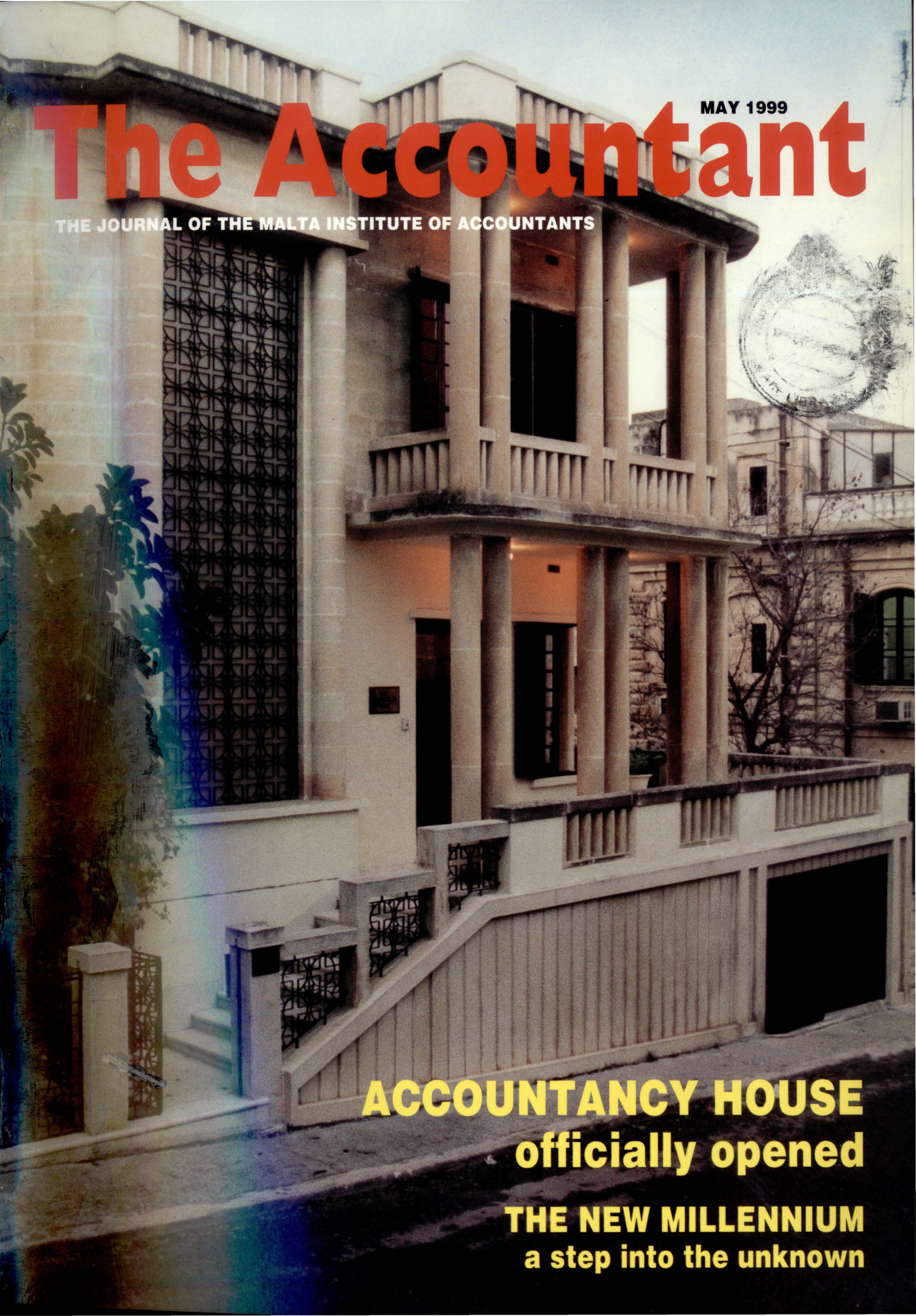
MAY 1999

The Accountant

THE JOURNAL OF THE MALTA INSTITUTE OF ACCOUNTANTS



ACCOUNTANCY HOUSE officially opened

THE NEW MILLENNIUM a step into the unknown

Dr. Fabri lectures on financial services legislation at the University of Malta. He is a director in charge of legal affairs of the Malta Financial Services Centre, where he is also a member of the Executive Committee. The views expressed in this article are entirely and exclusively his own.

From MIBA to MFSC

The first decade and beyond

David Fabri LL.D.

1998 - 1999

This year marked the tenth anniversary of the coming into force of what was originally called the Malta International Business Activities Act, which had been passed in 1988 but came into force the following year. The Act had a difficult passage through Parliament, with some serious disagreement and harsh words being exchanged between the two sides in Parliament. The parliamentary debates of the period reveal that while government spokesmen were happy promoting the offshore concept for its potential to open up new business and employment opportunities, opposition representatives expressed fear that the island would gradually sink into a banana republic, a haven for criminals and money-launderers. It was certainly not an auspicious start.

The 1988 Act introduced offshore business as a new industry to Malta on the strength of the legal and institutional foundations already then in place. These included a Banking Act that had been enacted in 1970 (that is nine years before the United Kingdom adopted its own first Banking Act), a relatively modern company law that had been broadly modelled on the UK Companies Act of 1948, and an Insurance Business Act which provided for the comprehensive regulation of that particular sector. A number of other offshore jurisdictions (particularly the smaller and relatively impoverished ones) did not enjoy such luxury, and were tempted to create their offshore business simply out of nothing.

The offshore legislation was therefore conveniently and rather cleverly conceived as a development within the existing legislation and was not introduced in a vacuum. A number of fiscal advantages were made available to non-residents contemplating carrying on international business through an establishment in Malta. The Malta International Business Activities Act also established a new public entity to act not simply as the licensing body but also to oversee and assist the development of this new industry. The Malta International Business Authority was set up as a largely autonomous authority whose major role was to serve as the point of reference and as a form of one-stop centre in respect of offshore activities carried on from Malta. The new Authority immediately put in place a number of measures including a code of practice for the acceptance of new business including a series of "know your customer" rules. These anticipated by several years regulations eventually made mandatory under the money-laundering legislation introduced in 1994.

Another significant creation was the nominee company. Every offshore company, with very few exceptions, had to have a nominee company as its director or as its company secretary. Licensed by the Authority and directly answerable to it, the nominee company not only promoted offshore business to Malta, but also served as a watch-dog to help keep away undesirable business. Much of the satisfactory performance of the industry lies to the credit of the nominee companies. It appears safe to claim that through the medium of the nominee company mechanism, the offshore industry helped to make local professionals (particularly lawyers and accountants) more open to international business opportunities and encouraged them to establish close professional links with foreign counterparts.

1994- change of course

Several relatively successful years later, at some point during 1993, government decided to change course and commenced a studied implementation of a more ambitious objective. This new direction envisaged the development in Malta of an international financial and business

centre to replace the original offshore centre. Such a step required the gradual phasing out of the offshore legislation. This objective also necessitated the implementation of a considerable body of new laws that could guarantee the appropriate regulatory framework, suitable levels of investor protection and internationally accepted controls over such relatively new white-collar crimes as insider dealing and money-laundering. A policy decision was taken to construct the new framework on the existing structures of the Malta International Business Authority. The alternative would probably have been to dissolve the MIBA altogether or perhaps restrict it to offshore and a gradual slow decline, or to create a brand new agency, possibly some Malta Financial Services Commission.

Accordingly, the Malta Financial Services Centre was established as the direct successor to the MIBA. This ensured continuity. The MFSC retained responsibility for the administration of the offshore legislation, which was now given a definite time-frame of up to the year 2004. New offshore companies could only be registered until the end of 1996. By the 31st December 1996, 2400 offshore companies had been registered. These included five offshore banks. By the 31st December 1998, the number of offshore companies still operating from Malta fell to around the 900 mark, while offshore banks were reduced to four following an amalgamation between two banks.

Under the new arrangements, the Centre was assigned a wider range of functions than had been the case with MIBA. The MFSC was also delegated authority to regulate and license the business of insurance and investment services, and some years later also responsibility for the administration of the Registry of Companies. This time round, the arrangements received the blessing of both sides of the House; few — if any — harsh words were exchanged.

The acknowledged cornerstone of the substantial financial services legislation adopted by Parliament during 1994 was the Investment Services Act. Since its coming into force in September 1994, a number of significant regulations have been issued. These include regulations establishing a number of exemptions from certain provisions of the Act and the custody of assets regulations. The MFSC has also published, and has frequently updated, an extensive set of guidelines which licensed operators are required to comply with. These guidelines do not have statutory effect but they form part of the quasi-contractual relationship between the licensee and the Centre as the licensing authority. While serving to highlight exactly what the Centre's expectations are, the guidelines are sufficiently flexible to allow for derogations or qualifications where appropriate.

1994 was clearly a very busy year where the adoption of laws is concerned. The financial services legislative framework was completely overhauled and in many senses upgraded. That year also witnessed important reforms in other areas including the administration of the tax laws. Other significant developments were the introduction of the Value Added Tax system for the first time, and the new legislative framework for the promotion of consumer rights and fair competition between businesses. The latter two pieces of legislation, adopted in late 1994, are of direct interest to the financial services sector as they help to define some additional parameters within which licensed operators are expected to perform in relation to their clients and in their dealings with their competitors.

Other legislative developments in which the Centre was directly involved included the Companies Act passed in 1995, the two new insurance business laws which came into force last October, and the regulations which made financial services-related back-office operations one of the approved ten-year tax holiday schemes for the purposes of the Industrial Development Act.

The Coming Decade

The coming decade will undoubtedly herald important changes. In the course of his budget speech at the end of last year, the Minister of Finance announced government's policy that supervision for banking should at some stage in the future pass to the Centre. This move was not entirely surprising seeing it was one of the assumptions in the legal framework that had been devised for the MFSC. The issue had also formed the subject of an exchange between government and opposition spokesmen during the parliamentary discussions concerning the establishment of the MFSC and the adoption of a new banking law administered by a competent authority. No time-frame has been announced by the Minister, but clearly the realisation of such a policy would have various and profound implications, possibly even on the internal structures of the MFSC.

Equally important will be the changes that need to be implemented in order to place our financial services laws in perfect alignment with the laws of the European Community (the so-called acquis communautaire). This process shall inevitably herald a flurry of legislative activity. Some of the more important changes which would have to be executed are the introduction of investor and depositor compensation schemes, the concept of the EU-wide single authorisation (or single passport) for financial services providers, rules on the mutual recognition of Ucits, and a number of other harmonisation and market liberalisation requirements.

In its recent update of its original 1993 opinion on Malta's membership, the European Commission was generally positive in its assessment of the island's financial services and company legislation. The Report considered these areas to be largely in line with the relevant directives and regulations. In order to achieve full compliance before actual accession, much work still needs to be done over the next three years or so. The update calls for a "programme for the systematic alignment" of Maltese legislation with Community law in a "gradual, harmonious integration". It warns of the importance that should be attached to ensuring that community legislation be incorporated "into national legislation effectively...and to implement it properly in the field via the appropriate administrative structures.". The Report however accepts that the appropriate administrative and judicial structures are already in place and functional. It would appear that the acquis implementation programme has been substantially facilitated by the reforms carried out since 1994.