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alta’s ascension into the EU ten years ago marked the start of its journey towards becoming the world class funds domicile it is today. The island’s hedge fund industry has continued to demonstrate stable growth over the past year, further solidifying its position on the global stage. Its Member State status, along with a favourable location and time zone, are among the many factors that have driven new managers to the island.

Under the stewardship of financial regulator the MFSA, the jurisdiction has remained flexible yet robust. The MFSA, meanwhile, has proven itself adaptable in both its response to regulatory requirements and increasing investor demands, despite the challenges posed by the legislative likes of Emir and the AIFMD. In addition, investors have long been attracted to Malta’s professional investor fund (PIF) regime, and interest is set to continue with the introduction of AIFs. In this report, HFMWeek speaks to some of the leading members of Malta’s funds industry, to find out how these, and many other developments, are helping to forge the jurisdiction’s burgeoning reputation.

Alexis Burris
Report editor
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Malta: Domicile Update

Since becoming an EU Member State in 2004, Malta has developed a reputation as a world-class financial jurisdiction with numerous benefits for hedge fund managers. Although more modest in size compared to European heavyweights Ireland and Luxembourg, the domicile, nonetheless, offers a robust and world-class centre for hedge fund services.

Situated in the heart of the Mediterranean and enjoying over 300 days of sunshine a year, the mild climate and sea breeze are not the only factors drawing hedge fund managers to the island. Malta’s regulator, the Malta Financial Services Authority (MFSA), is widely recognised as robust, pragmatic and flexible, and has forged a reputation for being able to adapt well to the recent regulatory upheaval.

The vast percentage of funds domiciled in Malta as of 2013 were made up of professional investor funds (PIFs), with the number licensed growing from a mere eight in 2004 to 853 as of 2013. The PIF regime has been popular and, despite regulatory changes, is set to remain an attractive option, particularly with small- to medium-sized managers. Under the AIFMD, it was thought the PIF regime would end, but instead it will continue to run parallel to the AIF equivalent, offering the best of both worlds for fund managers.

The island has demonstrated impressive resilience in recent years, remaining a consistent part of a tumultuous wider landscape. Moving into 2014, growth remains strong in Malta. Last year saw 115 new PIFs licensed, demonstrating consistent growth when compared to 117 new PIFs in 2012. The NAV of PIFs has remained resilient as well. Figure 2 shows the NAV in PIFs over the past ten years. Despite a dip in value during the 2008 financial crisis, Malta has bounced back, reaching over €6.6bn ($8.9bn) as of September 2013.

Regulatory changes such as the AIFMD and Emir have presented challenges for Maltese managers. Last June, Malta became one of the first jurisdictions to publish its final AIFMD implementing measures. Malta has also opted for the ‘depositary-lite’ option allowing for flexibility under the new regime.

While the AIFMD has created many challenges for managers and national regulators alike, its arrival has drawn attention to the positive changes it will have for Malta’s funds industry. Investors, for example, will find solace in the higher standards it demands, as their appetite for well-regulated funds demonstrating a high level of transparency and good governance persists. Many observers have also noted Malta’s cost benefit, which is generally lower compared to other EU jurisdictions.

The number of service providers in Malta has remained fairly consistent over the past few years, as illustrated in Figure 3. Some commentators have cited the small number of fund custodians on the island as a potential weakness, with only seven as of last year. However, this may soon be addressed, with talk of custodian passporting becoming an option under a future iteration of the Ucits directive. There are also more than 50 law firms established in Malta (with around 20 undertaking fund work), and about 40 accountancy firms, including the ‘big four’.

Moving forward over the next year, Malta’s hedge fund industry will continue to adjust to new regulations. But there is little sign that the steady growth experienced of late should falter.
Mamo TCV Advocates is a tier-one law firm in Malta with a strong international practice and actively involved in all areas of commercial law, with a particular focus on financial services.

The Financial Services Department within the firm is committed to providing bespoke legal solutions to credit and financial institutions, investment firms, family offices and other stakeholders in the financial services industry. Our mission is to deliver high-quality services in structuring and implementing investment proposals, operations and products in a pro-active, efficient and timely fashion. To this end, we continue to foster and develop our local and international network with a view to offering comprehensive and integrated services to clients.
Starting up a hedge fund can be a daunting experience for the emerging manager, with various rules and regulations interfering with the path to success. However, help is at hand in the form of fund administrator, International Financial Association (ifi na). Originating in the British Virgin Islands and Cayman Islands, ifi na has now branched out to Malta and is there to provide fund management services specifically for emerging managers looking to set up there. HFMWeek catches up with Derek Adler to find out more.

HFMWeek (HFM): What are the challenges when starting up a hedge fund in today’s market?
Derek Adler (DA): The days of carefree fund management are definitely over! In the past it was relatively straightforward to establish a fund without too much difficulty. Today, however, the emerging manager has several obstacles to overcome: the question of regulation of the manager, all of the participants, background information on the investors, not to mention the rules and regulations now imposed in all recognised jurisdictions. It is no surprise, therefore, that all of this has made investment managers think twice before considering establishing a fund. The offshore centre “bashing” is uncalled for and unnecessary since most regulators have tightened up and in fact the offshore jurisdictions have been better regulated in many cases. If Europe, with some of its draconian regulations, is now included in the equation, then the requirements are even tougher should the manager wish to market across Europe.

If this was not enough to deter anyone wishing to establish a regulated licensed fund, then consider the plight of the emerging manager. There are many talented manag-
ers offering exciting and rewarding strategies but do not necessarily have sufficient funds at launch to be administered by the big institutions. There is a plethora of firms willing to offer advice on structuring a fund but little else and there are relatively few who will consider administering anything under €50m. There are many managers who would love to be compliant, focus on what they do best, which is presumably managing money, and leave the regulatory issues to an independent third party. Given that these new talents should be encouraged and assisted in every possible way, the whole business of wanting to manage a regulated fund has definitely become more difficult. If there is less than €10m at launch, then finding an administrator or any institution wishing to participate, is extremely difficult, bordering on virtually non-existent.

Fortunately, help is at hand using a company like ifina. ifina has always championed the emerging manager as it was felt that it was an overlooked market and as a company, totally geared up to handle and project manage the proposed fund from start to finish, regardless of size.

**HFM: What are the advantages for emerging managers looking to set up in Malta?**

**DA:** Up until a few years ago, ifina focused on the BVI and Cayman Islands but started to promote Malta as a solid jurisdiction, especially with the development of the new conditions imposed on funds wishing to operate within the EU. This allowed ifina to offer a reasonable choice of jurisdictions to meet any potential requirements that its clients might have. ifina is also able to offer other jurisdictions but has found that this was more than sufficient to meet its clients’ needs. Having experienced how Malta works as a jurisdiction, it is refreshing to see how approachable the regulators are, despite imposing tough but sensible requirements. As an administrator, the company is fully in favour of this approach, as long as the regulation is logical, which it appears to be. Malta is well-placed geographically and the fact that everyone speaks perfect English makes life a lot easier.

**HFM: What can you offer to emerging managers that stands out over other similar firms?**

**DA:** As mentioned above, although ifina manages substantial funds, it has always specialised in start-ups. One of the big issues is the lack of knowledge and experience should a manager wish to establish a fund. There is a perception that it is relatively quick and easy. This is not necessarily the case, especially if the management company attempts to go through the process itself. Firstly, there are basic facts that need to be established, such as: is the manager regulated? Where is the manager domiciled? Where will the fund be marketed? To whom will the fund be offered?

This is just the start, as KYC and AML need to be processed, not to mention which is the most appropriate jurisdiction, applying for the licence, drafting of the OM, opening bank and broker accounts and appointment of an auditor. Where the ifina model comes to the fore is project managing the whole operation. This not only speeds matters up but saves time and more importantly money. In addition, and unlike many other firms, ifina is not only audited financially but all of the controls and procedures adopted are audited annually. In addition to all of this, ifina provides a daily indicative NAV, which offers total transparency and comfort to the investors as well as all of the participants. This service also acts as a great marketing tool for the investment manager.

**HFM: Can you explain the new umbrella policy you have launched and how it helps emerging managers to set up?**

**DA:** Some years ago ifina recognised that not only were funds of less than €50m being ignored and neglected but funds of less than €10m made it almost impossible to find an administrator willing to undertake such a small project, especially if they were to be fully licensed and regulated in a recognised jurisdiction. With this in mind, the initiative was grasped and a fully licensed umbrella structure was established that allowed the emerging manager with as little as a few million at launch to get up and running. The Primary Development Fund is domiciled in the Cayman Islands and is now well established with several sub-funds. This also enabled the manager to save money at the outset since the bulk of the set-up fees had already been covered. This is critical for start-ups, as the NAV can be adversely affected, particularly in the early stages. It has therefore enabled the manager to “rent a cell” quickly and at a cost-effective price. This has proved to be a much needed service and has been successful, and therefore it was decided to launch the exact same model being domiciled in Malta and will be The Primary European Fund SICAV. This gives the emerging management company an opportunity to start its own regulated mutual fund with all the benefits as already mentioned but with a European passport. The all inclusive price for this service is €12,000 with no hidden extras.

**HFM: What do the next 12 months hold for Malta’s emerging manager market?**

**DA:** There is no question that managers will need to be more compliant, particularly in relation to Europe, but this need not be the uphill struggle as it appears at first. Having just visited Malta fairly recently, ifina continues to be extremely upbeat about the possibilities and opportunities that Malta has to offer, and if the authorities deliver the controls and regulation that they suggest, then ifina strongly believes in the “Malta Experience” coupled with the services that ifina can provide. ■

Fund custody is a core business for Sparkasse Bank Malta plc. Our experience and knowledge enables us to be nimble and flexible, allowing us to offer practical, workable solutions to our customers. By choosing not to provide other related fund services such as Fund Administration or Management, we avoid all potential conflicts of interest and focus entirely on what it is we do best – safekeeping, record keeping, monitoring and reporting.

We acknowledge the responsibilities and obligations bestowed upon us as custodians – for this reason, we are committed to making the necessary investment in IT, Human Resources and ongoing training in Legislation, Regulation and Compliance. Only in this manner can we guarantee a high and robust standard of service to our customer.

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One of the primary drivers behind the Directive 2011/61/EU on Alternative Investment Fund Managers (the AIFMD) is to increase investor protection from future Madoff-style losses. Alternative investment fund managers (AIFMs) regulated under the AIFMD and marketing their funds in Europe are required to ensure that each alternative investment fund (AIF) they manage appoints a third party depositary – being a credit institution, an investment firm or another entity as permitted – in the AIF’s EU domicile or (in the case of Malta who exercised the Art. 61(5) derogation in terms of the AIFMD) in another EU member state, with respect to its underlying assets.

Of course, there is no disagreeing with the fact that investors should be protected from any arising market events. However, many industry participants fear that the attempts of this single-themed directive to create a level of protection through the depositary provisions could run counter to the measures already being adopted under the Third Basel Accord and may even lead to unintended side effects.

THE DEPOSITARY’S ROLE
The monitoring and the periodically reviewing of the AIF’s cash-flows, the holding in custody of physically deliverable financial instruments, the overseeing of the AIF’s operations and the safe-keeping and record-keeping of all assets for which it is satisfied that the AIF holds ownership are just a few of the depositary’s duties under the AIFMD regime. The Directive also imposes detailed standards on delegation and conflicts of interest. The most far-reaching development, and that which has perhaps been at the centre of much debate regarding the way in which the AIFMD will change the way the industry operates, is the depositaries’ assumption of liability for loss of assets.

THE MOST FAR-REACHING DEVELOPMENT [UNDER THE AIFMD] IS THE DEPOSITARIES’ ASSUMPTION OF LIABILITY FOR LOSS OF ASSETS

Dr. Sarah Scicluna of Fenech & Fenech Advocates discusses the benefit of Malta’s choice of the ‘depositary-lite’ option under the AIFMD

Dr. Sarah Scicluna, associate at Fenech & Fenech Advocates, graduated as Doctor of Laws from the Faculty of Laws, University of Malta in 2009. Admitted to the bar in 2010, she has practised in various areas and received exposure to diverse sectors of the law. In 2011 she joined ‘Fenech and Fenech Advocates’ focusing on tax and financial services.
party to whom the custody has been delegated, the depositary’s liability under Article 21(12) second subparagraph of the AIFMD kicks in. Such losses should be distinguished from investment losses resulting from a decrease in the value of assets as a consequence of an investment decision.

**STRICT LIABILITY**
The only instances when this liability is not triggered is when the depositary demonstrates that the loss ensued from an external event beyond reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. It is only when it is proven that these conditions have been fulfilled cumulatively that the depositary’s discharge of liability follows.

Firstly, one is to determine that the loss-leading event did not occur as a result of any act or omission of the depositary or the third party to whom the custody of financial instruments held in custody has been delegated, that is even where instruments are kept in custody by a sub-custodian. Next, comes the assessment of whether the event was beyond reasonable control through the verification that there was nothing a prudent depositary could reasonably have done to prevent the event from occurring. Finally, the depositary has to bring forward proof that there could not have been the avoidance of loss despite all reasonable efforts to the contrary with the depositary having informed the AIFM and taken the appropriate action.

A natural event beyond human control or influence, a change in the law, or war, riots or another major upheaval may all be considered as external events beyond reasonable control and hence incidents arising from both natural events and acts of a public authority may be considered as such. Nevertheless, this exemption from liability is narrower than it may seem and is in practice subject to strict rules. Accordingly, losses caused through the failure of applying the segregation requirements as laid down in Article 21(11)(d)(iii) of the AIFMD or through the disruption in the third party’s activity in relation to its insolvency, cannot be seen as examples of external events beyond reasonable control.

**ADDITIONAL COSTS**
The liability provisions are inevitably giving rise to a whole new range of costs as European depositaries need to hold additional capital against potential loss resulting in a capital charge. The setting up and implementation of new monitoring and reporting functions required by the AIFMD framework are also driving up costs. It follows that most, if not all, depositaries will pass on most of these increased costs to the managers, the latter in turn passing them on to the funds, with these ultimately being passed on to investors. This attempt for higher investor protection will ultimately increase investor costs.

The requirement for depositaries to evolve and expand their current capabilities into a function which in many ways could be arguably closer to auditing than custody banking, will again lead to an increase in charges giving larger custody banks a competitive advantage over small ones on account of the economies of scale, leading to more small and mid-tier custody banks to withdraw from higher-risk markets.

**THE DEPOSITARY LITE**
The AIFMD contemplates the possible provision of depositary services by a so-called “depositary lite” and in certain specific instances Member States are able to allow a notary, a lawyer, a registrar or another entity to be appointed to carry out depositary functions, without being subject to the detailed rules on delegation, strict liability and conflicts of interests.

In the instances where a non-EU AIF is marketed in the EU by using the national private placement regimes and where AIFs have no redemption rights exercisable during the period of five years from the date of the initial investments and which, in accordance with their core investment policy, generally do not invest in assets that must be held in custody or generally invest in issuers or non-listed companies in order to potentially acquire control over such companies, such as private equity, venture capital funds and real estate funds, the depositary may follow the “lite regime”.

This regime permits hedge funds to appoint one or more other entities to perform oversight and cash-monitoring functions whilst continuing to use of their prime brokers for the safe-keeping of assets.

**MALTA’S FRAMEWORK**
Malta has opted for the “depositary-lite” regime and the Malta Financial Services Authority (MFSA) now allows recognised fund administrators and Category 2 Licence Holders [MiFID investment firms, other than fund managers] to provide depositary lite services, as well as custodians holding a Category 4 Investment Services Licence.

These entities will also be eligible to provide depositary services to closed-ended private equity or real estate AIFs being those without redemption rights during the first five years and which as a general rule do not invest in assets that must be held in custody.

**THE WAY FORWARD**
Without prejudice to the parameters of the AIFMD, managers should essentially be allowed to decide what is in the best interests of their funds and investors, together with the fund’s independent governing board, and it is expected that depositary-lite regimes should be relatively more straightforward to implement without posing major challenges.

Imposing a single depositary into a fund structure will be operationally and commercially burdensome and, considering it will never guarantee that Madoff-style losses are avoided, may not be justified. Creating the possibility for a lighter depositary role that can also be performed by other entities will open up the potential for other types of institutions to offer relevant services in this regard, at least when it comes to a certain category of AIFs. While revenue opportunities will be lower, so will costs and it will be of interest to see whether the larger, established depositaries will exercise a higher degree of flexibility in this regard.

It is anticipated that Malta, already a growing European domicile for alternative funds, will see significantly increased growth also in this sector in the coming years as international investment managers seek to take advantage of this “lighter” regime.
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Malta Stock Exchange is a member of leading organisations, including the Federation of European Securities Exchanges, the World Federation of Exchanges. It is also a signatory to the EU Code of Conduct on Clearing and Settlement.

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With 80 countries positioned, or positioning themselves, as international financial centres across the world, deciding on the most appropriate fund domicile to establish a fund is one of the biggest challenges facing fund managers today. To compound matters, the EU’s Directive on Alternative Investment Fund Managers (AIFM) has markedly changed the playing field and brought with it new rules applicable to all fund management companies which will also have an impact on non-EU funds and fund managers. Consequently, choosing a fund domicile has become a highly challenging task as the ultimate decision needs to be taken following an in-depth evaluation of a number of considerations, the key ones of which are listed below:

1. **Jurisdiction location and time zone** – the geographic location of the domicile has multiple ramifications on various other business and operational considerations such as: the location of the end investors; the ease of access to the jurisdiction in terms of flight connections; and the time zone of the domicile and its implications on the valuation of the investments held by the fund and its service providers.

2. **Economic and political status of the jurisdiction** – the development of the jurisdiction’s fund industry is, among other things, highly dependent on the presence of a robust and resilient banking sector which I consider as being the backbone of any developed or developing financial services jurisdiction.

3. **Language barriers** – are often cited as concerns, and validly so as the day-to-day operational workflows linked to the services of a fund are, to a significant extent, dependant on the presence of a workforce where English (or any other language) needs to be widely spoken (and written).

4. **Legal and regulatory framework** – these must be both comprehensive and efficient. The recent interest in Ucits structures will, in my view, be beneficial for the European funds industry for this reason. Equally important, the introduction of the AIFM Directive will possibly contribute to strengthen the growth of those fund managers that will fall within its remit.

5. **Operational and service framework** – the presence of a highly developed operational and service infrastructure is also a critical decision making factor. The quality of service providers is of key importance to investors and fund managers as is the availability of experienced/competent support services, such as legal and accounting firms, fund administrators and the availability of skilled directors. The presence of a well developed IT communications infrastructure should equally be given due importance.

6. **Workforce** – a skilled and multilingual workforce is equally important, particularly as this will reflect on the quality of all the aforementioned services that will be delivered to the fund.

7. **Type of targeted investors and their domicile** – a jurisdiction close to the investor target market may psychologically have an impact on the ultimate decision as to whether to invest in the fund or otherwise.

8. **Time to market** – the speed of set-up as translated into the amount of time a fund takes from conception to launch is also significant. An understanding of the way the local authority processes investment applications for investment services licences is necessary, as this will have an impact on the planned execution in a timely manner of the business plan for the fund and the fund management company.

9. **Set-up and ongoing costs** – these critical factors will ultimately have a bearing on the expense ratio of a fund which will, in turn, impinge on its performance. This is particularly applicable to new fund set-ups, especially those that are launched with relatively low seed capital, say sub-€25m.
CHOOSING A FUND DOMICILE - THE CASE FOR MALTA

Within the context of the above, Malta’s positioning as an international EU-based fund and fund management domicile presents a compelling proposition for fund managers either planning to set-up/re-domicile their fund(s) in/to Europe or setting up/relocating their fund management operation in/to Europe. The growth of Malta as a fund domicile has so far been spearheaded by the registration of various professional investor funds (PIF) falling under the PIF regulatory framework introduced by the Malta Financial Services Authority (MFSA), Malta’s single regulatory body, in the year 2000. Currently there are over 600 investment funds authorised by the MFSA consisting of PIFs, private equity and Ucits schemes. The regulatory framework is supported with an equally comprehensive legal framework allowing such funds to be set up as SICAVs, limited partnerships, trusts and contractual funds. As a result, Malta has recently been voted as Europe’s most favoured fund domicile for 2013 by HFMWeek.

Malta is increasingly enjoying recognition as a fund domicile of repute because it fulfils all the aforementioned criteria. It has a comprehensive legal and regulatory framework falling under the auspices of a single regulator, the Malta Financial Services Authority.

Malta’s geographic location right in the middle of the Mediterranean makes it an ideal gateway to the EU for non EU financial services firms and, an open door to the financial services businesses of the Arab world. On the point of economical and political stability, despite the crisis that has hit the eurozone countries, Malta has managed to boost its competitiveness and fiscal stability in the last five years. Malta’s banking sector was also ranked as 13th soundest out of 144 countries by the World Economic Forum in its 2012/13 report.

The English language is widely spoken in Malta with legislation written in both English and Maltese with the former taking precedence in the case of any necessary legal interpretations. The operational and service framework continues to grow with the formation of an industry cluster consisting of not only alternative investment and private equity funds, but also the presence of global custody services providers. Notable is the strong presence of all the top four audit firms. Equally, Malta’s legal firms are multi-disciplinary providing advice across a broad range of financial services areas. Firms which are very well-connected with the major international networks such as Lex Mundi, Lexis Nexis, Chambers and Martindale among others.

Malta’s highly skilled workforce is driven by the presence of an excellent educational system where students seeking to pursue tertiary education are actually paid a stipend by the government. Malta also has a sophisticated telecommunications infrastructure, with large bandwidth networks providing high capacity communications to and from the island. Digital networks, satellite technology and high capacity fibre-optics link Malta with Europe, and mobile telephony operators provide wireless internet connections based on GPRS technology.

Lastly, Malta’s regulatory processing efficiency is becoming increasingly notable as are the highly competitive set-up and ongoing costs to operate a fund in Malta. Malta also has in place over 60 double tax treaties with both EU and non EU countries which lend themselves to the possibility of setting up tax efficient structures.

Within this context, Valletta Fund Services, a fully owned subsidiary of Bank of Valletta plc, Malta’s largest banking group, is well positioned to provide its services to international fund managers seeking to set up their funds in Malta. VFS is currently managing more than $3.6bn in assets and servicing 135 funds including alternative investment funds, Ucits and private equity funds. As a result of our strong investment in our IT infrastructure, VFS is well positioned to offer a myriad of specialised services to help fund managers respond to today’s challenges, coupled with deep consultative expertise and an unwavering commitment to the fund servicing business. Confident that they are supported by VFS as a trusted fund servicing partner, fund managers can focus on their fundamental business goals, which revolve around acquiring assets, managing risk and maximising performance.

Malta clearly ticks all the boxes as a European fund domicile and testimony to Malta’s competitive positioning was the award Malta received last December where the jurisdiction was voted as the most favoured European Fund Domicile by a pre-eminent hedge fund publication. Equally just last month Valletta Fund Services was successfully chosen as the winner of the 2014 Corporate Intl Magazine Global Award in the category ‘Fund Administration Specialist Firm of the Year in Malta’.

10. Tax status – the importance of structuring a fund in a tax-efficient way will always be paramount as this will bring with it the possibility to benefit from the domicile’s double-tax treaty network. Likewise, the jurisdiction will need to provide the most advantageous taxation scheme for the investors.
We pursue a philosophy which emphasises both study and pro-activity. We seek to identify trends in the international commercial and financial markets leading to opportunities for Malta once translated into tangible form. It is no surprise that we have been consistently at the forefront of local legislative initiatives and have provoked on several occasions over the years major legislative change in many fields, not least in maritime, ship finance, banking, aviation, trusts and investment services.

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FUND CUSTODY IN AN EVOLVING LANDSCAPE

HFMWEEK CATCHES UP WITH PAUL MIFSUD, MANAGING DIRECTOR OF SPARKASSE BANK MALTA, TO DISCUSS THE BANK’S FUND CUSTODY OFFERING AND THE CHANGING LANDSCAPE OF EUROPEAN FUNDS

Regulatory compliance stands as one of the most pressing issues for Malta’s fund space as managers scramble to become compliant with new regulations such as the AIFMD and Emir. One of these is the necessity of a custodian. At Sparkasse, fund custody has become the core of the business’s offering, as Paul Mifsud explains.

HFMWeek (HFM): In what ways has Sparkasse taken a core approach to your fund custody offerings? What are some of the advantages of this?

Paul Mifsud (PM): When the board decided that it would like the bank to enter the custody and depositary space in Malta, it wanted to send a clear message to any potential asset managers that the bank would deal with its role as custodian as a core function within the existing suite of services the bank was offering at the time and not as an ad hoc service the bank may be willing to take on from time to time. Besides allocating resources, this meant building a banking system that would cater for the full integration of investment services as a seamless function from one account, building a comprehensive and robust infrastructure of central depositories in addition to its large international global custody network and motivating a team of dedicated and highly skilled professionals who understand the business and tasks ahead to deal with the new unit.

The bank set out to develop the custody department as an independent business line within the bank with its own profit centre, IT and human resources. It also decided to keep away from potential conflicts by choosing not to provide fund related services such as administration, corporate or investment services to the fund. In this manner it would be able to conduct its function of oversight and monitoring as purely as possible with no conflicts whatsoever with other service providers.

This focus gave management the necessary motivation and resources within the bank to set up a team and infrastructure focused entirely on one thing – custody. Our aim is to deliver a relationship-driven service at all times. A service, that as private bankers we have extended to our custody services, which we refer to as “private custody” – a term more frequently used in banking. We endeavour to deliver all we do in a timely and friendly manner, via competent professionals capable of understanding and most of all, resolving various issues that face the industry and managers daily. It is this focus and willingness to solve problems that gives us an edge in this space.

HFM: What steps has Sparkasse taken to ensure you are fully AIFMD ready? Will you offer reporting, for example, and will it be a complete solution?

PM: From the outset, our custody services were modelled on the obligations and the role of a custodian under the Ucits regime – hence, oversight and monitoring duties have been embedding in the department’s DNA from birth – the AIFMD will be no different. To cater for this, the bank has invested heavily in human resources, compliance reporting and IT infrastructure. Furthermore, it has revisited all existing relationships and agreements to dovetail these with the new directives.

The challenge we see with the directives on the other hand, is whether managers are ready for this culture change. The new directives will most likely see more and more dialogue between managers and custodians/depositaries at the concept stage, entering into detailed discussions with asset managers on topics related to portfolio make-up, feasibility and leverage etc. We envisage that in order to cater for the new risks involved under the directives the custodian’s involvement at the pre-structure stage will need to be solicited at the very beginning – a ‘privilege’ that until recently was rather one sided.

The on-boarding processes in general will continue to evolve a more risk-based approach from what could have been seen prior to the Directive, as custodians will endeavour to mitigate risk and evaluate risk profiles they feel
more comfortable with. Portfolio strategies in the future will be influenced by the depositaries’ appetite for the risk involved in holding and monitoring the underlying.

**HFM:** More generally, what opportunities does the AIFMD provide to the Malta fund custody industry?

**PM:** The Directive has instilled the notion and requirement of a custodian—a service provider that until recently was ‘optional’. One could argue that this should lead to more institutions wishing to enter this space. However, the contrary seems to be true. Banks are already exceedingly under pressure to allocate more capital to cover risks emanating from their everyday activities to be distracted by non-core functions. We have seen many banks wind down their custody involvement in light of the heightened regulatory and loss liability provisions in the directives. This makes it all the more interesting for us as a bank, knowing we enjoy the full backing of our board to provide this service locally and possibly in other areas within the EU in the near future.

**HFM:** What are the greatest issues facing the fund management space and how will you handle them?

**PM:** One may argue that the greatest issues facing the fund management space is certainly the capability to keep up and maintain regulatory compliance. For example, this year we will witness the introduction of the European Markets Infrastructure Regulation (Emir). Emir is the European Commission’s response to the commitment by G20 countries to address risks related to the OTC derivative markets. I will not go into the specificities of Emir, however I would like to mention that European companies are in danger of not being able to comply with the new reporting requirements under this regulation as they are struggling to come to terms with the complexities of the implementing procedures and the systems that will have to be in place to enable them to report their derivative transactions. As a result we are witnessing a last-minute scramble from all affected parties.

This is mainly a result of the industry having its attention focused on the AIFMD during 2013 only to be faced with another important regulation shortly down the road. With only six months to go until the full implementation of the AIFMD on 22 July, new research by BNY Mellon has found that fewer than 20% of alternative investment fund managers (AIFMs) have submitted an application to their local regulator for AIFMD authorisation. Given that securing authorisation typically takes a number of months, bottlenecks and delays are now likely to develop. This is putting even greater pressure on AIFMs, depositaries and services providers as they seek to implement the necessary changes in time for July’s deadline.

At Sparkasse Bank Malta, we believe that one of the best ways to handle similar situations is by taking a proactive rather than reactive approach. With constant in-house training by professionals in the field, the custody team can offer the necessary guidance to its customers when required. This is achieved by regular discussions with service providers and frequent open discussions with managers and above all the willingness to assist.
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As we all know, the global economy has taken a battering during the past few years. No one has been immune, least of all financial sector operators who have borne the brunt of all the financial turmoil. Malta and its burgeoning international financial centre, providing a very transparent, robust but flexible regulatory framework, has fared better than most maintaining growth and the confidence of operators and is now ideally positioned to take on new business as economies and the financial sector start to recover.

The integrity and robustness of Malta’s financial operators and the strength of our financial regulation have continued to generate confidence in our international financial centre which is now firmly on the map as an alternative place where one can do business, as is witnessed by the number of operators who have selected Malta as their jurisdiction of choice, be these banks, funds and fund administrators and other practitioners. Indeed, the fund industry remains the strongest performer within the financial sector and Malta remains the domicile of choice for funds and related service providers attracted by a market-driven, strong regulation, flexibility, transparency, good governance, cost-effectiveness and a willingness by all concerned to get things done.

Since the inception of its operations in 1992, the Malta Stock Exchange has developed into an internationally accredited, regulated market which together with its role also as operator of the post-trading infrastructure can support the whole value chain of any transaction executed on its market. On the other hand, during the past few years, as a response to industry requirements, and also to sustain its own development and growth, the Exchange has, however, also unbundled and expanded its services in order to provide better and more market specific services to its users, a policy that has borne fruit as we have seen an expansion in the use of

Eileen V Muscat is chief executive of the Malta Stock Exchange. She chairs the executive committee and technical committee, as well as represents the Exchange on a number of other local and foreign committees.

"Since the inception of its operations in 1992, the Malta Stock Exchange has developed into an internationally accredited, regulated market."

EILEEN MUSCAT, CHIEF EXECUTIVE OF THE MALTA STOCK EXCHANGE, DISCUSSES THE STRENGTH OF MALTA’S FINANCIAL INDUSTRY

EILEEN MUSCAT

Eileen V Muscat is chief executive of the Malta Stock Exchange. She chairs the executive committee and technical committee, as well as represents the Exchange on a number of other local and foreign committees.
the Exchange’s services and a diversification of users. Particular emphasis has been made to promote the services offered through the post-trading infrastructure, not only the traditional central securities services including clearing and settlement and register maintenance but other new areas of business such as custody and services to non-listed companies, also bolstered by links with international operators and infrastructures.

In order to sustain development, continue to grow and also to continue to support the development of Malta’s international financial centre, as it has done throughout its operating history, the Exchange has, particularly over the past few years, invested significantly in technology, both in regards to trading and post-trading software as a business enabler and importantly to provide connectivity to other markets and infrastructures. This investment in technology will continue over the next year as the Exchange moves towards integration with Target-2 Securities, the pan-European securities settlement platform developed by the European Central Bank intended to create a single settlement platform and reducing risks and costs. The Exchange considers this to be a vital cog in order to be able to offer its clients including funds and the global custodians who support the fund industry, more liquidity through easy access to its markets and international markets while operating within international harmonised standards.

New European directives have provided the Exchange with the opportunity to open up new avenues of business, such as Emir. While derivatives and similar instruments are not yet traded on the Exchange’s markets, the Exchange recognised an opportunity not only to generate business for itself but also to support relevant operators, including funds, to comply with the considerable requirements of the new Directive by providing a simple way in which such operators, both financial sector operators and others, can report to a registered trade repository. While this service is not directly related either to the Exchange’s market functions or to its post-trading services, the Exchange felt it was ideally placed to provide such services, which are built on the experience and expertise that the Exchange has gained in these fields over the years and its compliance function, its existing technical infrastructure and in particular, the solid relationships and links it has with international operators.

While it would seem that the attractiveness and benefits of listing and admission onto a regulated market have diminished over the past few years for certain fund structures, the Exchange believes that there are still great opportunities for it to synergise with, and support the fund industry locally, not only by providing a primary and secondary listing and admission venue as has been the case up to now, but also through developments in the post-trading space, such as Target-2 Securities as already mentioned.

Other considerable opportunities, not only for the Exchange but also for the local financial sector, may be afforded through the AIFMD. While still in the early stages of consideration, the Exchange is looking into the possibility, encouraged by a strong market feeling, of providing depositary services to funds captured under the AIFMD. The Exchange believes that it is in a good position to leverage on the experience and expertise gained through the provision of its market and central securities depositary services over the years and its technology and infrastructure to provide depositary services as envisaged under the AIFMD, ranging from oversight duties to safe-keeping, settlement, distributions, valuations, cash monitoring and due diligence, many of which functions the Exchange already provides, albeit in a different context.

It is recognised that in order for the Exchange to develop such depositary services and functionality, while leverage on its current positive attributes provides a very solid springboard for such development, the implementation of Depositary services will involve significant regulatory and corporate considerations, as well as significant investment, particularly in resources. Any such developments must, therefore, obviously be made within the context of a very solid business case. The Exchange believes that such an opportunity and indeed the need to provide such services exists and that such a development would be an important element not only to continue to support the fund industry within the jurisdiction but also to ensure that our international financial centre can provide all the services required by financial operators.
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Once it had come to terms with the reality of the regulatory overhaul instigated by the AIFM Directive, and while still in the throes of ‘decrypting’ effective compliance therewith, the financial services industry was hit by a second wave of regulatory reform. The European Market Infrastructure Regulation, or Emir, entered into force on 16 August 2012, and the first compliance obligations come into force on 15 March 2013.

Prompted by the global financial crisis, which was widely attributed to the weakness or outright absence of adequate regulation of OTC derivative contracts and the lack of sufficient mitigation of counterparty risk, the G-20 Pittsburgh Summit, held in September 2009, concluded that “all standard OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest” and, moreover, that “derivative contracts should be reported to trade repositories and that non-centrally cleared contracts should be subject to higher capital requirements”.

Indeed, several of the European Union’s G-20 commitments to reform OTC derivatives markets have effectively been engendered in Emir. As such, the Regulation’s key provisions largely serve to implement the G-20 policy aims of improving the transparency, integrity and regulatory oversight of the OTC derivatives market and reducing counterparty and operational risk in trading.

Clearly, Emir also comprises a robust regulatory response to the ‘interconnectedness’ in OTC derivatives markets which led to (i) counterparty credit risk and resultant systemic implications of default; (ii) lack of transparency – such that accumulations of pockets of risk within the financial system went undetected by regulators; and (iii) insufficient risk management – culminating in realised losses in times of market stress.

Consistent with the widely held perception that the EU should endeavour to promote its interests and values more assertively and the European Council’s commitment to accelerate the implementation of strong measures to bolster transparency and regulatory oversight of OTC derivative contracts in an internationally consistent and non-discriminatory manner, Emir was promulgated in the form of a regulation (directly effective) rather than a directive, which must be transposed into national law in order to take effect. The underlying rationale of the EU regulator is clear; that is, the elimination of regulatory arbitrage within the EU will facilitate the uniform and coherent application of Emir, thereby ensuring a level playing field for market participants. To this end, various requirements contained in Emir mirror, in principle, the reforms proposed in the US by means of the Dodd-Frank Act. Again, this is essential to dissuade transatlantic regulatory arbitrage.

The most significant changes brought about by Emir relate to the various requirements that will be incumbent upon Financial Counterparties (FC) and Non-Financial Counterparties (NFC) to derivative transactions. A collective investment scheme established and licensed in Malta will be deemed to be an FC for the purposes of Emir to the extent that it is a UCITS or a self-managed AIF or has appointed an external investment manager which is duly registered or authorised as an AIFM under the AIFMD. Insofar as a Malta licensed collective investment scheme is counterparty to a derivative transaction and is not a FC as aforesaid, the said Maltese scheme will be classified as a NFC in terms of Emir.

Compliance with the provisions of Emir by FCs and NFCs broadly comprises the following three main obligations.

**THE REPORTING OBLIGATION**

All derivative contracts (i.e. both exchange traded and OTC) are to be reported directly to an authorised or recognised trade repository, such that information on the risks inherent in derivatives markets may be centrally stored and easily accessible, inter alia, to Esma, the relevant competent authorities, the European Systemic Risk Board (ESRB) and the relevant central banks of the ESCB.

Reporting to a recognised trade repository will be required to be done no later than one working day following the conclusion, modification or termination of a derivative contract. The various details to be reported to trade repositories as aforesaid are set out in the Commission Delegated Regulation (EU) No 148/2013.

For the purposes of the reporting obligation, collective investment schemes will need to obtain a Legal Entity Iden-
The Emir reporting obligation will apply as of 12 February 2014.

**THE CLEARING OBLIGATION**

Certain classes of OTC Derivative contracts are to be centrally cleared through an authorised or recognised Central Counterparty (CCP).

The interposition of a regulated CCP between two counterparties to a transaction effectively renders that CCP the buyer to every seller and the seller to every buyer. As such, a CCP assumes the counterparty risk of every party to an OTC derivative transaction, thereby 'insulating' the counterparties from each other, as would be the role of clearing houses in exchange traded derivatives. Accordingly, CCPs will assume responsibility for clearing trades, mitigating the potential adverse effect of the failure of a major counterparty by means of its default protections including, inter alia, the collecting and maintaining of collateral and margin from the counterparties.

NFCs which use OTC derivatives to hedge risk may be exempt from the Emir’s Clearing Obligation insofar as their non-hedging derivatives activity does not exceed certain predetermined thresholds, but must still comply with the reporting and some risk management obligations.

**COUNTERPARTIES MUST APPLY CERTAIN RISK MITIGATION MEASURES WHEN ENTERING INTO NON-CLEARED OTC DERIVATIVE CONTRACTS**

Upon the entry into force of this technical standard (earmarked for Q3, 2014) it is anticipated that Esma will publish a register listing the relative derivative classes which are subject to the clearing obligation.

**RISK MITIGATION TECHNIQUES**

Counterparties must apply certain risk mitigation measures when entering into non-cleared OTC Derivative contracts including, inter alia, the fulfilment of margin and collateral requirements and clearing-like operational risk management processes.

In terms of Emir, all counterparties that enter into OTC derivative contracts which are not cleared by a CCP, are required to ensure that appropriate procedures and arrangements are in place to measure, monitor and mitigate operational risk and counterparty credit risk, including at least:

i. the timely confirmation of the terms of the relevant OTC derivative contracts, by electronic means; and

ii. formalised processes which are robust, resilient and auditable, in order to reconcile portfolios, to manage the associated risk and to identify disputes between parties early and resolve them, and to monitor the value of outstanding contracts.

While operational risk management processes to non-centrally cleared trades have been phased-in over the course of 2013, it is understood that prescriptive margin and collateral requirements are still being developed.

Failure to comply with the relevant provisions of Emir may be sanctioned by an administrative penalty imposed by the MFSA in accordance with the Financial Markets Act (OTC Derivatives, Central counterparties and Trade Repositories) Regulations (Legal Notice 81 of 2013).

**CONCLUSION**

The inevitable increase in cost and complexity of trading inherent in Emir compliance, coupled with the looming changes to the Markets in Financial Instruments Directive (MiFID II / MiFIR) and to the Capital Requirements Directive (CRD IV), has led many operators to point to the ‘over-regulation’ of the industry. What is certain is that proper preparation and lessons properly learnt from AIFMD will be paramount to deliver a robust and reliable Emir compliance programme.
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STEPHEN CASTREE AND ALAN MCKENNA OF EQUINOXE AIS HOLDINGS EXPLAIN THE CHALLENGES START-UPS FACE AND WHAT IT TAKES TO BE A SUCCESS IN THE CURRENT LANDSCAPE

Every year, hundreds of new managers start the journey to build a new hedge fund and raise significant investor capital. The reality is, however, that a majority of these funds will fail. This article is designed to discuss some of the classic building blocks required for building a hedge fund in general and where applicable what Malta has to offer and the reason why many of them never get off the ground.

The single biggest point of failure in most hedge funds comes from improper planning. This failure of the planning and structuring phase then results in an operational due diligence failure carried out on behalf of the potential investor. Lack of a proper structure or processes typically planned during the start up phase of the business plan are surprisingly common. A hedge fund is a business looking for clients. This is no different to every other industry and, therefore, potential investors need to be given a well thought out business plan.

The majority of funds do not realise that they fail in investors’ eyes from an operational due diligence standpoint as investors are seldom forthcoming with the reasons for non-investment.

Choice of fund location or jurisdiction is one of those planning points in a fund’s formation that can illustrate to investors the strategic structuring by the investment manager. Malta, given its robust regulatory environment, EU presence and close proximity to the UK, has a clear advantage on the domicile portion of operational due diligence as investors are extremely comfortable operating in this environment.

The regulatory hurdle in place forces managers to consider the business aspects of operating in this regime and forces them to address core components of the fund which comprise a large portion of the operational due diligence.

As a background, Malta’s reputation as a hedge fund domicile was established with the island’s accession to the European Union in May 2004 and has grown from only four hedge funds then to more than 570 today. The Malta Financial Services Authority (MFSA) regulates this sector with a sound regulatory and legislative framework which inspires confidence that the current growth can be replicated in the future as its desirable characteristics are appealing to hedge fund managers.

Major components of the operational structuring of a fund that Malta has to offer new or existing manager are listed below:

- Numerous regulated fund service providers and an abundance of qualified fund professionals
- EU passporting rights
- AIFMD set up, including an advantage over other jurisdictions in the remuneration policy section of AIFMD
- UCits IV legislation
- Fast track authorisation and flexible structures

With approximately 40% of the investment funds in Malta managed locally, there is a substantial local presence of investment managers that, compared to other jurisdictions, is an indication of the strength the market is building. That said, there are a number of components that are not related to the jurisdiction that a manager needs to consider; these include:

- Investment cost and funding of the business or the management company and the new realities of doing business today
- Initial hedge fund launch capital
- Management team
- Investment process and risk management
- Service providers (in some instances)
- Infrastructure and technology

The largest hurdle for existing or new funds is the identification and attraction of investors’ capital. There are four typical stages as a rule of thumb in the marketing phase of a fund and it is important for an investment manager to understand these stages, which are summarised below.

Stage 1: Launch and initial fund raising: the starting point for every fund is the soft circling of potential investors for the initial launch. This period typically ranges from less than six to over six months of the fund’s life. These investors are typically known to the managers as seeders who are prepared to invest for a share of the business.

Stage 2: Moving beyond known investors: this phase should start within the first six months after the fund becomes operational when core personnel are in place and marketing materials are ready for
emerging manager investors. These investors may consist of due diligence firms, consultants, HNW individuals, FOFs and family offices.

Stage 3: Introductory institutional threshold: this stage is the hardest hurdle and represents the glass ceiling for most managers and often an absolute minimum of $100m and an 18 month track record in this current product offering is required. At this stage managers probably had some success with family offices, FOFs, consultants and third-party marketers, however are unprepared to meet the requirements of institutional investors. The following is needed:

- Replication
  The ability to describe your process and replicate alpha generation

- Data
  Risk reporting, exposure analysis, benchmark analysis, asset allocation

- All the team on the same page
  This sounds simple but the whole team need to message institutions in a consistent fashion. Very few firms do this extremely well.

- Corporate Structure
  Organisational structure and fund structure/documents are all viewed in depth at this stage and frequently changes are required prior to investment. Requirements for an independent board, additional personnel in the organisation structure or fund documentation changes are often requested.

- Ability to offer managed accounts
  This has become a new model for institutions but increases the operational workload for the investment manager

- Institutional Quality Infrastructure
  Understanding the industry best practices and your own business requirements is vital. Many managers at this phase move to their own GL system and start looking at Control audits.

- Key man risk
  How has your firm addressed key man risk

- Understanding your weaknesses
  A weakness is only a weakness to an investor if you have not identified it. In this circumstance a timeline for addressing the issue needs to be built.

- Know your competitors
  Institutions examine many managers and like to benchmark strategies, so understanding where your firm stands in relation to your peers is important.

Stage 4: Institutional threshold. Congratulations on achieving Stage 4. Now investors require long lead times and standards of best practices in the industry. Continual investment is a requirement to maintaining this standard. Sometimes an external consultant can add value by reviewing your marketing material and investor targets. It can result in providing a number of comments that can save a number of rejections or wasted time. The key in this section of the business is to focus on higher quality leads and not waste time with a shotgun approach.

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THE PIF REGIME AND THE AIFMD REGIME IN MALTA: COMPARISON AND TRANSITION

With the AIFMD now fully transposed into Maltese law, Dr. Nicole Saliba of Mamo TCV Advocates discusses the transition from PIFs to AIFs.

The MFSA's announcement in July 2013 confirming that it had fully transposed the provisions of the AIFMD into national law, instilled a sense of relief among local operators, practitioners and other interested players. Prior to that, the fate of the Professional Investor Fund (PIF) regime post AIFMD-transposition was still unclear.

The PIF regime has largely contributed to Malta’s success story in the financial services industry, placing it as a fund domicile of choice for a number of fund promoters, with the vast majority of funds in Malta being licensed as PIFs. The benefits identified by such promoters include lower costs and salary scales, reasonable periods to license processing and a favourable tax treatment offered by Malta (especially for fund service providers established locally). More importantly, as an EU Member State, Malta offers an adequate level of regulation and supervision which has become even more crucial from an investor’s protection point of view, and at the same time it has become very popular with small- to medium-sized managers and fund promoters for whom recourse to other renowned EU fund domiciles would be cost-prohibitive.

The MFSA retained the PIF regime in place, almost unchanged with all the flexibilities attributable thereto, which will co-exist in parallel with a new regulatory framework for Alternative Investment Funds (AIFs) published by the MFSA in July, 2013 implementing the provisions of the AIFMD. While the AIFMD was principally intended to regulate investment managers (both EU and non-EU), it also affects collective investment undertakings qualifying as AIFs (namely capturing all funds which are non-Ucits such as the Maltese PIFs, irrespective of the structure and legal form of the AIF).

Similarities & Comparison

Similarly to the PIF regulatory framework, the AIFMD imposes no restrictions on the permissible asset classes of AIFs and an AIF’s portfolio may consist of a wide array of financial instruments and other assets without any industry, issuer or geographical limitations, as long as it is strictly promoted to professional investors, since a number of onerous investment restrictions and borrowing requirements need to comply with in case of distribution to retail investors, as in the case of the quasi-retail PIF category, namely those offered to experienced investors.

Under the AIFMD, EU Member States were given discretion to regulate and supervise AIFs at national level and were empowered to impose additional stricter requirements. The MFSA tried to retain as much flexibility for AIFs as those offered by the PIF, subject however to mandatory limitations on such flexibility inherent in and emanating from the AIFMD, with the end result that in some respects the PIF regime remains more advantageous in terms of offer structuring possibilities and choice of service providers. There are a number of distinctive dissimilarities between the two regimes which are worth mentioning.

The AIFMD deals mainly with marketing to ‘professional investors’ as defined therein (which forms the basis of the EU marketing passport created thereby). ‘Professional investors’ are defined by the AIFMD as investors qualifying as ‘professional clients’ within the meaning of MiFID or which request to be treated as such in terms of MiFID.

On the other hand Maltese PIFs may be constituted as one of three prescribed categories (those offered to experienced investors, qualifying investors or extraordinary investors) each with different prescribed eligibility and minimum investment requirements to be satisfied by the respective category of investors. Some of these eligibility criteria are more lax and flexible than the MiFID professional clients criterion adopted by the AIFMD, and in this respect the PIF offers a more flexible offering opportunity. At the same time, however, marketing a fund to investors satisfying the less onerous eligibility criteria of PIFs will automatically prevent the use of the marketing passport under the AIFMD. In this respect, therefore, the PIF should continue to be attractive only to promoters who intend to continue to market their funds in the EU under the national private placement regimes of Member States, as long as they will be allowed to do so by the local laws of such Member States and by the AIFMD regime.
PIFs may be structured as self-managed funds (subject to a number of requirements impinging on local substance), without the need to appoint an external investment manager. Furthermore, as long as adequate alternative safe-keeping arrangements are put in place there is no obligatory requirement to appoint a custodian unless the PIF targets experienced investors, in which case the appointment of a custodian with both safe-keeping and monitoring functions is compulsory. Under the AIFMD, an AIF can still be self-managed, but in such case it will qualify as an AIFM ‘per se’ and will therefore be subject itself to the onerous business conduct and responsibilities imposed by the AIFMD on managers. Moreover, all AIFs are now mandatorily required under the AIFMD to appoint a single custodian for all the assets of the AIF, satisfying the eligibility and domicile requirements imposed by the AIFMD and carrying out the various cash and other monitoring duties prescribed by the AIFMD in addition to the custody/safe-keeping function.

Passporting Opportunities and Scope for PIFs
Indisputably the major benefit under the AIFMD is the pan-EU management and marketing passport afforded to EU investment managers to manage and distribute EU AIFs in the EU without the need to obtain another authorisation in the host states in addition to that obtained in the home Member State, thus enhancing further the single market in the alternative investment sector. Local investment managers which exceed the thresholds prescribed by Article 3 of the AIFMD (€100,000 total AUM for leveraged AIFs and €500,000 total AUM for unleveraged AIFs subject to a five year lock-in period) are seeking to become fully AIFMD authorised and have their licence upgraded, thereby opening up broad opportunities without any geographical limitations in the EU. At the same time, local funds managed by these managers are making the necessary changes to their offering documents to reflect the AIFMD provisions.

It is envisaged that sometime in 2015 (subject to Esma’s positive opinion and endorsement thereof by the EU Commission) the said passport will be extended to third county managers and funds, and at the same time non-EU managers of EU funds will be required to apply for AIFMD authorisation to be able to continue to manage these funds. This is of particular relevance to Malta, where a considerable number of PIFs are managed by non-EU managers (such as Swiss managers) and are currently distributed in the EU subject to national private placement rules in the particular target EU jurisdiction(s), as allowed by the AIFMD. So far these managers manage their funds under the PIF regime; however, if these presently exceed the AIFMD thresholds, they will need to either set up a new management operation authorised as AIFM in some EU jurisdictions and then avail themselves of the passport without conditions, or else remain established in their existing non-EU territory but nonetheless apply for AIFMD authorisation with an EU Member State of reference and thereafter be eligible to the passport but subject to the cooperation and tax disclosure agreements and other conditions prescribed by the AIFMD.

The national private placement marketing option permitted by the AIFMD (currently used by non-EU managers of both EU and non-EU funds, and which will probably after 2015 remain relevant only to non-EU managers of non-EU funds) will probably be phased out in the EU in 2018, and thereafter even non-EU managers of non-EU funds exceeding the AIFMD thresholds will need AIFMD authorisation to continue to actively market their funds in the EU.

While the AIFMD ‘iter’ described above may see some managers and funds move away from Europe, those managers who have distribution in the EU as a core element of their business model will probably progressively seek more integration of their operations in the EU. EU managers themselves with operations in more than one EU state will also probably seek concentration and rationalisation of these operations into one EU domicile. In both cases Malta stands out as a prominent candidate domicile, given the cost-saving and beneficial tax treatment opportunities that it offers.

The PIF regime will probably continue to prove very popular and widely used by small managers falling below the AIFMD thresholds and targeting small numbers of investors, for whom the EU passport is not highly relevant.

"The major benefit under the AIFMD is the pan-EU management and marketing passport afforded to EU investment managers to manage and distribute EU AIFs in the EU"
Since 2000, Malta has made steady progress in attracting alternative investment fund promoters to the jurisdiction, with year-on-year growth in both the number of funds and the assets under administration. This growth has been supported by a strong set of economic and commercial fundamentals. The island continues to enjoy political and economic stability, as confirmed by the international rating agencies in their 2013 reports on Malta. Its banking systems were resilient in the face of the international banking crisis and fared extremely well compared to other economies in the eurozone. In September 2013, the World Economic Forum’s Global Competitiveness Report confirmed Malta as a top-20 financial services jurisdiction.

Malta benefits from a sound commercial infrastructure and an English-speaking business community with a strong cadre of professionals able to service the needs of alternative investment fund promoters. Its strategic location at the centre of the Mediterranean facilitates communication with investors and other third parties located in different time zones.

**FAST LAUNCHES, LOW COSTS**

Malta’s success as a domicile of choice for alternative investment fund promoters can be attributed in no small measure to the Malta Financial Services Authority’s (MFSA) streamlined approach to the licensing of alternative investment funds (AIF), with an approval process which on average takes just eight to 12 weeks to complete. Of course the time required does vary on a case-by-case basis, but the average completion time sets Malta ahead of other comparable jurisdictions. With the timing of a fund’s launch often being a critical factor in its success, particularly in the light of fast-moving markets and the need to secure investor funding, this point cannot be overemphasised. Service providers also benefit from an approachable and nimble regulator, which supports the island’s ‘can-do’ approach to servicing the needs of the fund management industry.

**MALTA’S PROFESSIONAL INVESTOR FUNDS (PIF) REGIME, WHICH HAS BEEN IN EXISTENCE FOR ALMOST 15 YEARS, OFFERS MANAGERS A PARTICULARLY FLEXIBLE AND COST-EFFECTIVE PLATFORM**

“...
An overview of the factors making Malta a domicile of choice for fund promoters would not be complete without mentioning the jurisdiction’s favourable regulatory and ongoing operating costs, which are significantly lower than those of comparable jurisdictions. Of particular note is that a Malta-domiciled fund manager will also benefit from Malta’s attractive tax regime, which can result in an effective tax cost of 5%, provided certain conditions are met. The combination of these potential cost savings, a pragmatic regulatory environment and flexible options for launching a fund (discussed further below), makes Malta a compelling choice for fund promoters.

**FLEXIBLE STRUCTURING OPTIONS**

Malta’s Professional Investor Funds (PIF) regime, which has been in existence for almost 15 years, offers managers a particularly flexible and cost-effective platform.

The regime accommodates a variety of fund types such as hedge, real estate, and private equity funds, and also enables funds to be set up as a partnership, investment company, unit trust, or contractual fund, whether open-ended or closed.

An investment company may be established as a multi-fund collective investment scheme with segregated sub-funds. PIFs can be set up to target experienced, qualifying or extraordinary investors. The criteria for investors to be eligible for any of these fund categories are clearly defined, and a minimum investment in respect of each category is set at €10,000, €75,000 and €750,000 (or equivalent).

PIFs targeting experienced investors must comply with certain borrowing restrictions, whilst funds targeting qualifying/extraordinary investors would need to comply with any specific borrowing restrictions set out in the scheme’s Offering Memorandum. There is flexibility as to where the fund’s service providers are established and each fund must appoint a compliance officer/money laundering reporting officer, a role that can be fulfilled by the same official. Funds are required to appoint an external auditor and to file their audited accounts with the MFSA.

In June 2013 the MFSA updated its Investment Services Rulebooks as part of Malta’s implementation of the Alternative Investment Fund Managers Directive (AIFMD). As with all EU jurisdictions, investment funds in Malta that do not fall under the Ucits regime, such as PIFs, are now subject to the regulations set out in the AIFMD framework. The degree to which they are subject to the AIFMD depends on the characteristics of the fund.

Malta offers a strong, cost-effective platform on which alternative investment fund managers (AIFMs) can establish and operate an AIF that complies in full with the AIFMD regulations, giving it a ‘passport’ that allows the marketing of the AIF to investors in other EU member states without having to meet separate licensing requirements in each jurisdiction.

The AIFMD framework also provides a lighter or de minimis regime for AIFMs which directly or indirectly manage funds with total assets of no more than €100m (with leverage) or €500m (with no leverage and no redemption rights for five years from the first investment).

AIFMs below this threshold are exempt from the majority of the AIFMD’s requirements, except for certain reporting requirements in relation to the investment strategy, traded instruments and principal exposures of the AIF. However, in return they do not benefit from having the AIFMD marketing passport and any marketing to EU investors must be conducted via the national private placement regimes of the EU jurisdictions in which they are promoting the fund. The requirements of these private placement regimes do vary from country to country.

The PIF structure can be fully AIFMD compliant but also offers smaller managers a flexible and cost-effective platform, with the option to apply for a full AIFMD licence in the future if the marketing ‘passport’ becomes desired (even if the fund has not breached the de minimis threshold). Unlike some other EU jurisdictions, where even a de minimis fund is required to appoint a custodian, Malta’s PIF regime requires the appointment of a custodian only in the case of a PIF targeting experienced investors.

A PIF can either be managed by an external manager or established as a self-managed fund, without the need to establish a separate entity appointed as the fund manager. The board of directors of a self-managed PIF would appoint an investment committee of at least three members. At least one member of the investment committee would be expected to be a Malta resident and the members of the committee would have to be approved by the MFSA, as would the members of the fund board and other proposed service providers. In a self-managed fund the investment management decisions must be taken by the board.

A self-managed PIF is an interesting, low-cost and very flexible option for fund promoters looking to establish an EU-onshore fund below the de minimis threshold, whether to market to investors outside or inside the EU. In a self-managed AIF, the designated AIFM is the AIF itself, so it is very clear if it qualifies or not for the de minimis exemption.

**CONCLUSION**

From small beginnings the island has garnered itself a reputation as a credible player in the alternative funds space. By providing fund promoters with access to funding both within and beyond the EU, regulatory certainty and a network of service providers that support the fund management industry, Malta will become an increasingly attractive jurisdiction for the establishment of alternative investment funds.
MALTA’S PIF & DE MINIMIS RULEBOOKS: BOOTSTRAPPING YOUR START-UP

DR. CHRISTOPHER MALLIA OF GANADO ADVOCATES TALKS TO HFMWEEK ABOUT HOW TO START-UP A HEDGE FUND

Starting a hedge fund is easy. Rent a one-room office, rope in a couple of analysts, spread the word in the right circles and before you know it you’ll have more seed capital than your strategy can house. Workable ideas and elbow grease quickly become competitive advantages, absolute returns abound and performance fees will pretty much make themselves.

Except that’s not how it works at all.

Building a hedge fund requires a commitment: to regular refining strategies, to locating opportunities, and to building a team capable of exploiting both. Finding your feet, much less thriving, in the hedge fund sector is no mean feat.

Falling victim to the business cycle is (almost) par for the course.

Hedge fund start-up primers stress the importance of identifying “advantages” over others in that space, translating advantages into a “strategy”, adequately capitalising the start-up, identifying target investors and tailoring marketing/sales plans. Investor domicile is often the principal determining factor in selecting a jurisdiction – both in terms of demographics and regulatory infrastructure complimentary to a start-up’s needs. Getting all these right is important.

Selecting legal advisors that understand how to navigate a jurisdiction’s challenges, however, is particularly valuable for a start-up. They should be picky. The wrong structure can leave them dead in the water.

The AIFM Directive ushered in robust regulation and compliance costs are rising accordingly. Commentators have (correctly) criticised one of its outcomes: while purportedly aiming to mitigate systemic risks, the current regulatory infrastructure is less hospitable for smaller, less systemically relevant funds with contributions south of €300m. Some have gone as far as to say that funds with seed capital south of this benchmark are not viable.

This need not be the case. True, the economics of the hedge fund industry have changed dramatically. Compliance costs have soared. Fee appetites, predictably, have not. Nonetheless, this constantly evolving sector need not exclude the survival of smaller, agile players. Arguably, they can thrive.

“UNTIL THE BENEFITS OF THE AIFMD TAKE SHAPE, ANY SMALL OPERATOR AIMING TO GROW THEIR FUND ORGANICALLY MIGHT BEST TRY TO EVADE THE STRICTURES OF FULL AIFMD COMPLIANCE”

START-UP STRUCTURES AND THE AIFM

A start-up AIFM’s compliance and operational costs should be minimised as a matter of necessity during the operator’s first foray into this space. Until the benefits of the AIFMD take shape, any small operator aiming to grow their fund organically might best try to evade the strictures of full AIFMD compliance.

There are various options for lightening the regulatory load woven into the text of the Directive itself, allowing new operators to legitimately operate outside the full scope of the AIFMD including (1) ‘Fund of One’ solutions, (2) securitisation special purpose entities, (3) group AIFMs, and (4) the holding company exemption. These particular exemptions/scenarios might not be ideal to accommodate a new venture. The most important feature of the AIFMD for a hedge fund start-up is the de minimis exemption.

De minimis AIFMs will be subject to a lighter regime, but are not afforded access to the AIFMD Marketing Passport (unless they opt-in to the full regime).

MALTA’S DE MINIMIS RULEBOOK AND PIF REGIME

In line with industry practice, the AIFMD formalises the split hedge fund operation between the fund (the AIF) and the manager (the AIFM) – unless a self-managed structure is opted for.

Malta’s offering is well placed to service both markets. By harnessing the de minimis provisions in the AIFMD and marrying these with elements of Malta’s pre-AIFMD regime, Malta has created a light-touch offer attractive for asset managers looking to get off the ground fast.
With respect to the management company, the MFSA opted to retain and enhance its successful pre-AIFMD fund management authorisation regime for de minimis AIFMs (as opposed to opting for registration). This licensing regime, which is based on MiFID requirements, seeks to strike a balance between providing a flexible regime for smaller/start-up fund managers and protecting Malta’s standing. Indeed, with the exception of a potential reduction in the minimum capital requirements and other simplifications, the Rulebook broadly reflects the successful pre-AIFMD regime in Malta for non-Ucits fund managers. Experience has shown that authorisation and supervision in an aptly regulated jurisdiction such as Malta benefits promoters when targeting potential investors.

To qualify for the de minimis exemption an AIFM must either manage leveraged AIF(s) with combined (notional) assets of less than €100m, or unleveraged AIF(s) with combined assets below €500m, provided in the latter case that the AIF(s) have locked investors in for the first five years from initial investment.

With respect to the fund regime, before the current torrent of regulation, Malta was favoured by start-ups. A non-retail system by design, Malta’s Professional Investor Fund (PIF) regime attracted hedge fund promoters with its expedited approval, less prescriptive rulebook, and a flexible supervisory philosophy.

The need for an AIFMD compliant AIF regime created the assumption that the MFSA would scrap the old PIF regime. The MFSA did not – it was retained in parallel with the new AIF regime. A PIF is essentially an AIF, but one with a proven record of successful application to various strategies, an ad hoc regulatory regime, and one that need not be fully AIFMD compliant when managed by a de minimis or non-EEA manager.

It is proving a valid onshore proposition for start-ups. De minimis and third country AIFMs that need not fully comply with the strictures of the AIFMD can opt for Maltese vehicles offering old world (pre-AIFMD) charms.

The PIF niche was well exploited in the pre-AIFMD context. Post AIFMD it is experiencing a re-birth, and is an interesting option to pair with a de minimis AIFM or as a de minimis self-managed fund. If growth warrants full AIFMD compliance, this can be tackled at the appropriate time. Until then, promoters will benefit from onshore credibility without unduly oppressive compliance obligations.
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MALTA: MORE THAN BUSINESS

MALTA'S VERSATILITY MAKES IT AN IDEAL HOLIDAY DESTINATION AS WELL AS A GREAT PLACE TO DO BUSINESS

Malta may have a world class reputation for its financial sector, but the ease of business in this country is not the only thing it is known for. The island also boasts a booming tourism sector with a growing number of visitors flocking to these Mediterranean shores each year. 2012 was another record year for Maltese tourism and saw a 2.1% increase in visitors from 2011 with 1,443,974 tourists coming to the islands.

When the time comes to decide on your next holiday destination, Malta could be a perfect getaway, regardless of the time of year. Malta has mild winters, dry hot summers and sea temperatures never dropping below 13°C even in the winter months. The Maltese Islands are an archipelago consisting of three islands – Malta, Gozo and Comino – each of which have no shortage to offer their visitors. Malta is an island of diversity with a wide range of activities to suit numerous interests. With its outstanding climate year round, Malta provides a sunny escape within easy reach of the rest of Europe.

After a day exploring everything the island has to offer, there is a wide range of accommodations to rest your head. Malta is home to 98 hotels including 15 five-star accommodations offering full luxury amenities, as well as 48 guest houses/hostels for the budget-friendly stay. Malta’s small size means that all accommodations are within easy reach of everything the island has to offer. Most hotels in Malta are located on the coast, with close access to its many beaches.

BEACHES
The key attraction for tourists flocking to Malta is its world-class beaches, which have a number of attractive features including:

- Choice of natural unspoilt bays and coves
- Blue Flag sandy beaches
- Lidos or hotel beaches
- Life guards at popular beaches
- Safe swimming zones – areas not accessible to boats
- Public bus service to all popular beaches
- Hire of beds, umbrellas and fun water sport accessories
- Restaurants and snack bars by the beach

Malta had the second best bathing waters in the EU in 2011 according to Bathing Water Report published by the European Commission in May 2012. Scuba diving is a popular activity here as well with over 40 dive schools on the island. The clear Mediterranean waters offer 20/20 vision to explore rocky reefs, caves, plentiful marine life and wrecks of ships from all eras of maritime history.

IDEAL FAMILY DESTINATION
Families visiting Malta will find no shortage of activities. The mild climate is perfect for outdoor activities for the whole family. Malta also offers special rates for children for many attractions, museums and on transport. Some of the major family-friendly attractions include:

- Limestone Heritage – a multi-lingual walk through quarry experience featuring an animal petting zoo, folklore traditional evenings and stone sculpting demonstrations
- Splash and Fun and Mediterraneo Bio Park – featuring dolphin shows and the opportunity to swim with dolphins, sea lion shows, waterslides, wave pool, restaurants and more family fun
- A new national aquarium which opened in 2013
- Boat rides, jeep tours, horseback riding and harbour cruises

THE ISLAND OF GOZO
Visitors can also explore Malta’s sister island Gozo, only a short ferry ride away from Cirkewwa. The island is a popular family outing destination with great places to stay including afford-
TOURISM

THE MALTESE ISLANDS ARE AN ARCHIPELAGO CONSISTING OF THREE ISLANDS – MALTA, GOZO AND COMINO – EACH OF WHICH HAVE NO SHORTAGE TO OFFER THEIR VISITORS

CULTURE AND HISTORY
From museums and festivals to world heritage sites, Malta is rich in history and culture. Malta boasts over 7,000 years of history and a number of UNESCO World Heritage Sites. Its top cultural activities include:

• The oldest free standing temples in the world – UNESCO World Heritage Sites
• The Hypogeum of Hal-Saflieni – a prehistoric underground temple and UNESCO World Heritage Site
• Medieval festivals
• Wine and gastronomy festivals
• Fireworks festival
• Local village feasts, concerts, events and firework displays
• Good Friday processions and Easter festivities
• Notte Bianca – annual Valletta celebration

FOOD
The traditional local cuisine in Malta features healthy dishes that are perfect for the food enthusiast. Must-try Maltese dishes include:

• Traditional dishes: torta tal-lampuki (dorado fish pie), fenek (rabbit, stewed or fried), bragoli (stuffed beef rolls, kapunata (Maltese version of ratatouille), soppa tal-armla (widow’s soup), ross fil-forn, (baked rice), imqarrun (baked macaroni) or timpana (a special meaty pasta dish baked in pastry) and local fresh fish.
• Hor d’oeuvres: gbejniet (sheep or goat’s cheese), galletti (water crackers), zalzett (coriander flavoured Maltese sausage), pickled capers and olives together with bigilla (paté of broad beans, garlic and olive oil), fresh Maltese bread with tomato paste and olive oil, are commonly served as starters at traditional restaurants, or in local bars with your drinks.
• Snacks: ‘hobz biz-zejt’ (bread dipped in olive oil, rubbed with ripe tomatoes & topped or filled with a mix of tuna, onion, garlic, tomatoes and capers), pastizzi (flaky pastry parcel filled with ricotta or peas).

• Sweets: kannoli (tube of crispy fried pastry filled with sweetened ricotta), qarabat (flat pastry filled with dates and honey deep fried, best served hot), helwa tat-tork (a Maltese version of Turkish sweet), qubbajt (nougat), qa’ghaq tal-ghasel (honey rings).

SHOPPING
Malta offers a variety of shopping, catering for all budgets and tastes. The island is particularly well known for its internationally renowned crafts offering a truly unique shopping experience for visitors. Combine a shopping day out with a historical and cultural visit in the capital of Valletta and explore the many shops on Republic Street and Merchants Street. Sliema also offers a number of shopping choices along the seafront as well as the modern Point Shopping Mall featuring more than 50 shops. In addition, visitors to Malta can find:

• A fantastic range of casual to formal retail shops with Italian influence in style and collections
• International sport and casual kids brands
• Great value for money on jewellery including silver and gold products
• Unique mouth-blown glass items
• Value for money franchise outlets of top high street brands
• Variety of local traditional products including filigree silver, glass, ceramics, knit-wear, Malta lace and local delicacies for export

With so much to offer visitors, it is no surprise that Malta has seen strong recent growth in its tourism sector. While its financial sector will continue to be a world leader in the financial industry, it is clear that the Mediterranean gem has more to offer than just business.
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