PIF regime proves popular with non-EU managers

Loan funds present a compelling opportunity

Plenty of options for forming AIFMs in Malta
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Photographs: Viewing Malta
Published by: GFM Ltd, Floor One, Liberation Station, St Helier, Jersey JE2 3AS, Channel Islands
Tel: +44 (0)1534 719780 Website: www.globalfundmedia.com

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“What we are seeing under AIFMD is increased interest in asset managers using Malta as a domicile for the setting up of AIFMs,” observes Kenneth Farrugia, Chairman of FinanceMalta.

He continues: “Over the past ten years, the MFSA has authorised quite a number of Category 2 management companies. In fact, as at 30th June 3014, the MFSA had authorised 99 category 2 companies, and when one considers the advisory and custody service providers there are around 132 asset servicing operators in Malta. Beyond the 620 funds currently authorised by the MFSA, we have started to witness cluster formation on the asset management side.”

In the main these AIFMs are part of wider European operations according to Farrugia. In time, non-EU managers will increasingly look to jurisdictions like Malta as they search for a cost-effective way to becoming compliant under the AIFMD. In this regard, Malta has carved out an attractive value proposition.

“The main reasons for this (amongst many) are that: a) we have an equivalent legal and regulatory framework governing the set-up of fund managers and funds; b) the MFSA is accessible and pro-business; c) Malta has a competitive licensing process; and finally, d) the costs of setting up funds and fund management companies are highly competitive.

“For example, the turnkey cost of setting up a fund in Malta costs in the region of EUR15,000 to EUR25,000. When you apply that kind of cost to a fund of EUR30-40m, it becomes very attractive as the overall impact on the TER is a manageable one, particularly as these costs are amortised over a five-year period,” comments Farrugia.

Malta’s attractiveness as far as its cost competitiveness is concerned is not just limited to the set-up costs but equally to the ongoing servicing costs. To illustrate, the fund administration costs for a Maltese start-up fund are traditionally in the region of EUR15-20,000 per annum depending on the key features of the fund; e.g. the frequency of valuation, number of positions, trading volumes and number of share classes. The audit fees would be in the region of EUR6,000 per annum.

If a new manager has the opportunity to receive day one capital from an investor in exchange for discounted fees, that manager has to move quickly to bring their fund to market. Factors such as cost and speed are crucial and go some way to explaining why Malta’s reputation continues to be enhanced.

“When fund promoters come to Malta and speak to the various stakeholders such as lawyers, auditors, fund administrators and the regulator they are pleasantly surprised by what they can set up in Malta in a relatively cost-efficient and timely manner,” adds Farrugia.

“If you look at the growth rate, the number of funds has risen from just 100 in 1995 to 620 funds today. We have 28 fund administrators, around 120 licensed entities (advisors, fund management companies). As a result, Malta has created a robust fund servicing ecosystem which is leaving its mark.”

As global hedge fund managers typically run multiple funds spanning different jurisdictions, one of the consequences of this is that domiciles like Malta are increasingly being used as an administration hub.

“A number of fund servicing providers in Malta are increasingly being entrusted with the administration of funds that are domiciled in other jurisdictions such as Cayman, BVI and the Channels Islands as Maltese providers are deemed to be more cost competitive for the same service offering,” confirms Farrugia.
Malta’s PIF regime proves popular with non-EU managers

By James Williams

Retaining its Professional Investor Funds (PIF) regime is possibly the single biggest development for Malta in recent memory. The island is now home to over 600 MFSA-authorised hedge funds and whilst a number of those are now being transitioned into AIFs to comply with the AIFMD, the fact that small and emerging managers can choose whether to run de minimis funds outside the scope of the directive cannot be underestimated.

“Pre-AIFMD Malta’s PIF regime had already generated a lot of interest among managers. The MFSA performed mental acrobatics working out how it was going to retain the PIF regime alongside AIF. They did a great job. For smaller managers, they can grow under the PIF regime and then graduate to an AIF when the manager’s gross assets exceeds the de minimis threshold,” says Dr Kurt Hyzler, Advocate at CSB Group.

According to James Farrugia, who spearheads the Investment Services & Funds team at Ganado Advocates, by running two rulebooks for both the PIF and AIFMD regimes Malta has a clear competitive advantage over other domiciles: “Ireland and Luxembourg have taken the decision, rightly or wrongly, that irrespective of whether the AIF is de minimis or not the manager will still be required to appoint a local depositary, a local administrator and so on.”

Of the 600-plus investment funds registered in Malta “at least 85 per cent of them can be characterised as being in the EUR20-50m range,” explains Joseph Camilleri, Head of Business Development at Valletta Fund Services, one of the island’s leading fund administrators. “For fund managers who don’t have grand plans to grow their funds beyond the EUR100m threshold they can choose to remain under the PIF regime and privately place their fund(s), which is typical of many of the funds that are domiciled here.”
There are three types of PIF to choose from: those that are promoted to experienced investors, which come with a minimum investment of EUR10k, those that are promoted to qualifying investors, with a minimum investment of EUR75k (the most popular choice), and those that are promoted to extraordinary investors, with a minimum investment of EUR750k.

The number of funds domiciled in Malta can be expected to grow over the next few years as AIFMD beds in and more third-country AIFMs look for distribution solutions in the European market. Equally, however, the number of AIFMs being established will also likely grow. Indeed, signs of cluster formation are already in evidence.

“We are seeing that. Managers are coming here from a tax perspective because Malta offers them the right jurisdiction for their business. We are working with several start-up managers from the EU,” confirms Hyzler.

Malta’s tax regime is certainly attractive. From a personal tax perspective, the Highly Qualified Persons Rules ensure a flat rate of 15 per cent tax, which would apply to hedge fund professionals. With respect to AIFMs, Maltese fund managers benefit from a highly competitive fiscal regime, which is FATF and OECD-compliant, whereby a refunds system can be availed of.

Laragh Cassar, partner at law firm Camilleri Preziosi, explains this last point by saying: “Malta is the only EU member state that operates a system of dividends based on full imputation. A fund management company would be required to pay the standard corporate tax rate of 35% on its profits. However on distribution, the shareholder receiving the dividend qualifies for a credit in respect of the tax paid by the AIFM. Distributions to shareholders would trigger refunds to the shareholders of 6/7ths of the tax paid by the AIFM on the distributed profits.”

“This is an important consideration for an AIFM in determining which jurisdiction it should run its business from.”

Farrugia confirms that the bulk of Ganado Advocates’ clients have been approved as AIFMs by the MFSA, noting that the process has actually been quite smooth.

“There are a few managers still being processed but from an MFSA perspective the whole process has been relatively straightforward. The MFSA published a questionnaire which our clients completed as part of the transitioning into AIFMD. On average, the transition has taken two to three months,” says Farrugia.

He adds that this year has also seen increased demand in new AIFMs and AIFs setting up on the island: “We have received a number of enquiries from promoters wishing to set up AIFMs in Malta. On the fund side, there’s been a tangible increase in the number of promoters contacting us to set up new funds. Towards the end of last year it was a bit slower as managers were still getting used to AIFMD and how they could transition into it.”

What is becoming interesting in Malta is how managers, particularly non-EU managers, are exploring different fund structures within the PIF regime to cater to European investors yet ensuring that they remain out of scope of the directive.

Some observe a pick up, for example, in funds-of-one.

Another option is to establish the collective investment scheme (CIS) under the PIF regime as a SICAV investment company structure; an umbrella fund with legal segregation between sub-funds.

“By virtue of the separate patrimony between sub-funds of multi-fund SICAVs the assets and liabilities of one sub-fund will not contaminate the assets of other sub-funds. This gives peace of mind to managers who create sub-funds for particular investors who want exposure to a specific strategy and want to be insulated from other strategies of sub-funds of the same SICAV.

“Each sub-fund of the PIF can be managed by a different entity (though this

Dr Kurt Hyzler, CSB Group
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Choosing the right fund structure in Malta

Interview with Kevin Caruana & David Barry

For emerging managers, the fact that Malta retained its PIF regime alongside the new AIF fund regime means that a number of fund structuring opportunities now exist.

The most popular option, to date, has been for managers to register with the MFSA, obtain a fund management licence and launch a de minimis PIF. But according to Kevin Caruana, Managing Director of Custom House Global Fund Services (Malta) and David Barry, Head of Sales & Business Development, EMEA, there are other viable options to consider.

These include a de minimis self-managed PIF or the opportunity to join a pre-established multi-fund SICAV platform.

The self-managed PIF, in particular, is becoming an interesting trend.

“It is an option we are seeing more interest in,” confirms Barry. “Under this structure, the board of directors is responsible for the discretionary management of the assets of the fund. The Board may appoint an investment committee who will be responsible for the day-to-day management of the assets according to the terms set out by the Board.”

At least one board director needs to be resident in Malta and may act as the Compliance and Money laundering officer. Also, board meetings must take place on a quarterly basis.

“There is no regulatory obligation on the portfolio manager to be based in Malta. What’s important for the MFSA is that they have a contact point in Malta that is responsible for the fund irrespective of where the portfolio manager is. The MFSA has always adopted a cautious approach. It wants peace of mind that the parties are reputable and fit and proper,” explains Caruana.

The self-managed PIF is an alternative solution for managers who want to build a track record but do not necessarily want to go through the rigorous regulation process of setting up a regulated asset management company. It initially caters to a limited number of private investors e.g. friends and family. What should be noted, however, is that asset raising maybe a challenge given that there is no regulated investment manager.

Which is where the second option becomes interesting: the pre-established SICAV platform. Here, any manager wanting to run a sub-fund under an umbrella structure must be regulated in a jurisdiction approved by the MFSA. Another difference to note is that these are sub-funds and not standalone funds, so you need to operate under the terms and conditions of the platform.

Custom House was one of the first to offer such a platform in Malta when it launched its Nascent Fund SICAV plc in 2010. There are currently six managers running sub-funds on the platform, each of which is fully segregated to protect against other managers potentially imploding.

“This turnkey solution helps managers establish a fund in a cost efficient manner. The idea is that we provide them with the infrastructure and assistance to allow them to grow. As their AuM increases, they can then choose to “fly the nest” and launch their own fund, retaining their full track record,” confirms Barry.

The provider running the umbrella structure takes care of all the operational and regulatory aspects of running a fund. In that sense, working under a SICAV structure provides guidance to the manager on regulation and compliance.

Whether managers choose a self-managed PIF or join a platform like Nascent will be determined by how they structure themselves internally: “Regulated or unregulated? Non-AIF or AIF? These are probably the first and most important questions a manager needs to answer,” concludes Barry.
is uncommon) – if the manager has, for example, two of the three sub-funds on the SICAV and together with any other funds it could be managing, its AuM goes beyond the de minimis threshold, then the entire Fund would have to become AIFMD-compliant. In such a scenario, all the sub-funds would need to be managed by the same Manager.

“The safest way for a Fund to stay out of scope of the AIFMD is for the Fund to be self-managed as it will not get ‘contaminated’ by the AuM of the Manager with respect to the other funds they manage. The self-managed PIF is a recent trend that we’ve started seeing in Malta,” explains Hyzler.

This self-managed de minimis PIF works very nicely for non-European managers targeting small numbers of investors. They may have a group of three of four investors looking to allocate EUR75m, for example. These assets would go straight into the self-managed PIF, which would then be closed to other investors. Farrugia says that investors are keen to invest into EU-domiciled funds but aren’t keen to pay the costs of AIFMD.

“This solution helps them to avoid AIFMD altogether. Malta’s self-managed PIF is quite unique in that sense,” comments Farrugia.

“A third country manager managing a de minimis self-managed PIF will avoid the need to register in a Member State of reference should the Third Country Rules under the AIFMD come into force in 2015/2016. On the assumption that they do, a Swiss manager, for instance, managing a Maltese fund, will need to be registered in a Member State of reference. But if the Swiss Manager is managing a de minimis self-managed PIF in Malta, that registration requirement will not apply.”

With a self-managed PIF, investment management decisions are retained by the PIF Board of Directors rather than have them delegated to an external discretionary investment manager.

“An internally managed AIF would outsource the day-to-day portfolio management function back to the Swiss manager. Therefore, if the Swiss manager sets up a self-managed PIF in Malta and keeps it below EUR100m, it would remain outside the scope of the directive. Moreover, the Swiss manager would then not be viewed as an external AIFM,” clarifies Farrugia.

Cassar further confirms that Camilleri Preziosi has received an increase in applications – in some cases from US-based private equity managers – to set up self-managed de minimis PIFs.

“It is the main selling story right now,” says Cassar.

Expect, then, to hear a lot more about self-managed PIFs going forward. One other interesting area to keep an eye on will be that of loan funds and direct lending vehicles, which continue to court the interest of institutional investors. Up until now, managers would never have considered Malta because the provision of loans required a financial institutions licence from the MFSA.

That has now changed. The MFSA will now allow PIFs and AIFs to engage in loan investing provided certain conditions are met – refer to Camilleri Preziosi’s article, page 10 in this report for further details.

Naturally, this is good news for private equity managers who wish to engage in lending activity as part of their investment strategy. Cassar observes that more clients this year have looked into setting up standalone loan funds in addition to engaging in a series of lending activities as part of the investment objective of the fund.

“Previously, in both cases there was a huge stumbling block from a regulatory perspective because it meant that in addition to your fund licence you would also need to become, in effect, a financial institution. You could have done it on a one-off basis, originating one loan, but that meant it was extremely restrictive,” says Cassar.

She continues: “The MFSA amendment has opened up a real opportunity now although a few issues still need to be ironed out – for instance, where does one draw the line when determining what
For a number of years, it has been practically impossible for funds to grant loans to third parties unless done on a one-off basis. Potential loan funds have, until now, not considered Malta.

The issue in this regard has always been a licensing one in that, in terms of the Financial Institutions Act, generally speaking the provision of a loan on a regular or habitual basis requires a financial institutions licence from the MFSA. This, coupled with the often strict interpretation of the MFSA as to what constitutes ‘lending’ and what constitutes ‘regular’ or ‘habitual’, has meant that funds have been unable to grant loans without risking a licensing trigger. In response to this issue the MFSA created a new model for funds wishing to carry out lending activities by allowing alternative investment funds (AIFs) and professional investor funds (PIFs) to grant loans provided a number of conditions are met.

A fund may now ‘invest through loans’. This has been defined as:

i) the direct origination of loans by the scheme; or

ii) the acquisition by the scheme of a portfolio of loans or a direct interest in loans which gives rise to a direct legal relationship between the scheme as lender and the borrower.

A loan fund may issue loans solely and exclusively to unlisted companies and small and medium sized enterprises, subject to a number of conditions, including that financial undertakings are not eligible to receive financing from these schemes.

The fund must be closed-ended and may only target specified professional investors, these being:

a) investors which are considered to be professional clients in accordance with MiFID; or

b) investors which, on request, elect to be treated as professional clients in accordance with MiFID and commit to investing a minimum of EUR100,000.

Such schemes may therefore be established as AIFs or PIFs marketed to Qualifying or Extraordinary Investors in accordance with the applicable Investment Services Rules.

Such a fund would be subject to a number of investment restrictions, including that it may not invest more than 10 per cent of its capital in a single undertaking, it may not encumber the assets held in the portfolio of the scheme; and may not use leverage or reuse collateral. The fund manager is also obliged to implement a number of policies, including a credit risk policy in order to establish the framework for lending and guide the credit-granting activities of the fund.

Whilst this initiative is welcomed, one still finds that previous issues remain unresolved – the Financial Institutions Act linked the licensing obligation to a frequency factor which in the case of loan funds has not been maintained. So in essence a fund must immediately obtain a licence as a loan fund if it intends to lend funds to an entity even if on a single instance.

Furthermore, questions still remain unanswered as regards what constitutes a loan, the acquisition of a portfolio of loan or direct lending.

On the other hand, it is expected that this initiative will provide the necessary regulatory framework to entities that are actively seeking the opportunity to use the fund vehicle to carry out lending activities. We are confident that, together with the flexibility and success of the de minimis AIF/PIF structure already established in Malta, this opportunity will add additional pages to Malta’s already successful fund storybook.
Overview

“I believe that ultimately the Directive will follow the same path being taken by the UCITS regime. UCITS IV introduced the ability to passport management company services and one expects that the same cross-border capabilities will apply to depositaries under UCITS V,” opines Farrugia.

If it doesn’t, the likely solution for a Maltese AIF that prefers to work with JP Morgan (to continue the example) will be to appoint a local depositary such as Bank of Valletta and have them enter into a sub-custodian arrangement. Not ideal, but it’s an option if the depositary passport hasn’t been ratified.

“In Malta, the great majority of the depositary and prime brokerage arrangements for hedge funds domiciled here are making use of foreign-based service providers such as Interactive Brokers, Saxo Bank, Credit Suisse, Goldman Sachs, JP Morgan, Deutsche Bank and UBS,” says Farrugia.

To conclude on an optimistic note, Hyzler confirms that CSB Group’s turnkey solution – which is available for all financial and investment services institutions – has started to generate interest from custodians.

“We can help with the process of getting custodians set up here in Malta, just as we can with fund managers. We are currently working with one European custodian at the moment,” says Hyzler.

“I don’t understand the rationale behind it,” says Kenneth Farrugia, Chairman of FinanceMalta. “There is a clear drive under UCITS V to introduce the passport for custody services; currently the state of play is that as from 2017, a custodian registered say in London, will be prevented from providing their services to hedge funds domiciled in different Member states. As a result, this will complicate matters for a manager wishing to establish an AIF in a particular jurisdiction as they will be precluded from appointing a custodian of their choice operating in any other EU jurisdiction.”

The requirement to have a depositary in the same jurisdiction as the fund is set to be invoked in July 2017.

Currently, Malta allows the fund promoter to service the fund with foreign prime brokers, custodians and administrators; there is no restriction whatsoever. Why, for example, should a promoter that appoints JP Morgan in London to service the fund require the bank to have a local footprint? At the end of the day it’s the same counterparty no matter where it’s located.

Nonetheless, all things being considered, this is a positive step for Malta since it offers a regulated product for an increasingly popular investment, particularly within the EU.”

To date, the MFSA has done a good job of keeping Malta in the spotlight for managers wishing to launch AIFs and/or AIFMs. If it can add more strings to its bow by promoting the benefits of self-managed PIFs, and by bringing further clarification to the loan funds market Malta will reap even more rewards.

But it’s not all peaches and cream. One area of Malta’s service provider infrastructure that remains slightly under-developed is the number of global custodians operating there. Yes, the likes of Deutsche Bank and Citco are present, but if, as mooted, the AIFMD introduces a requirement in 2017 that the depositary needs to be in the same jurisdiction as the AIF it could become an issue.

Actually constitutes a ‘loan’? The previous regime allowed one-off lending activities to take place without triggering a licence requirement. However under the current rules, the one-off lending activity would bring the fund into the new loan fund regime. Nonetheless, all things being considered, this is a positive step for Malta since it offers a regulated product for an increasingly popular investment, particularly within the EU.”

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¹ Vide Article 36(1)(a) AIFMD
² Vide Article 21.7 from the said directive
³ Vide Article 21.8 from the said directive
⁴ Vide Article 21.9 from the said directive

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The AIFMD transition in Malta

By Robert Higgans & Clare Farrugia

Since the end of the transition period applicable to Alternative Investment Fund Managers (AIFMs) that were undertaking activities before the coming into force of the AIFM Directive on 22 July 2013, a clearer picture is emerging on the preparedness of operators to conduct activities under AIFMD – a Directive which has attracted mixed reactions from various sectors, with some advocating the added advantages of increased investor protection and the passporting opportunities whilst others are highlighting the increased compliance costs, uncertainty and complexities that it has brought about.

Whilst AIFMD has posed various challenges to industry operators and regulators alike, Malta was at the forefront of implementation, ensuring a timely transposition. This transposition entailed amendments to the Investment Services Act, 1994 with the primary law being supplemented by four legal notices and changes to the MFSA’s Rulebooks.

With respect to the transitional period, the MFSA received around 100 applications from existing local fund managers and internally managed schemes, which were in operation before 22 July 2013. Such licence holders were required to undertake a gap analysis and identify those areas that required changes to ensure compliance with AIFMD. Whilst many applicants already had certain structures and procedures in place in line with AIFMD, one of the areas they needed to tackle was the separation of the portfolio and risk management function and the addition of staff to ensure a more robust risk and compliance infrastructure.

The practical implementation of the Directive has proven to be a challenging task particularly in view of the uncertainty in the interpretation of certain requirements. One such area concerned the delegation requirements of AIFMs. The lack of clarity on the requirements on delegation and the application of the quantitative and qualitative criteria set out in the Commission Delegated Regulation, created certain uncertainty for some applicants. The MFSA sought to address this through the exchange of views and discussions with the industry. Where certain elements of the portfolio management function were delegated increasing focus was made on the need to have a fully operational and independent risk management function undertaken by competent people in Malta.

As part of the MFSA’s pragmatic approach to the implementation of the AIFMD it took the initiative of introducing an Alternative Investment Fund regime by way of a new Rulebook. This new regime provides Maltese/EU AIFMs with a regulatory framework that allows them to establish AIFMD-compliant funds for marketing to professional investors in Malta or across the EU.

With reference to de minimis AIFMs that qualify for the exemption available under Article 3 of the AIFMD, Malta introduced a specific regulatory framework as it opted to regulate such entities. De minimis AIFMs are required to be licensed rather than merely registered.

The transition and application of the AIFMD has been facilitated by the MFSA through the provision of guidance to the industry not only through ongoing discussions with industry representatives but also the issue of circulars, brochures, guidance notes and feedback statements including frequently asked questions.

Whilst challenges and scope for greater clarity on aspects of the Directive remain, much progress has been made resulting in increasing interest and confidence of fund managers and internally-managed schemes to operate under the AIFMD.
The official grandfathering period of the AIFMD only ended this July so assessing how different jurisdictions and their fund industry networks are adjusting to the new challenge is a little too early to call. Nevertheless, as burdensome as the Directive is for managers, it is at least pushing service providers to further extend their solution sets; whether that be from a regulatory reporting perspective, providing depositary services to AIFs - both onshore and offshore - or simply providing platform capabilities to allow new managers to feel their way; to get up and running without incurring the full cost and glare of regulation.

Malta, in that sense, is no different to any other European jurisdiction. In fact, many would argue that it has a distinct competitive advantage, certainly from a fund structuring perspective.

Speaking to Hedgeweek about the importance of Malta to its strategic growth plans in Europe, Mike Hughes, Global Head Fund Services, Institutional Cash & Securities Services at Deutsche Bank says: “Malta has established itself as a domicile of choice for financial services providers and our local presence gives us the opportunity to provide a platform of services to fund managers not available through any of the other financial institution channels in Malta. In essence, Malta is vital to the expansion of our global footprint and European business.”

These services are comprehensive for

Options aplenty for managers running funds in Malta

By James Williams
managers needing to comply with the Directive.

“Where our competitors rely on passporting their depositary services into Malta, we contract directly with our clients locally – this makes us unique in Malta,” explains Hughes. “We have an extensive depositary and fund administration product suite covering banking services, collateral management, middle office, fund accounting, custody, foreign exchange and investor services for locally domiciled fund managers.

“Currently, we service in excess of USD2.5bn in assets across our product portfolio. Our award winning fund administration is a vote of confidence in our business and that too for Malta.”

One of the biggest adjustments under the AIFMD is the need for managers to appoint a depositary to their AIF. Whilst the number of local custodians in Malta remains limited, those that are there – including Deutsche Bank, HSBC and Sparkasse Bank are more than prepared. Indeed, as Paul Mifsud, Managing Director at Sparkasse Bank Malta plc confirms, the firm adopted a highly principled approach to monitoring client portfolios way before the AIFMD was even conceptualised.

“After all, these are investor funds and they need to be protected. A look-through capability has always been ingrained in who we are and what we do. So AIFMD for us was basically reaffirming what we thought from day one,” says Mifsud, who confirms that the majority of enquiries currently are coming from EU-based managers.

“People are waking up and smelling the coffee. Fund managers now realise they need to get aligned under the Directive. The depositary, which until recently was the last service provider a manager talked to in the overall chain of service providers, has now become a focal point.

“In 2014 we would have doubled the amount of clients from two years ago. We are seeing a mix of managers; start-ups as well as existing funds that previously operated under the PIF regime but now, because of their size, have had to be re-licensed as AIFs under the Directive,” says Mifsud.

The problem managers have in appointing a depositary, besides the fact that it is another layer of cost, is that there is now someone monitoring what they are doing and looking over their shoulder. That’s not something they’ve ever had to experience before; especially private equity managers.

“Previously managers could trade and do pretty much anything they wanted. Now, by appointing a custodian to hold the fund’s assets, the AIFM has to make sure that they are happy holding those assets; indeed can they even hold the assets? Can they verify the ownership? Can they provide adequate record keeping and safekeeping of the assets? It puts a manager’s portfolio under more strain.

“The fact is we are on the hook for the safekeeping of the AIF’s assets if the fund is domiciled in Malta. We are responsible for loss of liability,” says Mifsud. This is very different to the “Depo Lite” solution under AIFMD; here, the custodian (or prime broker) is not on the hook for loss of liability as these are non-EU funds.

Given the complexities of asset verification for non-financial assets – private companies, land, real estate – Mifsud says that they are largely working with clients trading transferable securities.

“Land and property are not the easiest assets to work with; planning permissions, insurance issues, the list just goes on and on. If you find a depositary willing to work with these assets, they will need independent experts on the ground working on behalf of the depositary to verify the assets wherever they may be. That’s not going to be cheap. Will the manager be willing to pay for that?” questions Mifsud.

TMF Custom House Global Fund Services launched a Depo Lite platform on 15 September 2014 to provide the cash flow management and general AIF oversight
Regulation drives wider range of reporting solutions

Interview with Joseph Camilleri

With the Alternative Investment Fund Managers Directive (AIFMD) which came in force last July 22, together with the introduction of the European Market Infrastructure Regime (EMIR) and Foreign Account Tax Compliance Act (FATCA), fund administrators are facing big challenges in terms of getting up to speed on the full ramifications of these directives.

AIFMD and EMIR in Europe represent opportunities to administrators whose level of preparedness is such that, through the identification and implementation of multiple reporting options, places themselves at the forefront to increase their revenue streams. With the right technology solutions, reports can be generated and validated to meet these European regulatory requirements.

Complex reporting requirements such as the ones associated with AIFMD, impose the need to identify and apply innovative and new reporting tools.

Joseph Camilleri, Head of Business Development at Valletta Fund Services, the fund administration arm of the Bank of Valletta, comments that Malta Financial Services Authority (“MFSA”), wisely opted to keep its Professional Investor Funds (PIFs) regime alongside the newly introduced AIF rule book that adheres to the AIFMD provisions.

“This provides small to mid-sized hedge fund managers that are classified as “de-minimis” the opportunity to opt out of the onerous obligations as set by the Directive, and pursue their distribution model based on private placement. This ensures that Malta’s strong position as an ideal domicile for de-minimis fund structures is sustained,” says Camilleri.

Having two rule books for alternative investment funds puts Malta in a highly advantageous position, enabling it to market itself to a wider fund promoter base. Coupled to this, Camilleri believes that Malta holds a compelling business case for the setting up of AIFMs to operate from Malta.

“The increase of AIFMs would lead to more onerous regulatory reporting requirements which will be imposed on the fund manager. “Annex IV” which is the major report to be compiled, is even more detailed than Form PF in the US. Fund Administrators are gearing themselves heftily in order to ensure that the fund managers are well supported and serviced.

“We have more than 120 investment services licences issued by MFSA, of which over 90 are fund management companies with an operational base in Malta. There is a mix between de-minimis managers and others well beyond the threshold (set at EUR100m), which are converting to AIFMs. Many local fund managers are subsidiaries of larger FCA-licensed UK management companies. A number of these have opted to convert their Malta operations into AIFMs, adopting a business model whereby the risk management activities are conducted locally in Malta, whilst the day-to-day investment management activities are outsourced to the UK-based managers that do not hold an AIFM licence.

“This is a business model that we envisage will grow steadily, strengthening Malta’s positioning as a domicile of choice for many operators in the funds sector” comments Camilleri.

The AIFMD, like most regulation, comes with relatively heavy baggage: not solely in...
terms of reporting obligations but also with respect to depositary services where the liability clauses on credit institutions offering such services can be onerous.

All of this translates into higher fund costs. It is a challenge for fund managers to ensure that the TER of their funds remains contained and costs do not spiral as they are ultimately borne by the investors. “This is ironic”, says Camilleri, considering that the Directive’s core objective “was to safeguard the interests of the investors themselves! Obviously, this would lead to lower performance results of the funds”.

“In this respect VFS, early on, ensured that all the reporting requirements, especially regarding Annex IV, were fully understood. Our systems were updated and set up where necessary, in order to facilitate the smooth running and integrity of such reports. The majority of the information required under Annex IV is already held by administrators in their normal course of business. Therefore VFS is best placed to provide this reporting services to its hedge fund clients, allowing them to focus on core competencies; that is, investment management,” says Camilleri.

The first step VFS took in developing its reporting capabilities for Annex IV purposes was, to examine each and every line item of the template report Annex in order to assess whether the necessary data was already held in its IT platform system and, whether there was potential to populate additional data from the portfolio positions, and finally to determine which data would need to be provided by each individual fund manager.

As it transpired, a fair percentage of the data was already held through the portfolio positions of the funds under administration. “That was part one,” says Camilleri. “Next, we identified what other data feeds were required for which the necessary details were held in the respect portfolios yet amounted to “idle” data that was not used for the purposes of determining the NAVs of the respective funds”.

“Plugging this additional information into the data repository beefed up the overall data captured, for eventual use in the compilation of Annex IV.”

When asked what kind of information this might entail, Camilleri states: “This may include areas like the value of turnover in each asset class, the borrowing and exposure risk, the five largest sources of borrowed cash or securities…. All such information was, as stated, available, yet untapped as not required for NAV calculation purposes.”

“The third and final leg was accessing additional information that was not in our possession; basically data that the fund manager has access to. We had to ensure that there was an IT interface that could effectively extract additional data from our systems and at the same time collate it with the additional data which can be produced by the fund manager. The aim is to produce a complete set of clean data, prepared in an automated fashion, which we can then file with the MFSA on behalf of the client.”

This reporting solution is in the final stages of being completed, so as to fully support AIFMs, most of whom will be required to make their first filing of Annex IV by 31 January 2015.

Unfortunately, the reporting obligations for EU managers do not end here. Back in February this year, institutions and their bank counterparts were required to start reporting financial derivative transactions made under EMIR (European Market Infrastructure Regulation). Then, on 1 August 2014, phase two of EMIR began: namely, valuation and collateral reporting, requiring both the fund manager and broker/dealer to report the valuations of all derivative transactions to an appointed trade repository at the end of each day.

“With respect to EMIR, VFS has been providing services to our clients that are two-pronged. On the one hand we have been registering the funds for the LEI (Legal Entity Identifier) with the London Stock Exchange, whilst on the other hand, we provide the daily reporting necessary to the relevant trade repository, which in our case is the Malta Stock Exchange.

The daily EMIR reporting is automatically extracted from the funds’ portfolios, (the information utilised is similar to that required for compiling Annex IV). This information is obtained from our ICON platform. As in the case of reporting for Annex IV, a few clients opt to appoint their prime broker to file said EMIR report, whilst others request VFS to generate and file EMIR reports on their behalf,” concludes Camilleri.
functions needed under the AIFMD. As the administrator is not attached to a bank it cannot provide the asset safekeeping function; something the prime broker is able to continue doing on behalf of the manager running a non-EU fund.

“It’s an area we wanted to move in to. Not only will it add value to us as a business, it was a case of ‘We can’t not offer this solution to our clients’,” says Kevin Caruana, Managing Director of TMF Custom House Global Fund Services (Malta). “The important thing is that we can provide clients with exactly what they need as the regulatory environment changes. We have a FATCA solution, a Form PF solution and we now have a depo lite solution. We are also in the process of finalising our Annex IV reporting solution for AIFMD, which should be ready in Q4 this year.”

On the issue of providing cash flow monitoring and general oversight functions to non-financial assets, Caruana explains that this is something any good administrator currently provides: “As a member of the TMF Group, we now offer full depositary services to private equity and real estate funds as well as funds of other nature that do not primarily invest in financial instruments typically held in custody.”

Service providers face substantial costs upgrading their technology infrastructures and strengthening their capabilities to monitor and report on funds, many of which are moving into ever-more complex areas such as direct lending, asset-backed lending, etc.

“In order for fund managers to achieve cost efficiencies whilst abiding to the new regulations, they are relying to a greater extent on their fund administrators to deliver an array of solutions,” explains Joseph Camilleri, Head of Business Development at Valletta Fund Services, the fund administration arm of the Bank of Valletta.

Camilleri continues: “The AIFMD has been pushing consolidation in the market and possibly over the next couple of years we’ll see a squeezing out of smaller service providers who opt out from providing services that cater for the requirements of these regulations, both on the depositary side and the fund administration side. The key for those who want to survive is to invest more in training and IT infrastructure and provide all the necessary services that managers now expect. If not, managers will simply move on and look for service providers who tick all the boxes.”

Valletta Fund Services is fortunate to be able to use the robust infrastructure built by the Bank of Valletta and to that end it is helping the administrator develop a FATCA solution.

“We are now availing ourselves of the infrastructure that Bank of Valetta has put in place to do the necessary registration and ongoing reporting for managers under FATCA. VFS has communicated with all of its clients offering our services in relation to FATCA obligations” confirms Camilleri. “It’s an area where we have invested a significant amount of time and energy.”

One other important area of development to help support emerging managers in particular is the provision of multi-fund platform services. In effect, umbrella structures in the form of an open-end SICAV. These structures can best be thought of as incubation platforms that enable start-ups to build their track record and assets steadily without having to incur all the costs of setting up a standalone fund.

“The Primary European Fund SICAV is the name of our Malta umbrella structure. Like our Primary Development Fund in Cayman it is a turnkey solution for managers wishing to launch in Europe,” explains Derek Adler, Group Director of fund administration firm ifina. “If you’re a three-person start-up you’re not going to have the resources – both in terms of personnel and finance – to take on the burden of regulation. Our umbrella structure helps to accommodate the little guy that would ordinarily find it difficult to get off the ground in Europe.”

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A developed and expanding financial centre

By Derek Adler

There are many questions being asked by Investment Managers (IMs) today and relatively few satisfactory answers available. For many years IMs have merely had to satisfy the regulatory requirements of the chosen jurisdiction and with limited restrictions have been able to go about their business without too much difficulty.

Along comes the financial crisis in the mid noughties and the situation changed quite dramatically. As always, the pendulum swings from one extreme to the other but in this case the pendulum had clearly not reached its extreme, as several draconian rules were brought out by the very people that had a major part to play in the problems in the first place and caused the pendulum to swing even further.

For many large institutions, the latest rules and regulations will not cause major problems but perhaps the occasional headache. They have the personnel and financial resources to meet the stringent demands being implemented by global regulators and will no doubt deal with everything in their stride. However, the cost of all of these extra rules and regulations will no doubt be passed on to the investor.

Spare a thought for the smaller IM who is restricted on personnel, finance or more likely both. Does the emergence of all the new rules and regulations – such as AIFMD, FACTA – mean that this is the end of the emerging manager and the monopoly by the big institution to control the investment market? The answer is an emphatic no!

As a director of a multi-jurisdictional fund administrator, we are often asked, “where should my fund be domiciled”?

There is no definitive answer as each potential fund has different characteristics. Basic issues include: where is the IM domiciled, where will the fund be marketed and to what type of investor? Depending on certain basic facts, one jurisdiction could be more suitable than another. This was the case up until this year and due to the fact that AIFMD is in now place, created an additional bridge to cross.

For IMs who wish to market in the Americas, the Far East – in effect any continent other than Europe – then all of the current well established jurisdictions are fine. However, should the IM wish to market within the EU then the choice becomes more limited. Luxembourg and Dublin do a fine job of regulating funds but they are predominantly retail and tend to be managed by large institutions.

The problem for smaller IMs is where can they go that is well regulated and provides the EU passport for marketing purposes? The choice has become even more restricted. Thank goodness then for Malta!

Not only does Malta provide a well regulated environment but the Maltese speak both Maltese and English despite the fact that it is a sovereign state within the EU. Thus it becomes the gateway of choice for those emerging IMs wishing to promote their funds across Europe.

There are services available to accommodate both the large standalone funds as well as umbrella structures, so that the emerging manager can also compete and get up and running at very competitive pricing. This is a good thing and ensures that there is still a place for the innovative and entrepreneurial IM to develop, despite the initial barriers that appeared to be in place.
Nascent. Finally, the manager launches their own standalone fund and, eventually, becomes AIFMD-compliant. TMF Custom House supports their clients at each stage of evolution. Our philosophy is to grow with clients and we have been doing this for over 25 years,” explains Barry.

In that sense, Malta is an excellent environment in which to allow managers to grow and feel their way in to becoming regulated asset managers under the Directive.

Adler says that interest in the Primary European Fund SICAV has been good and is confident that it will continue to grow now that the AIFMD grandfathering period has ended.

“The barriers managers face today are off putting. We want to get a message out there and tell these start-up managers, “All is not lost!”

“We act as the project manager. We are the link between the manager and the lawyers, the auditors, the brokerage account, and help get the licence. We are the hub basically. That makes getting set-up far quicker and cost-effective for the manager. If you don’t know what the regulators want when you apply for a licence you could run into trouble. We make sure all the Ts are crossed and Is are dotted. We know what the MFSA is looking for and that’s important for managers who want to get up and running yesterday,” says Adler.

Ifina charges a set fee of EUR13,000 to establish a sub-fund on the platform and according to Adler “launching a standalone fund would cost double that. We'll consider funds that are launching with as little as EUR1-2m.”

All of which is very reassuring for new talent coming to market.

As a concluding remark on the need for Malta to have more custodians in case, as predicted for 2017, AIFMs will be required to appoint local depositaries in the same jurisdictions as their AIFs, Mifsud says:

“My gut feeling is that it'll be difficult for the simple reason that banks are downsizing rather than upsizing and are going back to basics. It’s difficult to predict the future but that’s what I see today.

“Is it good for the jurisdiction? No. Do we need one or two more custodians? Yes. Will they come? I don’t know.”