Regulated Business

Dissolution, insolvency and the role of the regulatory authorities

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This paper is loosely based on an address given at the Malta Institute of Accountants Seminar on Liquidation and Insolvency held between the 27th and 28th of November, 1997. However, for the purposes of this publication, substantial revisions have been made to the original text, and considerable new material has been added. The new material includes a brief review of some relevant aspects of the new insurance business legislation recently debated in Parliament. This paper, which for reasons of space is being divided in two parts, represents the writer's own views and do not reflect any official position.

In matters concerning the dissolution and winding-up of companies, the Companies Act, 1995 is undoubtedly the most relevant piece of legislation and it would usually be considered the most appropriate point of departure for a discussion on the subject. In this paper, a different approach is adopted and an attempt shall be made to explore certain issues relevant to the subject of insolvency and winding up that arise outside the restricted ambit of the Companies Act, 1995. For this purpose, we shall be having a look at the role and powers assigned to the various regulatory authorities established over the past twenty years in respect of companies carrying on certain regulated activities. We shall also briefly compare our findings with the regulatory framework for co-operative societites, an exercise which should provide a more comprehensive and complete overview of the current legal position governing regulated business.

As the title indicates, the common feature in the laws that shall be reviewed here is that they are all concerned with a regulated business. Regulated business is here taken to mean a sector of economic activity whose exercise has been subjected to the requirement of a licence or other type of authorisation and which is subject to supervision and monitoring by a public authority established by law. The laws we shall be mainly considering for our present purposes are the following:

- The Malta Financial Services Centre Act of 1988
- The Investment Services Act of 1994
- The Banking Act of 1994
- The Malta Stock Exchange Act of 1990
- The new insurance legislation
- The Cooperative Societies Act of 1978

The Malta Financial Services Centre Act of 1988

The Malta International Business Activities Act of 1988 introduced offshore business as a distinct regulated activity in our law, and it established the Malta International Business Authority as the new regulatory authority entrusted with licensing offshore entities and supervising the offshore industry in general. The offshore legislation was not created in a vacuum; it was developed and structured on the existing laws, especially the Commercial Partnerships Ordinance which had been the first law to introduce modern company law rules into our legal system. The new Companies Act does not apply to offshore companies (section 431(1)(a) of the Companies Act), and most of the relevant MIBA provisions have survived the amendments effected in 1994. (Following the amendments, the Act is now designated the Malta Financial Services Centre Act, and it is administered by the Malta Financial Services Centre). The Ordinance therefore continues to apply to offshore companies subject to the small number of interesting variations which had marked a clear departure from the ordinary company law framework found in the Ordinance, particularly in the fields of dissolution and winding-up. We shall now review the more important modifications and novel provisions relating to the dissolution and winding-up of offshore companies introduced in the 1988 MIBA Act.

One of the significant provisions is section 26. This section assigns to the Centre the power to dissolve an offshore company in a number of defined instances, such as where a company has breached any of its licence conditions, or where an investigation by the Centre establishes a material change in the circumstances of an offshore company which if known to the Centre at the registration stage would have caused it to withhold the registration. The Act does not define or in any way restrict the meaning of "change in the circumstances" used here, clearly intending to allow the Centre to use this draconian measure in any set of facts which could justify its use. The Act goes even further and authorises the Centre to "proceed to the immediate cancellation of the registration of the company" for any reasons which in its opinion qualify as being of "sufficient gravity". This means that the Centre may cancel an offshore company's registration without any pre-warning and without giving it the opportunity to submit its representations. A useful weapon against illegal activities, but certainly one to be used sparingly and with great caution. There may be other solutions: in one case, rather than simply canceling the company from its register, the Centre advised it of its decision not to retain the company on its books allowing it sufficient time to re-think its plans and to re-organise its future by for example re-domiciling the company in another jurisdiction.. Clearly, where the facts and circumstances known to the Centre reveal a clear case of illegality or serious abuse, it is hardly likely that the Centre would be willing to encourage a similar solution. The Centre would seek to define its most appropriate line of action in the light of the issues raised in the particular case.

A further question that may be raised is whether the Centre would or could consider an offshore company's insolvency or inability to pay its debts as warranting its dissolution on the basis of section 26. Clearly the drafting of the section seems sufficiently wide to allow this in the appropriate circumstances, even in view of the Centre's general statutory functions (listed in section 4 and the Third Schedule to the MFSC Act) to promote integrity and high standards in the industry. To date, this provision has not been used in circumstances of insolvency or of an offshore company's failure to pay its debts, and there has to my recollection never been, in practice, any actual suggestion that the Centre should have intervened in this fashion. However, conceptually, the possibility cannot be excluded.

We find at least two other novel causes of dissolution under the offshore legislation. Dissolution may result from a company's failure to pay the annual renewal fee due to the Centre (section 25). Additionally, under section 26, where an offshore company is shown to have received income derived from illegitimate activities, it will lose its offshore status and consequently find itself dissolved. All its property would be forfeited in favour of the Government.

Where an offshore company is dissolved for any reason, the Company's nominee company is automatically appointed to act as liquidator. This safeguards the confidentiality of the offshore company's affairs and hopefully reduces the cost of the liquidation. The nominee company may however be removed and substituted as any other liquidator (section 27 (10)). Where an offshore company is being wound-up by its nominee company, it benefits from a special concession given by the 1988 Act, which exempts it from having to file the usual accounts and other financial returns that a liquidator would otherwise be obliged to submit to the Registrar of Companies in terms of the Ordinance. Instead, it would be sufficient for the nominee company to file a certificate with the Registrar saying that the company has been "fully wound up with the approval of the company in general meeting". This concession does not apply where the winding-up is being carried out by some person other than the company's last nominee company.

Another very significant section is that which assigns to the Centre all the powers and functions of the company in general meeting and the board of directors, in all cases where an offshore company loses its offshore status and is dissolved (section 27). This is a truly extraordinary provision, which gives the Centre the right to remove the liquidator and to appoint somebody else, and in general to intervene in the winding up of any offshore company should this step be justified by circumstances. It is possible to envisage a scenario where the Centre having dissolved an offshore company for some serious reason as explained above, may also consider it inadvisable or inappropriate to retain its nominee company as liquidator, especially where the nominee company may have been held answerable, even in part, for the offshore company's troubles. In this case the Centre may decide to remove the nominee company from the post of liquidator, replacing it by a liquidator of its choice, irrespective of the wishes of the shareholders or of the nominee company itself.

Nominee companies are the intermediaries exclusively authorised to service offshore companies in terms of the 1988 Act. They have played a determining part in Malta's short-lived but moderately successful offshore experience. The entire Part III of the Act is dedicated to matters relating to nominee companies, and section 51 deals specifically with the "Winding up of nominee companies". It requires a liquidator appointed to wind up the affairs of a nominee company to immediately advise the Centre of his appointment, and to "do all that may be necessary, or which the Centre may require or direct, for the purpose of any of the provisions of this Act". This section discloses the legislator's intention to safeguard the interests of the non-resident investors, and to ensure that matters involving a nominee company and its offshore clients do not escape the Centre's supervisory reach, even in the event of a winding up. In practice, there have been very few instances of nominee companies winding up and no problems have ever been encountered in this area.

The Investment Services Act of 1994

The Investment Services Act was passed in 1994 and the MFSC was appointed the competent authority for all the purposes of this Act, responsible for its administration and its enforcement. It would be useful to consider the powers exercisable by the competent authority in the context of liquidations and insolvency.

One of the principal objectives of financial services legislation is to create a framework of measures which seek to prevent or at least seriously reduce the chances of a licensed operator becoming insolvent. The law pursues this objective in the interests of customers, creditors and of the financial system in general. Certain devices and measures have been created precisely for this purpose under the Investment Services Act and other financial services legislation. But today we are not concerned with these devices and measures (which may include rules relating to large exposures, own funds, minimum capital requirements, indemnities, unimpaired assets, reserve funds and margins of solvency, prohibited investments and transactions, and so on), but rather we shall focus on the statutory powers given to the regulatory authorities to deal with a license holder who finds himself in irreversible financial distress.

Under the Investment Services Act it would appear that faced with an operator in serious financial difficulties, the MFSC may take action at either of two distinct levels of intervention, which we shall briefly consider in turn. The first level is represented by section 7. This section authorises the Authority to cancel or to suspend an operator's licence in a number of circumstances described in the Act. These include the situation where the MFSC "considers it desirable.....for the protection of the public or the reputation of Malta". This rule applies both to investment services providers and to collective investment schemes.

At a second level, and perhaps more significantly for our present purposes, section 15 of the Act gives the competent authority the power to issue "directives" to any licence holder. A directive under this section may order the licence holder to cease operations and to wind up its affairs "in accordance with such procedures and directions as may be specified in the directive or further directive" (paragraphs (d) and (e) of subsection 2). The directive may also "provide for the appointment of a person to take possession and control of all documents, records, assets and property belonging to or in the possession or control of the licence holder.". In this manner the law makes it possible for the competent authority to control and monitor developments affecting its licence holder. This may perhaps imply that the normal company law procedures have been considered either insufficient or inappropriate.

The licence holder in respect of whom action is taken by the MFSC in terms of section 7 or section 15, which we have just reviewed, may appeal to the Financial Services Tribunal). This Tribunal, which is actually set up under section 10 of the Banking Act, 1994, constitutes a special mechanism for administrative redress, meant to guarantee a greater degree of transparency in favour of licence holders. In the ISA, matters relating to the competence and working of the Tribunals are governed by the provisions of section 19. This section lists the instances when an appeal may be made to the Tribunal and explains the powers of the Tribunal. Generally, the submission of an appeal under the ISA would not suspend the operation of the decision taken, except where the decision relates to the cancellation of a licence (subsection 4).

Going back to section 15, the directive section, it may be useful to analyse what it does not say:

(1) there is no reference to the appointment of a "liquidator" or to any professional or other qualifications that the person appointed by the competent authority should hold; and
(2) there is no requirement that the person appointed to wind up the licence-holder's affairs should adhere to the procedures laid down in the companies legislation, of which again there is no mention.

What we do find instead in the same section is a statement in subsection (2) that the competent authority may issue a directive ordering that the winding up is to follow "such procedures and directions as may be specified in the directive". We find no indications or parameters regulating the shape and the extent of these "procedures and directions".

These sections of the Investment Services Act which we have been considering have never really been tested in practice, but it would be useful to reflect on whether some parts of section 15 may not actually exist comfortably with the equivalent provisions of the Companies Act. This raises a more general issue of whether complete symmetry and consistency exist between the rules in the Companies Act and certain provisions introduced in regulatory laws such as the Banking Act and the Investment Services Act. Fortunately, it may be stated at the outset that the Companies Act specifically acknowledges the role of the various competent authorities in respect of companies carrying on regulated financial services business, and makes a number of explicit references to them. Section 420 actually lists the various competent authorities in the financial services sector and safeguards their interest in information that may have been obtained by the Registrar in the course of investigating the affairs of a regulated company. On the other hand, section 403(4) obliges the Registrar to consult with the relevant competent authorities before undertaking any investigation in respect of regulated companies; a measure which seeks to promote cooperation and consistency, and to avoid confusion. Indeed, we find a number of scattered provisions in the Companies Act which have attempted to define aspects of the inter-action between the Act on the one part and the regulatory authorities and their respective legislation on the other. In my view, these sections constitute a promising start which may be further developed for the purpose of ensuring that these different laws co-exist rather than collide in matters of common concern such as insolvency and winding up.

The Banking Act of 1994

Much of what has been stated in relation to the Investment Services Act applies to the Banking Act of 1994, with a few exceptions. In the Banking Act we again find a competent authority, which in this case is the Central Bank of Malta (CBM), being vested with tremendous powers of intervention in the affairs of companies carrying out the regulated business of banking. Differently from the ISA, however, the provisions of the Banking Act distinguish between the "competent authority" and the Central Bank, and this has certain significant implications, as we shall see in the second part of this paper to be published in the next issue of this journal.