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GANADO
ADVOCATES

BANKING AND FINANCIAL INSTITUTIONS NEWSLETTER

News Items & Industry Updates
Court Update
Maltese Legislative Updates
Questions & Suggestions

INTRODUCTION

It is a pleasure for me to introduce this new **Banking & Financial Institutions Newsletter** which the Banking and Finance team at GANADO Advocates intends to publish on a quarterly basis going forward.

The need has long been felt for a regular newsletter to serve as a quick update on what is happening in this fast changing world of banks and financial institutions. As a start, this newsletter will be targeting senior officers, whether in-house legal counsel or having an interest in law, working in credit institutions and financial institutions (including e-money and payment services institutions) licensed under Maltese law. I am sure however that other professionals within the wider financial services and legal world will also find this newsletter of interest.

As we all witness both regulatory developments (on a European and Maltese level) as well as developments in the private law sphere, keeping up with the wave of change is clearly becoming an arduous task. This newsletter should represent a small but significant step in assisting our colleagues in this sector. Over the years, GANADO Advocates has built a very strong and capable team of lawyers and other professionals with specialisation and depth in most aspects of banking and finance law and the aim of this newsletter will be to share ongoing developments with you as they arise from time to time. In particular, the newsletter will include:

(i) Maltese legislative updates;
(ii) Selected European legislative updates; and
(iii) Court updates.

I do hope you will find this newsletter of use. Should you have any queries or suggestions to make or should you know of anyone who might be interested in receiving this newsletter in the future, please do not hesitate to contact me at **cportanier@ganadoadvocates.com** or Dr Leonard Bonello at **lbonello@ganadoadvocates.com**. We would be more than pleased to hear from you.

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NEWS ITEMS AND INDUSTRY UPDATES

FITCH AFFIRMS 'A+' RATING FOR MALTA

Fitch Ratings issued a report dated 16 April 2013 affirming Malta's long-term foreign currency and local currency ratings at 'A+'. Both rating have a stable outlook.

In view of the recent developments in Cyprus and the comparisons with other small jurisdictions in the EU, Fitch Ratings suggests that "Malta's differences from Cyprus far outweigh the similarities, and that Malta's banking sector does not face the risks of Cyprus' before its bail-out. Malta's much smaller domestic banking sector, lower reliance on non-resident deposit funding, negligible ECB/ELA funding, stronger asset quality and capital buffers and more effective financial supervision make it fundamentally different."

SHORT SELLING AND CREDIT DEFAULT SWAPS

As of 1 November 2012 short selling and credit default swaps are subject to the restrictions and requirements set out in 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 (the "Regulation") as supplemented by Commission Implementing and Delegated Regulations. The instruments subject to these new rules are defined by reference to specific parts of section C of Annex I of MiFID. The Regulation introduces a number of transparency requirements and restrictions in relation to short selling and credit default swaps:

Transparency requirements – A person who has a significant net short position relating to issued share capital is required to notify the competent authority and/or disclose this position to the public based on thresholds set out in the law by reference to a percentage of issued share capital. Notification is also required for a significant net short position in sovereign debt by reference to thresholds published by ESMA for the sovereign issuer concerned. A notification obligation also arises in respect of uncovered positions in sovereign credit default swaps in cases where the restriction on same has been lifted temporarily.

Restrictions – Uncovered short sales of shares admitted to trading on a trading venue are restricted unless certain conditions are present. Short sales of sovereign debt are prohibited unless they fall within certain exceptions (e.g. where the transaction serves to hedge a long position in debt instruments of an issuer, the pricing of which has a high correlation with the pricing of the given sovereign debt) or the prohibition has been lifted because the liquidity of sovereign debt has fallen below a certain threshold. Uncovered sovereign credit default swaps are prohibited however the competent authority can temporarily suspend this restriction.

REPORT ON ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING IN EUROPE

The Joint Committee of European Supervisory Authorities issued a Report [http://bit.ly/10mAZmb] on the application of AML/CTF obligations to, and the AML/CTF supervision of e-money issuers, agents and distributors in Europe (link). The report provides an overview of Member States' implementation of European anti-money laundering and counter-terrorist financing requirements in the context of the issuing, distribution and redemption of electronic money. It describes Member States' approaches to the Anti-Money Laundering and Counter Terrorist Financing supervision of e-money issuers, their agents and distributors providing services on their domestic territory and/or across the European Union and identifies areas where differences in the national transposition of European legislation could affect the integrity of Europe's Anti-Money Laundering regime.

Prior to the entry into force of the Regulation, Malta did not have any rules restricting short selling or requiring disclosure of short positions. The Regulation is therefore the first Maltese legislation in relation to these activities. Although these rules derive from an EU Regulation which is directly applicable, Malta has adopted certain measures to facilitate and supplement the Regulation.

The Financial Markets Act (Short Selling) Regulations, 2012 (Legal Notice 344 of 2012), designate the Malta Financial Services Authority ("MFSA") as the competent authority in Malta for the implementation of the Short Selling Regulation, and empowers the MFSA to issue "Financial Market Rules" binding on all persons engaged in short selling, and, or who trade in credit default swaps and other financial instruments as maybe specified in such rules.

The Regulation is relevant for persons engaged in short selling and/or trading in certain credit default swaps in or from Malta. The requirements and restrictions provided for therein will, broadly speaking, apply to trading in shares which were first admitted to trading on a trading venue licensed by the Maltese competent authority, sovereign debt issued by the government of Malta and credit default swaps in relation to sovereign debt issued by the Government of Malta.

Furthermore, the MFSA has issued Guidance Notes [http://bit.ly/Z7YmgG], which purport to provide guidance on the transparency requirements and restrictions regarding (i) shares which are admitted to trading for the first time on a trading venue licensed by the MFSA, such as the Malta Stock Exchange; (ii) sovereign debt issued by the Government of Malta; and (iii) Credit Default Swaps in relation to sovereign debt issued by the Government of Malta. The Guidance Notes also include the standard forms to be used for notifications to be made to the MFSA.

The Guidance Notes state that the notification requirements regarding significant net short positions in shares and sovereign debt and the disclosure requirements in the case of significant net short positions in shares do not apply to market makers and primary dealers falling within the meaning given in the Regulation, as further defined in guidance which may be issued by ESMA from time to time, and that application of this exemption requires a specific authorisation from the MFSA.

A dedicated section was created on the MFSA's website [http://bit.ly/17KDBdU] for public disclosures of net short positions in shares which are admitted to trading on a trading venue licensed by the MFSA, where the net short position reaches a value equal to 0.5% of the issued share capital of the company concerned and each 0.1% above that. To date there have been no notifications posted on the MFSA's website.

THE LIIKANEN REPORT
HIGH-LEVEL EXPERT GROUP ON BANK STRUCTURAL REFORM

The High-Level Expert Group on Structural Bank Reforms, established by Commissioner Barnier, produced its report on 2nd October 2012. The Group's recommendations follow on from similar positions adopted by the U.S. (in the Dodd-Frank Act) and the UK (recommendations of the Independent Commission on Banking).

The main reform being proposed is that of separating proprietary trading activities (and all assets or derivative positions incurred in the process of market-making) from deposit-taking (and other exempted activities). Separation would only be mandatory if trading activities amount to a significant share of a bank's business, or if the volume of these activities could impact financial stability. According to the recommendations, the two entities would still be able to operate in a group structure.

The Liikanen Report also built on the proposed Bank Recovery and Resolution Directive (the "BRR"): the BRR had proposed to allow authorities to change the legal and operational structure of banks to ensure that they can be resolved without threatening critical functions of the bank, threaten financial stability, or involve costs to the taxpayer. The Group proposed that the European Banking Authority should also be responsible for setting harmonised standards for assessing the systemic impacts of recovery and resolution plans, as well as establishing "trigger elements" which would allow the EBA to reject recovery and resolutions plans, depending on the size and risk position of the bank.

The Group also proposed further amendments to the BRR by improving the loss-absorbing ability of a bank. This will mean that there will be predictability of which assets should be turned to in order to bail-in banks. The Group therefore proposed there being a clear definition of the position of bail-in instruments within the wider hierarchy of debt commitments, allowing investors to know the eventual treatment of the respective instruments in case of resolution.

The fourth proposal of the Liikanen Report was of improving the bank's capital requirements by ensuring that these cater for systemic risks and risks of contagion. The Group suggested there being a revision of the proposals of the Basel Committee to make sure that the amendments to capital requirements will be sufficient to cover the risks of both the deposit bank and the trading entities.

EUROPEAN PARLIAMENT VOTES TO ADOPT CRD 4

The European Parliament has adopted the legislative package comprising the amended Capital Requirements Directive and Regulation (CRD 4). The legislative package has been accepted by the Council and is now subject only to formal Council approval.

CRD 4 will implement the Basel III capital requirements into EU law and will impose a cap on bankers' bonuses. A copy of the European Parliament's press release [http://bit.ly/17uUK8s] is embedded for ease of reference.

The High-Level Expert Group also advocated the strengthening of governance and control of banks. The Expert Group considered it essential to: (i) strengthen boards and management; (ii) promote the risk management function; (iii) revamp compensation schemes; (iv) facilitate market monitoring; (v) strengthening enforcement by the competent authorities.

The above proposals made in the Liikanen Report continue to formalise the regulatory and authorisation processes for credit institutions in the European Union. These far-reaching effects of the above proposals mirror the current thinking of European regulators which have adopted a cautious approach to bank regulation. In Malta, the MFSA has similary adopted a more cautious approach to bank licensing and regulation. Proof of this approach is the MFSA Policy Paper issued on the 13 February 2012 [http://bit.ly/10myU9W] as amended by a paper dated 16 May 2012 [http://bit.ly/103x6eF] which effectively established that the MFSA will require any new applicant for a credit institution licence to include participation by another regulated entity by way of shareholding and/or active participation in the management of the proposed entity. On the other hand, where an applicant bank proposes a funding structure which does not have an impact on the local Depositor Compensation Scheme, the MFSA may waive the requirement for the backing of another credit institution of repute in the shareholding structure of the applicant.

AMENDMENTS OF THE IMPLEMENTING PROCEDURES BY FIAU

The Financial Intelligence Analysis Unit has amended Part II of the Implementing Procedures [http://bit.ly/Z3Z3sb] which are specific to the banking sector. Of particular relevance to banks is the fact that it is possible for banks to adopt simplified due diligence in respect of the beneficial owners of pooled accounts when these are held by auditors and accountants. A similar rule already existed in relation to pooled accounts held by lawyers.

EUROPEAN MARKET INFRASTRUCTURE REGULATION: CLASSIFICATION OF COUNTERPARTIES

The 15 March 2013 saw the entry into force of some of the provisions of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("EMIR"). On 19 December 2012 the European Commission adopted without modifications the regulatory technical standards developed by the European Securities and Markets Authority (ESMA). These technical standards were published in the Official Journal on 23 February 2013 and entered into force on 15 March 2013.

Over-the-counter (OTC) derivatives are often criticised as lacking transparency due to the fact that they are privately negotiated contracts and any information concerning them is usually only available to the contracting parties. They create a complex web of interdependence which can make it difficult to identify the nature and level of risks involved. EMIR lays down conditions for mitigating those risks and improving the transparency of derivative contracts.

In the long run, no entity will be in a position to enter into OTC derivatives without considering its obligations under EMIR. In short, the main obligations that will arise under EMIR will consist of:

- Central Clearing for certain classes of OTC derivatives;
- Application of risk mitigation techniques for non-centrally cleared OTC derivatives;
- Reporting to trade repositories;
- Application of organisational, conduct of business and prudential requirements for CCPs;
- Application of requirements for Trade repositories, including the duty to make certain data available to the public and relevant authorities.

This article does not purport to discuss all of the aspects and consequences of EMIR but will instead focus on the classification of counterparties. Since the obligations under EMIR depend on the categorisation of the entity, it is essential to have a proper understanding of the different categories. The two main sub-divisions under EMIR consist of financial counterparties and non-financial counterparties.

Financial Counterparty (FC) – means an investment firm, a credit institution, an insurance undertaking, an assurance undertaking, a reinsurance undertaking a UCITS and, where relevant, its management company, an institution for occupational retirement provision and an alternative investment fund managed by AIFMs authorised or registered in accordance with Directive 2011/61/EU.

Non financial counterparty (NFC) – means an undertaking established in the Union other than a financial counterparty.

It is also worth noting that that there is an additional category commonly referred to as NFC+ which is effectively a non-financial counterparty whose positions in OTC derivatives exceed a specified clearing threshold. The background to the category of NFC+ is that some non-financial counterparties make considerable use of OTC derivative contracts in order to cover themselves against commercial risks directly linked to their commercial or treasury financing activities. Consequently, due to the volume and use of the derivatives, in determining whether a non-financial counterparty should be subject to the clearing obligation in the same way as Financial Counterparties, consideration should be given to the purpose

for which that non-financial counterparty uses OTC derivative contracts (for example whether for hedging purposes or for speculative purposes) and to the size of the exposures that it has in those instruments.

One of the main obligations in force with effect from the 15 March 2013 consists of the obligation on NFCs which takes a position in OTC derivative contracts and whose positions exceed the clearing threshold as defined in article 11 of the Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 (NFC+) to make a notification to ESMA and the MFSA.

The MFSA has created a dedicated EMIR page [http://bit.ly/Z3WMgB] on its website. Authority has uploaded the OTC derivative notification form on the MFSA website. This may be downloaded through the following link. The MFSA website also contains a separate form which should be completed and submitted by a non-financial counterparty where it no longer exceeds the clearing threshold. Notification forms should be submitted to **emir@mfsa.com.mt** and **EMIR-notifications@esma.europa.eu** The MFSA is also working on guidance notes on the various aspects of EMIR which should be issued in due course.

The team at GANADO Advocates is closely following the EMIR process and will utilise this newsletter to put a spotlight on some of the more relevant EMIR updates as the arise.

BETTINA VOSSBERG ET *VS* EQUINOX INTERNATIONAL LIMITED ET

The Vossberg vs Equinox judgement is a very interesting judgement as it is one of the relatively few judgements by Maltese courts involving trusts and therefore represents an important step in the evolution in local jurisprudence of this institute. This particular judgment considered the use of trusts by a husband which had the possible consequence of evading maintenance obligations towards his wife (from whom he was legally separated) and his minor children.

The husband had settled his immovable property in Malta on trust. The settlor also retained the beneficial interest of the said property. Bettina Vossberg, acting on her behalf and on behalf of her two minor children, wanted to ensure that maintenance due to her and to her minor children from her ex-husband, Andreas Gerdes, was safeguarded. The Court of Appeal here considered the application of the 'actio pauliana' to the facts at hand and viewed the settlement of property on trust to be gratuitous, rather than onerous, and hence held that it was not necessary to prove that the trustee knew that the settlement on trust was carried out in order to defraud the plaintiff (by reducing the pool of assets available for distribution of maintenance). Had the Court considered the transaction to have been onerous, the plaintiff would have had to prove knowledge on the part of the trustee too (the 'participatio fraudis') in order to be successful in her action.

The Court therefore ordered the rescission of the contract through which the property had been settled on trust. The importance of this judgment is in the fact that it has recognised and established that trusts should not be utilised as a vehicle so that individuals would defraud third party creditors. It is also interesting to observe the interplay between trust law and the 'actio pauliana' which has been embedded in Civil law since Roman times and which safeguards creditors or potential creditors from fraud by their debtors.

MALTESE LEGISLATIVE UPDATES

FINANCIAL MARKETS ACT (OTC DERIVATIVES, CENTRAL COUNTERPARTIES AND TRADE REPOSITORIES) REGULATIONS, 2013

The purpose of Legal Notice 81 of 2013 [http://bit.ly/Z80mWf] is to create a registration framework and, in part, to implement the relevant provisions of the EMIR Regulation on OTC derivatives, central counterparties and trade repositories.

CONSUMER CREDIT AMENDMENT REGULATIONS

Legal Notice 28 of 2013 [http://bit.ly/ZBA7ny] amends the existing Consumer Credit Regulations (Subsidiary Legislation 378.12) [http://bit.ly/11pRFDf] which prescribe the contents of certain consumer credit contracts. The Consumer Credit Amendment Regulations include a number of amendments; most notably it sets out a number of assumptions for the calculation of the annual percentage rate of charge.

INTEREST RATE (EXEMPTION) (AMENDMENT) REGULATIONS, 2013

By virtue of Legal Notice 107 of 2013 [http://bit.ly/14B4HW6] – the Interest Rate (Exemption) Regulations (Subsidiary Legislation 16.06) [http://bit.ly/11pSNqu] a further exemption has been provided to the existing ones. This new exemption provides that the restrictions of the Civil Code on in so far as they limit or restrict the charging of interest and the compounding of interest shall not apply to profit participating loans or profit participating notes and other similar obligations or instruments where the return on the obligation or instrument is variable and is linked to the performance of the business of the borrower or issuer or the performance of an asset or a basket of assets.

This exemption is subject to the conditions that (i) the aggregate principal sum of the loans or notes and other similar obligations or instruments is at least two million euro, and (ii) that the issuer or the borrower, as the case may be, of the said loan, notes, obligations or instruments is not a natural person.

QUERIES & SUGGESTIONS

We trust that this issue of our **Banking & Financial Institutions Newsletter** was of interest to our readers, however, should you have any queries or suggestions to make, please feel free to contact **Dr Conrad Portanier** at **cportanier@ganadoadvocates.com** or **Dr Leonard Bonello** at **lbonello@ganadoadvocates.com**. We would be pleased to hear from you.

Further, should you wish to stop receiving this newsletter please click **unsubscribe** on the email sending this newsletter, or by contacting **rmizzi@ganadoadvocates.com.**

DISCLAIMER

This update is not intended to impart advice; readers are advised to seek confirmation of statements made herein before acting upon them. Specialist advice should always be sought on specific issues.

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