Issue № 3
February 2014

GANADO
ADVOCATES

BANKING AND FINANCIAL INSTITUTIONS NEWSLETTER

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INTRODUCTION

Keeping up with legal and regulatory developments is indeed becoming a great challenge for all of us.

With this in mind, on the 19 February, we are organising a half-day banking and finance law seminar, in collaboration with the Malta Bankers' Association. The seminar is unlike many others we see on the island, as it is mainly geared towards lawyers and senior officers handling legal risks. We are not aiming for a ball-room style event, but rather a focused theatre-seating seminar, where interaction between the attendees will be encouraged.

Needless to say, we are immensely honoured and privileged to have as a guest keynote speaker Prof. Philip Wood. Philip Wood is, amongst many other things, Visiting Professor in International Financial Law, University of Oxford and is one of the world's leading experts in comparative and cross-border financial law, a celebrated speaker, a well-known writer and an experienced practitioner. We are delighted that he has accepted our invitation to come over to Malta to address this event.

Following the seminar, speakers and attendees are all invited for drinks at our premises at 59, Strait Street, Valletta.

We do hope to personally meet as many of you as possible.

CONRAD PORTANIER
Partner
Banking & Finance Team

GANADO
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IN COLLABORATION WITH THE
MALTA BANKERS' ASSOCIATION

BANKING AND FINANCE LAW SEMINAR

SELECTED DEVELOPMENTS

WEDNESDAY 19 FEBRUARY 2014
PHOENICIA HOTEL, VALLETTA
14:00 HRS - 17:45 HRS

VIEW PROGRAMME →

NEWS ITEMS AND INDUSTRY UPDATES

INCREASE IN FEES FOR LOCAL BANKS

By virtue of Legal Notice 11 of 2014, the Credit Institutions (Fees) (Amendment) Regulations, 2014, the application fees and annual supervisory fees for local banks have increased with effect from 1st January 2014. While the application fee for credit resolutions has increased from €12,500 to €35,000, the annual supervisory fee has increased from 0.000175 of a banks deposit liabilities to 0.0002. Furthermore, the minimum annual fee has increased from €21,250 to €25,000, and the maximum annual supervisory fee has more than doubled from €500,000 to €1,200,000. Similar fee increases have also come into force from the same date in relation to financial institutions (Legal Notice 10 of 2014, Financial Institutions (Fees) Amendment) Regulation 2014) and Maltese branches of European credit institutions (Legal Notice 5 of 2014, European Passport Rights for Credit Institutions (Amendment) Regulations, 2014) .

4TH AML DIRECTIVE AND ITS IMPLICATIONS FOR THE BANKING INDUSTRY

The freedoms inherent in the EU single market have allowed individuals and businesses to flourish, however the removal of barriers has also inadvertently facilitated money laundering and terrorist financing activities. The EU has sought to counter this threat with legislation intended to safeguard the financial system by ensuring that entities vulnerable to being used for such activities play a role in combating same.

Maltese banks and financial institutions are familiar with the statutory obligations imposed on them as subject persons under the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR) which implemented the third EU Anti-Money Laundering Directive. They should also prepare for the fact that their obligations may soon be varied and/or increased further to publication by the European Commission of a proposal for a fourth Anti-Money Laundering Directive (4 AMLD) which is intended to, inter alia, increase the focus on risk assessment and further align EU and international positions.

With the 4 AMLD likely to be adopted in 2014, following its progress closely will allow subject persons to prepare for any changes required in their systems and policies. Below are some proposals the banking sector should note:

Beneficial owners – in addition to clarifying the threshold resulting in a more accurate identification of beneficial owners, the 4 AMLD seeks to increase transparency by requiring legal persons and trustees to hold information on beneficial ownership and make this available. It is hoped this will facilitate the gathering of due diligence by banks and reduce time and cost associated with delays resulting from customers who do not have such information appropriately organised and readily available.

Risk Based Approach – this will feature to a larger degree under the 4 AMLD in various areas. Banks and other subject persons will thus need to ensure they have adequate systems in place to assess the level of risk posed by a customer, based on a number of risk factors, and apply customer due diligence accordingly. Amongst the proposals which reflect this shift is the removal of the so-called white list of equivalent jurisdictions. While subject persons already have risk assessment procedures in place, these should be revisited to incorporate any additional areas and proposed changes.

Politically exposed persons (PEPs) – the 4 AMLD widens the scope and includes new requirements for domestic PEPs / PEPs working in international organisations. Subject persons will need to consider this added dimension in order to be able to identify a customer as a PEP and carry out the appropriate due diligence. The level of enhanced due diligence to be applied to domestic and foreign PEPs will also be based on risk assessment.

Data protection – in order to find a balance between the wealth of information required under AML CFT legislation on the one hand and safeguarding of personal data on the other, the 4 AMLD will require personal data to be destroyed after the 5 year retention period following termination of the business relationship (with limited exceptions). Banks should consider whether their existing record keeping arrangements will require modification for effective compliance.

The above is just a snapshot of the proposals and these may be developed further prior to adoption. There will certainly be time for implementation following adoption but keeping abreast of these developments will allow for the analysis and time that may be needed to adapt any systems to reflect the 4 AMLD.

SEPA MIGRATION

COUNCIL REACHES AGREEMENT WITH EUROPEAN PARLIAMENT

The Permanent Representatives Committee of the Council of the EU has reached an agreement with the European Parliament that the deadline for the migration of domestic and intra-European credit transfers and direct debits to the Single European Payments Area (SEPA) format be pushed back until 1 August 2014.

The European Parliament is expected to vote on the proposed Regulation amending Regulation (EU) No 260/2012 as regards the migration to Union-wide credit transfers and direct debits, which enables such delay, in its plenary session on 4 February 2014, after which the Council will formally approve the legislation.

MORTGAGE CREDIT DIRECTIVE

On the 10 December 2013, the European Parliament confirmed its willingness to make the mortgage credit sector subject to heightened consumer protection measures at EU level by approving the new rules on mortgage credit lending. The final text of the Mortgage Credit Directive, dated 16 January 2014, has been published.

A copy of the Mortgage Credit Directive is available **here.**

THE SINGLE SUPERVISORY MECHANISM

A SHIFT OF POWER FROM MALTA TO FRANKFURT ON THE ROAD TOWARDS A EUROPEAN BANKING UNION

INTRODUCTION

We have all heard about the move towards a centralized European regulator for banks. This article tries to shed some light on this moving target.

The failure of several European banks during the 2008 crisis and the utilisation of the European Stability Mechanism (the "ESM") to save the Spanish banking system in 2012, resulted in broad political agreement that more needs to be done at an EU level to protect Member States from the spill-over effects of bank failures. This led to the eventual introduction of the Single Supervisory Mechanism (the "SSM") which transfers certain prudential regulatory and supervisory powers from national competent authorities ("NCA") to the European Central Bank (the "ECB"). In fact, the SSM and the ECB were seen as a pre-requisite for any direct bank recapitalisations that were to take place through the use of the ESM.

The SSM is one of the pillars of a European Banking Union, comprising centralized supervision, a centralized resolution regime (including a centralized resolution fund) and a European-wide deposit protection scheme. It has been described as the most momentous step towards unification of the Eurozone area following the creation of the euro currency. The shift in functions and powers will result in a reduction of powers of the MFSA and will lead to a centralization of certain central prudential powers at EU level.

In creating the SSM, the following legislative instruments have been used: firstly the SSM Regulation (Regulation No 1024/2013), which confers specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions; and secondly, the regulation amending the European Banking Authority Regulation (Regulation 1093/2010), which has been amended to clarify the role and powers of the European Banking Authority (the "EBA") under the SSM.

MFSA – ECB – DIVISION OF TASKS

All banks within the eurozone, including Malta, will have the ECB as a new regulatory authority. The ECB will be given specific tasks in relation to the prudential supervision of eurozone banks, financial holding companies and mixed financial holding companies. However, the extent of the ECB's powers of supervision will vary depending on whether the bank is judged to be "significant" or "less significant".

The SSM Regulation sets out what is considered to be a 'significant' bank when compared to a 'less significant' bank and this depends on whether a bank, on a consolidated basis, satisfies one of the following criteria: (1) the total value of the banks assets exceed €30 billion; (2) the ratio of the banks total assets over the GDP of its member state of establishment exceed 20% (unless less than €5 billion); (3) whether the bank has ever requested any public assistance in the past; and (4) the three largest banks in each member state will automatically be considered to be significant. Other factors that the ECB will take into consideration include the significance of the cross-border activities of the bank and the importance of the economy of that bank's member state of establishment. In any case, the ECB has the discretion to decide that a bank is of significant relevance notwithstanding that it doesn't satisfy any of the above criteria. At the moment, we understand that the three Maltese banks deemed to be 'significant' for this purpose are HSBC Bank Malta, Bank of Valletta and Deutsche Bank Malta, but this is yet to be confirmed.

For the 'less significant' banks, the majority of tasks will remain within the competence of the MFSA, except for the following matters which will in all cases be the exclusive domain of the ECB:

- authorisation and withdrawal of authorization of banks; and
- authorisation of changes in qualifying shareholdings in banks.

In practice, this means that any acquisitions and/or disposals of shareholdings exceeding 10% in any Maltese bank will be decided upon by the ECB. The SSM Regulation clarifies that notification of an acquisition of a qualifying shareholding must first be introduced with the national competent authority which then assesses it and forwards the notification and a proposal for a decision to oppose or otherwise to the ECB. The ECB will have the power, even for less significant banks, to issue regulations, guidelines or general instructions to the MFSA and the ECB will retain the power to step in and supervise a less significant bank directly.

Insofar as 'significant' banks are concerned, the ECB will be exclusively responsible for:

- authorisation and withdrawal of authorization of banks;
- authorization of changes in qualifying shareholdings in banks;
- ensuring compliance with prudential requirements in the areas of own funds requirements, securitization, large exposure limits, liquidity, leverage, and reporting and public disclosure of information on such matters;
- ensuring compliance with rules relating to governance requirements, including the fit and proper requirements for the persons responsible for the management of credit institutions, risk management processes, internal control mechanisms, remuneration policies and practices and effective internal capital adequacy assessment processes;
- carrying out supervision on a consolidated basis; and
- carrying out supervisory reviews, including stress tests, in connection with the European Banking Authority, where appropriate.

Functions not given to the ECB will remain vested with the MFSA. The ECB's powers will not extend to consumer protection, securities trading, payment services, anti-money laundering, passporting notifications and MiFID related matters, which will remain the responsibility of the NCAs. Therefore, for local purposes, there will be a clear distinction between the powers of the ECB and the MFSA, with the former focusing on the prudential supervision of credit institutions, and the latter retaining its tasks in relation to conduct of business and consumer protection. Furthermore, until the introduction of any recovery and resolution directive, the MFSA will be responsible for resolving failing banks, even though the ECB still has the power to take control of such banks itself where the ESM unanimously requests it.

Similarly to the MFSA, the ECB will have many of the regulatory, supervisory, investigatory and administrative powers that the MFSA currently has; these include the power to investigate, inspect and issue fines, as well as the power to intervene and take remedial action (for example, when a bank is in breach of its capital requirements).

The ECB, which will take over these tasks and powers from early November 2014, will have to ensure there is property separation between its roles of being responsible for the monetary system and for prudential review.

It is anticipated that there will be an increase in supervisory fees, as local banks would be required to pay fees to both of the ECB and the MFSA. During the initial stages of the transfer of powers, the ECB will have a demanding task on its hands as it would suddenly be responsible for the prudential supervision of all eurozone banks; it will require a substantial increase in its staff and their training and expertise, and there are questions as to whether it will be able to handle the increase in work-load immediately. In this regard, it has been reported that Madame Daniele Nouy, who will be at the helm of the ECB, will be hiring 1,000 bank supervisors and support staff for this purpose.

In the meantime the Commission and the EBA continue to move towards achieving a genuine single rule book which will be applicable to all EEA banks (not just eurozone banks). Such a rule-book may also be complemented by possible changes to the Deposit Guarantee Scheme Directive and the proposed Recovery and Resolution Directive, which would grant the ECB further powers and tasks in relation to the prudential supervision of all banks within the eurozone member states and will represent a further change to the supervision of EEA banks and to the banking union landscape.

We are actively monitoring developments in this area and we hope to keep you updated along the way.

DR PHILIP ATTARD MONTALTO AND OTHERS vs THE PRIME MINISTER AND OTHERS

On the 9th of January 2014 the First Hall of the Civil Court, presided over by Mr. Justice Joseph R. Micallef, handed out a prominent judgment where it held that the right of shareholder's of the National Bank of Malta ("NBM") to enjoyment of property under article 37 of the Constitution was violated when they were forced to transfer their shares in NBM to the Government – without receiving any compensation.

This case centers around the controversial transfer of the assets and shares of NBM to the subsequently established Bank of Valletta as a result of a run on the bank by its depositors. The shareholders transferred all their shares to the Government and the Council of administration appointed by the Government transferred all NBM assets (on behalf of the NBM) to the Government without receiving any form of payment or compensation for the NBM or its shareholders.

The Government claimed that this was an attempt to safeguard the jobs of NBM's employees and to protect its deposit holders. On the other hand, the shareholders claimed that they were under undue pressure to transfer their shares to the Government, while not receiving any compensation or payment in return. They claimed that the transfer for zero consideration of NBM's assets was manipulated through various capital reduction methods so the bank would appear not to have any value. They alleged the violation of their right to enjoy property under article 37 of the Constitution of Malta and to their right of free association under article 42 of the Constitution. The Government denied infringing the shareholders' human rights, alleging that the shareholders had freely transferred their shares in NBM. The Government asked the Court to decline to exercise its powers in terms of the proviso of article 46(2) of the Constitution, in view of the availability of other remedies to the shareholders under ordinary law.

The Court held that there was no doubt that the shares of NBM belonged to the claimants and that the shares constituted a form of property in terms of article 37 of the Constitution. Furthermore, the Court stated that there was no doubt that by transferring the shares, the claimants lost possession of the same shares and all rights attached thereto. The Court held the circumstances surrounding the share transfers constituted a transfer which was forced. The Court concluded that, although at the time of the transfer the shares did not have much value, NBM still had substantial assets which exceeded its debts; this was evidenced by the fact that the business of the bank remained strong, stable and profitable even after the business was transferred to Bank of Valletta. Therefore, the Court held that the share transfer was unfair as it resulted in a disproportionate burden on the shareholders. This resulted in a deprivation of possession and the loss of enjoyment by the shareholders, without any compensation which violated article 37 of the Constitution. However, the Court did not agree that the claimants suffered any breach of their right of association in terms of article 42 of the Constitution.

The case has to be continued for the Court to provide the claimants with an adequate remedy, while the Government still has the right to appeal the decision within the legally stipulated time period.

BCL GAMING LTD vs SPARKASSE BANK MALTA P.L.C.

In this case, presided over by Judge Lorraine Schembri Orland, the Court issued a warrant of prohibitory injunction against Sparkasse Bank Malta p.l.c. (the "Bank") preventing it from enforcing the pledge it held over the client's account of BCL Gaming Ltd ("BCL"), since the enforcement of the pledge on the account would result in the withdrawal of BCL's gaming licence issued by the Lotteries and Gaming Authority ("LGA"), which would have irremediable consequences on its operations.

Here, Betclass Limited ("Betclass") obtained a loan from the Bank, which was secured by a pledge in favour of the Bank over a deposit account of Betclass. Subsequently, the Bank, BCL and Betclass agreed that the Bank release and terminate its pledge over the account of Betclass and that BCL grant the Bank a pledge over one of its client's account. Subsequently, the Bank informed BCL that it did not recognize this pledged account as a 'client's account' any longer.

BCL inter alia claimed that the Bank knew that the pledged account was a 'client's account' as evidenced by a letter sent by the Bank to the LGA whereby it undertook not to "attempt to enforce or execute any charge, write off, set off or other claim" against the same client's account. Furthermore they claimed that if the Bank had to enforce its pledge over the client's account, BCL would suffer irremediable prejudice since its gaming licence issued by the LGA would be withdrawn as a consequence of it violating its licensing conditions.

The court referred to article 873(2) of the Code of Organisation and Civil Procedure and stated that three conditions need to be satisfied for the issuing of this warrant, namely: (1) that some act is prevented from taking place; (2) that the person requesting the issuing of the mandate has, prima facie, a right to request its issuance to prevent a person from carrying out an act which will cause him harm; and (3) that this is necessary to preserve a right of the claimant and not solely to avoid damages.

The court pointed out that these were summary proceedings and therefore did not enter into certain merits of the case. The court stated that the Bank, when entering into the pledge agreement with BCL, knew that the account was a client's account, as evidenced by its letter sent to the LGA, where it confirmed the same. On this basis the Court held that it was proven that, prima facie, the rights of BCL would be irremediably prejudiced by the enforcement of the pledge over the client's account, and therefore, all necessary elements for the issuing of the warrant of prohibitory injunction were satisfied; therefore the Court proceeded to issue the same warrant.

Although the Court did not tackle the point directly, it is good to note that the Court that the court recognized the fact that the account consisted of a client's account which BCL was holding subject to fiduciary duties.

TIME TO REPORT

The next EMIR-related milestone is fast approaching on the 12 February 2014. After various discussions and disagreements between ESMA and the Commissioner, reporting under EMIR for all asset classes (e.g. derivatives on commodities, credit, foreign exchange, equities, interest-rates and others) will start in February 2014 as outlined above, with no postponement in respect of reporting of exchange-traded derivatives, as requested by ESMA.

With effect from 12 February 2014 all counterparties to derivatives transactions (regardless of whether they are categorised for EMIR purposes as financial counterparties or non-financial counterparties above or below the relevant clearing threshold) will be required to report details of all OTC and exchange traded derivative transactions they enter into to registered trade repositories.

WHICH TRANSACTIONS ARE REPORTABLE AND WHEN?

The classification of transactions can be sub-divided into three main categories:

From 12 February 2014 –

- all new derivatives transactions entered into on or after 12 February 2014 (the report must be delivered to a trade repository by the end of the business day following the date of execution); and
- all derivatives transactions which were entered into on or after 16 August 2012 and which remain outstanding on 12 February 2014 (the report must be submitted to a trade repository by the end of 13 February 2014).

By 13 May 2014 – all transactions which were outstanding on 16 August 2012 and which remained outstanding on 12 February 2014; and

By 12 February 2017 – all transactions which were outstanding on 16 August 2012 but which were terminated prior to 12 February 2014 must be reported.

Once a transaction is subject to the reporting requirement, it will also become necessary to report other key ‘life-cycle’ events relating to that transaction, including modifications to any of the reported terms, cancellation and termination.

CAN THE REPORTING OBLIGATION BE DELEGATED?

In terms of EMIR it is possible to delegate the reporting obligation, although any principal counterparty subject to the reporting obligation retains responsibility so will still be liable if the delegate fails to report or mis-reports. The delegate may be the other counterparty to the transaction (such as a swap counterparty or an investment bank) or a third party (such as a CCP or trading platform or a specialist provider of reporting services).

If you will not be able to, or would rather not, set up direct links with a trade repository, you should – if you have not done so already – be speaking to your counterparty or other third party now in order to ensure that the reporting obligations are met when they go live.

TO WHOM MUST REPORTS BE REMITTED?

The only trade repositories which have been registered with ESMA so far are:

- DTCC Derivatives Repository Ltd. (DDRL), based in the United Kingdom;
- Krajowy Depozyt Papierów Wartosciowych S.A. (KDPW), based in Poland;
- Regis-TR S.A., based in Luxembourg;
- UnaVista Ltd, based in the United Kingdom;
- ICE Trade Vault Europe Ltd. (ICE TVEL), based in the United Kingdom; and
- CME Trade Repository Ltd. (CME TR), based in the United Kingdom.

LEGAL ENTITY IDENTIFIER NUMBER

In order to report derivative transactions, each entity requires a legal entity identifier number (LEI) which is a unique number attributed to the specific counterparty.

WHAT MUST BE INCLUDED IN A REPORT?

The details which must be reported are set out in the Annex to Commission Delegated Regulation (EU) No 148/2013 containing the relevant regulatory technical standards (see **here**)

CONCLUSION

It is time to act and get ready for the 12 February 2014. Make sure you have obtained a LEI and ensure that you or your counterpart will be reporting your trades to an authorised trade repository.

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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