A robust yet flexible regulatory framework helps secure Malta’s position as a leading domicile
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All change

Sufficient time has elapsed since the financial system was knocked off balance for matters to be seen from a better perspective. The hedge fund industry was probably the first to come under immediate and intense scrutiny and possibly also the first to be discharged from the responsibility of causing systemic shock.

At the height of the financial crisis, tough new measures were introduced, which included a ban on short-selling. The G20 sensitised the regulatory world to carry out a search for better reporting standards and more effective risk-management tools. The big debate started in Europe amid widespread uncertainty as to whether hedge funds behave in a pro- or counter-cyclical manner to the rest of the financial system in a crisis of the current type and magnitude.

Meanwhile, almost on the quiet, a lot of restructuring was going on in the industry. Managers and prime brokers fine-tuned their due diligence tools, investment strategies were revisited and positions were unwound as gate and lock-in mechanisms were reviewed. Performance is showing signs of recovery to a reasonable degree as investors’ money has started slowly finding its way back into the sector. New funds are being launched, with old and new money seeking more refined strategies and a sounder operating base.

The market appears to be regaining its balance but it remains to be seen how the safety mechanisms can best be re-calibrated. The greatest challenge will be to determine what the real challenges are. Europe can yet become a mecca for managers and investors if the proposed AIFM Directive succeeds in separating the real challenges from the perceived ones, and in addressing the former successfully.

It is difficult to isolate the effects that hedge funds may have on the market. Hedge funds are a global industry and without empirical data it is neither easy to assess their impact nor to understand what effect regulatory measures can have on them. On the other hand, hedge funds must remain able to take a risk. In a business that depends on the appetite of highly sophisticated institutional investors, protections nor-

“Better regulation” before “more regulation”

Malta has taken a balanced approach towards the hedge fund industry. Hedge funds have been regulated since the Investment Services Act came into effect in the mid-1990s. Due diligence procedures are an obligatory pre-requisite for licensing and information disclosure is an ongoing obligation for all funds. On the other hand, there is not a one-size that fits all. Different categories of alternative investment funds have been created and regulations are structured according to the different types of investors. Furthermore, the global nature of the industry is acknowledged. Funds are allowed to have external administrators and custodians in recognised jurisdictions. This is in contrast to other jurisdictions which require service providers to be present in the domicile. The value of innovation is also recognised and this has been complemented particularly by providing regulation for self-managed funds and redomiciliation procedures for management companies and funds.

At the same time the MFSA is mindful as to what is happening in the industry and in the wider financial world - the risks that cut across all markets and the lack of centrally available information at an international level. A lot of information for assessing systemic risk may already be available and hopefully the new Supervisory Framework being introduced by the EU will lead to an integrated approach to the analysis of systemic risk.

This is partly the reason why, based on eight years of experience as a single regulator, the MFSA felt it was time to revise its regulatory and supervisory structures by introducing a more common integrated approach. The outgoing sector-based structure has, from the beginning of this year been replaced with a more harmonised structure that combines sector-specific supervision with an integrated approach to authorisation, risk-based supervision and regulatory development. This has led to the creation of a single Authorisation Unit together with three Specialist Supervision Units - for Banking, Insurance and Occupational Pensions, and Securities and Markets – and a Regulatory Development Unit, to look, among other things, into cross-sectoral issues.

In this way the Authority is already geared to interface with the new European regulatory structures which will be coming on stream in the near future. It will be better equipped to deliver regulatory effectiveness as the jurisdiction continues to grow successfully in the current challenging times.

Joe V Bannister
Chairman, Malta Financial Services Authority (MFSA)
IN THIS ISSUE

6 Resilience in the face of adversity
   STOCK EXCHANGE
Mark Guillaumier of the Malta Stock Exchange outlines the ways in which the Exchange has contributed to Malta’s continued growth

8 Malta’s continued success story
   LEGAL
Danièle Cop of Mamo TCV Advocates explains the continued attraction of Malta as a domicile of choice, in the light of recent and ongoing developments in the financial services sector

11 A flourishing domicile
   ADMINISTRATION
Charles Azzopardi of HSBC gives a detailed account of Experienced Investor Funds, Qualifying Investor Funds and Extraordinary Investor Funds

15 Make Malta your domicile of choice
   LEGAL
Simon Tortell of Simon Tortell & Associates discusses the advantages for fund managers who choose to redomicile their fund structures to Malta

16 What will the future look like?
   ADMINISTRATION
Anthony O’Driscoll of Apex Malta believes that Malta is set for a period of growth, due to managers choosing to redomicile their funds to an onshore European-regulated jurisdiction

19 Smart onshore shifts
   LEGAL
Dr Joseph Ghio of Fenech & Fenech Advocates explains why, on the back of compelling reasons for choosing as a fund jurisdiction, moving to the island is fast and easy

22 Alleviating liquidity issues
   ADMINISTRATION
Laragh Cassar of Camilleri Preziosi outlines the implications of the use of side pockets in a distressed market within the hedge fund industry

25 Malta: a rising jurisdiction
   LEGAL
Dominique Leccq of leccqassociate discusses how the range of funds available such as PIFs and UCits have led to an increasing number of hedge fund companies looking to redomicile in Malta

28 Redomiciling to Malta
   LEGAL
André Zerafa of Ganado & Associates, Advocates outlines the benefits that hedge fund companies that choose Malta as a redomiciliation option can enjoy

31 Malta’s well-earned reputation
   ADMINISTRATION
Kevin Vella of ITL Advisory Services talks to HFMWeek about the issues that fund managers choosing to outsource their back-office solutions to Malta need to be aware of

33 Malta gains momentum
   ADMINISTRATION
Dermot Butler of Custom House lists the five trends the hedge fund market has witnessed over the past year and outlines their potential effect on the industry

37 The European UCits evolution
   PROMOTIONAL BODY
Kenneth Farrugia of FinanceMalta believes that the impending UCits IV Directive will reshape Europe’s hedge fund landscape
MamoTCV 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.

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Mark Guillaumier of the Malta Stock Exchange outlines the ways in which the Exchange has contributed to Malta's continued growth

Resilience in the face of adversity

The period of financial turmoil that has so vividly coloured the past year has prompted plenty of talk globally about the need for banks to return to basics in order to avoid facing similar problems in the future. Malta is one of those jurisdictions where the financial system suffered no systemic shocks or banking failures and the main reason for this is that the Maltese banks have stuck to the traditional banking model. In fact, Maltese banks have continued to follow the basic intermediation model between retail depositors and borrowers, a model which does not rely on the acquisition of wholesale funding. Furthermore, they can bank on substantial levels of liquidity and adequate capital.

Even if very dependent on trade, manufacturing exports, tourism and financial services, the Maltese economy continues to be essentially resilient in the face of the global recession. In a report in January this year, Moody’s ratings agency confirmed Malta’s A1 government rating, which, they said, mainly reflects the country’s high economic resiliency and financial robustness.

The contribution of financial services to our national product has been growing steadily over the past 15 years and the authorities, regulators and operators have all worked together to provide the legislative, institutional and operational platforms necessary to project Malta as an international financial centre of repute, supported by modern financial legislation and regulations designed to support this goal. The Maltese financial services sector, in fact, continued to grow notwithstanding the financial meltdown, rising by 22% between the third quarter of 2008 and the third quarter of last year. Should this growth rate be maintained, this sector would comfortably meet the target set by the Government for this industry, that of doubling its contribution to GDP up to 25% within the next five years.

The financial services sector, in fact, must be able to support and sustain the growing needs of the real sector in the economy, companies operating in the manufacturing sector, tourism and other services. As Maltese industries shift gear to face new competitive challenges, the financial services industry must similarly keep abreast with growing customer needs. The key words here are improved business competitiveness, higher efficiency and the implementation of policies that encourage growth and initiative. A constant upgrading of the technological base, human resource skills and a regulatory regime which is able to maintain Malta’s reputation as a financial sector of integrity without stifling market initiatives and innovations; these are all essential elements if the financial services sector is to perform its proper role in the ongoing development of the Maltese economy.

Committed to Malta’s financial growth

The Malta Stock Exchange is today a very important component in the local financial services industry. Eighteen years have passed since the Exchange opened its doors for business in January 1992. During these years, it has consistently and diligently performed its legal responsibilities by providing facilities for the trading, settlement and registration of listed securities to the general public.

Since it was set up, the Exchange has had, among its most important objectives, a commitment to operate within internationally recognised standards. Towards this end, the Exchange has sought and achieved membership of the most important international organisations in this field. The Malta Exchange is, in fact, today internationally regarded as a serious and well-managed regulated institution operating in an EU jurisdiction fully compliant with international regulatory standards and occupying an important niche in the Maltese financial and economic infrastructure.

What is the Stock Exchange’s strategy for the future? In line with the Maltese government’s 2015 vision for the financial services sector, the Exchange is stepping up its efforts to attract more local and foreign companies to the market. The relatively small size of the Exchange means it is able to react faster to business queries, providing a more intimate, flexible and fast service at costs which are very competitive when compared to those in other markets. These considerations are particularly relevant to smaller companies who might find it is too
onerous and expensive to list on a larger international exchange. Indeed, it is possible for a company to go through the preparation for an IPO in Malta with much more support and guidance than would be the case in the larger exchanges. In this respect, the Exchange is taking advantage of the opportunities being offered by the MiFID to set up new technical links with foreign exchanges, depositories and settlement systems. These links are designed to provide the necessary infrastructure to facilitate entry into the local market by foreign investors, both at institutional and at retail levels. At the same time, the Exchange is working on a number of new initiatives aimed at further widening the range of products and services on offer in order to attract new business to the Exchange. The technological infrastructure is also being overhauled and upgraded in order to support new functionalities.

The Maltese regulatory regime for the establishment of ‘professional investor funds’ (PIFs) – including hedge funds – has been in place since 2000 when the local regulator, the Malta Financial Services Authority (MFSA) first issued its Guide to the Establishment of Professional Investor Funds. Prior to the publication of this guide, all funds domiciled in Malta, whatever their target market and nature, were regulated by a set of detailed guidelines on Collective Investment Schemes, which were clearly inappropriate to regulate funds offered to “sophisticated” investors. The guide was, in fact, published in order to encourage fund promoters to consider Malta as another viable and attractive jurisdiction for the licensing of hedge funds and other alternative investment funds.

The Exchange is closely following events on the international financial scene and it is particularly interested in the opportunities that currently exist in the international fund business. While the Malta Financial Services Centre has been quite successful in attracting investment funds to Malta, particularly in the areas of domicile and fund administration, these funds, even when domiciled in Malta, have not really approached the Exchange to seek a listing.

Promoting all that Malta has to offer
It is quite clear that, at a point in time when investment funds are today looking at new jurisdictions as alternatives to the more “traditional” bases from which to operate their business, this is, indeed, the opportune moment for Malta and for the Exchange to try to capture new business in this area. However, notwithstanding all that the Maltese financial sector and the Exchange can already offer, it still appears to be a relatively little-known jurisdiction in the fund business. Accordingly, the Exchange is developing a strategy aimed at marketing itself much more aggressively particularly in the current global financial situation which has created a window of opportunity for new jurisdictions to capture some of the business which hitherto has been the unchallenged province of a few established jurisdictions.
Danièle Cop of Mamo TCV Advocates explains the continued attraction of Malta as a domicile of choice, in the light of recent and ongoing developments in the financial services sector

Malta’s continued success story

Since Malta joined the EU in 2004, there has been a steady growth in the number of funds, investment firms and other services providers setting up in, relocating to or providing cross-border services into Malta. In particular, the success story of Malta’s professional investor fund (PIF) regime has put it on the map of well-regulated jurisdictions known as a domicile of choice for alternative investment funds and has led a number of renowned fund administrators to set up shop in Malta.

One of the clear advantages of the PIF regime is that PIFs are allowed to appoint service providers such as investment managers, fund administrators, custodians and prime brokers established outside Malta. The fact that setting up and running a collective investment scheme is significantly cheaper in Malta than it is in other established European fund domiciles has allowed promoters of hedge funds, funds of hedge funds, private equity funds, real estate and infrastructure funds, and other alternative investment vehicles, and more recently, Ucits, to commence operations with low-seed capital, within a robust yet flexible regulatory framework.

There are clear signs, however, that future growth in the Maltese funds industry will be fuelled by the ongoing trend to launch hedge funds in Ucits version and to relocate offshore funds to onshore jurisdictions, which funds are by nature larger in size than the average type of PIF established in Malta so far. Also, the implementation of the Ucits IV Directive, and eventually the Directive on Alternative Investment Fund Managers (the ‘AIFM Directive’), is expected to give the Maltese financial services sector a further boost.

Malta not only offers a friendly environment for collective investment schemes, but also for investment managers, fund administrators and other regulated entities. Cost competitiveness, the flexibility and responsiveness of the single regulator – the Malta Financial Services Authority (MFSA), and the favourable fiscal regime, appear among the key factors for financial services providers to choose Malta as a base for their operations. The fact that local presence requirements may be kept to a minimum (coupled with appropriate outsourcing arrangements) and that an investment services licence issued by the MFSA can be used as a passport to provide MiFID services in other EU/EEA Member States, has proven interesting so far, especially for “boutique” investment firms. However, the Maltese regulatory and tax regime is exceedingly attracting the attention of established foreign investment managers and custodians that are seeking to relocate or extend their operations to domiciles within the EU/EEA. The main reasons for this appear to be the shift in investors’ appetite, following the financial turmoil in recent years, towards products emanating from a well-regulated onshore jurisdiction that offer greater transparency, and the anticipated changes in the regulatory landscape.

Considering the growing appeal of Malta as a domicile for Ucits which, unlike PIFs, are required to appoint a local depositary, it is expected that the demand for custody services provided locally will continue to rise significantly. The MFSA is aware of the need to encourage enhanced competition within the local market for custody services and has taken a clear stance on the regulation of custodians operating in or from Malta in order to facilitate the establishment of local branches and subsidiaries by for-
eign institutions. It adopts a flexible and pro-active approach, for instance, towards the fulfilment of the local presence requirements for Maltese-licensed custodians; these are minimal especially in the initial stages and until the volume of business calls for a stronger presence.

Recent initiatives
The continuous efforts of the MFSA, in consultation with local stakeholders, to streamline the legal and regulatory framework and generally to foster the sustainable growth of the local financial services industry, can be illustrated by some recent initiatives in the following areas:

- **Continuation of companies**: the legal framework for the continuation of companies (the relocation of a body corporate from one jurisdiction to another without dissolution and winding-up, for example) was put in place in 2002 and has been successfully tried and tested since. Seeing that migration of foreign funds into Malta (particularly from offshore jurisdictions) is now reaching a critical mass, the MFSA issued Guidelines to Redomiciliation of Offshore Funds to Malta in December 2009, to offer more certainty and facilitate the procedure for inbound redomiciliation of foreign non-retail funds.

- **Collective Investment Schemes**: in December 2009, changes to the Investment Services Rules for Professional Investor Funds were adopted, mainly with regard to PIFs targeting Experienced Investors, essentially lowering the minimum investment threshold from €15,000 (£13,200) to €10,000, while imposing a few new investment restrictions for such PIFs to enhance investor protection.

- **Pension Schemes**: the UK’s HM Revenue & Customs recently confirmed that pension schemes established in Malta and regulated by the MFSA may be considered on a case-by-case basis to be eligible for the status of Qualifying Recognised Overseas Pension Schemes (QROPS) under UK Law.

- **International co-operation**: in January 2010, the MFSA and the China Securities Regulatory Commission signed a Memorandum of Understanding to promote and develop the securities markets by providing a framework for co-operation, increased mutual understanding and the exchange of information, to the extent permitted by the laws and regulations in force in both countries. This MoU has now been added to the long list of similar bilateral and multilateral arrangements concluded by the MFSA with various jurisdictions, apart from the ever-increasing list of double tax treaties to which Malta is a party and which increase Malta’s international exposure as a financial services centre.

- **Improvements to the MFSA’s internal set-up** came into effect as from 1 January 2010 to generate further efficiencies. A dedicated Authorisations Unit was created to deal with licensing of all financial services entities, while three specialist Supervision Units (Banking; Insurance and Occupational Pensions; and Securities and Markets) are now handling supervisory functions. The Regulatory Development Unit is responsible for the implementation of cross-sectoral policies and product development.

**Gearing up for UCITS IV**
As the 2011 deadline for the transposition and implementation of the UCITS IV Directive is looming, the MFSA is actively preparing for a timely transition. It has already issued a number of circulars to keep the financial services industry updated on recent developments and to indicate the MFSA’s intended approach regarding the implementation of the UCITS IV Directive. From Malta’s perspective, the main elements of the UCITS IV Directive that are expected to create further opportunities for growth are:

- first and foremost, the possibility for UCITS management companies to effectively exercise their European passport rights, not only for the distribution of units but also to manage UCITS on a cross-border basis;
- the possibility to establish master-feeder structures and for existing UCITS to convert into a UCITS feeder fund, whereby the master and feeder UCITS may be located in different member states and may have different depositaries, auditors and management companies; and
- the streamlining of the procedure and requirements for the cross-border marketing of UCITS throughout the EU/EEA.

In Malta, most options and discretions, which were available to member states under the UCITS III regime have been exercised (allowing delegation of functions by management companies to third parties, and relaxation of certain investment and borrowing restrictions, for example) and this is not expected to change once UCITS IV becomes effective.

**Outlook on the AIFM Directive**
The MFSA and local practitioners are, of course, closely watching the trajectory of the proposal for the adoption of the AIFM Directive. For Malta as a financial services centre within the EU, the proposed AIFM Directive is generally perceived to create opportunities rather than to pose threats.

Collective investment management is already a licencable and regulated activity, if carried out in relation to financial instruments, in or from Malta, and non-UCITS funds such as PIFs (although on the lower end of regulatory spectrum) also require a licence. It emerges from the current proposal for the AIFM Directive that management companies falling within its scope will be able to manage AIFs established in other member states through a branch or on a cross-border basis and to market units in the AIFs it manages to (professional) investors throughout the EU, subject to the relevant passporting rules.

Now that managers and promoters targeting European investors appear to be on the lookout for friendly but well-regulated EU jurisdictions, even more so, given the uncertainties surrounding the proposed AIFM Directive (for example, with regards to the marketing of AIFs established in third countries), the obvious choice for many of them would be Malta.
areas of practice

**collective investments:** incorporation, structuring and licensing of Swiss, Maltese, Luxembourg and Cayman Islands funds, funds of funds, single hedge funds; advising on structured products; advising on multi-manager platform; structuring managers and advisors.

**regulatory banking:** advise on banking operations; request for banking license; anti-money laundering compliance; and all banking, and securities and currencies dealers, regulatory legal aspects.

**corporate and structured finance:** corporate; equity and debt securities; credit facilities; up-stream loans and guarantees; financing transactions; securitization; group (re)structuring and joint-ventures.

**private equity and project finance:** structuring project finance and venture capital; corporate acquisition and real estate acquisition.

**regulatory insurance:** advise on insurance; licensing of insurance lines and request for business approval; insurance portfolio transfer; structuring of life policies including unit-linked policies; advise on tied assets and solvency margin.

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Charles Azzopardi of HSBC gives a detailed account of Experienced Investor Funds, Qualifying Investor Funds and Extraordinary Investor Funds

A flourishing domicile

Malta is becoming increasingly attractive as a fund domicile and it has been making significant strides in establishing itself as a prime onshore domicile. The turning point has been, undoubtedly, Malta’s accession to the European Union in 2004 and since that point the interest in Malta has increased considerably; we have seen a strong and sustained inflow of both investment funds and fund managers relocating here.

If one were to examine the underlying reasons for this positive trend, this is due primarily to the robust regulatory framework that is in place. More importantly, behind this framework there is a regulator, Malta Financial Services Authority (MFSA), whose main focus is the protection of the investor. The MFSA is proactive and pragmatic in its regulatory approach. The regulator also adopts a policy of seeking consultation from major industry bodies as part of the legislative process and it provides constructive feedback on the issues raised by them. Relations between industry players and the MFSA are healthy; the MFSA is generally viewed as approachable and willing to discuss any issues that arise within a relatively short timeframe.

The main statute that regulates the funds industry is the Investment Services Act 1994 and subsidiary legislation that is issued by the Minister of Finance in consultation with the MFSA. This Act provides for the setting up of Ucits and non-Ucits retail funds as well as Professional Investor Funds (PIFs).

The MFSA has the power to issue Investment Services Rules regulating, amongst others, hedge funds, private equity funds, property funds and other funds that pursue alternative investment strategies. In this respect, the MFSA has issued Investment Services Rules for Professional Investor Funds. These Rules provide the regulatory framework for the alternative type funds referred to above.

Maltese legislation allows for a fund to be set up under a number of legal forms such as an investment company with fixed or variable share capital (Sicav or INVCO), a limited partnership, a unit trust or a mutual fund. It is important to note here that segregated cell structures can be used by PIFs— it is possible to set up an umbrella Sicav (one company) with a number of sub-funds where the assets and liabilities of one sub-fund are separate (and more importantly) ring fenced from those of another sub-fund within the same Sicav. It follows therefore that should a sub-fund become insolvent, the assets of the other sub-funds within the same umbrella structure may not be utilised to meet these obligations.

PIFs must be authorised by the MFSA. The process and documentation requirements are very clearly explained by the MFSA on their website www.mfsa.com.mt. The MFSA would typically encourage consultation prior to the submission of an application for a licence. The time to market is efficient, always depending on the timely and accurate submission of documentation. Typically this would translate into four to six weeks from the date of filing to completion.

The PIFs regulatory framework allows for three types of funds – Experienced Investor Funds, Qualifying Investor Funds and Extraordinary Investor Funds.

Experienced Investor Fund

The Experienced Investor Fund is a PIF available to investors who can meet the criteria of an Experienced Investor and imposes a minimum investment amount of €10,000. The Experienced Investor Fund regime contains a number of investment restrictions which include:

• Direct borrowing for investment purposes and leverage via the use of derivatives is restricted to 100% of NAV;
• The fund may invest up to 20% of its total assets in securities issued by the same body and up to 30% of its assets in money market instruments issued by the same body (although there are some exceptions to this rule); and
• The fund may invest up to a maximum of 35% of its total assets in deposits with a single body.

The Experienced Investor Fund is subject to the oversight of the custodian which is required to monitor the fund and ensure that investment restrictions are adhered to.

Qualifying Investor Fund

Qualifying Investor Funds tend to be the most common and practical approach for a fund sponsor seeking the widest flexibility in terms of investment strategies. Understandably these types of PIFs can only be promoted to investors who have a higher degree of financial sophistication than Experienced Investors and the entry level to these funds is consequently much higher, at €75,000. There are also other criteria which an inves-
tor needs to satisfy to certify himself as a Qualifying Investor and, in turn, to invest in a Qualifying Investor Fund. These funds may also enter into OTC agreements and take short positions. In summary, when a fund is promoted exclusively to Qualifying Investors and the investment objectives, investment policies and investment restrictions, if any, are clear and well disclosed in the Fund’s Offering Memorandum, then there would normally be limited scope for intervention by the regulator.

Extraordinary Investor Fund
The Extraordinary PIF is similar in nature to the Qualifying Investor Fund and it, too, lends itself as a suitable vehicle for a number of strategies. The most important difference between these two categories of PIFs is that the Extraordinary Investor Fund has a significantly higher entry level at €750,000 and it does not need to publish an Offering Memorandum; a Marketing Document would suffice.

From a taxation point of view, a fund that has 15% or more of its assets situated outside Malta is exempt from Maltese tax on all its investment income (which includes realised capital gains – except for income arising from immovable property situated in Malta, if any). Likewise distributions to non-resident investors are exempt from Maltese tax. In so far as Value Added Tax is concerned, investment funds are exempt from the tax on ‘services that are core and essential for the running of a scheme’. (Please note that this information is correct as at time of writing (February 2010) and is based on current tax law and practice which may be subject to change in future.)

Apart from the flexible regulatory regime described above, a number of other factors contribute to Malta’s success and attractiveness as a fund domicile. No doubt, the availability of well-established service providers and a skilled workforce, as well as the Maltese ingrained work ethos of having business done, play an important role. Similarly, I would mention cost-effectiveness which compares very favourably to jurisdictions within and outside the EU. Clearly Malta remains well poised to benefit for further growth as we see the hedge fund industry recover and regain lost ground.

**PROFESSIONAL INVESTOR FUNDS**

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<th>Experienced Investor Fund</th>
<th>Qualifying Investor Fund</th>
<th>Extraordinary Investor Fund</th>
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<tbody>
<tr>
<td><strong>Minimum investment</strong></td>
<td>€10,000</td>
<td>€75,000</td>
<td>€750,000</td>
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<tr>
<td><strong>Eligibility Criteria for investors</strong></td>
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<td>Must satisfy the definition of Qualifying Investor</td>
<td>Must satisfy the definition of Extraordinary Investor</td>
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<td><strong>Investment restrictions</strong></td>
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<td>None</td>
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<tr>
<td><strong>Leverage</strong></td>
<td>100% of NAV (unlimited for liquidity purposes)</td>
<td>No restrictions unless fund invests in immovable property</td>
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<td><strong>MFSA response on proposed fund structure</strong></td>
<td>7 business days</td>
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<td><strong>Fit and proper test</strong></td>
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<tr>
<td><strong>Offering memorandum</strong></td>
<td>Minimum requirements prescribed</td>
<td>Minimum requirements prescribed</td>
<td>Marketing document will suffice</td>
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<td><strong>Financial statements and statutory reporting</strong></td>
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<td><strong>Manager</strong></td>
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<td>Optional if there is competence within board of fund</td>
<td>Optional if there is competence within board of fund</td>
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<tr>
<td><strong>Advisor</strong></td>
<td>Optional</td>
<td>Optional</td>
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<tr>
<td><strong>Custodian/Prime broker</strong></td>
<td>Compulsory, assuming also a monitoring role</td>
<td>Optional, merely required to implement proper safe-custody arrangements</td>
<td>Optional, merely required to implement proper safe-custody arrangements</td>
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<td><strong>Local representative</strong></td>
<td>Required where all the service providers of the PIF are based outside Malta</td>
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<td>Required where all the service providers of the PIF are based outside Malta</td>
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<td><strong>Independent director from manager and custodian</strong></td>
<td>Mandatory</td>
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Simon Tortell of Simon Tortell & Associates discusses the advantages for fund managers who choose to redomicile their fund structures to Malta.

Make Malta your domicile of choice

A number of fund managers are actively considering Europe as an ideal location to redomicile their existing structures in order to be in a position to offer a wider range of products and cater for new classes of investors. Unlike other European financial centres, redomiciliation to Malta has been a reality for a number of years. In fact, an ad hoc redomiciliation framework has been in place since 2002 and despite being most commonly used in the context of insurance and private companies, the Continuation of Companies Regulations and the Investment Services Act have adequately provided for the redomiciliation of investment funds to Malta for a number of years. In December 2009, the MFSA published guidelines for the redomiciliation of offshore funds to Malta, which supplement the existing legal framework and outline the mechanics related to the licensing of an investment fund being redomiciled to Malta.

Why choose Malta?
But why should a fund manager migrate investment funds to Malta? Malta has a transparent regulatory regime for Professional Investor Funds (PIFs) which are investment funds targeting sophisticated investors. The existing Maltese regime provides for three types of PIFs; the experienced investor fund, the qualifying investor fund and the extraordinary investor fund. The Maltese regulatory framework also allows the possibility of converting a PIF, which has been redomiciled to Malta into a Ucits product, thereby maximising the fund's distribution potential through the passporting regime. An investment fund migrating to Malta may also benefit from favourable licensing and supervision costs, a modern and competitive fiscal regime, the availability of professional and competent service providers and the presence of a proactive and approachable financial services regulator – the Malta Financial Services Authority (MFSA).

The redomiciliation of an offshore fund to Malta involves two review processes. On the one hand, the Registrar of Companies reviews the corporate documents and declarations contained in the Continuation of Companies Regulations and on the other hand, the MFSA’s Authorisation Unit reviews the fund’s licensing application to ensure compliance with the requirements contemplated by the applicable Investments Services Rules. The two review processes are run simultaneously, which therefore allows the redomiciliation process to be carried out within a reasonably short time and in an effective manner. Another two key aspects of the Maltese redomiciliation process are the provisional certificate mechanism and the MFSA’s reliance on the fund’s board of directors to confirm that; (a) there are no regulatory issues relating to the redomiciliation, (b) there are no pending litigation or disputes; and (c) the directors are not aware of any potential litigation or disputes.

Flexibility is key
Flexibility is another important characteristic of the process governing the continuation of an investment fund to Malta. The redomiciliation process is not limited to investment companies, but is available to any body corporate, formed, incorporated or registered in a country outside Malta and carrying on the business of a collective investment scheme, which (a) is similar in nature to a body corporate as known under the Laws of Malta, and (b) would, if it were such a local body corporate qualify to be authorised, or recognised as a collective investment scheme under the Investment Services Act.

Finally, it is also important to point out that there are a number of advantages of redomiciliing an investment fund to Malta as opposed to a fresh incorporation. In fact, the migrating hedge fund will be able to continue its corporate existence under the laws of Malta and shall retain all its assets, rights and liabilities. The fund’s existing performance track record can also be retained and therefore the marketability of the fund will not be affected as a result of the redomiciliation.
What will the future look like?

Predictions about global finance markets are always difficult to make particularly during periods of volatility. However, there are a few clear trends emerging among both funds and managers that provide an insight into how the industry is developing. These trends include: an increasing movement to new jurisdictions, increased demand for the UCITS product and changing operating environments. These trends are expected to act as the catalyst for a number of changes in how the key players operate and interact with one another.

One of the most significant forces for managers is to remain competitive and they are increasingly looking to their administrators to provide more middle- and back-office services. Consequently expectation is growing for administration services providers to meet the increasing demands from investors who are placing more emphasis on transparency, increased liquidity terms and funds structured in well-regulated jurisdictions.

Despite the turbulence experienced during 2009, there are a number of positives that can be drawn from the period for both managers and investors. In particular, many side-pocketed assets have bounced back as markets have improved. This has enabled some funds to reduce the big side pockets created last year to counter the unprecedented levels of illiquidity.

While the hangover of illiquid assets continues to weigh down on many managers, there has been some improvement. For example, managers are working out or liquidating some of these assets and investors, aided by a better understanding of the condition of their portfolios, and have adjusted their expectations to more realistic levels.

Already in 2010, hedge funds are showing signs of recovery. This, of course, is good for investors who are recouping losses and for managers who are earning their way back to or above high-water marks. Net outflows of assets have given way to steadily increasing net inflows. However, raising new capital still remains a challenge, but investors, albeit with a high degree of caution, are once again showing interest in the industry.

Challenges facing managers

For some managers, their 2009 performances may not have been strong enough to ensure their survival, particularly those managers that did not have meaningful inflows of new capital. As a result, during 2010 we may see more downsizing or closures if managers do not take action. In the UK managers have been quick to take the necessary steps to respond to the government’s increase in top rate of tax and also to the streamlining of their business to reduce operating costs.

New managers continue to face start up barriers principally due to the level of resources required to meet investor demands, increased regulation and compliance. Overcoming investor concerns about operational and compliance risks is particularly acute for younger and smaller firms. While the number of start-up management companies is increasing, the number of platforms offering sound infrastructure and the availability of seed investors who focus on emerging managers are scarce.

Managers are also facing a change in attitude from investors who are now looking for funds that are domiciled in regulated jurisdictions, which offer greater transparency and reporting processes. This leaves managers with the dilemma of whether to go onshore or offshore and the subsequent increase in operating costs.

Finally, the impact of new regulation remains a relative unknown. On the legislative front, the industry has accepted the inevitable prospect of increased regulation and reporting. This is already in the process of being introduced in the US and Europe and will certainly mean increased compliance and regulatory costs – in whatever final format it takes.

This scenario creates exciting opportunities for jurisdictions such as Malta, which continues to grow as a domicile of choice. Increasingly, Malta is seen as a jurisdiction that offers solutions to the new challenges faced by managers.

Benefits of locating in Malta

Malta provides an ideal location as an EU domicile for both funds and management companies offering the following advantages:

- Low set-up costs (a PIF can be setup for less than €20,000) and availability of high-quality professional resources;
- A single regulator – the Malta Financial Services Authority (MFSA) allows for streamlined processes with flexibility and accessibility to allow for custom made solutions;
- Fast-track approval processes;
- Presence of quality global service providers;
- Extensive double-tax treaty network, most recently with the US.
• Being able to avail of the EU Passport and promote their funds in all EU member states;
• Ability to use Special Purpose Vehicles;
• Only EU member states with a full imputation system of taxation – for example, a Maltese fund manager that is incorporated as a company and tax resident in Malta will be subject to tax in Malta on its taxable profits on a worldwide basis at the flat tax rate of 35%. However, upon distribution of dividends to its non-resident shareholders, these shareholders would be entitled to a refund of six-sevenths of the advance corporation tax that has been paid (after the refund the actual tax paid would be of 5%, for example);
• Cost-competitive centre where office space and human resources are two-thirds the cost of other European jurisdictions;
• Highly qualified and multilingual staff;
• A strong telecommunications network;
• Strategic Eurozone location.

Redomiciliation
The redomiciliation of funds to Malta has become possible following the enactment of the Continuation of Companies Regulations (the “Regulations”) in 2002. Redomiciliation results in time and cost savings while the management, ownership, structure and assets of the fund remain largely unaffected. The actual change that occurs is in the funds’ domicile relevant legal system, regulator and taxation framework.

Two factors stand out that contribute to the attractiveness of Malta as a location for redomiciliation. Firstly, its regulator – which is known for its efficiency, approachability and commitment to the maintenance of high standards. Secondly, Malta is a low-cost jurisdiction that offers a highly favourable system of taxation for investor funds. This is due in part to the exemption of income tax and capital gains tax at the fund and non-resident investor level and its framework of double taxation treaties.

Fund choice
Malta offers two main investor routes in the form of the Ucits and the Professional Investor Fund (PIF) regime, which as the name implies is targeted towards professional investors that fall within the classes below. These funds target investors in accordance with their minimum investment threshold. The funds are non-retail and are therefore not subject to the some of the usual restrictions on their investment or borrowing powers as normal retail funds.

The PIF has three investor classes:
1. Experienced investors with a minimum investment of €15,000 (€10,000 when certain investment restriction at the portfolio level are met),
2. Qualifying investors €75,000 and
3. Extraordinary investors €750,000.

Collective investment schemes carry an exemption from income tax and capital gains tax at fund level and at non-resident investor level and may be set up as an incorporated open or close-ended investment company (Sicav or INVCO respectively), a limited partnership or a unit trust.

Even though not as popular as PIFs and Ucits, Malta also offers other types of funds such as Private Schemes, Specialist Schemes (which target special sectors such as venture capital, money market funds, property funds, futures and options funds) and retail funds.

Middle- and back-office services
Market conditions have forced managers towards funds, with multi-prime broker models. Even though the implementation of such models would spread counterparty risk, managers would still be required to support multiple execution platforms, complex reconciliation, trade allocation and counterparty risk. As a result, managers would need to have bigger middle-office functions.

Some managers are undoubtedly finding it both easier and more cost-effective to outsource these activities to administrators who can provide not only post-trade services but also pre-settlement trade processing and support, position and trade reconciliation, fund accounting and risk-management reporting.

In addition, as compliance and regulator reporting increases, medium and small managers should consider outsourcing these tasks to specialist service providers. This will reduce risk levels as well as driving further cost savings.

In summary, Malta is in a prime position to take advantage of the changes that the whole industry is facing and to become the domicile of choice for funds who wish to move to onshore European-regulated jurisdictions. With a strong proactive regulator, flexible service providers and a highly educated workforce with a ‘can-do’ attitude towards the industry, Malta is well positioned to see continued growth.
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ever before was there such a flurry of funds and managers debating whether to move onshore. With investors reconsidering the regulation of funds in traditional offshore centres and managers uncertain about how the proposed EU Alternative Investment Fund Management Directive will affect their cross-border business models, many have relocating to another jurisdiction very high on their agenda.

The financial crisis has brought lasting changes in the way institutional investors go about selecting funds. Funds and their managers recognise that onshore/offshore distinctions have never been more pronounced. There are plenty of precedents around to prove that Ucits III funds, retail by convention, can be used to pursue alternative investment strategies giving investors who are perturbed by recent unpleasant market experiences the comfort of investing onshore in an EU-regulated vehicle.

While some still find Ucits requirements somewhat too restrictive for their investment strategies, the need for a well-regulated jurisdiction is now beyond debate. It is likely that there will not be the exodus from offshore jurisdictions anticipated in the aftermath of the crisis when hedge funds were demonised and labelled as the source of all financial evil. We have seen, however, a number of managers and funds moving out of Cayman, Bermuda and the British Virgin Islands. We have also seen Caribbean managers launch new onshore funds and while standing short of actually relocating out of their traditional jurisdictions of choice, they are adding new onshore funds to their range of offerings making for more investor choice.

Moving to Malta
As early as 2002, Malta introduced legislation allowing the redomicilation, or continuation, of bodies corporate to Malta providing a fast and easy option for shifting jurisdictions while maintaining the same, continued, legal personality. This avoids the complications of a merger or amalgamation which in the case of funds would normally mean a share for share sale and redemption of units by way of transfer in specie to the new fund in the new jurisdiction with the original fund being wound up in the old jurisdiction thereafter.

In the case of funds structured as Professional Investor Funds (PIFs), Malta can offer the added advantage of not requiring the service providers of the fund such as the manager, administrator, custodian or prime broker to be established in Malta as is required in other European jurisdictions. This would make a redomicilation to Malta much easier than it would to other European jurisdictions, which have only very lately started to allow redomicilations and which would still require some service providers such as the custodian to be replaced with one established in the same jurisdiction.

Particularly popular is the possibility for an offshore fund redomiciling to Malta and converting itself into a Ucits III vehicle in the process without having to wind up and reincorporate in the traditional sense. In this way Malta becomes a gateway not only to tapping European markets without the need to seek further authorisations overseas, but an international trust mark contributing to investors investing their money with added confidence.

Redomicilation to Malta is possible under the Continuation of Companies Regulations, 2002, as amended. It is available to both unregulated and regulated entities established in a jurisdiction which specifically allows redomicilation out and which have a corporate form similar to that known under the laws of Malta, typically a limited liability company which broadly follows the Anglo-Saxon model. The continuation for the other jurisdiction must also be specifically allowed in the Articles of Association or similar incorporation document of the foreign entity. Banks, insurance companies, trust companies, publicly listed entities, investment funds, managers, administrators and custodians can all redomicile to Malta without being wound up and reincorporated. The redomiciled company, open-ended or closed-ended investment company would then be continued in Malta under the Companies Act, 1995 which is based on its English Law equivalent and transposes the EU Company Law directives.
The procedure

Although financial services entities have been redomiciling to Malta ever since the introduction of the 2002 Regulations, following membership of the European Union in 2004, joining of the Eurozone in 2008 and the turmoil of the financial crisis, international interest in redomiciling to Malta has increased exponentially.

The procedure is straightforward and inexpensive, and is divided in two synchronised processes happening in tandem: the corporate process to move the existing entity to Malta and the regulatory process to obtain a new licence from the local regulator in terms of the applicable law.

A foreign fund, manager, administrator or custodian would first submit an application, in draft form, for the relative licence to the Authorisations Unit of the Malta Financial Services Authority (MFSA) together with the necessary documents (such as an Offering Memorandum in line with Maltese requirements in the case of a fund), assuming the position obtainable following the continuation of the corporate entity in Malta on issue of a Certificate of Continuation by the Registrar of Companies in Malta.

While the draft licence application is being processed and necessary due diligence checks are undertaken by the MFSA, including enquiries with any existing regulator of the foreign fund or service provider as the case may be, a request for continuation in Malta is submitted to the Registrar of Companies. Documents which should accompany the request include:

a) evidence of the approval by an extraordinary resolution of the shareholders of the foreign entity for it to be continued in Malta;

b) the revised Memorandum and Articles of Association of the entity to comply with Maltese company law requirements; and

c) a declaration by the directors or other governing body of the foreign entity confirming the name under which the entity is to be continued in Malta, the current jurisdiction and date of incorporation, that notices or other formalities in the current jurisdiction in connection with the redomiciliation have been followed, that there are no pending legal or administrative breaches by the entity and that the entity is solvent.

After vetting the licence application documents, the MFSA would communicate its comments to the promoters of the continued Maltese entities. Upon resolution of any material issues in connection with the licensing, the MFSA would issue its in principle decision to grant a new licence to the entity in terms of the Maltese regulatory framework contemporaneously with its continuation in Malta.

The Authorisations Unit would liaise with the Registry of Companies and the new fund, manager, administrator or custodian would be licensed on the same date that the entity is formally certified to be continued in Malta by the Registrar of Companies.

Other specific documentation that is ordinarily requested by the MFSA with respect to a redomiciliation of entities that will be carrying out a licensable activity in Malta include:

a) recent copies of audited financial statements;

b) a copy of the Memorandum & Articles of Association (with details of the directors), and in the case of funds, the Offering Memorandum, in the form used prior to the redomiciliation to Malta;

c) evidence of board approval to redomicile and seek licensing in Malta and confirmation that there are no regulatory issues, pending litigation or disputes and that there are no such potential litigation or disputes of which the Board of Directors of the foreign entity is aware.

Certain formalities in the foreign jurisdiction from where the entity is redomiciling would also have to be complied with. These normally include the serving of notices to secured creditors and publishing notices on national newspapers before the entity can be discontinued or de-registered from its original jurisdiction.

Heritage of hospitality

Malta’s reputation for hospitality is first recorded in classical times. An island in the middle of the Mediterranean, Malta has been a safe haven for traders and travellers since time immemorial. In a globalised economy, the EU member state is emulating its age old traditions and instead of sea farers Malta is today welcoming financial services businesses looking to move to a jurisdiction that is strongly regulated, supervised by a pragmatic yet flexible regulator, has an attractive fiscal regime and wide double-tax treaty network and offers a professional English-speaking workforce. And the 300-plus days of sunshine every year which Ulysses may have experienced during his mythical Homeric stay on the island have remained unchanged.
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Laragh Cassar of Camilleri Preziosi outlines the implications of the use of side pockets in a distressed market within the hedge fund industry

Alleviating issues of liquidity

The difficulty in valuing underlying investments of funds has been one of the direct impacts of the unprecedented turmoil in the world economy resulting in a number of funds holding positions in investments which are increasingly hard to value or are illiquid. This has brought on the imposition of gates on redemptions or the indefinite suspension of redemptions.

Gates normally limit the amount of redemption to a percentage of the fund’s net-asset value. The creation of side pockets in the fund context involves the separation of such investments from other liquid investments through a creation of a separate fund or class of shares which are allocated to existing participants. Such participants will therefore hold units within the liquid as well as the illiquid portfolio. On the basis of the nature of the investments, the fund would thus be in a position to resume or continue to value the liquid assets and to enable the redemption and transfer of the units associated therewith.

On the other hand, the participants investment in the illiquid class of shares would typically be locked until such time as assets within the illiquid portfolio are capable of being realised. This would necessitate the fund having the power to suspend the determination of the net-asset value of the side-pocket portfolio until such time as they deem necessary. Side-pocket investments are typically valued at cost (or the value at which they were transferred into the side pocket) until circumstances are such that a revaluation can be made. The fair valuation of assets prior to their transfer is required to ensure that any losses are appropriately allocated to existing shareholders of the fund.

Attracting new investors

Furthermore, side pockets may, depending on investor appetite, seek to attract new investors in the liquid units; however, particular attention would have to be provided to avoid the possible upturn that new investors may get from the realisation of the illiquid investments. Once the fund is in a position to value illiquid investments or when trading thereon can be resumed, the fund may choose to realise that investment and distribute the proceeds thereof to investors typically through the redemption of units. This, however, may not always be possible depending on the constitutional documents of the fund. Alternatively, the fund may choose to transfer such investments from the illiquid to the liquid class of shares. In doing so, the consideration of such transfer would need to be attributed directly to the investors that appeared on the register of members at the time when the side pocket was created. This will serve to establish a fair approach to the old and new investors. The form of wind-down operation of the illiquid portfolio of investment used may also have taxation implications and therefore ought to be analysed within such a context.

Exit fees and dilution levies

One of the issues faced by the fund relates to the risk of a run by investors on the liquid class of shares. Funds have sought to address this issue by seeking to implement measures aimed at acting as a disincentive to investors to exit the fund, namely, the introduction of exit fees and dilution levies and the increase of redemption notice periods. Furthermore, management fees generally chargeable to the fund are often waived or deferred with respect to the illiquid portion of units, in particular, in respect of management and performance fees.

Needless to say, the introduction of side-pocket arrangements and the measures presently described are to be analysed both in the context of the regulatory framework of the fund in question, as well as the contractual undertakings issued by the fund pursuant to its offering document and service contracts. Furthermore, transparency remains imperative to ensure that investors properly understand the impact and benefit of the introduction of side-pocket arrangements.

Within the context of the Maltese market, the regulator (the Malta Financial Services Authority) has issued guidelines of the introduction of side-pocket arrangements. The said guidelines are applicable to certain types of non-retail funds generally used as vehicles for hedge funds and regulate the disclosures required to be given to investors, as well as the manner in which such side pockets are
created. The MFSA contemplates the creation of a separate class of units holding the illiquid portfolio. One of the repercussions under Maltese law in respect of multi-fund/multi-class funds relates to the creation of separate patrimonies. While in terms of Maltese law, a multi-fund company may elect to have the assets and liabilities of each sub-fund comprised in that company treated for all intents and purposes of law as a patrimony separate from the assets and liabilities of each other sub-fund of such company, this benefit is not attributed to a class of shares not constituting a separate sub-fund of the company.

Separation of patrimonies

Accordingly, once a company registered in terms of the Maltese Companies Act creates a separate class of units to hold the illiquid portfolio of investments, creditors of that class of shares still retain their right of recourse against the liquid portfolio of assets. In the light of this, funds have sought to enter into arrangements with existing creditors of the fund to contractually achieve this separation of patrimonies. However, this may prove to be difficult, or not all possible, in relation to future creditors of the fund and appropriate risk warnings to investors would need to be provided particularly within the context of future investors in the liquid class of units.

Once the illiquid portfolio has been transferred or realised in its entirety, the fund will close the illiquid class of units through the redemption of the said units. The introduction of properly documented and structured side pockets may help to alleviate liquidity issues for both the fund and its investors and may avoid an unnecessary closure of the fund potentially realising investments at an undervalue.

“Transparency remains imperative to ensure that investors properly understand the impact and benefit of the introduction of side-pocket arrangements.”
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Dominique Lecocq of lecocqassociate discusses how the range of funds available such as PIFs and UCITS have led to an increasing number of hedge fund companies looking to redomicile in Malta.

Malta: a rising jurisdiction

Over recent months Malta has continued to experience optimism in its funds, and more broadly its financial services sector, with an increasing number of investor funds together with firms servicing the fund industry, particularly managers from London (following the British government’s latest spur in taxation measures), showing a great degree of interest in setting up in Malta. The Malta Financial Services Authority (MFSA) continues to prove its credibility as a serious regulator, which maintains high-regulatory standards and remains responsive to developments in the financial industry and its particular needs. The financial sector is indeed one of the major pillars of the Maltese economy and in this regard, the Maltese government is maintaining its pro-growth stance and is strongly committed to the objective of increasing the financial sector’s contribution to GDP up to 25% from the current 12% within the next six to seven years.

Redomiciliation of offshore funds into an EU Jurisdiction
The MFSA has not remained unresponsive to international interest in Malta and has recently published Guidelines to Redomiciliation of Offshore Funds to Malta. These guidelines provide a general overview of the current procedure and documentation required for inward continuation into Malta. Redomiciliation has proven very attractive for fund managers as it results in the fund migrating from the exit jurisdiction to Malta without any need for the dissolution of the fund and with little disturbance to the investors, the existing service providers and the fund’s assets. What will change is the fund’s domicile and consequently the applicable legal system and framework of taxation. The fund will keep its track record which is very important for managers.

Investing in China
A recent development which is set to contribute to Malta’s attractiveness as a fund domicile is the signing of the Memorandum of Understanding (MoU) between the MFSA and the China Securities Regulation Commission (CSRC). The MoU makes it possible for Chinese investors to invest in Malta domiciled retail and non-retail funds by placing their investment with investment firms qualifying as Qualified Domestic Institutional Investors (QDIIs), thereby opening up MFSA regulated funds to a market of over 1.2 billion potential investors. Furthermore, Malta-domiciled funds will be able to apply for the Chinese Qualified Foreign Institutional Investor (QFII) status and invest directly in the China A share market, subject to certain foreign exchange flow and disclosure requirements.

Fund managers will also appreciate the various fund structures available in Malta. Maltese financial legislation offers fund managers a number of fund structures to choose from. Most collective investment schemes domiciled in Malta are structured as open-ended investment companies (with the exception of UCITS funds), limited partnerships, unit trusts or common contractual funds. However, Malta also offers a number of regulated closed-ended investment companies, but may also take the form of closed-ended investment companies (with the exception of UCITS funds), limited partnerships, unit trusts or common contractual funds.

Professional Investor Funds
Non-retail funds, such as hedge funds, are typically set up in the form of Professional Investor Funds, more commonly known as PIFs, which are regulated by specific and more flexible rules and are not subject to the investment and borrowing restrictions applicable to retail funds. Furthermore, there is no requirement to appoint service providers which are based in Malta – a feature which is not found in other comparable fund jurisdictions such as Ireland and Luxembourg.

The three categories of PIFs apply a different minimum subscription requirement and investor qualification criteria. PIFs targeting “experienced investors” have a minimum entry level of €10,000, which was recently reduced from €15,000. They also require the appointment of a custodian, which need not be situated in Malta, and restrict borrowing to 100% of the fund’s net asset value. Following amendments in December of last year, persons who qualify as “professional clients” in terms of the MiFID automatically qualify as “experienced investors”.

On the other hand, PIFs targeting “qualified investors” apply a minimum subscription requirement of €75,000 and PIFs targeting “extraordinary investors” apply one of €750,000. Moreover, PIFs targeting qualified and extraordinary investors do not require the appointment of a custodian, in which case responsibility for the

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establishment of proper arrangements for the safe keeping of the fund’s assets falls upon the directors, general partners or trustees, as the case may be.

A new platform for UCITS funds
Retail funds, on the other hand, are regulated more stringently than non-retail funds, such as PIFs, since retail funds are intended for public distribution. However, retail funds set up as UCITS are becoming increasingly popular. Despite being subject to tighter regulation in terms of permissible investments, risk exposure and investor protection disclosure requirements, UCITS funds possess certain features which give them a competitive advantage over non-retail funds such as PIFs. The UCITS brand is coming to be seen as a seal of quality and their “European Passport” makes cross-border marketing a straightforward and cost-effective procedure which cannot be availed of by non-UCITS funds. The UCITS are advised to apply the Value-at-Risk (VaR) model (or other model approved by the MFSA) when calculating their risk exposure, which allows greater flexibility than the Commitment Approach applicable to their non-sophisticated counterpart. Sophisticated UCITS should also carry out stress tests every quarter to help manage risks related to potential abnormal market movements. The results should be appropriately documented and relevant records kept at the fund’s registered office. The UCITS should keep the VaR model under review by means of regular back-testing comparing the actual portfolio returns to predicted market risk amount as calculated by the VaR model.

In the coming months, the transposition of UCITS IV into Maltese law will make UCITS funds even more competitive. In the coming months, the transposition of UCITS IV into Maltese law will make UCITS funds even more competitive. In fact, last month the MFSA published a circular on the proposed adoption of the provisions of the UCITS IV Directive with respect to the setting-up of master-feeder UCITS structures in Malta. Under UCITS III, master-feeder structures were specifically excluded due to fund diversification rules and, accordingly, the MFSA did not accept applications for master-feeder schemes, unless these were set up as PIFs. However, the new UCITS framework will allow a feeder UCITS to invest most of its assets in a master UCITS. The master and feeder need not be situated in the same member state and may also have different depositories and auditors, subject to putting in place adequate information sharing arrangements.

Under the current system, the management company and the UCITS have to both be domiciled in Malta. Currently, foreign management companies may only manage a UCITS if the fund is structured as a self-managed Sicav. This has been recognised by EU regulators, and following the transposition into Maltese law of UCITS IV, any UCITS management company which is established within the EEA will have the right to manage funds in Malta, thus generating significant economies of scale and resulting in a greater choice of investment products.

Converting PIFs into UCITS
With investor confidence in hedge funds not restored to pre-Madoff levels and in view of the high esteem UCITS funds enjoy with investors (both retail and institutional), their ease of cross-border distribution and the increased efficiency in terms of the removal of administrative barriers and reduced costs set to be achieved by UCITS IV, the UCITS market is geared to expand dramatically both in Malta and in other comparable fund jurisdictions within the community. Moreover, the possibility of redomiciliation of offshore funds into Malta and their subsequent conversion into a UCITS-compliant fund are part of the local efforts aimed at attracting the attention of hedge fund managers seeking to go the UCITS route, provided they can appreciate the differences in the investment strategies and disclosure requirements of a UCITS fund.
André Zerafa of Ganado & Associates, Advocates outlines the benefits that hedge fund companies that choose Malta as a redomiciliation option can enjoy

Redomiciling to Malta

Over the past few months, several articles have appeared in the financial press on the redomiciliation or continuation of companies, particularly funds, from offshore to onshore jurisdictions. Only recently Ireland introduced a redomiciliation framework, which is targeted at investment fund vehicles. Interestingly Malta introduced such a framework as long ago as 2002 through the Continuation of Companies Regulations issued pursuant to the Maltese Companies Act.

The continuation of offshore funds into Malta is then specifically provided for in Article 31 of the Investment Services Act, which also refers to the Regulations. The said Article 31 was also introduced in 2002. Over the past eight years, Maltese professional advisers, regulators and counterparties have been involved in hundreds of redomiciliations of holding and trading vehicles which moved their domicile to Malta from a number of other countries, both offshore and onshore.

Legal framework requirements

A fundamental requirement for any redomiciliation to be effected is that the legal framework of the country from where the entity is seeking to move permits outward redomiciliations. Indeed the regulations provide for both the inward and outward redomiciliation of companies in or from Malta while outlining the effects, which such a redomiciliation would have on the corporate vehicle.

A continued entity would be deemed to ‘continue’ under the laws of the country to where it is being redomiciled without any change in its corporate structure or obligations. Indeed the Regulations specifically provide that the redomiciliation does not operate to create a new legal entity, nor would it prejudice or affect the continuity of the company and it would not affect the property of the company which would retain all its assets, rights, liabilities and obligations.

Furthermore any legal or other proceedings instituted by or against the company would remain in force. The redomiciliation would not release or impair any debt, liability or obligation due or existing against the company or against any member, director, officer or other persons vested with the management of the company.

Continuation of corporate vehicles

The regulations allow for the continuation of any type of corporate vehicle, be it a fund, a trading company, a holding company or a limited partnership. There are no limitations under Maltese law of what entity can be redomiciled in or out of Malta so long as such an entity is a corporate vehicle. Nevertheless, no legal prohibition exists under Maltese law precluding an FCP (common contractual fund) or a unit trust from changing its domicile to a Maltese domicile (such as by changing its governing law clause or the domicile of its custodian, depositary, trustee, or investment manager) albeit the continuation of such types of structures would not fall within the parameters of the regulations.

Furthermore, on 22 December 2009, the Malta Financial Services Authority (MFSA) issued guidelines on the redomiciliation of funds into Malta. These guidelines do not purport to be a new set of rules regarding redomiciliation of offshore funds to Malta but merely provide further guidance on how such a process should be handled within the context of the regulations already mentioned above.

So it would be correct to say that the possibility for offshore funds to redomicile to Malta has existed for the past eight years and, in fact, there have been cases where such an option was taken up and the offshore fund continued under Maltese law and obtained a licence from the MFSA as a collective investment scheme in terms of the Investment Services Act.

A continuation of a fund under the regulations has proven to be the most straightforward process in that this process would not affect the fund’s portfolio as such or the fund’s performance record or its fee structure. In some cases, investors or counterparties would be notified of such a redomiciliation if so provided in terms of the fund’s constitutive documents or its prospectus. Moreover we have seen funds opting for other options when shifting their funds from an offshore country to an onshore jurisdiction.

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In some cases, funds decided, with the consent of their investors, to transfer their portfolio to a newly constituted onshore fund which would, as consideration for the transfer, issue new shares to the offshore fund which would in turn distribute such shares to its investors by way of an in-specie redemption. In other cases we have seen investors in the offshore fund requesting an in-specie redemption of their shares in the offshore fund (so such investors would be receiving a portion of the offshore fund’s underlying portfolio equivalent to the net-asset value of the shares which they hold) and then reinvesting such assets by way of an in-specie subscription in a newly constituted onshore fund.

Although such structuring is possible and has been implemented effectively, these might not be the most straightforward options particularly in view of a number of tax consequences which could arise for investors in their country of residence or domicile, and also for the offshore fund itself in terms of the tax framework of the countries in which such offshore fund has its investments.

**The cost of redomiciliation**

The cost of a straightforward redomiciliation tends to be the same as the cost for incorporating a new fund under Maltese law. The process in itself is straightforward from a Maltese law point of view and is based on a set of documents which assume shareholder and director consent. These documents are listed in the regulations and in the MFSA’s guidance note referred to above and which are eventually lodged with the Maltese Registrar of Companies and also filed with the MFSA as the regulator of the fund vehicle.

The redomiciliation option is another legal mechanism worth full consideration by fund promoters when analysing any particular jurisdiction in the context of either a new fund set up or a fund restructuring. It is also important for fund promoters to choose a domicile which does not only permit inward redomiciliation but also allows for outward redomiciliation in an effective manner. Maltese redomiciliation legislation seems to tick all the right boxes.
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Kevin Vella of ITL Advisory Services talks to HFMWeek about the issues that fund managers choosing to outsource their back-office solutions to Malta need to be aware of.

**Malta’s well-earned reputation**

As more and more funds opt to outsource their back-office solutions to Malta, HFMWeek speaks to Kevin Vella of ITL Advisory Services to find out which issues funds wishing to outsource these functions should take into consideration and discover exactly why Malta has become such a popular jurisdiction in this area.

**HFMWeek: (HFM) Are you seeing an increase in funds opting to outsource their support and management functions? What do you think has contributed to this?**

Kevin Vella (KV): Yes certainly. The two most important reasons for this is the hard-earned reputability of the jurisdiction and the topmost quality of its service providers. Malta has seen a considerable growth in domestic business related to the funds industry over the past five years or so, through a combination of redomiciliation of service providers from other jurisdictions and also newly set up service providers. There has been a considerable amount of work which has been outsourced to other service providers in the process. The nature and extent of work varies but includes everything such as accounting and other statutory reporting, fiscal and regulatory compliance, payroll processing, office management and even client reporting. This excludes fund administration business which is a more directly related independent function and which has also grown considerably in stature in Malta recently.

**HFMWeek: What are the benefits of outsourcing such operations to Malta? Do you expect continued growth in this area?**

KV: Quality of service in line with highest international standards. Add to this that Malta is an English-speaking country, forming part of the EU with extremely reasonable costs. I am cautiously optimistic of the significant growth potential of this sector in Malta in the next few years.

**HFMWeek: What are the Maltese authorities doing to encourage the growth of Malta as a centre for outsourced support and management functions?**

KV: There are a number of incentives, including fiscal which favour the provision of back-office operations in Malta. These are typically administered by a dedicated agency called Malta Enterprise which has done a lot to bring Malta on the international level it enjoys now.

**HFM: How does Malta compare to other domiciles as a jurisdiction for outsourced back-office solutions?**

Malta is probably one of the best-placed jurisdictions, extremely favourably. This comes out of hard facts such as statistics related to operating costs and also, more importantly, from statements made by fund managers and other providers that come to Malta, having had experience in other jurisdictions. The various ingredients that make up the whole operating environment in Malta are considered to be second to none. The biggest risk to our country is for it to become a victim of its own success, at such a critical stage of its development. Few or no jurisdictions would admit to having been a victim of this syndrome but we have come across too many instances of people moving out of competing jurisdictions for this reason not to be in a comfortable position to make such statements about the risk that we face as a country. I can safely say, however, that most operators strive hard to uphold our advantage at this point in time.

**HFMWeek: What legal considerations should a company seeking to outsource its support and management services to Malta or in Malta take into account?**

KV: Maltese-registered companies having any authorisation to carry out financial services business from the Malta Financial Services Authority (MFSA) must ensure that outsourcing arrangements are carried out with individuals or companies who are competent, qualified and experienced enough to carry out such duties, especially if such outsourced functions are considered to be critically important.

The MFSA would investigate closely such arrangements and licence holders would be required to submit details of contractual arrangements to this effect. Management authority can never be delegated and the board of directors of licence holders would always remain ultimately responsible for the actions of third parties in so far as these third parties are engaged to carry out work for such companies. The MFSA rightfully places a lot of emphasis on the fitness and “properness” of the directors and key management personnel of licence holders, but similarly acknowledges that professional, independent advice and outsourced duties are equally important in maintaining a high level of standards in corporate governance.

Companies registered outside of Malta but wishing to outsource any of their functions to Maltese service providers may also do so, provided that the former satisfy all requirements applicable to Maltese companies above in their home country. We have never come across any requirement of any overseas jurisdiction which could not be (at least) reasonably met.
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There have been five noticeable trends in the hedge fund markets over the past year and I think these will continue.

These have been:
- A reaction to the UK penal tax raises
- A reaction to the draft EU AIFM Directive (“AIFM Directive”)
- The demand for managers and investors for Ucits funds
- The demand for managed accounts
- The demand for managed account platforms

There has been a discernible migration of hedge fund and alternative investment fund managers out of the UK, primarily into Switzerland, Singapore, the Channel Islands and, to a lesser extent, Malta. This has undoubtedly been tax driven and is nothing to do with the proposed AIFM Directive.

The AIFM Directive has yet to be finalised and it is not clear whether the Spanish, who now have the presidency of the EU for the first half of 2010, will be able to complete this, as they seem to have relegated this Directive to a second-priority status. What is almost certain, however, is that eventually the sale of alternative investment funds, including hedge funds, CTA funds, funds of funds, managed accounts and private equity and real estate funds (collectively “the funds”) in Europe will require the establishment of either the funds themselves or the managers of those funds (or both) in a European centre.

Logic suggests that a European-regulated fund should be sufficient, because the relevant regulatory authority, where that fund is domiciled, will have to approve the management structure of the fund before they approve the actual fund itself - but since when has logic been a factor in political decisions? But, if logic does prevail, many of these European funds, which may be standalone funds, or part of a master-feeder structure, are likely to be established in Dublin as Qualified Investor Funds (QIFs), Luxembourg as Sophisticated Investor Funds (SIF) or Malta as Professional Investor Funds (PIFs).

If the managers (or their investors) are looking for a higher level of regulation – and post-Madoff, this has become an important factor to investors – as well as the ability to sell the fund to the retail market, then they are likely to want to establish a Ucits III or IV fund, in one of the same three jurisdictions. A Ucits fund is “Eurospeech” for a regulated fund and means “Undertakings for Collective Investment in Transferable Securities”.

The benefits of Ucits IV
The Ucits IV fund is a less restricted fund than the earlier Ucits fund regimes, but nevertheless, there are limitations and not all alternative investment strategies would be appropriate. For example, the funds have to offer liquidity at least twice a month and, of course, that precludes illiquid securities of any sort. Nevertheless, there is a definite increase in demand by the managers, although we haven’t yet seen a huge take-up by investors, except for some large existing hedge funds, which may have converted into a Ucits fund. I would suggest that, for a Ucits fund to be successful, the manager must have credible distribution in place. Ucits funds can only be established in EU member states, which have both implemented the relevant EU Directives and have a suitable regulatory regime. The same three jurisdictions, Dublin, Luxembourg and Malta, lead the pack here.

Having said all that, there is no doubt that Dublin and Luxembourg have a higher profile than Malta with regard to Ucits funds, but equally, there is no doubt that Malta is now generally recognised as the third jurisdiction of choice, behind Dublin and Luxembourg, whereas only a year or two ago, if you mentioned Malta to people in our industry, many were unaware of the domicile’s potential benefits. The fact is that Malta started introducing regulation to make it compliant with EU regulation in 1985, some 10 years before Malta became a full member state of the EU.

Today, Malta, which has been a full member of the EU since 2005, has positioned itself as a very credible alternative jurisdiction to its two major competitors and has the advantage of being substantially less expensive. With a highly educated
population of some 400,000 people, it is, in terms of population, way below Dublin, but equal to Luxembourg. Of course, Luxembourg has a daily immigration from its neighbours, which probably doubles or even, perhaps, trebles its population!

A costly Directive
What is clear is that the final AIFM Directive is likely to be very disruptive to the hedge fund industry – it will be expensive to comply with – even if the “lightest” option (establishing an EU feeder) works. Other compliance options, including establishing a full management office in the EU, could be disproportionately costly. As a result, the claim by Dan Water of the FSA that 40% of the world’s hedge funds won’t have access to the EU markets appears quite realistic and bodes worse for the EU investors than for those hedge funds.

Another trend that we have seen has been the demand for managed accounts by investors seeking transparency and liquidity. The main disadvantage to both investors and managers is providing the resources to handle the increased administration, but of course, any competent administrator who can provide daily valuations can also provide administration for managed accounts – after all, a fund is merely a managed account with corporate wrapper.

Alongside the managed accounts, we have seen the growth in managed account platforms, which can provide the same liquidity and transparency to both direct investors and managers of funds of funds who can convert their funds of funds into managed account platforms. Indeed, from the Maltese perspective, NBC (National Bank of Canada) and Innocap established their managed account platform as the NBCG Master Feeder Fund in Malta some time ago (which, I should disclose, Custom House administers). This structure provides the manager (Innocap) with the liquidity and transparency they wanted to manage and rebalance their portfolio, as well as, by using the Maltese segregated-cells structure within the master fund, also eliminating the Amaranth syndrome (which is the cross-collateral risk between different managed accounts).

Of course, the daily liquidity achieved through the provision of a daily dealing NAV was absolutely essential. We were able to achieve this because each Custom House office involved, including Malta, Dublin, Chicago and Singapore is a very efficient cog within equally efficient machinery, which enables Custom House to provide some 200 daily dealing NAVs out of approximately 600 funds, sub-funds, managed account platforms and managed accounts – a total of over 4,400 valuations each month, and growing.

What is clear is that, if I am right about the five main trends in our markets, then Malta can benefit to a greater or lesser extent from each of those trends and, as a result, so can all Maltese hedge fund administrators.
Simon Tortell and Associates

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The European UCITS evolution

The UCITS IV Framework Directive in the Official Journal of the European Union was published on 17 November 2009, with the new directive scheduled to come into force in July 2011. Much has been discussed and written about the implications of the implementation of the UCITS IV Directive with the key findings in various surveys that have been undertaken so far revealing that UCITS fund managers are gearing up for the new UCITS IV regime. The new regime is expected to strengthen the degree of harmonisation across all EU member states, albeit one expects that this new framework will bring with it both challenges and opportunities for the European investment fund industry.

A hoped for consolidation

Ultimately, one is hopeful that this will lead to consolidation at both the investor and service provider level which the industry very much beckons and thereon translate into increased competitiveness as a result of the cost-efficiencies that are expected to be induced in the process.

In the last quarter of 2009, the Committee of European Securities Regulators (CESR) published its advice on the UCITS IV implementing measures, covering both the Key Investor Information Disclosure Document (KID) and the much-awaited management company passport. CESR has also submitted its technical advice on mergers of UCITS, master-feeder structures and cross-border notification of UCITS, together with its first wave of advice, specifically addressing the synthetic risk and reward indicator as well as ongoing charges. In summary there are five core matters that will be addressed in this new UCITS variant:

1. Management company passport: This will permit UCITS managers to set up funds in any EU domicile, and manage these cross border. The requirement for the custodian to be based in the same domicile of the UCITS scheme has been retained (a development that may be reconsidered when we come to UCITS V aligning this to the management passport that is being introduced under UCITS IV).

2. Notification procedure: This development is intended to further strengthen the current CESR advice on the notification procedure and addresses the information a member state should make available in relation to marketing in their jurisdiction of UCITS established in another member state. This should instill increased clarity and guidance and therefore reduce subjectivity which in itself has somewhat proved to hinder efficient cross-border fund passporting. The new procedure contemplates a template notification and attestation letter and provides guidance as to how the regulatory authorities of the home state provides access to the updated notification document, as well as which procedure should be applied for electronic transmission of notification files with the ultimate aim for these files to processed through a centralised IT system.

3. Fund mergers: This covers the information that needs to be provided to unit-holders of funds to be merged, as well as the broad approach to be adopted in the circumstances.

4. Master-feeder structure: This will allow for the creation of master-feeder structures. The feeder UCITS will be allowed to invest in excess of 85% of its assets in the units of one target UCITS (and the agreements that will have to be entered into between both entities including those for the custodian and auditor of the scheme).

5. Key investor information: This will replace the simplified prospectus and facilitate the provision of clear unequivocal information to the end unit-holder.

CESR’s advice has also extended itself to other related areas. These include the following:

(i) The introduction of a synthetic risk and reward indicator: CESR proposes methodologies for the calculation of this indicator. Starting from a general methodology (based on the volatility of the fund), it also addresses special cases, notably market funds with insufficient performance history, absolute return funds, total return funds,
The new Ucits regime is expected to strengthen the degree of harmonisation across all EU member states.

(ii) Ongoing charges: CESR defines what counts (or does not count) as ongoing charges which need to be disclosed. It outlines the methodology for the calculation of ongoing charges, dividing between existing funds and the case of new funds.

Merging of funds
With all these new developments being brought to fruition, one anticipates that the number of Ucits-fund management operations managed by the same houses will be consolidated. In addition, one expects a wave of cross-border mergers of smaller funds into larger funds. Coupled with the centralisation of middle- and back-office services, one envisages leaner expense ratios as well as greater efficient cross-border distribution processes.

Despite these welcome developments, there are still a number of issues that need to be addressed. Surely enough, leading the pack is the issue of taxation vis-à-vis the tax treatment of investors under Ucits IV. The European Fund and Asset Management Association (EFAMA), as well as a number of international firms, has already raised these issues with the European Commission as to the need for the member states to focus on the domicile of the fund rather than the management company when applying income tax. In the case of cross-border fund mergers, proposals have already been made for these to be tax-neutral in the hands of the investor. The best approach would be one where a homogenous tax treatment is applied by all EU member states – a challenging option and possibly a utopian one!

The Malta Financial Services Authority (MFSA) is actively following up on developments. In fact, on 4 December 2009, the MFSA issued a circular to brief the financial services industry on the developments concerning Ucits IV. The circular provides a brief overview of the principal elements of the Key Investor Information (KII) together with information of CESR’s advice on KII. The circular also provides an outline on how the authority plans to transpose the requirements on the KII. In this regard, the industry is being consulted on the new rules which the MFSA intends to adopt in order to transpose the relevant articles in Ucits IV which set the requirements relating to the KII.
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