights and obligations, terms and conditions and investor application processes. This section is typically referred to as the 'Securities Note'; and
- the third part of the prospectus document is a summary of the other parts and is referred to as the 'Summary'.

In each of the above parts, a section on risk factors is included, relating to the issuer (and any other party relevant to the securities on offer), its business and the securities being issued.

The list of disclosures required in a prospectus comes out of Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 which supplements the Prospectus Regulation and provides insight with regards to the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading

on a regulated market.[23] Such information is presented in the form of annexes and depending on the type of issuer and issue, a specific annex would apply. The new Prospectus Regulation aligned the information that prospectuses ought to include, depending on the transaction (for example, the information about shareholders' meetings that was required to be included under the Prospectus Directive in debt issuance prospectuses is no longer required under the Prospectus Regulation, given it is not important information for debt holders). Other changes that were brought about by the Prospectus Regulation will be looked at in more detail in next chapter that discusses recent developments.

2.2.4 The Transparency Directive

The Transparency Directive was issued in 2004 and revised in 2013. It draws up on the need towards a more harmonised level of disclosures to the market related to issuers of securities which are listed on a regulated market. It regulates the need for a regular flow of information to investors, including regulated information which consist of financial reports and disclosures, information about major holdings of voting rights and other information required to be disclosed in terms of MAR. The local transposition of this directive and the requirements emanating therefrom were passed in the Capital Market Rules.

Issuers of securities that trade on regulated markets are expected to publish annual and half yearly financial reports, as a minimum. Recently, ESMA also published the regulatory

[23] Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation (EU) 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No 809/2004 (Text with EEA relevance) *OJ L 166, 21.6.2019, p. 26–176.*

technical standards specifying the requirements for the European Single Electronic Format (ESEF) that became applicable as from 1 January 2020, which uses XBRL as a standard. The objective is aligned to that of the Transparency Directive, in making financial information published in a format that makes it more accessible and easier to analyse and compare with other financial reports.

Information is key for efficient capital markets, as evidenced by the Efficient Market Theory, which "*asserts that the price of a security reflects all available information about its fundamental value*".[24] Furthermore, it enhances investor participation in capital markets and provides a basis for investor protection since it ensures that all stakeholders have the same information in a timely manner.

2.2.5 MiFIR and MiFID II

Another important set of legislative acts applicable to capital markets have been MiFIR and MiFID II. These two pieces of regulatory acts build on the first MiFID issued in 2004, and deal with the licensing and operation of trading venues, the roles and obligations of investment intermediaries, while providing a legal framework for securities markets. The main objective of these two legislations is the increasing investor protection by creating a more efficient, risk-aware and transparent market for investment services and activities. These legislative acts impose requirements on product governance and investment advice, while also seeking to regulate the practices of investment services firms in the execution of client orders, the distribution of investment research and recommendations, cross-selling and remuneration of

[24] Andrew Ang, William N Goetzmann and Stephen M Schaefer, *The Efficient Market Theory And Evidence: Implications For Active Investment Management* (Foundations and Trends in Finance 2011).

staff, in order to reduce any potential conflicts that could put the investor at a disadvantage. In Malta, most of these prudential rules and related guidelines are found in the Conduct of Business Rule Book of the Malta Financial Services Authority.[25]

MiFID has been a key piece of legislation in Europe for capital markets since it has helped shape this area to how we know it today, but also serves as the basis for the CMU as it seeks to harmonise structures and requirements in the operation of capital markets across the EU.

2.2.6 Market Abuse Regulation

Market abuse arises when someone has and acts on information on a security or an issuing company that is not publicly available in order to take advantage of that information, while market manipulation occurs when a person, knowingly, gives out false or misleading information about a company whose securities are admitted on a trading venue in order to influence the price of the securities for personal gain. Market abuse and market manipulation benefit those few that take the unfair advantage to the detriment and prejudice of others, and as such undermines investor confidence in the market if allowed.

The Market Abuse Regulation (MAR), which builds on the Market Abuse Directive (also referred to as "**MAD**")[26] seeks to protect investors and improve confidence in capital markets

[25] Conduct of Business Rulebook, MFSA (revision version of 29 July 2022) <https://www.mfsa.mt/wp-content/uploads/2019/08/20190819-Conduct-of-Business-Rulebook-Revisions.pdf?Ver=10000> accessed 5 August 2022.
[26] Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive) *OJ L 173, 12.6.2014, p. 179–189* .

by regulating market abuse in terms of insider dealing, unlawful disclosure of inside information and market manipulation:

> "*Market abuse is a concept that encompasses unlawful behaviour in the financial markets and, … consist of insider dealing, unlawful disclosure of inside information and market manipulation. Such behaviour prevents full and proper market transparency, which is a prerequisite for trading for all economic actors in integrated financial markets*".[27]

Recital 2 of MAR clearly identifies the objectives of this regulation – integrity, efficiency and transparency of financial markets:

> "*An integrated, efficient and transparent financial market requires market integrity. The smooth functioning of securities markets and public confidence in markets are prerequisites for economic growth and wealth. Market abuse harms the integrity of financial markets and public confidence in securities and derivatives*."

The general objective of improving investor confidence in the capital markets links MAD/MAR to MiFID II and MiFIR, while the objective of transparency is linked also to the Transparency Directive, albeit secondary in importance in this context. While MAR provides the detailed provisions and administrative sanctions applicable to market abuse practices, MAD establishes the minimum rules for criminal sanctions for market abuse.

2.2.7 The Shareholder Rights Directive

This directive, as amended, aims to promote the exercise of shareholder rights at general meetings of companies whose shares are admitted to trading on a regulated market. The original directive of 2007 sought to strengthen shareholders' rights in relation to proxy and

[27] Recital 7 of the Market Abuse Regulation.

electronic voting at general meetings, participating at general meetings via electronic means (thereby reducing cross-border boundaries) and be able to propose items on the agenda of a general meeting and propose resolutions (when shareholding is 5% or more of the share capital of the company).

In the 2017 amendments, the directive added further rights including: a shareholder's right for a say on directors' pay; a company's rights to identify its shareholders when such holding is held through a nominee account; facilitating the participation of shareholders resident in another EU country at general meetings; intermediaries through which the shares are held under nominee are to allow shareholders to exercise their right to participate and vote in general meetings; and requiring additional transparency disclosures in relation to related party transactions.

Malta's transposition of these directives has been included in Chapter 12 of the Capital Markets Rules.

2.2.8 The Takeover Directive

The Takeover Directive[28] is another piece of European legislation that has been key for the development of capital markets. The aim of this directive, like many other directives related to capital markets, is to protect the interest of holders of the securities of companies, particularly the minority holders, when such companies are the subject of a takeover bid, or when there is a change in control. This directive requires clear communication to the market

[28] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (Text with EEA relevance) *OJ L 142, 30.4.2004, p. 12–23.*

when and if there are intentions of an offeror company to launch a bid to acquire the shares of another company whose shares are listed on a regulated market. This draws on the need for transparency to the market, which also aims to reduce any scope for insider dealing and market abuse.

The directive determines what an offering document should include in terms of the information necessary for shareholders to determine whether a bid for their securities is to be accepted or not. National rules determine when the trigger of a mandatory bid is to take place, which sets down a set number of ways how to determine the minimum offer price for the securities. In Malta, the Takeover Directive was adopted within Chapter 11 of the Capital Markets Rules and the trigger of a mandatory bid is at the point a shareholder (or persons acting in concert therewith, as defined in the said chapter) acquire at least 50% plus one of the listed shares of a company. In other countries, such trigger of control is determined at lower levels (only Estonia was determined to have the same 50%+1 control threshold as Malta), ranging between 25% and 50%, with the majority homing in on the 30% level.[29]

2.3 The Framework for the Maltese Capital Markets

MiFID establishes three different types of trading venues: i) regulated markets; ii) multilateral trading facilities; and iii) organised trading facilities (introduced by MiFID II). These have been incorporated into the Financial Markets Act. In Malta we have regulated markets and a

[29] European Securities and Markets Authority, 'Information On Shareholder Cooperation And Acting In Concert Under The Takeover Bids Directive' (2013) <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-1642_esma_public_statement_-_information_on_shareholder_cooperation_and_acting_in_concert_under_the_takeover_bids_directive.pdf> accessed 15 April 2022.

multilateral trading facility, but do not have organised trading facilities, which are venues that facilitate the trading for structured financial instruments, emission rights and derivatives.[30]

All Maltese trading venues are all operated by the Malta Stock Exchange. The existence of the Malta Stock Exchange came into effect with the enactment of the Malta Stock Exchange Act, back in November 1990. Trading commenced just over a year later in January of 1992. Back then, the Malta Stock Exchange was the entity that licensed stockbrokers and authorised listings. The Malta Stock Exchange was, as such, the operator and promoter of the local capital markets (two roles it holds till this very day), and also the regulator – the MSE's council was responsible for and had the powers and functions to "*grant a listing on the Exchange in respect of stocks, shares and other securities*".[31]

Today, the Malta Stock Exchange provides the structure for the admission to listing of a variety of financial instruments, including the platforms for trading, settlement and registration of capital market transactions and trades. The markets operated by the exchange are the following (explained in further detail in later parts of this chapter):

- the Official List (a regulated market);
- the Alternative Companies List (a regulated market);
- the Institutional Financial Securities Market (a regulated market); and
- Prospects MTF (a multilateral trading facility).

Since its establishment, 89 companies sought listing of their securities on the Official List, of which 19 issued both debt and equity securities, 53 were debt issuers and 17 were equity

[30] The focus of this dissertation is restricted to the regulated markets and multilateral trading facilities, which are the venues that are operated in Malta.

[31] Article 5(b) of The Malta Stock Exchange Act, 1990, Act XXXIII of 1990 of the Laws of Malta.

issuers. The Official List also acts as the listing venue for funds (48 funds are listed on the Official List, although the study will not focus on this aspect). Prospects MTF listings amounted to 25 issuers, of which 2 were equity issuers and 23 were debt issuers. There were a further 23 listings in total on ACL (9 issuers) and IFSM (14 issuers).[32]

The local regulatory framework which contours the capital markets is a concoction of legislative acts, rules, bye-laws and policies. In terms of regulation, apart from the European regulation that are directly applicable in Malta as a Member State of the European Union, Malta has its own laws, some of which date back to 1994 when Malta enacted a substantial legislative package which was aimed at evolving Malta into an international financial and trading centre, and which have been amended along the years to reflect new legal requirements as well as European legislation (following Malta's accession to the European Union in May of 2004).

What follows is an analysis of the structure of the Maltese capital markets as well as the legal and regulatory framework that support these markets.

2.3.1 The Malta Financial Services Authority

In Malta, the MFSA is responsible for the approval or otherwise of "*prospectus of any offer of securities to the public in Malta*" and "*the admissibility of securities to a local regulated market*".[33] Locally, the offer of securities and the application for admissibility to listing thereof are two processes which are often combined. As such, when the MFSA is presented with an

[32] Data obtained from the Malta Stock Exchange and correct as at 30 August 2022.
[33] Article 11(1) of the Financial Markets Act, Chapter 345 of the Laws of Malta.

application, it would be assessing the aspect of disclosures in the prospectus, and the compliance (or otherwise) of the applicant with the specific rules and conditions related to listings (known as the Capital Market Rules for the purposes of the Official List).

The regulatory role of the capital markets was passed on to the Malta Financial Services Authority in 2002 when the Malta Stock Exchange Act was repealed and the Financial Markets Act came into effect. The authority for the approval of prospectuses is entrusted to the Board of Governors of the MFSA, as stipulated in Article 7A of the Malta Financial Services Authority Act (Chapter 330 of the Laws of Malta):

> *"Without prejudice to the functions and powers of the Board of Governors under this Act or any other law, the Board of Governors shall be responsible for the approval of prospectuses and admissibility to listing."*

2.3.2 Regulated Markets in Malta

The Financial Markets Act, in terms of Title III of MiFID, deals with what may be authorised as a regulated market, which is to be operated under the supervision of the competent authority, which is the MFSA in the case of Malta. In Malta, we have three regulated markets – the Official List, the Alternative Companies List (ACL) and the Institutional Financial Securities Market (IFSM).

The **Official List** was the first market that was operated in Malta, back in 1990 and was subject to the Listing Rules.[34] The Listing Rules were based on the UK's Listing Rules at the time. Today, the Listing Rules are known as the Capital Markets Rules.

[34] The UK Listing Rules have developed over the years, keeping up with new regulations and adjusting accordingly to accommodate the national capital markets' strategy. The Maltese Capital Market Rules have been subject to some changes (particularly those necessary to transpose directives), however, are yet to undergo an overhaul that will set a strategy for capital markets in Malta.

The **Alternative Companies List** was next to be launched in 1999, which was aimed at providing a listing venue for companies that sought a listing but did not necessarily meet all the eligibility criteria of the Official List as detailed in the Listing Rules, thereby encouraging more companies to come to market. The rules applicable to listings on the Alternative Companies List are found in chapter 10 of the Capital Market Rules. While the eligibility criteria are different from those of the Official List, the continuing obligations, it being a regulated market nonetheless, would still be the same for companies listed on the ACL.

The **IFSM**[35] is an institutional market, which attracts debt and other non-equity listings with a minimum denomination of €100,000. It operates under a set of rules designated to regulate wholesale securities markets in Malta - the Capital Markets Rules for Wholesale Securities Markets. Until July 2022, the approval process was through the MFSA Board of Governors, however following changes to the approval processes within MFSA when it comes to listing applications, the approval process for IFSM listing applications has now been shifted to the Executive Committee at MFSA.

All these three markets are operated by the Malta Stock Exchange and the admission of securities thereon is determined by the MFSA as the competent authority under the Prospectus Regulation (further details on the process is provided below).

2.3.3 Prospects MTF

[35] Before the IFSM, the MSE operated another trading venue for institutional investors – the EWSM (European Wholesale Securities Market) – which was a joint venture with the Irish Stock Exchange and provided a regulated market for fixed-income securities targeting institutional investors. The MSE held 20% of the shareholding into EWSM and was the market operator, while the Irish Stock Exchange owned the remaining 80%.

Title II of MiFID regulates the operational structure of Multilateral Trading Facilities, which may be operated by either a market operator or an investment firm, and which provide a venue for trading of securities. In 2016, the Malta Stock Exchange (MSE) obtained the authorisation from the MFSA to operate Prospects MTF as Malta's first Multilateral Trading Facility (MTF). To date, this remains the only MTF in Malta. It was aimed at generating interest from SMEs which sought to raise finance in a cost-effective manner. Nevertheless, the Prospects MTF Rules were drafted in a similar manner to the Capital Markets Rules, and as such, the continuing obligations that companies seeking trading of their securities on this market are still required to follow most of the requirements emanating of the various EU securities regulations. Furthermore, Prospects MTF was not launched under the SME Growth Market regime allowed under MiFID II, which would have provided more flexibility and alleviations of onerous reporting obligations otherwise applicable, as shall be looked at below. This may have also been a missed opportunity in Malta due to the flexibility that an SME Growth Market could afford, since there are a number of family businesses that qualify as SMEs and which may find it burdensome, due to characteristics of their own, to seek a listing on the Official List – this topic necessitates its own sub-section at a later part of this dissertation given its prominence and importance for the local economy.

2.3.4 The Capital Markets Rules

The Capital Markets Rules (CMRs)[36] are the responsibility of the MFSA in terms of the Financial Markets Act. These rules, formerly referred to as the Listing Rules until August 2021, as the

[36] The Capital Market Rules, MFSA (revision version of 6 December 2021) <https://www.mfsa.mt/wp-content/uploads/2021/12/Full-Capital-Markets-Rules-as-amended-on-6-December-2021.pdf> accessed 3 January 2022.

name implies, set out the rules applicable for any company seeking to list on the Official List or the ACL.

The Capital Market Rules are split in 12 chapters, and a definitions section at the beginning, covering the following topics:

- The role of the Malta Financial Services Authority and compliance with and enforcement of the Capital Markets Rules (Chapter 1)
- Sponsors and their responsibilities (Chapter 2)
- Conditions for admissibility (Chapter 3)
- Application for admissibility to listing (Chapter 4)
- Continuing obligations (Chapter 5)
- Circulars that are to be issued by the listed companies (Chapter 6)
- Specific rules for property companies (Chapter 7)
- Admissibility requirements for Collective Investment Schemes (Chapter 8)
- Rules for public sector issuers (Chapter 9)
- Alternative Company Listing requirements (Chapter 10)
- Takeover bids (Chapter 11)
- Shareholders' rights (Chapter 12)

Companies seeking a listing need to appoint a sponsor in terms of Chapter 2 of the CMRs and ensure they meet the requirements for admissibility to listing included in Chapter 3. The disclosure in the prospectus emanates from Chapters 4, 5 and 7 of the CMRs. Following listing,

companies are required to comply with the continuing obligations found in Chapter 5 of the CMRs.

2.3.5 The MFSA Listing Policies

Apart from the rules mentioned above, the MFSA has a number of policies applicable to applicants seeking admissibility to listing of securities to the regulated market. A set of such policies are published by the MFSA and are known as the 'MFSA Listing Policies'. These were drafted in March of 2013 and have recently been revised (in August 2021) to reflect changes to the FMA with regards to the terminology used for the MFSA Board of Governors (from Listing Authority) as the approving body for listing applications.

These published policies cover certain requirements for debt issuers, particularly those targeted at the retail investors. In addition, the MFSA has other policies which are yet unpublished, but which are applicable to applications for admissibility to listing in various circumstances, depending on the type of issue (such as lock in periods for equity offers). Several discussions have been held and numerous attempts have been made to encourage the MFSA to include these 'unpublished policies' in the Capital Markets Rules or within the Listing Policies, as such transparency in terms of specific listing requirements are deemed necessary to ensure a smoother process in the application for admissibility to listing.

2.3.6 Other Rules

The Institutional Financial Securities Market (IFSM) operates under a set of rules designated for wholesale securities markets – the Capital Markets Rules for Wholesale Securities

Markets. These rules regulate the offers made, the prospectus that needs to be published and conditions for admissibility to listing applicable to the different type of securities which may be listed on IFSM, that is, asset backed securities, debt securities, convertible debt securities and derivative securities. Like the Capital Market Rules applicable for the Official List and ACL, there is a set of continuing obligations that issuers listing on IFSM are bound to comply to, also because IFSM is a regulated market and as such, certain disclosures emanating from the Transparency Directive and MAR would still apply. Nevertheless, given the nature of the investors on this market being institutions, investor protection afforded is lower than that afforded to retail, and the requirements are lighter. The applications for admissibility on IFSM are handled by the Listing Agent with the MFSA, and approval is through the MFSA Board of Governor, as may be delegated.

The Prospects MTF rules set out the process and the criteria for securities to be admitted to trading on the local MTF. The rules also set out a number of continuing obligations which, compared to the continuing obligations emanating from the Capital Markets Rules, are quite similar, despite it being an MTF. The rules were approved by the MFSA and, given the fact that securities offered to the public and admitted to trading on Prospects MTF were offered to retail, the rules sought to provide for a comparable set of disclosures as those of securities admitted on regulated markets. The applications for admissibility to trade on Prospects MTF are handled through the Corporate Advisor – a role which is somewhat similar to that of the Sponsor for the Official List – and the approval process is through the MSE Board.

Another set of rules are the MSE Bye-Laws. The bye-laws set out the administrative and approval processes undertaken by the MSE of the applications for admissibility to trading on the various markets, the operations and functions of the exchange, including the admission

requirements of the various venues, and the rules relating to the central securities depository, clearing and settlement of trades.

2.3.7 The Financial Markets Act

In 2002, the Malta Stock Exchange Act was repealed and replaced by the Financial Markets Act (Cap. 345 of the Laws of Malta, FMA). The FMA is the main legislative act that regulates capital markets in Malta, determining market operators, their role and obligations, the requirements to attain a listing in Malta and establishes the Malta Financial Services Authority as the competent authority responsible for the approval of prospectuses, approval (or otherwise) of applications for admissibility to listing on regulated markets, monitoring of market disclosures by issuers, ensure the compliance by issuers to rules and continuing obligations, the issuance of the Capital Market Rules and for the cooperation with ESMA.[37]

The FMA specifically states that "*no securities shall be: a) offered to the public in Malta unless and until a prospectus is approved by the competent authority; and (b) eligible for admission to listing and trading on a local regulated market unless and until the competent authority has approved the admissibility to listing of those securities*".[38]

2.3.8 The Companies Act

Companies are regulated through the Companies Act (Cap. 386 of the Laws of Malta). Companies seeking a listing are required to be either "*a company formed and registered in*

[37] Article 11(1) of the Financial Markets Act, Chapter 345 of the Laws of Malta.
[38] Article 12(1) of the Financial Markets Act, Chapter 345 of the Laws of Malta.

accordance with the Companies Act; and (ii) a company constituted or incorporated or to be constituted or incorporated outside Malta, irrespective of whether the company has or has not established a place of business in Malta".[39]

For a company to be able to offer its shares or issue bonds (debentures) to the public, it cannot be a private company, as clearly stated in Article 209(2) of the Companies Act:

> *"A private company shall not - (a) offer to the public, whether for cash or otherwise, any shares in or debentures of the company; or (b) allot or agree to allot, whether for cash or otherwise, any shares in or debentures of the company with a view to all or any of those shares or debentures being offered to the public, within the meaning given to the expression "offers of securities made to the public" in article 2(3); or(c) allow any of its equity securities to be admitted to listing or trading."*

Furthermore, a company applying to list its shares, whether making an offer to the public or not, in terms of (c) above, needs to also be incorporated as a public limited liability company. However, where an offer to the public is not made for debt securities (also referred to as a technical listing), the issuer need not be a public limited liability company.

The Companies Act provides the framework for the incorporation of Maltese companies that seek admissibility to listing, although this is also supported by the requirements of the Capital Market Rules in terms of board complement, corporate governance, timeline for the publication of financial statements and the publication of notices to the public (referred to as Company Announcements).

[39] Article 2(1) of the Financial Markets Act, Chapter 345 of the Laws of Malta (as cross-referred by the CMR definition of the term "*Company*").

2.4 Concluding Remarks

The next chapter will delve into more detail on the characteristics of the local capital markets, how these compare to other jurisdictions, and how recent developments have helped shape capital markets, locally and abroad. Such analysis is key to be able to identify ways how the local capital markets may be improved, for them to be more effective in their intermediation role of finance.

While the legal and regulatory framework identified in this chapter may be regarded as having a restrictive effect, this may not always be the case. While Europe has been aiming to maximise harmonisation amongst a number of areas in the capital markets sphere, European regulation and directives have been drafted in a way that does not just apply a one-size fits all in a variety of ways. They allow for a degree of flexibility in how national capital markets may operate, particularly for small and medium sized enterprises (SMEs).

CHAPTER 3 THE LOCAL CAPITAL MARKETS & RECENT DEVELOPMENTS

3.1 Introduction

With the aim of seeking ways on how to make capital markets more effective for the local economy, this chapter will assess what enables effective capital markets, identifying the characteristics of the local markets, how such characteristics may at times present several challenges and identify what may be lacking or is ineffective in the local setup. It will also consider what developments in the regulatory sphere have taken place that may allow for a more effective capital market and how such developments may be implemented locally to have a more viable capital market that seeks to benefit both its two main stakeholders – the issuers and the investors – and which in turn, ought to have a positive impact on the economy in general.

As intimated in earlier parts of this dissertation, the trading venues operated by the Malta Stock Exchange are the following:

i) The regulated main market (widely referred to as the Official List);

ii) The Alternative Companies List (ACL, also a regulated market);

iii) The Institutional Financial Securities Market (IFSM, also a regulated market); and

iv) Prospects MTF (a multilateral trading facility).

As noted earlier on, in Malta, the MFSA is responsible for the approval of prospectuses required for the purposes of a public offer of securities as well as the applications for admissibility to listing of securities on a regulated market. The Financial Markets Act

specifically states that "*no securities shall be: a) offered to the public in Malta unless and until a prospectus is approved by the competent authority; and (b) eligible for admission to listing and trading on a local regulated market unless and until the competent authority has approved the admissibility to listing of those securities.*"[40]

3.2 Approvals for Regulated Markets and Prospects MTF

The rules applicable to regulated markets are found in the Capital Markets Rules (the IFSM has its own lighter regime rules, but this market falls outside the scope of this dissertation) and the Prospects MTF Rules. Applications for admissibility to listing of securities on the regulated market and offers to the public are reviewed and approved by the MFSA. While the issuer has to submit an application for admission to trading on the regulated market venue with the MSE, this is considered as a formality since the MSE Bye-Laws determine that an issuer has to comply with the Capital Markets Rules, which is the basis on which the MFSA approves the application for admissibility to listing.

Research shows that these two processes are very often linked also in other jurisdictions as well, as competent authorities would be responsible to ensure compliance with regulation related to prospectus disclosures for public offer of securities and conditions for eligibility to admissibility to listing of securities on regulated markets. However, while the whole process and the eligibility rules for admission on the regulated markets are assessed by the MFSA in Malta, there are some jurisdictions where the relative stock exchange on which the securities are listed would have their own rules and conditions applicable to companies seeking a listing

[40] Article 12(1) of the Financial Markets Act, Chapter 345 of the Laws of Malta.

or a venue for trading of their securities. This difference becomes even more pronounced in instances where the stock exchanges provide various types of listings, including listings on regulated markets.

While the basic rules emanating out of the European regulation are applicable to all companies that seek a listing of their securities on regulated markets, some issuers on foreign markets may be expected to adhere to more stringent rules for being eligible to list on specific regulated markets, particularly when such markets also allow for the distribution of the securities with retail investors across a number of jurisdictions in Europe. This was tested to a certain extent with the Alternative Companies List (ACL) in Malta, however, the connotations that were attached to ACL market was that only companies that cannot make it to the Official List get listed there. As such, the ACL was only used a few times and currently there is only one company[41] listed thereon.

Furthermore, when it comes to Prospects MTF, the process is overseen by the MSE. However, the fact that the rules for admission to trading were designed around the Capital Market Rules, the difference between seeking admission to trading on the Official List and on Prospects MTF becomes blurred, and practically all that remains is the different name given to the document required (a Prospectus vs Admission Document) and the advisor needed (Sponsor vs Corporate Advisor). Moreover, it can also be argued that the Prospects MTF can be more onerous in certain respects, including the obligations imposed on the retention of a Corporate Advisor for as long as the issuer's securities continue to be admitted to trading on Prospects MTF. Another similar instance which is more onerous than the rules applicable to

[41] The company is called Loqus Holdings plc – data correct as at the date of publication of this dissertation. Information accessed from Malta Stock Exchange www.borzamalta.com.mt.

companies listed on the regulated market is the obligation on the Prospects MTF issuers to employ a compliance officer that will need to ensure that there is constant compliance with the Prospects MTF rules.[42] These, among other obligations, exert cost pressures on those companies seeking to use Prospects MTF for the purposes of the trading of their securities, which arguably discourage issuers from considering this venue.

3.3 Characteristics and Challenges of the Local Capital Markets

The characteristics of the Maltese capital markets are, very often, challenges in themselves. These characteristics shape the Maltese capital markets, and, along with the rules and regulations that have been discussed at length thus far, have an effect on the type of transactions that come to market and the level of participation of the local investor base therein.

3.3.1 The Predominant Retail Investor Base

The predominant type of investor in Malta remains the retail investor, which has its own benefits and challenges, as shall be seen going forward.

Following the 2008 financial crisis, interest rates slumped and bank 'fixed term' deposits no longer attracted meaningful returns. As a result, par of the liquidity held by bank depositors was re-channelled towards the capital markets, which yielded better returns, albeit with (arguably) higher risk. This made fixed income securities most attractive when compared to

[42] Definition of "Compliance Officer" under rule 1.01.02 of the Prospects MTF Rules.

other securities issued on the local capital markets, because they were considered a substitute to the "fixed term" deposits at banks. As a result, pensioners seeking to invest to complement their monthly pension (previously done so through their bank deposits) and other strata of the low-income earners of the population, who may not necessarily understand the underlying risk of investments as much as they should, but have only regard to the returns generated thereby, end up featuring as the majority of the retail investor base in Malta.

In fact, this predominance of the retail investor poses a few challenges to the operation of the local capital markets, namely:

i) the lack of sophistication of the investor base;
ii) a lower level of participation from institutions, which is particularly necessary for larger issues and offers;
iii) activity on the secondary market is subdued, more so after COVID-19; and
iv) there are no market makers which could otherwise encourage more participation of institutions.

3.3.2 Sophistication of Investors

Fama (1970, p. 383)[43] writes, "*The primary role of the capital market is allocation of ownership of the economy's capital stock. In general terms, the ideal is a market in which prices provide accurate signals for resource allocation: that is, a market in which firms can make production-investment decisions ... under the assumption that security prices at any time 'fully reflect' all*

[43] E.F. Fama The behavior of stock-market prices J. Bus., 38 (1) (1965), pp. 383.

available information". While issuers on capital markets are obliged to be transparent with the market and there is an expectation of disclosure, also from a regulatory point of view, the reality in Malta is that very few retail investors actually subscribe to company announcements, are aware of them or read them. Company announcements are issued by the company and posted on their website and on the officially appointed mechanism section of the Malta Stock Exchange website.[44] The ones that actively read company announcements are either investment services firms, institutional investors or retail sophisticated investors, which are typically those who understand and follow actively financial markets, have a more in-depth knowledge of reading financial statements and those who typically have a diversified portfolio of financial assets and would therefore have a vested interest in following companies actively.

The skewness of market participants towards non-sophisticated retail investors in Malta contributes to a market which may be less efficient (Chen, Kelly & Wu, 2020).[45] This may also exacerbate the issue of lack of liquidity and depth of the local capital markets, since the majority of the holders of securities, being unsophisticated, may not be aware of the information issued through company announcements and thus would not trade on the basis thereof, or would not understand or interpret the information in a manner that would generate or lead to trading activity.

[44] The Officially Appointed Mechanism of the Malta Stock Exchange (https://www.borzamalta.com.mt/officially-appointed-mechanism).

[45] Yong Chen, Bryan Kelly and Wei Wu, 'Sophisticated Investors And Market Efficiency: Evidence From A Natural Experiment' (2020) 138 Journal of Financial Economics.

3.3.3 Institutional Investor Participation

> "*Institutional investors may be defined as specialized financial institutions that manage savings collectively on behalf of small investors toward a specific objective in terms of acceptable risk, return maximization, and maturity of claims"* (Davis & Steil, 2004).[46]

Institutional investors are a category of sophisticated investors and typically include institutions such as insurance companies, investment services firms, pension funds and other funds managed by banks and investment firms. Their activity in response to information disclosed by issuers is key in generating trading activity on the secondary market but also during the initial public offering of securities. This is particularly important for equity issues since participation in such securities are typically not popular amongst those less-sophisticated investors who seek visibility of returns such as that derived from fixed income securities. As such, and as discussed earlier, those seeking to complement their income (and who represent a majority of the investors in the local sphere), will seek to do so in a more assured manner through fixed coupons from bond and similar securities rather than variable dividends dependent on company performance.

In addition, institutional investors typically would have a pool of money from their subscribers or clients (depending on the type of institution) and would be able participate in an offer to the public with substantial amounts, thereby allowing for issuers to tap the capital markets even with larger issues. The more institutions there are participating in an offer of securities, the after-market (secondary trading) could be somewhat better, since they are generally more active.

[46] E. Philip Davis and Benn Steil, *Institutional Investors* (The MIT Press 2004).

The participation of institutional investors calls upon issuers to have sound corporate governance practices that follow the '*Code of Principles of Good Corporate Governance'* as presented in Appendix 5.1 to Chapter 5 of the Capital Markets Rules (the "**Code**"). While the Code is on a comply or explain basis, issuers are expected to comply with the principals set out in the Code and should institutional investors not feel comfortable with the quality of governance at issuer's board level, they may decide to refrain from investing in the company, use their shareholding to make changes to the structure of the issuer's board, or sell their shareholding at a price that could have a significant effect on the market capitalisation of the company. This concept is also being augmented by the increased importance of two other aspects – Environment and Social, which together with Governance, make up ESG. Nowadays, there is even more pressure on public companies to disclose their ESG metrics (how they contribute to the environment, what measures they have that complement and promote good social practices and governance matters) and institutional investors expect companies to disclose their ESG metrics which may affect the willingness of the institutional investors to invest in the company or not, also based on other peer comparisons.

3.3.4 Secondary Market Activity

The local capital markets tend to suffer from low levels of secondary market activity. The reasons behind this are various, including;

- the composition of the investor base, which, as discussed earlier, is primarily retail and may not be aware of information disclosed to the market due to lack of following or not sufficiently sophisticated to interpret the information and act thereon.

Furthermore, a number of investors tend to acquire securities, including equity, without any regard to trade during the lifetime of the investment;

- significant trading activity on the secondary market tends to be by institutional investors, which do not represent the majority of the investing public in Malta;
- institutional investors tend to acquire larger blocks which may not be easy to sell at a go on the market due to the lack of liquidity and the lack of participation of other institutional investors; and
- securities may be thinly spread amongst investors. This is due to the way the distribution of the securities is structured, particularly when securities are pre-placed or distributed amongst a select number of financial intermediaries rather than a wider list.[47]

3.3.5 Market Makers

Malta's capital markets do not have a private market maker (sometimes also referred to as primary dealers) which take on the role of actually making a market in securities when an active market is missing due to lack of liquidity, thereby stepping in to maintain an orderly market. This role can stabilise security prices and avoid irregular volatility. An example of this volatility, would be the sale of a small number of equity securities which would wipe off a substantial value off the equity's market capitalisation due to a price substantially lower than

[47] This is augmented by the fact that financial intermediaries are being inundated with the amount of paperwork needed to accept applications which, apart from the client fact-find and know-your-customer requirements, also in terms of anti-money laundering rules and regulations, financial intermediaries may also be required to carry out appropriateness or suitability assessments for their clients prior to proceeding with the investment, depending on the type of service requested as well as the type of security being sold, as necessary, in terms of MiFID and the Conduct of Business Rulebook. As a result, some financial intermediaries opt to accept fewer larger applications, resulting in the offerings being thinly placed.

the previous day closing price, thereby destabilising the security and market indices – such thing happens frequently on the Official List in Malta in view of the fragmented holdings of securities particularly amongst retail investors, who generally avoid seeking investment advice, and the lack of deeper trading volumes which lead to wide bid and ask spreads. Similarly, there are instances, as discussed earlier, where institutions would be looking to sell a particular sizeable investment in a security, but interest for that security would be low or highly fragmented. Subject to certain terms and conditions being met, the market maker could step in to facilitate the market in those securities, thereby adding depth and stability without the need to destabilise the price of the security.

3.4 Regulatory Challenges to the Local Market

In addition to the characteristics of the investor base, there are other matters that emanate from the rules and regulations that also have an effect on the way our capital markets are organised.

3.4.1 Free Float

Depth in any capital market is enhanced when there is a sufficiently diversified distribution of the security. This is particularly important for equities, which tend to be more tradeable than debt instruments, which are typically purchased for a longer tenure to generate recurring income rather than to trade and recognise capital gains.

A requirement in terms of CMR3.26 is that upon listing, at least 25% of the applicant company's class of shares need to be in the 'hands of the public'. CMR3.27 lists what would

not constitute shares not held in public hands, including those held directly and, or indirectly by:

i) a director of the applicant company or any of its subsidiaries;

ii) a person connected with a director of the applicant company or any of its subsidiaries;

iii) the trustees of any employees' share scheme or pension fund established for the benefit of any directors and employees of the applicant company or any of its subsidiaries;

iv) any person who under any agreement has a right to nominate a person to the board of directors of the applicant company; or

v) a substantial shareholder, who in terms of the definitions found within the Capital Market Rules, includes someone who can exercise control over 10% or more of the applicant company or is able to control the composition of the majority of the board of directors of the applicant company.

This Rule does tend to be a stumbling block to conglomerate companies with diverse operations and which have a large asset base (in terms of value) since 25% of the valuation thereof could be a substantial amount and could therefore be too large for the local market to absorb. With an investor base in Malta which is traditionally income-oriented, equity issues tend to be less popular and therefore, the pool of investors shrinks when compared to that for issuances of debt instruments. Furthermore, in view of the matters discussed above with respect to the low participation of institutional investors, given their issue with lack of liquidity and depth of the local markets, participation in an initial public offering of equity tends to be lower. With this in mind, the larger companies tend to face this challenge with succession planning if they wish to do so through the capital markets route in Malta due to this Rule

which ignores other factors that may encourage trading activity, such as number of shareholders rather than the percentage shareholding held. For instance, a 25% free float shareholding held between three shareholders each holding 9.9%, 9.9% and 5.2%, respectively, would technically be acceptable in satisfaction of the rule, but 20% spread amongst a large number of investors (in the thousands, possibly), would not be acceptable for the MFSA in terms of this rule. It is a proven fact that such rigidness in the application of this rule has put off a number of the larger local conglomerates, failing to popularise the capital markets by attracting the larger diversified issuers.

For a capital market to be effective in attracting issues of a certain stance in the economy, it requires an element of flexibility in this respect that would serve as enablers to using the capital markets for the purposes of succession planning of long-standing family businesses. This topic will be looked at in some more detail in a subsequent part of this dissertation, as it is important particularly to the Maltese economy in view of the large number of family businesses which have grown to become conglomerates over the years, but which cannot use the capital markets as their venue of choice for succession planning.

When one compares these conditions to listing of securities in Malta to those in other European jurisdictions, whereas in Malta this rule is rigidly applied when an application for admissibility to listing is made, certain other jurisdictions apply a softer approach and allow for a lower percentage where the amount of shares in the public hands is deemed sufficient to promote secondary market activity. This is basically what the derogation in the Capital Market Rule 3.26 allows but, while in other markets this is applied because it is not a rigid 25% rule, in Malta, the lack of willingness by the regulator without any basis other than that of creating a precedent, has put local issuers at a disadvantage, also when combined with the

fact that appetite for equity in the local market may be subdued when compared to that for fixed income instruments. In itself, this restriction is hindering succession planning through the capital markets, which could boost the interest and deepens secondary market trading if such larger companies are allowed to float their shares at a lower percentage but spread across a large number of investors.

3.4.2 Type of Transactions

The transactions that are typically seen in the local capital markets are straightforward issuances of ordinary shares and corporate (fixed income) debt issuances. The lack of sophistication identified above as well as the fact that institutional participation is low, do not allow much room for innovation and experimenting with structured products. In addition, regulation over the years has increased with the aim of protecting investors from investing in products that they are not able to comprehend or withstand in terms of losses. As such, depending on the type of service that a client may require (execution of an order, investment advice or portfolio management), as well as the type of investment product (complex or non-complex), the investment firm may need to carry out an assessment of the client's knowledge and experience (referred to as an appropriateness test) and ability to bear investment losses (suitability test, which builds on the appropriateness test).

Article 25(4) of MiFID II allows investment firms to provide reception and transmission of orders, as well as execution of orders on behalf of clients without performing an appropriateness test described in Article 25(3), which entails asking "*the client or potential client to provide information regarding that person's knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as*

to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client".[48] The test of knowledge and experience, referred to as the appropriateness test, is not a requirement when the products of the subject transaction fall within the scope of Article 25(4) of the directive, which amongst others, require that such products are non-complex.

Aimed at protecting investors, ESMA issued an opinion paper[49] and a final report[50] on what constitutes complex financial instruments. As such, whenever there is any such complex instrument being on an execution only basis, investors have to undergo an appropriateness test in order for the investment services firm to assess whether they have the knowledge and experience to proceed with the transaction, and if the firm identifies that this is not the case, a warning is provided to the investor. The investor may, nonetheless, decide to proceed with the investment.

Another assessment that comes out of MiFID II which is also linked to complex financial instruments is that of suitability when the investment firm is providing advisory or portfolio management services. In terms of Article 25(2) of MiFID II, "*when providing investment advice or portfolio management the investment firm shall obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, that person's financial situation including his ability to bear losses, and his investment objectives including his risk tolerance so as to*

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[48] Article 25(3) of MiFID II

[49] ESMA, 'Mifid Practices For Firms Selling Complex Products' (2014) <https://www.esma.europa.eu/sites/default/files/library/2015/11/ipisc_complex_products_-_opinion_20140105.pdf> accessed 15 December 2021.

[50] ESMA, 'Final Report – Guidelines On Complex Debt Instruments And Structured Deposits' (2015) <https://www.esma.europa.eu/sites/default/files/library/2015-1783_-_final_report_on_complex_debt_instruments_and_structured_deposits.pdf> accessed 15 December 2021.

enable the investment firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him and, in particular, are in accordance with his risk tolerance and ability to bear losses".[51]

The MFSA has over the years conducted several compliance visits at investment services firms in respect of these requirements, particularly in relation to subordinated debt issuances by credit institutions (which are considered to be complex financial instruments in terms of MiFID II), which necessitated an appropriateness assessment until early 2021 on all subscriptions, and a suitability assessment in terms of BRRD II on all applications thereafter (and a minimum application amount depending on the size of the investor's portfolio, which is applicable only to retail investors). These rules were imposed through banking-related regulation (BRRD and BRRD II, respectively), and go beyond the requirements of MiFID in respect of complex products, although the underlying rational is similar. BRRD II[52] is a directive and the application of certain selling restrictions could have been avoided with respect to Tier 2 instruments such as subordinated bonds. However, the MFSA chose to implement some of the most restrictive options in the directive, which has led to challenges in the distribution of subordinated debts in the recent past issues.

It is worth noting that before BRRD II, the MFSA had devised its own unpublished policy on the distribution of subordinated bonds issued by banks, and which were subject to BRRD. The MFSA provided the issuer with two options: i) a minimum application of €25,000 (such minimum had to be retained at all times, and investors had to dispose of the investment in

[51] Article 25(2) of MiFID II.

[52] Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC PE/48/2019/REV/1 *OJ L 150, 7.6.2019, p. 296–344*

full if they needed to go below the €25,000 threshold), subject to an appropriateness test at all times (suitability assessment would be applicable where the investment service included investment advice or portfolio management); or ii) minimum of €5,000 investment amount, with a nominal value per bond of €1,000, and subject to a suitability assessment at all times.

When considering the additional assessments that investment services firms are expected to undertake, including also the case study of how the Bank of Valletta (BOV) La Valette Multi Manager Property Fund case turned out against BOV,[53] as the seller of the investment, investment services firms have become hesitant to act as distributors of complex products, unless such products have been widely distributed before, such as in the case of bonds that have an early redemption option.

As a result, the type of securities that are offered in Malta tend to be limited to the plain vanilla ones as, the distribution thereof would not be restricted to institutional or knowledgeable investors only. This results in an indirect restriction on issuers, which may wish to issue a particular instrument, but are limited to the simpler versions because of the composition of the investor base.

Similarly, from an equity perspective, given that the local retail investor mainly seeks periodic cash returns from any investment undertaken, equity issuers tend to stretch their finances or unjustifiably adjust their business model/forecasts to accommodate the prospect of a consistent dividend stream in a bid to attract retail investors to invest. Naturally, if such issuers are then unable to keep up with such promised dividend payments, market sentiment

[53] CAE vs La Valette Funds SICAV plc et – Case 028/2016 considered and decided by the Financial Arbiter <https://financialarbiter.org.mt/sites/default/files/oafs-decisions/ASF%20028-2016%20et.pdf> accessed 20 August 2022

turns sour not only towards the company in question but also adverse impacts investor sentiment and willingness to invest in other equity issues in the future.

3.4.3 Size of Issues

In view of the small size of the local capital markets, issues that are large in value tend to find it challenging to be subscribed for in full, particularly if they are issued by new issuers or those who are lesser known to the local investors. Given that the investor base is typically local, the issuers' names play an important role in the distribution and take up of the securities. Local investors tend to be supportive of local names and issuers, especially those they can relate to or have a "tangible" connection to.

In fact, some issues, irrespective of the size, tend to close earlier than expected as per the timeline indicated in the prospectus. This is because of the receptiveness of investors to the issuer and its securities. Nevertheless, there have been instances where issues were slow in take up, where the instrument was new to the market or where the issuer was less known.

Equity issues are typically not advised to be larger than €20 million, although recently the market was presented with the APS Bank plc equity offer which raised more than €60 million locally. However, this is an outlier for equity offers in terms of size which typically range between €10 million and €25 million. Debt issues tend to range higher, also supported by the fixed-income orientation of the majority of the investor base locally, between €20 million and €60 million.

The retail investor base has the liquidity to invest in capital market issues.[54] Their participation and the extent, however, go beyond the availability of funds, but it is a matter of selection of the issue they subscribe for. Investors are becoming more selective, also since they are given a choice of issuers which they can part with their money for (in recent years, the number of new issues that came to market was substantially higher than other years). Investors assign an intrinsic value to the reputation of the issuer and may not necessarily invest based on just financial metrics of the offer. In fact, we have seen issues which are priced more attractively than others, but investors choose to go for a name they feel comfortable with at the expense of returns.

3.5 Other Regulatory Requirements

A requirement that emanates from the Capital Market Rules applicable to companies seeking a listing on the regulated markets in Malta is that of track record. While the Prospectus Regulation does not impose a strict requirement for financial track record of issuers (it provides a caveat for the disclosure of a shorter period as the issuer has been in operation),[55]

[54] As at end of June 2022, there were approximately €16 billion held in savings accounts at banks belonging to households and non-profit institutions, which could be deployed (or part thereof) towards capital market offers - Central Bank of Malta (https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fwww.centralbankmalta.org%2Fsite%2FSubscriber%2520Categories%2FMonetary%2C%2520Banking%2520and%2520Financial%2520Markets%2Fomfidepsector.xlsx%3Frnd%3D20220815101906%26revcount%3D2124%26revcount%3D265&wdOrigin=BROWSELINK, accessed 20 August 2022).

[55] Item 18.1.1 of Annex 1 (which details what the Registration Document of equity issues should include) and Item 11.1.1 of Annex 6 (which details what the Registration Document of non-equity issues should include) of Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation (EU) 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No 809/2004 (Text with EEA relevance) *OJ L 166, 21.6.2019, p. 26–176* specify three and two years, respectively, with a caveat that allows for the inclusion of a shorter period should the issuer has not been in operation for the number of years specified.

the Malta Financial Services Authority, in its review of an application for admissibility to listing coupled with an offer of securities to the public, is stricter with respect to track record. For debt issues, while a number of companies set up a special purpose vehicles (SPV) as the company issuing securities subject to a listing application, which in itself would not have any track record and would, as the name implies, be used purposely for the issuing of the debt securities, the MFSA seeks to link the track record requirement to the other businesses within the group that the SPV forms part of (or of its founders) and which would ultimately make use of the proceeds raised by the SPV.

The requirements for a track record for equity issuers is stricter. The 'Conditions for Listing – Equity Securities' section within Chapter 3 of the Capital Market Rules establish a minimum track record of at least three years. This three-year track record rule extends to at least 75% of the applicant's business activities.[56] A dispensation of these requirements may be applied for in terms of CMR3.23, and there have been a few instances where the MFSA allowed the transaction to proceed even when the full extent of the said rule was not met in full. In dispensing with this rule, the MFSA typically looks at the business acumen of the promoters of the application, their expertise and other business ventures that provides a level of comfort to the Authority about their ability to progress with the company which is the subject of the application.

The requirement of track record is important when assessing applications because it will enable the MFSA, and eventually the investors, to assess the expertise of the promoters and the financial stability and sustainability of the company. These two matters, and in particular the second one, are given a lot of importance by the capital markets team at MFSA in their

[56] CMR 3.20.1

assessment of applications. Such importance emanates also from the role that the MFSA undertakes in investor protection which many a times, goes beyond the disclosures required in a prospectus that would enable an investor, or a prospective one, to make their own assessment. MFSA formulates its own assessment and there have been instances where, if the MFSA was not comfortable with the issuer, the application was rejected or had a number of conditions imposed to the application. Some issuers are known to have discontinued the process completely following such decisions imposed by the MFSA, while others complied with the additional requirements, even if such additional conditions put such issuers at a disadvantage when compared to similar issuers (for example, there were instances where MFSA requested the inclusion of conditions which are considered to be of a commercial nature and not regulatory, such as a corporate guarantee from a parent company or for a security be included when the coupon was deemed insufficient, but which were nonetheless imposed on the issuer). No such instances were discovered in the research process in other jurisdictions. This does not mean that these do not exist, but perhaps were or are not documented. However, when one looks at the requirements and the assessment criteria of other competent authorities, they typically focus on the requirements of the regulations and seek to determine that these are being fulfilled when making their assessment of the relevant applications and that the relevant disclosures are made in order to ensure that investors have all the information in hand to make an informed investment decision.

> *"The aim of this Regulation is to ensure investor protection and market efficiency, while enhancing the internal market for capital. The provision of information which, according to the nature of the issuer and of the securities, is necessary to enable investors to make an informed investment decision ensures, together with rules on the conduct of business, the protection of investors. Moreover, such information provides an effective means of increasing confidence in securities and thus of contributing to*

> *the proper functioning and development of securities markets. The appropriate way to make that information available is to publish a prospectus."*[57]

Disclosure of information is a fundamental principle of any of the securities regulations as it "*is vital to protect investors by removing asymmetries of information between them and the issuers".*[58]

3.6 Recent Developments

This section will focus on the various developments that have been implemented in recent years and how these have shaped and are shaping the capital markets across Europe. Some developments were not availed of locally and they could represent opportunities for the local capital markets to evolve, grow and become more effective for the benefit of the economy.

3.6.1 Enabling SME Issuers

Through MiFID II, which came into force in January of 2018, the European Union acknowledged the burdens that some SMEs face when dealing with the requirements to access the capital markets across Europe and to be able to sustain listings through the various continuing obligations:

> *"It is desirable to facilitate access to capital for smaller and medium-sized enterprises (SMEs) and to facilitate the further development of specialist markets that aim to cater for the needs of smaller and medium-sized issuers… The requirements applying to that new category of markets need to provide sufficient flexibility to be able to take into account the current range of successful market models that exist across Europe. They also need to strike the correct balance between maintaining high levels of investor*

[57] Recital 7 of the Prospectus Regulation.

[58] Recital 3 of the Prospectus Regulation.

protection, which are essential to fostering investor confidence in issuers on those markets, while reducing unnecessary administrative burdens for issuers on those markets."[59]

The way the local rules for listing on the various markets have been drafted tend to skew towards a one-size fits all. This is because they do not afford the flexibility that European legislation itself allows. MiFID II and the Prospectus Regulation sought to foster the development of markets which are aimed at benefitting SMEs, acknowledging their importance for the local economies. Most of these companies need external financing and tend to do so through bank borrowings or government grants, since most tend to be put off with seeking a listing of their securities when offered to the public because of the costs involved in keeping up with the disclosure requirements, the governance setup and the process itself. Unfortunately for Malta, this was a lost opportunity, because thus far, the MTF that was authorised to operate is subject to venue rules which are at times more onerous than those applicable to regulated markets.

While MiFID II provided the framework for SME Growth Markets, this was augmented by the SME Growth Market Regulation (Regulation (EU) 2019/2115) which amended the Prospectus Regulation, MiFID II and Market Abuse Regulation (MAR) in an attempt to provide proportionate alleviation to SMEs from certain regulatory burdens of the three pieces of legislation. This was done also in line with the CMU's objectives, where one of the action points in the plan published in 2020[60] was to direct more SMEs to alternative providers of

[59] Recitals 132 and 133 of MIFID II.

[60] European Commission, 'A Capital Markets Union for people and businesses-new action plan', 2020 <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2020:590:FIN> accessed 20 June 2022.

funding, by making finance more accessible across Europe to European companies, thereby reducing the dependency on banks for financing.

When compared to the requirements and regulatory impositions on issuers on the regulated markets, the differences are mainly the following:

i) Prospectus Regulation:

   a. Simplified prospectus to be issued by SME growth companies, when these opt to transition from the SME growth market to the main regulated market
   b. EU growth prospectus (again having simplified disclosure regimes than that applicable to the normal prospectus) for SMEs seeking an initial public offer targeting a market capitalisation of less than €200 million.

ii) Market Abuse Regulation

   a. Notification of the delay in disclosure of inside information to the national competent authority is not obligatory for issuers with listed instruments on SME growth markets, and will only need to provide an explanation if this is specifically required.
   b. Insider Lists – Issuers on SME Growth Markets have an obligation to retain the equivalent of the permanent insider list with names of those persons who due to their function or position within the issuer tend to have regular access to inside information (the default position for other issuers is that temporary insider lists are mandatory and have to be kept updated, while permanent insider lists are optional – the fact that the requirement has been alleviated to just the permanent list, which as the name implies, tends to change less frequently, reduces the burden on SMEs).

Such less onerous requirements on SMEs have been deemed necessary to attract such companies to the capital markets, especially when considering that SMEs are often referred to as the backbone of the European economy and therefore it is important that such companies have access to a diversified pool of financing options which include also the capital markets.

3.6.2 Securitisation

> "*Securitisation involves transactions that enable a lender or a creditor – typically a credit institution or a corporation – to refinance a set of loans, exposures or receivables, such as residential loans, auto loans or leases, consumer loans, credit cards or trade receivables, by transforming them into tradable securities. The lender pools and repackages a portfolio of its loans, and organises them into different risk categories for different investors, thus giving investors access to investments in loans and other exposures to which they normally would not have direct access. Returns to investors are generated from the cash flows of the underlying loans*".[61]

On 12 December 2017, the European Parliament and Council of the European Union adopted Regulation (EU) 2017/2402 which lays down a new regulatory framework for securitisation transactions, which is an additional regulation towards the development of the Capital Markets Union, aimed at fostering economic growth through capital markets in a sustainable manner, while providing additional investment opportunities. It also promotes "*broader distribution of financial-sector risk and can help free up originators' balance sheets to allow for further lending to the economy*".[62]

[61] Recital 1 of Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 *OJ L 347, 28.12.2017, p. 35–80 (the "**Securitisation Regulation**").*

[62] Recital 4 of the Securitisation Regulation.

Securitisation is not a new concept, particularly in the United States, although the European securitisation market, albeit being second largest, is just one tenth that of the United States.[63] The US market had a number of mortgage-backed packaged securities, particularly until the 2008 financial crisis but unfortunately, in view of the lack of proper regulation in respect of transparency obligations and the sale of complex investment products, such securitised transactions amplified the negative effects of the financial crisis. A report by the European Systemic Risk Board (ESRB) summarises the issues that link securitisation to the amplification of the financial crisis of 2008, as being:

- "*extensive intermediation chains that increased complexity and instability;*
- *misaligned interest and incentives (moral hazard) that weakened the monitoring and quantification of risk;*
- *complexity and opaqueness behind securitised products that obstructed the proper and adequate assessment of risk;*
- *overreliance on mathematical models and external credit rating agencies that created a false sense of security; and*
- *concentration of risk that not only remained but also accumulated within the banking sector*".[64]

By identifying and acknowledging these issues, when enacting the Securitisation Regulation, the European Union sought to establishes a risk-sensitive prudential framework for simple, transparent and standardised (STS) securitisations in order to create a level-playing field and standardisation of such securities and reduce variants that may lead to excessive risk being shifted towards the capital markets.

The concept of securitisation by banks is yet to be implemented in Malta. Thus far, there has been no bank that has taken a bold step towards approaching the MFSA with a securitisation

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[63] ESRB, 'Monitoring Systemic Risks In The EU Securitisation Market' (2022) <https://www.esrb.europa.eu/pub/pdf/reports/esrb.report_securisation.20220701~27958382b5.en.pdf?f6dea1a4f9feaf5354409a2e0acf8a1a> accessed 18 August 2022.

[64] Ibid.

transaction and it would be interesting to see how the MFSA will react if such had to happen, given its risk-averse appetite when assessing capital market transactions. Nevertheless, the experience of such transactions abroad indicate that securitised transactions attract institutional investors (such as pension funds and insurance companies) and not the retail investors and the MFSA, in this respect, could be more open in approving such applications.[65]

Locally, banks have been tapping the capital markets in order to boost their capital to support growth, through subordinated debt instruments or equity injection, to increase their capital base that will allow them to support additional lending and credit risk. Securitisation could be another way of re-balancing their balance sheets and free up some capital in order to support additional growth, rather than issue new instruments to increase capital.

3.6.3 ESG and Green Markets

ESG is the acronym that stands for 'Environmental, Social and Governance' and is used to describe factors related to the way companies operate, which factors are increasingly becoming the main focus of investors and regulators alike. The focus of ESG is on

[65] The issue that remains with institutions' participation in such securitisation transactions is the level of capital requirements applicable thereon, where the institutional investors holding securitisation positions are required to hold high levels of capital when compared to the requirements for other investment structures. These capital requirements were increased following the 2008 financial crisis and have still not been properly calibrated (according to the market). As such, this increase in capital requirements designed to protect the stability of the financial system has essentially pushed institutional investors away from securitisation and as a result has stifled the securitisation market. Recalibration under the Capital Requirements Regulation (Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/201) and under Solvency II (Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance) will be fundamental if to stimulate the growth of the securitisation market.

sustainability, as sustainable companies support a resilient economy which can withstand shocks. Following the COVID-19 pandemic, it became clear how interconnected everything is and how a failure in one part of the economy sent devastating shockwaves throughout the entire system.

The coined phrase may be current, however, the underlying concepts are not new. The Treaty of the European Union had already set down the principles of sustainability for the Union, as it aimed to promote "peace, its values and wellbeing of its people".[66] While some regard ESG as another word used for CSR (Corporate Social Responsibility), ESG, however, goes beyond CSR as it seeks tangible commitment from companies towards each of the environment, social and governance aspects of the business.

Investors globally have been shifting their preference for companies which go beyond the maximisation of returns and which can demonstrate responsible action towards the effect of their business on all three aspects. On environmental, there is more interest and assessment how a company's operations impact and put at risk the environment, assessing impact on pollution, greenhouse gas emissions, and stewardship over natural resources with a forward-looking view of future generations.

When it comes to social, assessment of the company's human resource policies in place, based on fair wages and employee engagement, and extends this also to other partners of the company in the supply chain.

[66] Article 3(1) [ex Article 2 TEU) Treaty on European Union OJ C 191, 29.7.1992, pp. 1-112*, as updated* <https://eur-lex.europa.eu/resource.html?uri=cellar:2bf140bf-a3f8-4ab2-b506-fd71826e6da6.0023.02/DOC_1&format=PDF> accessed 30 August 2022.

On governance, the focus is on the board that directs the company and how these promote transparency and accountability of their actions and incentives as well as with respect to the presentation of financial statements.

The capital markets are seen as a tool to promote ESG, whereby companies with little or no regard to ESG practices are not allowed to raise funds or list on certain markets, or would do so at lesser favourable terms than those who do, which ought to incentivise companies to align their priorities to the greater good through ESG compliant practices.

Listed entities are now expected to include in their annual reports disclosures on ESG. An ESG dashboard has been created for Maltese companies to submit, on a voluntary basis, ESG metrics.[67] This did not only attract listed companies but there are also some private companies that opted to participate in this initiative. While to date there have not been any changes or restrictions for companies to access the capital markets based on their ESG rating or metrics, there have been instances where institutions that themselves embrace ESG practices have questioned new issuers on their ESG practices, with particular institutions locally opting to not invest when they are not provided with such information from issuers.

Furthermore, thirteen[68] of Malta's largest organisations set up an ESG alliance, called Malta ESG Alliance (MESGA) in July 2022, which is a private sector initiative aimed at tackling ESG priorities faced by the country, with their first initiative being that of decarbonisation by each company working towards ways to reduce their respective carbon footprint.

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[67] The Sustainable Development Directorate website - https://sustainabledevelopment.gov.mt/.

[68] As at the time of publication of this dissertation, the thirteen companies that have founded and which form part of this alliance are: Alberta Group, APS Bank Plc, AX Group Plc, Bank of Valletta Plc, GO Plc, HSBC Bank Malta Plc, International Hotel Investments Plc, Malta Public Transport Services (Operations) Ltd, MAPFRE Middlesea Plc, MEDSERV Operations Ltd, Melita Ltd, PG Group Plc and Toly Products Ltd. Some of these are listed entities <https://www.ey.com/en_mt/press-releases/malta-esg-alliance> accessed 20 August 2022.

Another branch of ESG relative to the capital markets has been the development of Green Markets. In February 2021, the Malta Stock Exchange announced a new segment to the Official List – that aimed at the listing of Greed Bonds. While the eligibility to listing remain the same in terms of the Capital Market Rules, the admission to the Green Bonds List, and therefore the accreditation of the bonds as being 'green bonds', is subject to the categorisation of the project being financed (or re-financed) in one of the six environmental objectives identified by the International Capital Market Association (ICMA):[69]

i) climate change mitigation;

ii) climate change adaptation;

iii) sustainable and protection of water and marine resources;

iv) transition to a circular economy;

v) pollution prevention and control; or

vi) the protection and restoration of biodiversity and ecosystems.

To date, no company in Malta has issued any bond that was classified as a Green Bond. It is worth noting that there have not been any incentives by the MSE for companies to issue green bonds, including fiscal, which may incentivise companies to seek financing for their green projects through the capital markets.

[69] International Capital Market Association, 'Green Bond Principles', 2021 <https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Green-Bond-Principles-June-2021-100621.pdf> accessed 20 August 2022.

3.7 Observations in Other Jurisdictions

The jurisdictions that were reviewed also had their own minimum requirements for admissibility to listing on the regulated market. The main difference, however, was that most markets had more than one regulated market and while the minimum requirements started at levels very similar to those applicable locally, where the listing was considered a premium listing (referred to differently in all markets), the bar was raised to make access to such premium listing harder and therefore, those that can comply with that level of requirements would then be able to benefit from a wider access of investor base due to the level of confidence that they could afford to the investing public.

Such additional requirements were not only applicable upon listing application being made, but there were also some continuing obligations that were necessary in order to retain listing on the premium markets. For example, this is the case in Germany. The main exchange of the country is the Frankfurt Stock Exchange (Frankfurt SE) which operates two regulated markets – the Prime Standard and the General Standard. The Prime Standard, as the name implies, applies premium standards on the issuers seeking listing thereon, which in turn, allows it to access a broad range of international investors. Meanwhile, the General Standard applies the minimum thresholds for admissibility to listing on a regulated market, and in turn, the securities listed thereon are available for investment by national medium and larger investing companies and is generally considered to be more cost-effective in view of the lighter continuing obligations regime when compared to the Prime Standard listing.

Similarly, the UK's London Stock Exchange has a similar model when it comes to regulated markets. There are four markets – the Premium Segment, the Standard Segment, the High Growth Segment and the Specialist Fund Segment. The requirements for admission to listing

are different for each market, with the Premium Segment being the market that allows trading companies and investment entities to list their securities thereon and having to abide to the super-equivalent rules which impose higher regulatory standards than those imposed by the European regulations identified earlier. Such issuers would be eligible to be considered for the FTSE UK Index. The Standard Segment is equivalent to the local listing on the Official List in terms of requirements since it follows the requirements of the European regulations. The High Growth Segment, on the other hand, is a market that attract those companies which aim to be listed on the Standard Segment market but as yet do not fulfil the eligibility criteria in full. Such listing venue is open for EEA and UK trading companies alike. Meanwhile, the Specialist Fund Segment is one which lists instruments issued by UK and non-UK investment entities and where the offers and trading venues are open only for institutional, professional and knowledgeable investors.

SME Growth Markets and other MTFs in other European Member States generally had a lighter regulatory regime applicable to them when compared to the regulated market, where the market operator sought to harmonise only up to the applicable minimum regulatory or directive requirements. As already stated elsewhere in this dissertation, Malta still lacks the development of a proper MTF that seeks to encourage small businesses and issuers to expand their funding sources to include also consideration of the capital markets. In fact, ever since stricter Prospects MTF rules have been implemented in October 2021,[70] which meant that additional resources to be employed or outsourced by issuers of Prospects MTF listed securities, there was only one issue that was listed on Prospects MTF, and there were a few

[70] Updated Prospects MTF rules in terms of: https://cdn.borzamalta.com.mt/prospectsnotices/PROSPECTS_NOTICE_07_2021.pdf.

instances where service providers registered as Corporate Advisors for Prospects MTF were cancelled since then.

3.8 Concluding Remarks

Despite the European Union's quest for harmonisation, it recognises the need to allow for a flexible approach in the development of capital markets, albeit in a regulated environment. Such flexibility is key when seeking to make capital markets work for the national economies, since all economies have different requirements and different dynamics. A number of jurisdictions have taken advantage of the flexibility that the regulatory framework allowed and developed (or allowed the development of) capital markets to suit their national needs by allowing different issuers to tap different markets that have different characteristics.

While recognising that Malta is a small market in its own right, it is important for regulation to allow for this flexibility rather than rigidness and one-size-fits-all approach that is sometimes taken by the regulators, so that the appropriate medium of financing is made available for a wider spectrum of issuers, while investors may decide which investment best suits their risk appetite.

The Maltese capital markets have their own characteristics that frequently end up being regarded as inhibitors and challenges. It is key that regulators understand the challenges that the industry faces, the benefit that capital markets can have for the economy, and act as the enablers for effective capital markets when designing, adopting and, or authorising new venues, markets and their respective rules.

CHAPTER 4 THE LOCAL INDUSTRY & SUGGESTIONS FOR POTENTIAL REFORM

4.1 Introduction

While certain aspects of the local capital markets are similar to those in other jurisdictions, the way they are operated in terms of process undertaken to attain approval to listing as well as the distribution of the securities all contribute to the characteristics of the Maltese Capital Markets in distinguishing them from those in other jurisdictions.

This chapter will look at some aspects of the process, in order to bring out possible suggestions for reform that may be implemented to make the local capital markets more effective, by attracting more quality issuers and instilling more confidence in the investing public.

The process that will be looked into in more detail is that related to the regulated main market (the Official List), also because it is the main market where listings happen in Malta. As intimated earlier, the rules applicable to Prospects MTF have become, at times, even more onerous than the Capital Markets Rules applicable to regulated markets, and admission fees thereof are more costly than admitting the same securities on the Official List. This results in companies being either put off the capital markets altogether, or at times prefer to go down the route of the Official List, in recognition also of the fact that it is more liquid, in local terms, than Prospects MTF, and the fact that there is more visibility of the process given also that this is regulated. This is unfortunate, since this was a missed opportunity for Malta to make Prospects MTF work for the smaller companies which are more cost conscious to diversify their funding venues and raise funds in a cost-effective way.

4.2 The Process of Attaining a Listing on the Official List

This section will introduce the key players within the local Maltese context of capital market transactions related to debt and equity issues. In Malta, which has largely followed the UK format in many aspects, an issuer is obliged to appoint a Sponsor (in terms of Chapter 2 of the Capital Markets Rules), which, as shall be seen in a later part of this chapter, takes on more of an advisory role than just acting as the in-between of the issuer and its team and the MFSA. When researching the advisory teams in other jurisdictions, one main difference stood out – the investment banker and its important role in equity and debt fund raising, which shall be looked into more detail below.

As established earlier in this dissertation, the MFSA is the competent authority responsible for the approval of prospectuses and for the authorisation of admissibility to listing of securities on a regulated market in Malta. The authorisation process is three-pronged – first there is the vetting process of the Capital Markets Supervision Unit (the CMSU), then there is the review by the Executive Committee (ExCo) of the MFSA (made up of chief officers of the MFSA from within various units) and ultimately, there is the formal approval (or otherwise) by the Board of Governors of the MFSA, which is vested with the authority of approval of such applications. The actual process, documentation and requirements will be looked at in further detail below.

Recently (in July 2022), the MFSA introduced an element of delegated authority of certain approvals from the Board of Governors to the Executive Committee. This followed lengthy discussions held between industry groups and participants, representatives from the Government of Malta and the MFSA, which sought to highlight the inefficiency of this three-

pronged process until authorisation is obtained, including the inflexibility in terms of timing, amongst others. The authorisations that were delegated from Board of Governors to the Executive Committee relate to:

- equity offers and listings on the Official List;
- IFSM offers and listings;
- bond offers of up to €15 million which are secured and where the amount of bonds issued by the company does not constitute 3% or more of the total value of bonds listed on the Official List;
- bond issues of up to €10 million; and
- supplements to a prospectus.

While the new approval system is considered an improvement over the more stringent three-level approval process, there is still room for further progress, particularly when it comes to approval of applications of regulated entities (such as banks), higher-valued transactions and the date when the application can be presented for the Board of Governors approval. The latter relates to the fact that the Board of Governors meets on one fixed date per month (established only up to a month prior) which creates a number of challenges for the teams involved in the application process, including the CMSU within the MFSA, while possibly flooding the market with new issues at the same time rather than spread across the month, thereby putting pressures on distributors and on investors who need to evaluate multiple issues in a short period of time.

In terms of documentation, apart from the Prospectus, issuers and their teams are expected to prepare and provide additional documents to accompany a specific transaction, which may include:

Financial Due Diligence Report (FDDR)	this requirement comes out of the MFSA Listing Policies[71] and is a document prepared by the financial advisers, including a historic financial analysis and projections that cover the term of the bond, showing debt servicing capabilities of the issuer. This is a private document and is for team and MFSA consumption only and is required only for bond issues targeting retail investors.
Financial Analysis Summary (FAS)	this document is also a requirement in terms of the MFSA Listing Policies and is a summary of the FDDR, limited only to showing one to two year projections. This document is prepared by the sponsor and is attached to the prospectus, thereby being a public document.
Central credit register report	a report on credit facilities of the issuer and related companies to the transaction (such as guarantor)
Property Valuation Report	such report would be required when an applicant is a property company in terms of the CMRs, i.e. *"A Company whose principal activity is (and includes a closed-ended scheme investing or intending to invest 20% or more of its gross assets in Property): (i) the holding of Properties, both directly and indirectly and development of Properties for letting and retention as an investment; or (ii) the purchase or development of Properties for subsequent sale; or (iii) the purchase or development of Properties for retention as investments; or (iv) all or any of the above*."[72]

[71] MFSA Listing Policies (revised 13 August 2021) <https://www.mfsa.mt/wp-content/uploads/2021/08/20210802_MFSA-Policies_Revised2021Cln.pdf> accessed 18 August 2022.
[72] Definitions section of the CMRs.

Depending on the nature of the applicant or the transaction, other units within MFSA may be required to review the Prospectus and/or the ancillary documents, apart from the CMSU. Such instances would include issues by regulated entities, which would require the review by the Banking Supervision Unit,[73] the Insurance and Pensions Supervision Unit,[74] the Resolution Unit,[75] and the Conduct Supervision Unit,[76] as applicable.

In terms of Article 20 of the Prospectus Regulation, the MFSA Listing Team may take up to 20 working days for the vetting of the prospectus and ancillary documents for first time issuers and for the first submission. Review of subsequent submissions and submissions by secondary issuers may take up to 10 working days.

This notwithstanding, the turnaround by MFSA's CMSU team is typically more efficient than this, thanks to the expertise of the team that conducts the reviews and the cooperation of the Sponsors and the issuer's team to ensure that the drafts presented for review to MFSA are in as advanced form as possible, which reduces the amount of comments that the MFSA reverts with following its thorough review.

Between the initial submission and the official approval by the Board of Governors, the CMSU team reverts with queries and may ask for additional disclosure that it deems necessary in the Prospectus or clarifications on other documents submitted. The process from initial

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[73] The Banking Supervision Unit within the MFSA is responsible for the oversight of banking activities subject to a licence.

[74] The Insurance and Pensions Supervision Unit within the MFSA is responsible for the prudential oversight of authorised insurance and re-insurance firms and their activities, including intermediaries, as well as pension scheme providers.

[75] The Resolution Unit within the MFSA oversees the resolution plans of banks and some investment firms subject to BRRD II mechanisms.

[76] The Conduct Supervision Unit within the MFSA oversees the functions and conduct of regulated firms, namely those in banking, insurance, investments, amongst others.

submission until approval typically takes between eight to twelve weeks, depending on the requests of the CMSU team and the turnaround of the documents at both the issuer's team side and the MFSA.

Once the CMSU team is satisfied with the disclosures in the prospectus, it submits the documentation together with its recommendation (or otherwise) to the Executive Committee, which meets on a weekly basis and is made up of chief officers within MFSA. Following the discussions held at Executive Committee level, the application then goes to the Board of Governors which is made up of non-executive members, who meet up once a month. Applications for admissibility to listing need to be scheduled according to the meeting dates of the Board of Governors which creates a number of inefficiencies as highlighted earlier. Nevertheless, following the decision in late July 2022 to have some transactions approved at Executive Committee level, this inefficiency is expected to be less pronounced for those applications that fall within the delegated responsibilities.

4.3 Approval Bodies

In most cases, while the Prospectus Regulation directs the number of days for approval to be obtained following last submission, European competent authorities do require time to review the documentation and make submissions of comments and feedback for updates necessary to the disclosures made, where and as necessary. This lengthens the time for approval. In fact, the time for approval in other European Member States is very much similar to that applied in Malta, even if the extent of documentation requested is lower than that of Malta. For instance, applications for offer and admissibility to listing of debt securities offered to retail investors, the FDDR and FAS would be required. Requirement for these documents

is not found in other jurisdictions in Europe. Nevertheless, the review period of MFSA remains competitive to that of other jurisdictions which require less documents to be submitted.

Where Malta's approval process gets hindered is the actual process that an application goes through to be given the green light and the stringent timeframes. As intimated earlier, the MFSA's Board of Governors, which decides on a number of listing applications despite the attempt to delegate some of these to the Executive Committee, meets once a month (some months are skipped, particularly the holiday months), which therefore require that the teams (both the applicant's and the MFSA's CMSU team) work towards one fixed date. This rigidness prompts a number of challenges, both from a resources availability perspective, as well as from a market perspective, which may be "flooded" if multiple transactions are approved on the same one date of the month. This makes the process inefficient for both the industry participants on the issuer side as well as the investor market. Distributors are required to assess a number of transactions concurrently in a short period of time, advise their clients thereon (as applicable) and process the application in parallel. Similarly, investors need to evaluate the various transactions in a short period of time and seek advice (if applicable) through the distributors participating in the particular offers (which may differ). This creates significant pressures on resources on all fronts.

4.4 The Sponsor Role

Applicants for admissibility to listing of securities on the regulated market are required to appoint a Sponsor in terms of Chapter 2 of the Capital Market Rules,[77] which has to be a

[77] Prospects MTF applicants need to appoint a Corporate Advisor while IFSM applicants need to appoint a Listing Agent in terms of the respective rules.

licensed investment firm that acts as the direct contact with the MFSA and guides the team through the application process. The Sponsor has to be an independent party to the applicant.

The MFSA puts a lot of importance on the role of the Sponsor, who is expected to ensure that "*the Applicant has satisfied all applicable conditions for Admissibility to Listing and other relevant requirements of the Capital Markets Rules".*[78] In addition, the Sponsor is expected to advise and guide the applicant on its responsibilities and obligations under the CMRs, and that at all times, any matter that the MFSA should be made aware of about the applicant or the proposed transaction, unless disclosed in the prospectus, would need to be communicated accordingly. The Sponsor is responsible to ensure that all documentation required by the MFSA in respect of the application for admissibility to listing, is submitted in a timely fashion. During the process, the Sponsor reviews the documentation that is submitted to MFSA and gathers any additional documents which the MFSA requires in its review process. The expectation from the competent authority on the Sponsor is that the documentation submitted is of a high standard and in an advanced form of completion. The MFSA will also consult the Sponsor on any queries that the Authority may have on the contents of the prospectus and supporting documentation.

While on paper the Sponsor is expected to do "all the above", the Sponsor generally takes on a more active role in practice and provides significant guidance to the issuer and the team. Given that the Sponsor has to be a licensed investment services firm, it brings along knowledge of the market, of investor behaviours and of any changes in investment appetite noticed on the market. Such knowledge and experience are important in providing guidance

[78] CMR2.6.1

to the issuer on the commercial terms of an offer in terms of what the investors look for, including the risk-return reward expected.

Furthermore, the firm whose dedicated corporate advisory team acts as the Sponsor would typically also act as one of the authorised financial intermediaries in the distribution of the securities, albeit this is handled by a different unit within the firm. In terms of the Conduct of Business Rulebook, it is necessary that investment firms establish, implement and maintain effective policies to prevent, manage and mitigate conflicts of interest that may arise in relation to the provision of Sponsor services and investor services.

The combination of the sponsor services and the distributor services may be construed as the role that is undertaken by the investment banker in foreign capital markets. The distribution process and the comparison to that in foreign jurisdictions is delved into in a later part of this chapter.

4.5 The Role of the Distributors

During the process, there are various discussions held between the team, on the structure of the issue of securities, particularly when the issuer is doing this for the first time. Input is provided by the team of advisers on a number of matters, including the structure (such as secured or guaranteed for debt issues) and commercial terms (identifying market yields and assessing trends thereof to price accordingly, taking into account also the structure, how well the name of the issuer is expected to be received and the risks associated with the issuer, its business and future projects and trends). It is ultimately the issuing company that would decide and determine the final terms of the offering.

In parallel with the reviews of the MFSA teams, the applicant may decide to pursue a road show with selected financial intermediaries in order to assess appetite for its securities offering and secure a (part) placement of the offer. Such processes may fall within the definition of 'market sounding' in terms of MAR:

> "*Market soundings are interactions between a seller of financial instruments and one or more potential investors, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and its pricing, size and structuring. Market soundings could involve an initial or secondary offer of relevant securities, and are distinct from ordinary trading. They are a highly valuable tool to gauge the opinion of potential investors, enhance shareholder dialogue, ensure that deals run smoothly, and that the views of issuers, existing shareholders and potential new investors are aligned. They may be particularly beneficial when markets lack confidence or a relevant benchmark, or are volatile. Thus the ability to conduct market soundings is important for the proper functioning of financial markets and market soundings should not in themselves be regarded as market abuse."*[79]

Research as to how other jurisdictions operate, shows that roadshows and book building are integral parts of the application process. This also affects the way the transactions are structured. One particular example which is completely different to the way the industry operates in Malta is related to equity offers, whereby no static amount of shares or their respective share offer price is included in the prospectus, but this would be subject to the book building exercise that the investment bank undertakes with a number of intermediaries. The intermediaries assess the information in the prospectus, following its approval, any forward-looking statements contained therein, the trends of the sector of the issuer, as well as information on governance structures. Based on that assessment, the intermediary would quote price levels at which they would be willing to invest at, with the respective amounts for that price level. Such amounts are gathered from all interested intermediaries and the offeror

[79] Recital 32 of MAR.

would start allotting the shares on a best price basis depending on the orders received. The intermediary then distributes these amongst its clients.

In Malta, this is done differently, as the number of shares and their offer price of the offer would be known on application with the MFSA and thus prior to listing. It is only at market sounding stage, which is before approval, that changes to the offer price and the offer size are possible in Malta given the requirement to include these in the application and hardcode them in the prospectus document.

If MFSA were to allow for the structure to mirror that of European and other counterparts, the said flexibility will allow for better management and possibly better take up of equity issues, as investors would participate at the price level that they attribute given the metrics disclosed by the issuer.

4.6 Family Businesses, SMEs and the Capital Markets

One of the ways to improve the efficiencies and effectiveness of a stock market is to attract more listings. Approximately 99.5% of the local companies are SMEs,[80] with a majority of these being family-owned businesses. There is a reluctance by such companies, their founding shareholders and family members to generally consider listing on the stock market as being an integral part of their succession plans. The reluctance does not necessarily stem out of the lack of processes and structures in place that promote succession planning in Malta through

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[80] National Statistics Office, '*Registered Business Units: 2021*', 2022, <https://nso.gov.mt/en/News_Releases/Documents/2022/05/News2022_077.pdf> accessed 22 August 2022.

the stock exchange, particularly when one looks at the fiscal incentive that such transactions would benefit of when accessing the capital markets.

PwC, in their report,[81] highlighted a concern that many family-practices use internal resources (83%) and bank facilities (80%) for their funding purposes, while only 15% use the capital markets. Furthermore, only 9% of Malta's family businesses that participated in the survey confirm to have a succession plan in place for generations to come. As has been intimated earlier on in this study, the structure of the capital markets in Malta has not been developed in a manner that benefits or entices SMEs and family businesses to seek the capital markets for their future needs, whether this features additional funding plans or succession planning. The fees and expenses are the initial barriers. While the listing application with MFSA carries a one-time fee, the MSE charges a series of annual fees. One of these is based on the market capitalisation (both for the Official List and Prospects MTF), but there are also fees based on the number of holders in a debt or equity register, fees for any buy and sell transaction on the secondary market of the venues, all of which are charged to the issuer. In addition, while the professional fees to access the regulated market are generally expensed on application, the Prospects MTF, which was aimed at SMEs, requires the retention or employment of a number of advisers on a continuous basis, which adds on to the costs for the SME. In addition to the regulatory fees, issuers (including those on Prospects MTF) have to abide by continuing obligations which continue to add up to the costs applicable.

While the Family Business Office[82] in Malta promotes succession planning, the incentives provided are directed towards grants or schemes that reduce the financial burden of passing

[81] PricewaterhouseCooper Malta, 'The Value in Family Values: Family Business Survey 2019', 2020, <https://www.pwc.com/mt/en/publications/family-business-survey/2019/family-business-survey-2019.pdf> accessed 13 July 2022.
[82] Family Business Office - https://familybusiness.org.mt/

on the baton. However, for family businesses to stand the test of generations to come, it is also important to focus on strategy and acknowledging the fact that not all generations would be willing or capable of guiding the family businesses into new centuries to come. As such, focus on the capital markets, its benefits, making the process more cost effective and reducing certain regulatory burdens by providing new platforms where listing may happen which would be targeted to just SMEs and family businesses is direly needed in Malta.

As seen in earlier parts of this dissertation, the SME growth market already exists in other jurisdictions, and an MTF may also be set up locally to allow for these listings to take place, which would require less onerous disclosures and requirements. Such venues could also serve as a stepping stone for companies to eventually access the regulated market.

4.7 Suggestions for Reform

The fact remains, that Malta's capital markets are still quite small when compared to those in other Member States. Nevertheless, we have seen a certain momentum in the recent years. As has been intimated earlier, the more popular type of security in Malta are bond issues. Bond issuers tapped the capital market to diversify their funding base but also to take advantage of the fixing of rates particularly so since rates have been low for a good 14 years.

In addition, there has been a push by the industry to promote capital markets more, particularly by advisory firms that work in capital markets who may be best situated to identify potential candidates therefor. In fact, many new issuers are presented with capital markets proposals by their audit firms or legal counsels and at times even through their stockbrokers who possess experience in the industry. Admittedly, however, there needs to

be a more concert approach in providing more information to all the stakeholders about capital markets. Collaborations with professional entities such as the Chamber of Commerce, the Malta Chamber of SMEs, the Malta Institute of Accountants, the Chamber of Advocates and so forth are key to ensure a more widespread appreciation of the capital markets, what they may offer to companies and an understanding of the processes involved.

Furthermore, however, there needs to be a conscious drive towards improving the efficiency of these markets. As highlighted several times across this dissertation, barriers to effective capital markets continue to persist. It is a known fact that Malta is one of the smallest economies in Europe, however, that should not preclude us from using the regulations and directives to benefit our own economy.

The challenges that have been highlighted across this dissertation are summarised hereunder together with potential reforms that could potentially lead to more effective capital markets in Malta.

4.7.1 Expenses

In order to continue to attract issuers to the capital markets, it is important not to underestimate the costs associated with such an exercise, which may cost the issuers another 2% - 3% of the fund raise, to cover advisory costs and commissions payable to intermediaries. The former tend to be 1% to 2% on their own, and this is because of the documentation requirements that necessitate time by the advisory firms to prepare on behalf of the issuer (as explained above). The more structures MFSA dictate and the more documentation it asks issuers to produce, the higher these costs go. In addition, there are listing costs paid to both

the MFSA and the MSE. While the MFSA fee is a one-time fee on application, the MSE fees are various and expensed annually. These are calculated on a number of variables, including market capitalisation, number of trades taken place during the year (a fee for each buy and sell side of the trade), and the size of the register, all of which add another recurrent cost to companies, which may be high especially if the company has a large number of holders on its register. In order to incentivise listings, these costs may be curbed to a fixed fee per year depending on one of the variables (not all), while a more proportionate amount of documentation is requested from issuers depending on their size of operations and based on a risk-based approach. The latter could be complemented through the development of a more cost-effective market that is more affordable for SMEs (such as SME Growth Markets).

4.7.2 Incentives

Family businesses in Malta represent a majority of the local SMEs. The way succession planning has been incentivised over the past few years was through financial and fiscal grants rather than provide a more sustainable way of supporting local family businesses through instilling a disciplined path towards succession via the capital markets. Possibly very few companies realise that through an IPO of shares on the capital markets, the selling shareholders benefit from there being no capital gains tax imposed on the value shifting otherwise applicable when bringing in new investors privately. Many find the bringing in of new investors and the public disclosures intimidating, however, those companies that have successfully floated their shares on the regulated market appreciate the experience and the new source of finance that they may tap through their new partners in the business. Governance structures that are expected of listed companies, including the requirement to

have independent non-executive directors on the board, tend to generate new ideas to the boardroom, and may provide insight from their experience that could lead to diversification and growth of the business. Incentivising the capital market as a route for succession and growth would support the evolvement of more disciplined companies, which in itself will instil more confidence in the capital markets and will benefit investors, but also other stakeholders such as banks, which would be more willing to support companies that follow good corporate governance regimes.

4.7.3 Flexibility

Markets across the EU have taken advantage of the flexibility afforded by EU regulations particularly for the purposes of SMEs but also at how they applied stricter disclosure regimes for those companies that seek to offer securities to retail investors. An MTF that allows SMEs to experience capital markets without the full extent (or thereabouts, as is the case with Prospects MTF) of a listing on the regulated markets could be beneficial. It may also be a first step for such companies to eventually join the regulated market for a listing, as the company grows further. Such move would generate more interest in the capital markets, both from the issuers' side but also the investors, generating more liquidity and building the depth that is currently lacking.

4.7.4 Education and Seeking Investment Advice

The lack of sophistication of retail investors is worrying, particularly since, as a result, secondary market activity is subdued since investors are either not following company- and

industry-specific announcements or do not know how to interpret such news. More focus should be given on educating the investors, and encourage them to read prospectuses, participate in company meetings (such as the annual general meetings) and read the announcements issued by the company. Furthermore, investors ought to seek investment advice prior to investing in a product or a company that they do not know much about.

In order to do so, investors ought to be encouraged to attend educational events that are organised by the likes of MFSA or the MSE. However, the biggest investment, in the view of the author, is that of including an element of money-management education in the local academic curriculum at different levels of the education system (primary, secondary and tertiary). While the younger generations are typically those which are highly indebted and who have little to no money to invest, this could be the result of there not being proper money-management knowledge that would encourage a person to pay debt, save and spend in relative proportions to their income. Not focusing on the younger generation in this respect would be a missed opportunity.

4.7.5 Market Makers

Given the lack of liquidity in our local market, as discussed in earlier parts of this dissertation, market makers are required in order to create liquidity but also to help stabilise stock prices, which tend to fluctuate and affect market caps and indices on low volumes. The lack of volumes on the secondary market is possibly the reason why Malta is yet to have its first market maker in listed corporate bonds and equities. The Central Bank of Malta's Government Securities Office acts as a market maker for government stocks, publishing daily bid, offer prices and yields for all outstanding bonds issued by the Maltese Government. As a result of

this role, the Malta Government Stocks tend to be quite liquid. Replicating this for listed corporate debt and equities requires an entity that, during a particular time slot during trading hours, is able to quote firm prices at which it will buy (bid) or sell (ask) securities and the volumes they are willing to trade. This is done in order to fulfil orders initiated by investors or in response to an investor's request to trade. As such, a market maker needs to have structures in place to be able to hedge its positions, to fulfil these tasks, which may entail short selling.[83] Given the obligations expected from a market maker and the lack of prospective trades (as seen from the low amount of bids and offers) on the secondary market, it may be argued that the local capital markets are not sufficiently scalable for a market maker operation to make commercial sense. As such, there may not be any incentive for a firm to get authorised and set itself out as a market maker in Malta, and unless there are tangible incentives that would either push for more secondary trading (such as reducing the trading fees applicable) or fiscal incentives to firms that act as market makers, Malta will continue to remain without such an important role in its capital markets.

4.7.8 Openness to Foreign Issuers

While the Capital Market Rules apply to companies whether local or foreign, when seeking admissibility to listing of securities issued by foreign companies, there has been hesitance by the regulator to allow such applications. This especially applies if there is no sufficient track record of the issuing company or where the issuer is making an offer of securities to the public, and such funds would be used outside of Malta, with there being no tangible link to

[83] Short selling is subject to Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps Text with EEA relevance OJ L 86, 24.3.2012, p. 1–24.

Malta through the issuer or the project. The argument was that it was not easy for the regulator to assess an applicant who has no or very limited track record or presence in Malta, or where the project is carried out abroad and as such, there is no visibility of its progress.

In addition, in the one instance where a bond was listed on the regulated market in Malta, the foreign company encountered administrative issues when it came to the withholding tax on interest in view of the rigid application of wording in the Income Tax Act (Chapter 123 of the Laws of Malta) by the tax authorities where the foreign issuer could not collect the tax on behalf of the Commissioner for Revenue, as is the case with Maltese issuers, but had to appoint a third party to do so on its behalf. Such matters need to be ironed out if Malta wants to grow its capital markets beyond our shores and attract foreign issuer listings.

4.7.9 Flexibility in the Structure of Issues

As the competent authority responsible for the approval of prospectuses, an approval by the MFSA does not constitute the authority's endorsement of the issuer, but is only a confirmation that the document is meeting the standards of completeness, comprehensibility and consistency imposed by the Prospectus Regulation. As such, the disclaimer in all prospectuses to this effect explains that the MFSA approval should not be considered as an endorsement of the issuer and/ or relevant securities. Over the years, however, the MFSA has inherently taken the concept of 'investor protection' to an extent which goes beyond what European regulators sought to achieve with regulation and the directives, and beyond that also applied in other jurisdictions. As a result, despite such disclaimer, the MFSA has inadvertently created a perception in the market whereby the unsophisticated retail investor naively rests on the fact that the issue has been approved by the MFSA.

EU legislation makes it clear that the issuer's responsibility towards investors (and their protection) is disclosure-based, both from an initial offering and listing, and on an ongoing basis thereafter. Beyond that, in terms of determining what products should be made available (and what products are suitable) for investors or not and any restrictions that should be imposed in this regard, the focus of EU legislation is on the investment firms that actually sell securities to their clients, which is also found in the Conduct of Business Rulebook.

In fact, the industry has presented arguments to the MFSA on its role as competent authority responsible for listing applications which should essentially be limited to ensuring compliance with the Prospectus Regulation and the rules of the relevant market on which listing is sought and post-listing, with compliance and enforcement of an issuer's continuing obligations (which are largely disclosure and transparency based in terms of the Transparency Directive and Market Abuse Regulation).

CONCLUSION

It all starts with the policy makers. Regulation remains one of the key factors in shaping the effectiveness or otherwise of capital markets. Malta is small, its lobbying power may not be as strong as that of other Member States European regulation and directives have set minimum harmonisation requirements and expect Member States to comply with the minimum standards set therein, which have been deemed by EU legislators to provide the necessary level of investor protection. As such, Member States are not required to go beyond this through the implementation of additional investor protection policies. Nevertheless, we see that in Malta, the transposition of EU directives tend to go a step further, rules are applied to include additional requirements and the flexibility that certain directives allow, are not taken on, which tend to make our capital markets susceptible to being less competitive and more onerous, particularly to SMEs. This is augmented by the fact that, even where the regulations allowed for the development of a less onerous capital market targeted to attract SMEs (such as Prospects MTF), the rules that were approved therefor were pretty much equivalent (and sometimes they even went overboard) those applicable to regulated markets.

A 2018 publication issued by the UK government, which has since been withdrawn following Brexit, policy makers were guided how to implement EU legislation, which specifically states that:

> *"When transposing EU legislation the aim should be to avoid going beyond the minimum requirements of the measure being transposed. Taking such an approach will ensure that the UK does not create unnecessary legislative burdens and place UK business at a competitive disadvantage. This principle should only be departed from where there are exceptional circumstances which would justify it. Such circumstances*

> *would include where going beyond the minimum requirements would serve UK interests by, for example, reducing the regulatory burden imposed on business."*[84]

This is the spirit that our policy makers ought to embrace when they are deciding on how to implement EU legislation into national laws. It embodies flexibility, yet ensures compliance.

The characteristics of our capital markets do not afford rigid rules that deter the evolvement of capital markets but should be legislated by laws and rules that enable the development of the markets in a manner that benefits the economy.

Some changes, however, do not require drastic changes to the law. The delegated authority changes deployed earlier on in July this year with respect to the authorisation of listing applications was a step in the right direction in achieving better efficiencies. The MFSA ought to home in on its role of supervisor in ensuring that the investment firms acting as sponsor in terms of Chapter 2 of the Capital Markets Rules have the right expertise and resources to fulfil the role, the investment firms acting as distributors are conducting their role in terms of the Conduct of Business Rulebook and take actions when this is not the case. As competent authority in terms of the Prospectus Regulation, the MFSA should focus on ensuring that the issuers disclose the information necessary to the market to ensure that investors can take an informed decision on their investment. With respect to the Market Abuse Regulation, the MFSA needs to ensure that it has the tools necessary to monitor secondary trading transactions and evaluate them when there is a suspicion of market abuse or market manipulation. All this ought to be done to protect the investor, also in line with the spirit of the various EU securities regulation which harp on the importance of investor protection as a means of instilling confidence in the capital markets.

[84] HM Government, 'TRANSPOSITION GUIDANCE - How To Implement European Directives Effectively' (2018).

Nonetheless, it should not be the role of the MFSA to decide or opine on the level of risk of the securities being offered or the commercial terms of a transaction –the risk-reward trade-off must be assessed by the investor who may also seek the professional assistance of a financial adviser. This is also where the advisory team of the issuer plays an important role in guiding and advising where and as necessary. Nevertheless, the responsibility for commercial terms of a transaction remains with the board of director of the issuer. They ought to ensure that these terms adequately commensurate the risk attached to the securities and the company, while remaining competitive and in line with market returns prevailing at the time. This will determine if an offer to the public is well received or otherwise. However, this is also where the experience of independent non-executive directors sitting on boards of issuers come into play given their respective commercial acumen that they bring to the table and any expertise of the capital markets through other directorship appointments on listed entities.

What came out clearly in this dissertation was the fact that the way our markets were structured and have been regulated is not effective in attracting SMEs which are willing to step into capital markets, with a possibility of stepping up to regulated markets as they grow and evolve. Malta missed an opportunity to enable a SME Growth Market aimed at attracting SMEs with a lighter listing regime than that on the regulated market. On the contrary, the Prospects MTF Rules are at times more stringent than the Capital Market Rules applicable to the regulated markets, and lead to a costlier process, both at application stage and on a continuous basis. This is one of the matters that the policy makers ought to consider, which will also be beneficial to family businesses seeking new partners, as well as those seeking to plan their succession whilst also pursuing growth.

Education is another important aspect in enabling effective capital markets. Continuous professional development is a must for industry professionals whilst market participants should be given adequate opportunity to learn about the world of investments. In this respect, it is the author's view that this should not be restricted only to existing investors but industry wide efforts should be made to expose future generations to investments through targeted initiatives for schools, colleges and Universities. Although investing is not necessarily a trade and not everyone will seek a career in finance, it is important to enable the general population to understand the mechanics of investments particularly as a way of supplementing one's income through a more productive employment of their savings. Education can help with the understanding of the capital markets dynamics as well as the interpretation of information that the issuers share with the market through company announcements. This could generate secondary market trading, thereby tackling another of the main challenges with the local markets.

Naturally, liquidity is needed for the take up of issues and to maintain a healthy secondary market. While the liquidity may be there in terms of availability of funds, the willingness of investors to part with those funds to invest may not always be there. As has been seen, most local investors are fixed-income oriented and as such, when it comes to equity issues, these are not always successful. Participation of institutional investors need to be encouraged. Institutions typically have appetite for new equity issues, both as a means of diversification, as well as a way of matching any investment objectives of funds that they manage or when they have a mandate to fulfil. One way of doing this is to have a market maker. Given the size of the market, however, market makers need to be incentivised (fiscally or otherwise).

Another related challenge is depth – secondary market trading is limited on the local capital markets. The reasons for this are various including: (i) the fact that very few investors actually follow market announcements and trade on information shared with the market; (ii) investors may have entered into an investment for the longer term and as such would not be looking at trading in or out of their positions; (iii)_lack of institutional investors which are typically the first movers on market information; and (iv) the fact that there is no market maker.

Another main challenge that discourages companies from floating their shares is the minimum free float rule that is applied rigidly at 25%. While this rule could work well for smaller companies, where the 25% equates to a value which is within the range of what is acceptable as value of an equity issue, unfortunately, it has put off a number of the larger companies where 25% equates to a high value that the local capital markets may not be able to absorb, for a variety of reasons.

Capital markets provide an important channel in financing the real economy, allocating risk, supporting economic growth and sustaining financial stability and as such, it is important to find ways of enabling effective capital markets. Knowing the respective characteristics, acknowledging the challenges and making the adjustments necessary to make capital markets work for all stakeholders benefits the economy at large as well as issuers and investors alike.

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