ARBITER FOR FINANCIAL SERVICES

NEWSLETTER

Issue 1 (April 2024)

Malcolm J. Naudi interviews Alfred Mifsud, Arbiter for Financial Services

EVOLVING ROLE

The Arbiter of Financial Services, Alfred Mifsud, looks back at his first year in office and outlines the challenges he faced, the major milestones and some interesting new developments.

On 28 April 2023, experienced financial adviser and banker Alfred Mifsud took over the reins of the Office of the Arbiter of Financial Services from the first Arbiter, Dr Reno Borg, who had occupied the post since 2016. Mr Mifsud listed as the top challenge he faces ensuring the Office remains relevant to people in their daily lives.

"When the Office was launched in 2006, there was a Big Bang. It was a novelty. There had never been something like it with executive decision-making powers. So, people referred to the Arbiter because complaints could date back to 2004, before the law came into existence," he explained.

Once the initial impetus dissipated, it has now become more essential for the Office to remain relevant to people's lives, he said, adding: "It's important that we maintain the programme and the presence in people's lives, knowing that there is an Arbiter to whom (they) can refer cases. Many people might not be aware that they have this avenue to sort out their problems."

> **"It's important that we maintain the programme and the presence in people's lives"**

Immediately on appointment, Mr Mifsud made it his priority to ensure that the decisions he was called on to deliver would be taken in a timely manner. He first set out to adjudicate some 60 cases filed with the Office in 2022/2023. "By the end of the year, we had very few cases left that were pending for several months," he said proudly.

"I hope that, going forward, we will see the duration very much shortened because I strongly believe that to be relevant to the people – and people come here, apart from the informality and the lower costs of handling their complaints – because timeliness is also very important for them."

He explained that, for complainants, life needs to go on. "They await a decision so that they can programme their life accordingly," he said.

Mr Mifsud sees his role as being neither a regulator nor an operator: "I am an Arbiter, somewhere in the middle, defending the consumers against the service providers."

Contents:

ARBITER FOR FINANCIAL SERVICES

To see the full interview and get a deeper insight into the Arbiter's interview, you can watch the video clips on our YouTube channel. We have edited the interview into two parts for your convenience:

In PART 1, the Arbiter looks back at his first year in office, outlines the challenges he faced and is seeking to overcome, and explains the 'Model for allocation of responsibility between payment service providers and payment services users in cases of payment fraud scams', which he issued at the end of 2023.

In PART 2 of this interview, Mr Mifsud gives an outline of the decisions he has issued, how he sees his role evolving in the next 12 to 18 months, anticipating certain changes in the Office's remit, and his message to customers and service providers.

A major difference he sees is that, in his previous posts, as chairman of a bank, director and as Deputy Governor of the Central Bank of Malta, he had a very macro, strategic view of the financial services industry.

"What hits you when you are here is that you are down to the micro level – the individual case – and it is not a question of strategy, but of one particular circumstance of an individual life, an event or an incident that happened, which is very different from the macro strategy that you follow when you're a director or a chairman of a large institution."

What he has started to witness, though, is that "a number of cases with very similar characteristics, collectively, take on some macro dimension but not the same strategy dimension that I was used to".

> **"My objective is, as much as possible, that most cases should be settled at the pre-mediation, the mediation and the post-mediation stage"**

Towards the end of last year, acting on the proliferation of financial scams and a rising number in complaints being received by the Office, Mr Mifsud decided to draw up a *Model for allocation of responsibility between payment service providers (PSPs) and payment service users (PSUs) in cases of payment fraud scams.* And it was not only in Malta that the scams proliferated, as several financial ADRs across the world with whom the Office networks as member of the International Network of Financial Services Ombudsman, INFO, were also inundated by similar cases.

The European Commission had issued a revised Payment Services Directive, commonly referred to as PSD2, that was promulgated in 2016. "Things have changed substantially since 2016 – fraudsters have become much more creative, much more capable and much more persuasive," he affirmed, even with the advent of AI (Artificial Intelligence).

Yet, locally, the scams fall under two categories, he explained:

- scams related to crypto assets, hitting mostly international clients, with the crypto infrastructure so far enabling the fraudsters to hide their riches and facilitating anonymity – that hopefully is being addressed through EU legislation, which has yet to come into force; and
- scams where people receive fraudulent messages on the normal channels they use to deal with the banks. They believe the scammers and fall for them. The end result is that they are out of pocket by a few thousand euros.

Some of these innocent victims, he added, would have lost their life savings to the scammers. "It has become more challenging for the retail person, who is busy with his life, to distinguish between a fraud and a genuine case. Even though they are not millions, but individually they are very important," Mr Mifsud said.

> **"Thanks to legislation that is expected to be presented to Parliament in the coming months, the Office is going to take on the new role of a Credit Review Office…"**

Under current legislation, the bank can be held liable when unauthorised payments occur, he explained, except when there is gross negligence. "Now gross negligence is a very hazy concept, a generic term, and there is no really strong definition in the legislation of what is 'gross negligence'.

"So, we had to adopt this model to identify, in a local context, what are the factors that constitute or contribute to gross negligence. Most of the time, it's not a case of black or white – either the bank is fully responsible or the consumer is fully responsibility. There could be some responsibility on both sides, taking into consideration these various factors which define the gross negligence," he said.

"So, this model allocates that responsibility. It could be 100 and zero – it's not excluded; but it could be somewhere in between. And this model gives visibility. It should also define the expectations of the complainant and of the bank."

The model also serves as a guideline for the bank, enabling them to take initiatives to address these issues before they are brought before the Arbiter. Ultimately, the model is pushing more cases towards mediation. The bank would make an offer, knowing where they stand in regard to the model, and the consumer could accept that offer because they know where the ultimate decision could land.

"We have a very active mediation service here," Mr Mifsud said. "My objective is, as much as possible, that most cases should be settled at the pre-mediation, the mediation and the post-mediation stage, but before actual adjudication because that is a healthy situation. In that way, the adjudication is left to cases where they are really needed to be adjudicated."

In terms of the judgments, the Office has issued 137 decisions, apart from further more cases closed following mediation. There were several decisions related to investments, many of which related to pensions which were all cross-border cases. With life insurance products, he said, it was a matter of the expectations that subscribers were given when they were sold their policy as much as a quarter of a century or more ago.

"Those expectations had to be reframed by the developments that happened during the duration of the life contract."

The Office of the Arbiter for Financial Services will continue to evolve not only by fulfilling its role – better – but also by taking on new roles, Mr Mifsud said.

"Better also in the sense that we give fair decisions and timely decisions. And I think we're making very good progress on that front."

Thanks to legislation that is to be presented to Parliament in the coming months, the Office is expected to take on the new role of a Credit Review Office, on the model of what is already available in Ireland.

"One of the current government's electoral pledges was to set up such an office, where businesses, not individuals, who think that their bank is not being fair in taking credit decisions on their applications, both for new credit and for existing credits if they need to restructure them or if the bank thinks that they have to withdraw the credit lines, can present their case."

Mr Mifsud is currently building the necessary knowhow and expertise to carry out these credit reviews – although these will only be on a recommendation basis. "Still, they will be recommendations with a certain amount of moral weight. So, it's not easy for banks to neglect those recommendations," he added.

He is also confident that trends will soon emerge: "We will know better where the truth lies, whether it's a question of the banks not being flexible enough to allow the credit demanded, which will help the economy to grow, or whether customers are expecting the banks to take risks which the banks shouldn't be taking because regulation doesn't allow them to".

As a result of these trends, Mr Mifsud believes he will be in a position to make recommendations to the authorities to fill any service gaps in the country's financial services sector.

"Maybe we are not offering services that are demanded by a developed economy. Our economy now can no longer be called developing. It's a developed economy and needs some specialised institutions, which can give the credit that banks normally do not take on, but which the economy needs for somebody else to take on."

The major message Mr Mifsud sees emerging from his decisions is the importance of both parties to be fair. On the one hand there could be unrealistic expectations and on the other an attempt to avoid clear obligations purely on technical grounds.

"My appeal to them is: it is very important for the long-term health of the industry that they are fair. This is an informal mechanism, and one of the major principles is fairness and equity. We continue to deliver that message through our decisions."

CASE SUMMARIES

In the first four months of 2024, the Arbiter has issued just over 25 decisions. Below are summaries of four cases based on the Arbiter's decision. The complete decisions can be accessed on our website. Additionally, we provide weekly updates with a new case summary every Friday on our LinkedIn profile.

Arbiter recommends *ex-gratia* payment in denied travel insurance claim

On 15 January 2024, the Arbiter for Financial Services delivered a decision in regard to a claim relating to a travel insurance policy. Although the complaint was not upheld, the Arbiter recommended payment to the complainant, which was slightly higher than the amount that the insurer had originally offered to the insured (the complainant). You may read the full decision for case ASF 184/2023 by clicking this link: https://t.ly/x9qLh).

The complainant reported that, while travelling, his personal backpack containing cash, sunglasses, a mobile phone and earpods, among other items – a total of €4,795 - was stolen. A police report was filed, supported by CCTV evidence from the establishment where the theft occurred.

The provider refused the claim due to lack of evidence on the stolen items, despite complainant providing all available evidence.

The complainant argued that the provider failed in its duty since the policy did not specify that receipts and boxes for the stolen electronic equipment were required, insisting that the policy stated "any evidence" should be accepted. Complainant also presented affidavits from himself and another person present during the theft.

The provider responded that the complainant failed to provide evidence as required by the insurance policy conditions. They highlighted that no receipts or warranty were provided for the phone, a recent model, and that complainant took no steps to block the mobile phone after the theft.

Regarding the cash, they noted it was exchanged illegally and thus could not be considered. They also alleged that complainant was not truthful about the incident, constituting a "misrepresentation" and breaching condition number seven of the policy, leading to the claim being denied. The Arbiter observed that the primary disagreement between the complainant and the provider was the complainant's failure to provide necessary evidence for the allegedly stolen items. The Arbiter did not feel that a condition in the policy, which dealt with dishonest or exaggerated claims, applied in this case.

However, the Arbiter found that complainant did not adhere to the policy conditions requiring reasonable care to supervise his property, since the backpack was left unattended, leading to its theft.

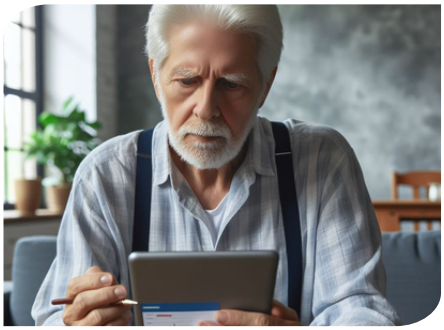
The Arbiter concluded that the service provider was not wrong in refusing the claim based on the exclusion that the stolen items were left unattended. Nevertheless, the Arbiter recommended, without obligation on the service provider, an *ex-gratia* offer of €780, slightly more than the €600 already offered by the insurer on a without prejudice basis. This was to cover the loss of smaller items, excluding cash and the mobile phone, since, despite the breach of policy conditions, the Arbiter did not doubt that complainant incurred a loss from the incident. The decision has not been appealed.

Arbiter orders compensation for loss in retirement scheme investment portfolio

On 22 January 2024, the Arbiter for Financial Services delivered a decision in regard to a complaint lodged against a trustee and retirement scheme administrator ("the provider") of a private retirement trust. The decision for case ASF 085/2022 is available online (https://t.ly/c8fiM).

The complaint centred on significant losses the complainant suffered within his retirement scheme, which he attributed to the provider's alleged failure to act in his best interests and to fulfil its legal duties. He claimed that his pension was invested in high-risk structured notes unsuitable for his low- to medium-risk profile, based on advice from an unlicensed investment adviser.

The complainant also accused the provider of not performing due diligence, failing to disclose fees, not providing pre-contractual information and denying him a 30-day cooling-off period.



In its response, the provider outlined its role as the Retirement Scheme Administrator (RSA) and trustee, stating it did not provide investment advice. The provider detailed the process of the complainant's investment through his advisor and the subsequent transactions and communications regarding the investments.

It contested the amount of loss claimed by the complainant and argued that the complaint was time-barred under the relevant laws. The provider also contended that the complainant was aware of the losses earlier than claimed and had full visibility of his investment portfolio.

The Arbiter observed that the complainant's retirement scheme was invested in structured notes that were not suitable for his risk profile and that the provider had a duty to ensure investments were prudent and in the best interests of the member. The Arbiter noted that the provider failed to exercise due diligence and did not act with the prudence required of a trustee.

The Arbiter also considered the legal framework, the provider's responsibilities and the nature of the disputed investments, concluding that the provider failed to meet the reasonable expectations of the complainant.

The Arbiter also noted that trustees must conduct business with integrity, exercise their fiduciary duties prudently and competently, and deal fairly with all clients. The provider did not fulfil these duties, as evidenced by the failure to treat the complainant's interests as paramount and the lack of care, skill and diligence in managing the trust's assets.

The Arbiter ordered the provider to compensate the complainant for 70% of the net loss incurred on his investment portfolio, amounting to £118,295.60, with interest at the rate of 5.25% per annum from the date of the decision until payment. The costs of the proceedings were to be borne by the provider. The decision has been appealed.

Dispute over rejected transfer from online investment account

The Arbiter for Financial Services upheld a complaint in a decision on 21 March 2024 regarding the rejection by a bank of a transfer from the complainant's online investment account, which included proceeds from crypto assets. The full decision of this case (ASF 198/2023) is available at this link: https://rb.gy/ogz05h.

A customer filed a complaint with the Arbiter against his bank for rejecting a €3,948.46 transfer from his online investment account. The customer claimed the bank had misunderstood the situation, caused him distress, and had unfair policies. He sought an apology, acceptance of the transfer, data privacy assurance, and policy revisions from the bank.

The bank responded that it had the right to reject payments that violated its policies and risk appetite.

It stated that there was no misunderstanding or need for policy review on its part. The bank also refuted the customer's claim of privacy breach and requested that the complaint be dismissed.

During the hearing, the customer explained he had liquidated his online investment portfolio, which was managed by copy traders who could invest in various products, including crypto assets. The bank had rejected the transfer due to its policy against accepting proceeds from crypto. The customer argued he had not directly traded crypto but acknowledged that copy traders might have done so on his behalf.

In his analysis, the Arbiter upheld the banks' right to set internal policies if consistently applied without discrimination. He found no evidence of the bank breaching the customer's privacy or manipulating policies. However, the Arbiter noted the bank's quoted policy prohibiting crypto business applied to corporate clients offering crypto services, not individuals with crypto in their portfolios. He observed the bank's less restrictive policy on outward crypto payments and the small crypto portion in the customer's portfolio.

The Arbiter decided in the customer's favour, ordering the bank to accept the €4,000 transfer and pay €100 in moral damages. He affirmed the bank's right to adopt clear policies, excluding such transfers in the future, though it would contradict financial innovation trends and their outward payment policy.

The decision has not been appealed.

Share purchase dispute over price limit and reverse stock split

On 5 January 2024, the Arbiter rejected a complaint lodged against a financial provider regarding an online share purchase order. The full decision for this case (ASF 086/2023) is available at this link: https://rb.gy/eqt3cl.

The complainant had placed an order for 4,700 shares of a particular company at a price limit of $0.28 per share, expecting to spend $1,316. The complainant received a contract note showing the acquisition of 4,700 shares at $4.26 per share, substantially higher than the price limit of $0.28 he claims to have set. Furthermore, the complainant did not have adequate funds in his account to cover the purchase at $4.26 per share, leading to a debit balance in his account.

The complainant argued that the financial provider's system defect led to the improper execution of his instructions.

As a result, the complainant sought compensation for a lost profit opportunity of $18,706, calculated as the difference between his intended purchase price of $0.28 per share and the price of $4.26 per share at which the order was executed, multiplied by the 4,700 shares ordered (4,700 x (4.26-0.28) = $18,706).

The financial provider responded that, due to a 1:15 reverse stock split announced by the company, which took effect at market opening on the day of the order, the share price increased significantly. They claimed the order had no price limit and was executed at the best market price of $4.2634 per share. Due to the system calculating costs based on the previous day's closing price, the order was processed despite insufficient funds.

Realising the issue, the financial provider calculated that the complainant's original intention was to buy 1/15th of the 4,700 shares (311 shares) due to the reverse stock split. To rectify the situation, the financial provider sold the excess 4,389 shares (4,700-311) at the best market price available at that time, which had dropped to $3.53 per share, resulting in a loss.

The Arbiter observed that the reverse stock split meant there was no opportunity to execute the order at the complainant's desired price limit. Therefore, the expected profit could not have been realised. The Arbiter found it irrelevant whether the order had a price limit or not since the outcome would have been the same.

The Arbiter concluded that the financial provider had already absorbed the loss from selling the excess shares and that the complainant's interests were not prejudiced. The complaint was dismissed.

The Arbiter's decision has been appealed.

PAYMENT FRAUD

NEW FRAMEWORK MODEL LAUNCHED

The Arbiter for Financial Services launched and adopted a framework model to apportion responsibility between banks and customers in cases of fraud, the first time such a model has been adopted in Malta. This model, drawn up by the Arbiter himself, considers factors such as gross negligence, customer awareness, bank communication efforts and special circumstances. Here are nine points that emerged from recent decisions by the Arbiter in which he applied the new model.

1. 🥷 **Spoofing and smishing scams:** Fraudsters impersonate banks or other trusted entities through sophisticated social engineering techniques, such as sending fraudulent SMS or e-mail messages containing links that appear legitimate.

2. 🚨 **Customer negligence:** Despite warnings from banks and regulators, customers often fall victim to these scams by clicking on the fraudulent links, leading to unauthorised access to their accounts and fraudulent payments.

3. 🏦 **Banks' responsibility:** Banks have a responsibility to protect their customers from fraud and to implement robust security measures to prevent unauthorised transactions. However, the allocation of responsibility between banks and customers in cases of fraud is often a complex issue.

4. 📜 **PSD2 and Banking Directives:** The European Union's Payment Services Directive 2 (PSD2) and the Central Bank of Malta's Banking Directive 1 provide regulations and guidelines for payment services providers and customer protection. These directives emphasise the importance of strong customer authentication and fraud prevention measures.

5. 📢 **Communication and customer education:** Banks need to enhance their communication efforts to educate customers about spoofing and smishing scams. Direct communication channels, such as SMS or e-mail, can be effective in raising awareness and preventing fraud.

6. 🔍 **Transaction monitoring:** Banks should have robust transaction monitoring systems in place to detect and flag suspicious activities, including payments to unusual accounts or countries.

7. 🔐 **Authentication processes:** Banks should implement secure authentication processes to prevent unauthorised access to customer accounts. Two-factor authentication is a common method used to add an extra layer of security.

8. ⏱️ **Response mechanisms:** Banks should have efficient response mechanisms in place to promptly address fraud reports and minimise the impact on customers. This may include recalling fraudulent payments or assisting customers in recovering their funds.

9. 🔄 Continuous improvement: Banks should continuously review and improve their fraud prevention measures to stay ahead of evolving fraud techniques and protect customers from financial losses.

All the Arbiter's decisions are available online. Technical notes on the Arbiter's framework model and how it is applied can be accessed at https://shorturl.at/ajyS8.

AMENDMENTS TO THE ARBITER FOR FINANCIAL SERVICES ACT

The Arbiter for Financial Services Act, Chapter 555 of the Laws of Malta, was recently amended by Act XIII of 2024. The new amendments entered into force on the 2 April 2024, the date of promulgation of the amending Act.

The salient amendments, outlined in this newsletter, are the following:

1. Widening of the Arbiter's jurisdiction;
2. Crystallisation of the financial service provider's duties in replying to a complaint; and
3. Co-operation between competent authorities in the financial services sector.

- **Widening of the Arbiter's jurisdiction**

The definition of a "financial services provider" was amended to widen the Arbiter's jurisdiction to hear complaints made against entities that are not licensed or authorised by the MFSA. Up until these amendments, the Arbiter's jurisdiction was tied to the fact that the financial service provider in question was licensed or authorised by the MFSA to provide the financial service in issue. This has now been changed to cover entities that, for example, are merely required to notify the MFSA that they are going to provide a given service in Malta. These service providers are not authorised by the MFSA, but by operation of the law itself (although they will fall within the supervisory jurisdiction of the MFSA). The Arbiter's jurisdiction is therefore now tied to the fact that the service provider is authorised at law to provide the service in question, irrespective of whether the MFSA is required to issue the authorisation. Examples are notified securitisation vehicles, notified professional investor funds and notified alternative investment funds.

- **Duties of service providers in dealing with complaints**

Chapter 555 did not impose time limits on the service provider to provide an official reply to a complaint made with it. The new Article 21A regulates this aspect of the service provider's conduct. It is true that other regulatory rules applied. However, the period to answer was not capped if the provider required more time than the initial period. Therefore, the time limit to reply to a complaint has been set at 15 working days from receipt of complaint.

A provider is justified in not sending a final response within 15 working days only where the delay is due to exceptional circumstances outside the provider's control. In these situations, the provider must exercise prudence and foresight and:

i. Inform the customer of this and of the reasons for the delay; and
ii. Provide an indication as to when a final reply is likely and to be provided.

However, the provider must always provide the final reply within 35 working days of receiving the complaint.

These time limits, applicable to all the financial services sector, largely reflect the provisions of paragraph 2 of Article 101(2) of Directive (EU) 2015/2366 (PSD2).

- **Co-operation between entities**

A new Article 27A was added to provide for the co-operation and exchange of information between the OAFS, MFSA, CBM, MCCAA and any other authority as the Minister may, by regulations prescribe, on issues that, in the Arbiter's opinion, are likely to have wider regulatory implications. This could include issues that appear to affect multiple customers of one or more financial services providers. The Arbiter can also direct the Board of Management of the OAFS to enter into memoranda of understanding with such entities. Any information so divulged or exchanged will remain confidential and can be disclosed only if permitted by prior written consent. This new provision fully transposes Article 17 of the Directive (EU) 2013/11 (ADR Directive).

The consolidated version of the Act is available at this link: https://legislation.mt/eli/cap/555/eng/pdf

NEW OFFICE LOCATION

The Office of the Arbiter for Financial Services is located in New Street in Regional Road, Msida MSD 1920. You can contact the Office of the Arbiter by calling 80072366 (local landlines only) or +356 21249245. Alternatively call or text on WhatsApp on +356 7921 9961. Further information is available at www.financialarbiter.org.mt.

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