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Skills, speed and cost lift Malta’s global profile

By Simon Gray

For most of the past two decades, there have been only two significant international fund domiciles and servicing centres in Europe, Luxembourg and Dublin. But just as new rules governing both traditional and alternative investments draw promoters’ and managers’ attention to the advantages of establishing fund vehicles within the European Union, the Mediterranean island of Malta is staking a serious claim to a share of this burgeoning market.

The inhabitants of the Maltese archipelago, which also comprises the sister islands of Gozo and Comino, have long wrestled with the conundrum of achieving economic development in a physically small, crowded country with little in the way of natural resources beyond a balmy climate and idyllic sandy beaches. Historically the Maltese have travelled far and wide as seamen, fishermen and emigrants, fostering an outward-looking mentality that is paying dividends in today’s globalised economy.

Over the centuries, Malta’s strategic location between Europe and North Africa and the superb natural harbour of Valetta have drawn the attention of outside powers. The islands’ many rulers have left...
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Legislative changes drive island’s appeal

By Katya Tua

Although Malta has seen its profile grow among the global financial services community particularly over the past two or three years, its fund industry has been developing for more than a decade.

Even at the outset, the island’s potential as a jurisdiction offering appropriate and flexible fund regulation was evident, and the regulations allowing companies to be redomiciled have existed since 2002. Redomiciliation is available for any corporate structure, regardless of whether it is licensed or not in the original jurisdiction, enabling other types of corporate entity to be redomiciled to Malta.

For a licensed entity such as a fund, the redomiciliation process takes place simultaneously with the licensing of the vehicle in Malta, enabling the fund to move as a going concern and retain its existing track record; there is no need for any redemption, nor tax implications for the fund or its investors. The investments remain in the same assets; all that moves is the domicile of the corporate structure. Compared with closing a company and launching a new one, or carrying out a merger, it is a very rapid and straightforward process.

One restriction is that the corporate body moving domicile must be able to adopt a similar corporate structure to that in its original domicile. However, the range of available vehicles was expanded in February this year with the extension of Malta’s existing cell company regulations to collective investment schemes. This means, for instance, that a Guernsey incorporated cell company structure may now be redomiciled, which was not the case in the past because Malta lacked a corporate structure in which each compartment had its own legal personality.

The addition of cell companies to the range of vehicles available to funds in Malta is just one of a number of ways in which the island has sought to meet the requirements of the international fund industry. For example, under the Companies Act funds can be structured as limited partnerships, although today the Sicav plc – open-ended investment company – remains the most popular structure among promoters.

Partnerships may gain more interest in the future following amendments to the Companies Act also introduced earlier this year that grant them more flexibility, while another recent change involves the introduction of regulations governing contractual funds. Malta strives to keep its regulation and laws in line with what clients require, which often involves anticipating developments that the market will seek in the future.

The success of the Professional Investor Fund regime is poised to benefit the island further when the EU’s Alternative Investment Fund Managers Directive makes regulation of the alternative fund industry the norm across the continent from July 2013. While passage of the directive has boosted interest in redomiciliation of funds to Malta, European managers with existing offshore structures are also looking to replicate them within the EU.

Having a fund domiciled in a jurisdiction within the union is an important factor for investors, as we saw with the upsurge of business following Malta’s accession. But ultimately it is the responsiveness of the legislator, adequate legislation and regulation, and the expertise of service providers that drive decisions to bring business here.
an interesting and diverse imprint on the country’s language, culture and legal system, according to Laragh Cassar, a partner with law firm Camilleri Preziosi.

“Malta’s culture reflects its geographical situation and history,” she says. “There is a strong European element, but also influence from the Arab world. Our history comes out in the way we speak, and people’s readiness to switch between English, Maltese and Italian expressions. And we should also be grateful to the English for leaving us with a work ethic more usually associated with northern Europe.”

The legal system is itself a mix of French, Italian and English concepts. “Throughout our history these influences have made their way gradually and naturally into our system,” Cassar says. “That means, for instance, that the trust is a well-established and understood concept in Maltese law, whereas its application in our neighbour Italy has not been as widespread. This has proved important to the development of our local wealth management industry.

“Our Companies Act is based on the UK Companies Act and our financial services legislation is largely inspired by the UK legislative framework, although over the past decade we have also implemented EU legislation [Malta became a member on May 1, 2004]. All our laws are published in English and Maltese, and generally, in the case of financial services legislation, the former prevails in the event of conflict.”

Cassar says the approach to adopting European directives into Maltese law reflects the country’s history of accommodating external influences. “The regulator is always trying to come up with new offerings,” she says. “With the introduction of the Alternative Investment Fund Managers Directive, it is seeking to develop a concept of regulation that will give Malta an advantage. The regulator has a great record of success in getting the most out of a situation like this.”

The proactive attitude of the Malta Financial Services Authority and its long-time chairman, Prof. Joe Bannister, is widely cited as an important factor in Malta’s growing reputation as a business-friendly jurisdiction. “The Maltese culture of doing business, including the firm yet flexible regulatory approach taken by the MFSA toward hedge funds, gives us an edge over more established jurisdictions,” says Dr Joseph Ghio, a partner with Fenech & Fenech Advocates.

“In other fund centres access to the regulator can best be described as remote. In Malta we do things differently, which is down in part to our small size. At times that can be a disadvantage, but in this case it is definitely a benefit. We can be very quick in responding to a new situation, and we have seen that on account of international market events, the backdrop for international fund business is almost unrecognisable compared with two or three years ago.”

Paul Mifsud, managing director of fund custodian Sparkasse Bank Malta, says a determination to assist managers in getting their fund projects up and running as quickly as possible distinguishes Malta from rival jurisdictions. “Local service providers do a lot of work that you might not find elsewhere, and speed to market is a priority for the MFSA, which tries as hard as possible to keep within an agreed timeframe for the launch of a fund,” he says.

Ghio notes that the MFSA continues to encourage face-to-face meetings with
applicants as part of the licensing process. “That's something you simply don't get in other jurisdictions, where licence holders only get to see their regulator when there is something wrong,” he says. “This reflects not only how much we value our reputation and pay attention to the quality of business we accept, but our openness to help applicants find flexible working solutions to meet our own and European rules.”

The openness of the regulator also underpins Malta’s ability to take on innovative types of investment strategy, which in turn helps to build up the skill base of service providers and boost the jurisdiction’s reputation for being capable of handling structures or asset classes that are off the beaten track. “The more business we see, the more our experience grows,” Ghio argues. “We are always very pleased to take on something that breaks new ground.

“Having quick access to dialogue with the MFSA is crucial, because we can discuss a variety of approaches and find workable solutions not just for the client but to ensure the regulator is comfortable with the structure and confident that there will be no damage to our reputation. Some complex structures would not have been possible had the regulator not been willing to listen to what the project was about. You probably won’t find many countries where practitioners sing the praises of the regulator in the way they do in Malta.”

The island’s appeal is not down to the virtues of the MFSA alone. According to Ghio, other contributory factors include Malta’s extensive network of almost 60 double taxation treaties, the everyday use of the English language, and the fact that the island is in a convenient time zone for Europe, Africa and the Middle East.

The country has also made considerable efforts to bring its technology infrastructure up to the standard required by the international financial services industry – IT, another industry that relies on brainpower and skills rather than raw materials, large numbers of employees or expensive operating facilities, is another priority for the government in its efforts to boost economic development.

“Since we opened our office in June 2008 a number of additional optic fibre cables have been laid to mainland Europe,” says Anthony O’Driscoll, managing director of administrator Apex Fund Services Malta. “The three telecoms operators, Vodafone, GO and Melita, have all invested heavily, and there is now plenty of redundancy built into the system. Being able to rely on a solid technological infrastructure is important not just for the financial industry but other fast-growing sectors such as gaming.”

There’s no escaping, however, the importance of the cost structure in Malta by comparison with its main rivals. “Setting up a fund from scratch in many popular jurisdictions is becoming increasingly expensive and requires the manager or promoter to have a substantial volume of assets under management,” Mifsud says. “In Malta it’s feasible to launch a fund with assets starting from EUR5m, whereas in Luxembourg or Ireland you would need significantly more to reach critical mass.”

Cost is an important factor to highlight abroad, Cassar agrees. “From service provider fees to regulatory charges, this country is much more cost-effective, and financial services firms are joining forces with the government and bodies such as FinanceMalta to get the message across,” she says. “Everyone is co-operating to raise the country’s international profile. Service providers may be marketing their own business as well, but there is a sense in which everyone is working for the same team.”

A great deal of work is done by FinanceMalta, a joint venture between the government and the private sector established in 2007 to promote the island as an international financial centre. “A number of initiatives involving local practitioners aim to put Malta on the map, including

“In Malta it’s feasible to launch a fund with assets starting from EUR5m, whereas in Luxembourg or Ireland you would need significantly more to reach critical mass.”

Paul Mifsud, Sparkasse Bank Malta
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PIFs: a flexible regime for hedge funds, private equity and more

Malta’s success in attracting international fund business is mostly down to the Professional Investor Fund regime, introduced in 2000 when the Malta Financial Services Authority issued the Guide to the Establishment of Professional Investor Funds. Previously funds established in Malta had been largely aimed at the domestic retail market, but the launch of PIFs started to draw attention from international fund promoters and managers targeting sophisticated investors.

There are three categories of PIF with differing minimum investment levels and other rules, reflecting the type of investors at which they are aimed. Experienced Investor PIFs are designed for more affluent and sophisticated retail investors, and their minimum investment level was reduced last year from EUR15,000 to EUR10,000.

These funds carry the highest level of restrictions to protect investors, including the requirement to appoint a custodian or prime broker (optional for other types of PIF), diversification of investment rules (strengthened at the time the minimum investment was lowered), and a leverage ceiling of 100 per cent of net asset value.

The Qualifying Investor PIF carries an investment minimum of EUR75,000 and is not subject to any restrictions on investment scope, borrowing or use of leverage; it does not require the appointment of a custodian or prime broker. According to Katya Tua of Simon Tortell & Associates, these remains popular among promoters, but demand for Extraordinary Investor PIFs, which have a minimum threshold of EUR750,000, has increased.

Extraordinary PIFs offer customised disclosure requirements and benefit from a faster licensing process at the regulator; they are often used for private equity investment, not only by institutions but wealthy individuals. Promoters can also set up self-managed PIFs whose investment management is the responsibility of the board of directors and that must have a minimum capital of EUR125,000.

Tua says the PIF framework is flexible enough to accommodate a broad range of asset classes, including ‘alternative alternatives’ such as diamonds, wine, energy and loans, as long as diversification requirements are satisfied. “We get the whole spectrum,” she says. “It’s up to the investor to decide whether the underlying assets are suitable.”

Fenech & Fenech partner Joseph Ghio adds: “Malta has licensed fund vehicles that invest in assets as diverse as precious watches and aircraft finance. Creativity is the only barrier to what you can do with a PIF. In addition to traditional hedge fund strategies, we have seen funds investing in alternative energy, foreign exchange and Asian real estate – you name it, you’ll probably find an example in Malta.”

The regulatory framework may be flexible enough to accommodate wide diversity of assets, but various fundamental rules have to be satisfied. “PIFs are companies and must be audited annually, and the auditor must ensure that valuation is carried out according to IFRS standards,” Tua says. “In addition, there must always be safekeeping of the assets in whatever shape or form they are.

“Qualifying and Experienced PIFs do not need a custodian, but the regulator must be satisfied that the safekeeping arrangements and valuation policies are adequate. At the end of the day the PIF is lightly regulated, but it is regulated all the same. In most cases the key is disclosure to investors, who can then make up their own minds about whether they are comfortable with aspects of the fund such as charges, liquidity and risk.”

International events and roadshows” says Katya Tua, head of the investment services department at law firm Simon Tortell & Associates. “It’s to everyone’s benefit that Malta should be better known.”

Andrew Frankish, a director of administrator IDS Fund Services, agrees, saying: “The more firms we as an industry can get interested in Malta, the bigger the fund services pie becomes, and our assets under administration will grow even if individual firms’ share of the pie stays the same. The industry is growing together and everyone is doing their part to promote the jurisdiction.”

Practitioners acknowledge that in other parts of the world the country’s position as a regulated jurisdiction within the EU and the sophistication and expertise of its financial industry are not as well known and understood as they might be. “We still sometimes get queries about what Malta is and where it is,” Tua says. “A surprising number of people still do not know it is an EU member.”

George Gregory, partner and head of tax and corporate services at professional services firm RSM Malta, says that the country still can be lumped together with offshore centres, especially in the US.
“Malta is not so well known as an onshore jurisdiction,” he says. “Luxembourg, which is of a comparable size to Malta, is better known, and is now a mainstay of Europe’s fund industry, whereas Malta has some catching up to do. However, I think Malta is doing a pretty good job about getting its name out there.”

The signs are that promotional efforts are making a difference, although for now the total assets of funds domiciled and serviced in Malta remain modest by comparison with numbers in other European jurisdictions. “Two years ago you wouldn’t have mentioned Malta in the same breath,” says Dermot Butler, chairman of Custom House Global Fund Services, whose global network of offices also includes operations in Dublin and Luxembourg.

“We’ve been present in Malta for nearly a decade, and I’ve long argued that it would come to the fore. Not only is it less expensive than its competitors, but Malta has been marketing itself very well. There may not yet be a huge volume of assets, but you have to consider that the jurisdiction has been in business for a considerably shorter time than its main competitors, and its growth rate is impressive.”

Mifsud says that the fallout from the financial crisis and its impact on attitudes among institutional investors continue to favour Malta over offshore jurisdictions. “We’ve seen an increase in hedge funds looking to be registered and regulated within the EU, whereas previously they would be domiciled mainly in jurisdictions such as Cayman, the BVI and the Bahamas,” he says. “Managers are following the requirements of their institutional investors, which want more robust regulation of the funds they invest in.”

Growth in Malta’s fund assets remains steady rather than breakneck. At the end of March this year, there were 331 funds with total assets of EUR7.93bn, according to the MFSA, a year-on-year increase of 7.7 per cent. Non-retail Professional Investor Funds accounted for more than three-quarters of the total at 256 funds and EUR5.31bn in assets. Malta’s fund assets peaked at EUR8.65bn at the end of December 2007 before slipping back as a result of the global financial and economic crisis, a decline from which the industry is now recovering.

O’Driscoll also expects the volume of assets for Malta-domiciled funds to grow in the near future. He says: “You have to consider the reduced number of funds globally that are launching with EUR100m or more, and the few that have such levels of assets tend to go to other centres. But for most managers, even those with well-known brand names, it’s difficult to raise assets in the marketplace.

“At the moment Malta appeals particularly to managers of smaller funds, but the focus is anyway more on the quality of the investment managers coming in than on the size of their assets under management. Already we’re starting to see asset volumes add up, and in two or three years’ time, when the market has turned, I expect to see rapid growth in asset size. It’s important that Malta starts building for that growth now.”

Gregory is more cautious. “The volume of assets is still relatively small,” he says, “perhaps smaller than some people might expect given the vigour of Malta’s marketing drive. But given the point at which we entered the market and our limitations in terms of size and geography, I think we’ve done a very good job.”

In the long term, Ghio believes, Malta is capable of challenging its established competitors for industry leadership. “Word of
Redomiciliation of funds into the EU

By Laragh Cassar

Malta’s rules on the redomiciliation of investment funds have contributed to its success story as an alternative fund domicile in the European Union. Coupled with a robust yet flexible regulatory framework and a highly skilled workforce, Malta can offer fund managers added value and synergies through increased efficiencies and returns.

Merit is also due to the Malta Financial Services Authority as it has lived up to its philosophy of offering a level of flexibility within firm regulatory principles, earning itself the title of a reputable authority while being sensitive to the particular requirements of applicants.

During a period when added returns have become an important consideration in the decision-making process, Malta offers lower compliance costs than other jurisdictions without undermining the high level of professionalism provided by the service providers available on the island.

As a result of the implementation of the Alternative Investment Fund Managers Directive, the redomiciliation of investment funds to Malta as an EU jurisdiction may also allow managers to benefit from the Europe-wide passport offered to professional investor funds. This will allow fund managers to establish a European base and promote their funds in all 27 member states of the union through the single authorisation requirement obtained from the MFSA.

With the surge of exchange-traded products in the funds industry, it is worth noting that Maltese funds may be listed on the Malta Stock Exchange as well as obtain access to listing on foreign exchanges. In fact, the Malta exchange has been recognised by the UK and a number of Malta-based companies have listed on the London Stock Exchange.

A redomiciliation of the fund to Malta would not affect the fund’s existing listing arrangements in other jurisdictions. Further efficiencies of redomiciling include efficient tax planning opportunities for the fund, its investors and its service providers, which are achieved by Malta’s established and efficient taxation framework as well as the extensive network of double-taxation treaties with around 58 countries.

The process of redomiciliation is available to funds (as well as service providers) in the form of corporate bodies and established in jurisdictions that permit the redomiciliation of their companies. The scope of the applicable laws regulating the redomiciliation of companies ensures continuity and a smooth transition from their original jurisdiction to their newly-acquired Maltese domicile.

This is reflected in the legal effects of redomiciliation under Maltese law, as this does not create a new legal entity nor does it affect the continuity of the company. The redomiciliation does not have any effect on the property of the company, its assets, liabilities and obligations, nor does it render defective any legal proceedings against the company. The applicable regulations also provide for the validity of share pledges made in the jurisdiction where the company was originally formed.

Fund managers and investors need not worry about the validity of existing contracts entered into with service providers, the registration of fund investors, or the ownership of the portfolio of assets belonging to the fund.

Continuity of the contracts entered into with a fund’s service providers is also facilitated by the fact that the MFSA currently does not require the service providers of non-retail funds to be established in Malta.
be kept on a handful of issues that could become problematic if they are not managed carefully. Perhaps least significant for the long term is a squabble between Valetta Fund Management and domestic investors left out of pocket when the La Valette Multi-Manager Property Fund was suspended in 2008 after its assets fell in value from a peak of EUR84m to EUR34m.

Some investors have claimed they were not informed of the risks of the fund, nor about fraud proceedings brought against directors of one of the underlying funds; that a number of privileged shareholders were allegedly informed of the fund’s difficulties, enabling them to redeem shortly before the suspension; and that a EUR0.75 per share buy-back offer from Bank of Valetta was inadequate. Nevertheless, the offer eventually won acceptances totalling 98 per cent of the fund’s capital.

"Disputes are something that happens as a domicile matures, but we have to be careful that such failures that do occur cannot in any way be attributable to a lack of regulation," Ghio comments. "You can’t regulate against all failures, but through the regulatory framework you can ensure that service providers offer adequate checks and balances against fraud. That is something that the MFSA continues to take very seriously."

There is also measured concern that as the Maltese fund industry grows, the regulator may find it harder to maintain its reputation for rapid and efficient licensing of funds. "It’s possible we could become victims of our own success," Ghio adds. "The MFSA can feel the strain sometimes when it has to service many applications at the same time. Currently one of our advantages is time to market, being able to get a structure licensed within weeks compared with a month in Luxembourg or Dublin.

"If bottlenecks start to grow, the MFSA will have to widen its pool of resources, which is not always easy to do quickly. You can’t just find new staff on the street, and nor can you leave new hires to their own resources. They have to be trained, and they need adequate supervision. This presents a challenge, but the MFSA has already increased headcount as its responsibilities and business coming to our shores have grown, and up to now it has coped quite well."
Malta’s efforts to put itself on the map as a fund domicile and servicing centre within the European Union have been an undoubted success. Although fund numbers and aggregate assets are still low by comparison with its main competitors within the EU, Luxembourg and Ireland, over the past three years the Mediterranean island nation has forced itself to the attention of managers and promoters examining whether investor attitudes and the new global regulatory environment make it advisable to base at least part of their fund range onshore in Europe.

Over the next few years, the authorities and industry practitioners hope, a sustained recovery in the global investment environment and increased awareness among investors of the benefits of alternative strategies will boost the size of the industry while Malta’s resources and skill base, coupled with significantly lower costs than its rivals, win a bigger slice of the growing pie.

An important factor will be the introduction in July 2013 of the EU’s Alternative Investment Fund Managers Directive, which will eventually oblige all managers seeking to market funds to sophisticated investors in Europe to comply with the continent’s regulatory system. This will include prescriptions regarding the responsibilities of
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Out of Africa into the European market

By Andrew Frankish

As South Africa’s leading alternative fund administrator, it was logical for the IDS Group to look to extend its services to Europe. The firm was examining the traditional options of Luxembourg and Dublin – when a meeting with Prof. Joe Bannister, head of the Malta Financial Services Authority, started the process that resulted in IDS setting up an office in Malta in the spring of 2010.

It’s not surprising that so many fund managers, promoters and service providers cite the welcoming and accommodating attitude of the MFSA as an important factor in the decision to establish funds in Malta. IDS found the regulator to be open and approachable, and the process of establishment and licensing was smooth and efficient.

More than a year later, the Maltese business has some USD250m in assets under administration, with new business coming less from pure start-ups than from established managers looking to create European-domiciled funds in parallel with their offshore vehicles. Many of these managers are testing out the European market, not only in terms of investor demand but the regulatory regime and the calibre of service providers, but in the longer term we and Malta look forward to attracting some of the big-name managers that will give the jurisdiction momentum to start building assets more rapidly.

The established strength of the IDS Group in South Africa, particular as a reputed administrator of funds investing throughout the African continent, has probably helped in attracting an important source of new business for the Maltese operation. Since 2010 the firm has been able to service the international funds of existing clients, including Cayman-domiciled vehicles, and this has been the biggest area of growth over the past year.

Managers see IDS as a specialist in handling the particular characteristics of Africa-focused funds and look to the group as a trusted partner when they decide to move into the European marketplace – although the political turbulence this year has temporarily put a brake on what had been growing interest in the North African region.

All the funds serviced by IDS in Malta and that are domiciled in the island are regulated under the Professional Investor Fund regime and follow classic hedge fund strategies, although there are also a number of private equity vehicles. In addition to Africa, we are seeing extensive interest from Middle East promoters targeting European markets, and the firm’s future marketing efforts will also focus on Switzerland and Liechtenstein, where awareness of the capability offered by Malta is growing.

There’s no doubt about the island’s advantages as a fund servicing centre, with its highly-educated, English-speaking workforce, extensive availability of accounting and legal skills, technological infrastructure and easy access to the main European business centres. All the building blocks are in place for Malta to grow into the major fund centre for the Mediterranean region, and this potential is increasingly translating into concrete business.

Getting Malta’s name established among managers and promoters throughout the world is a key element in this process, because the fund industry has traditionally exhibited a herd mentality, sticking to familiar service providers and jurisdictions. But the island’s cost-competitiveness is an important argument: it offers the same levels of qualifications and skills as Luxembourg and Dublin, but at a significantly lower cost. With the number of fund administrators growing, the industry as a whole has the expertise to compete on a global scale.
depositories and fund manager remuneration that industry members continue to regard as problematic, even though detailed implementation rules have not yet been finalised.

On one hand, the AIFM Directive could provide a significant boost to Malta, since EU-based managers and funds will gain earlier access to ‘passporting’ arrangements that will enable funds to be marketed (relatively) freely throughout the 27-nation union, and the island’s reputation for cost-competitiveness and flexibility should appeal to managers looking for a European base. But there are also fears that the directive’s uniform rules may iron out at least some of Malta’s current advantages.

The directive’s requirement on alternative funds to appoint a depositary responsible to a large degree for the safekeeping of assets also poses questions about Malta’s range of custodians, which remains limited enough to raise concern about the jurisdiction’s ability to deliver a full array of services in the AIFM Directive era – although the recent addition of Deutsche Bank as a depositary is a promising sign.

The relative shortage of custodians does not currently affect alternative funds set up under Malta’s Professional Investor Fund regime, but it is seen as a major reason why the island has not become more popular as a domicile for Ucits funds. This has probably cost it at least some business at a time when managers are rushing to target European investors by taking advantage of the more elastic rules on use of derivatives and leverage provided by the Ucits III Directive in 2002 to package alternative strategies within the Ucits framework.

In addition, some members of the industry worry that Malta’s cost advantage over its competitors could diminish. They point out that salaries and other expenses in the island’s fund sector are creeping upward, noting that Dublin went in a decade from a low-cost alternative to Luxembourg to an appreciably more expensive centre, although it’s hard to argue that rising costs braked Ireland’s growth to any significant degree.

A key priority for Malta is ensuring that the sector’s workforce remains capable of accommodating the growth expected in the coming years – itself an important factor in keeping costs under control – and the industry has undertaken various initiatives to strengthen links with the Maltese education system to help provide the skills firms will need in the future.

“The workforce is large compared with fund jurisdictions such as Cayman and Bermuda.”

Dermot Butler, Custom House Global Fund Services

in keeping costs under control – and the industry has undertaken various initiatives to strengthen links with the Maltese education system to help provide the skills firms will need in the future.

“Together with [promotional body] FinanceMalta, the Institute of Financial Service Practitioners has been in dialogue with the University of Malta for some time to remodel certain aspects of its courses, making them more practically oriented toward what the market needs,” says Dr Joseph Ghio, a partner with law firm Fenech & Fenech Advocates.

“Fund accounting was put on the university syllabus a few years ago, and now specialist elements are being introduced to that course. We have had a master’s degree in financial services for some 15 years, and it is now held by many of the professionals working in the industry. We are not only producing executives but also lower-level employees to complete the human resources package we need to do business.”

Malta may not be a very large country but its population of some 400,000 is not far off Luxembourg’s 500,000, notes Dermot Butler, chairman of Custom House Global Fund Services, although for obvious reasons it lacks the extensive pool of cross-border commuters available to the grand duchy in neighbouring areas of Belgium, France and Germany. “Still, the workforce is large compared with fund jurisdictions such as Cayman and Bermuda,” he says.

Butler is confident that the island’s labour pool is capable of sustaining significant expansion in fund services. “There may be a learning curve, and to begin with the legal profession may find itself under pressure, but it doesn’t take long for firms to gear up,” he says. “And since Malta is a member of the EU, there are no legal obstacles to importing trained people from other member states.”

Paul Mifsud, managing director of
Onshore shift draws international managers

By Anthony O'Driscoll

Apex Fund Services opened in Malta in June 2008 and the business has grown in tandem with the development of the jurisdiction as a European fund services hub. Malta’s attractiveness to international asset managers has increased particularly over the past two years with a shift in emphasis toward creating onshore funds that mirror alternative investment strategies previously mostly offered through vehicles domiciled in offshore jurisdictions such as the Cayman Islands and Bermuda.

While Malta is in competition with established European fund centres such as Luxembourg and Dublin, it has the great advantage of significantly lower costs. This has also been an important factor for managers in the wake of the global financial crisis and economic downturn, with investors more cautious about committing capital to alternative funds and cost-effectiveness issues becoming much more important than in the past.

Cost is an important factor in Malta’s emergence as a fund jurisdiction, but far from the only one. While initially it was particularly favoured by managers of smaller funds, often with between EUR5m and EUR10m in assets but sometimes EUR3m at the lower end, average fund sizes have grown larger as the island has increasingly appealed to larger alternative fund managers.

This is down in large part to the proactive attitude of the regulator, the Malta Financial Services Authority, which translates into a quicker and easier set-up and launch process than in other jurisdictions – important in a market environment where time to market is often crucial. If promoters have anti-money laundering checks and due diligence procedures in order, the process of becoming regulated and obtaining a licence can take as little as six to 12 weeks.

For now most fund business coming to Malta is from alternative managers, an across-the-board mix ranging from mainstream hedge fund strategies such as global macro to country- or region-specific investments covering Russia or Eastern Europe, as well as asset classes such as commodities. Most new vehicles are Professional Investor Funds, but more Ucits funds are likely to be established in Malta in the future as the jurisdiction attracts a wider choice of custodian banks.

The growth of Malta’s financial services sector has been assisted by the high standard of education and professional skills available on the island, boosted by the growing links between the industry and the University of Malta. Firms and individuals, including members of the fund sector, are helping to tailor the university’s range of banking and finance courses to the future staffing requirements of service providers.

In addition, the government has played its part by creating a special tax regime for expatriate employees in strategic industries, including the financial sector. The aim is to attract talent from abroad at senior levels who over time will pass on their experience to home-grown high-flyers. This strategy also targets moving beyond fund administration and other services to the eventual nurturing of an investment management community in Malta. The authorities’ long-term strategy is also bolstered by a growing network of double taxation treaties that aid the competitiveness of Malta-domiciled funds.

Unlike other island fund jurisdictions, Malta not only has a bigger population but has more flexibility in areas such as the housing market to accommodate expatriates. It also helps that it offers a high quality of life, including its Mediterranean climate, a good education system, a high-calibre telecommunications infrastructure and good air transport links to the UK and other financial centres around Europe.
Can Malta carve out a Middle East niche?

The political upheavals in North Africa in the first half of 2011, including the destructive civil war in Libya, have disrupted efforts to develop fund investment in the region, but over the long term industry members believe that Malta’s longstanding links with its Mediterranean neighbours can help it carve out a specialist niche as a centre both for investment in the region and for the establishment of funds by promoters based throughout the Middle East.

“We have seen more interest from the Middle East, particularly in Ucits but also in the alternatives space, since the financial crisis,” says Fenech & Fenech partner Dr Joseph Ghio. “Malta has historic cultural links with North Africa and the Middle East, and some people there now see our country as an oasis of stability. What is happening in Libya has shown a light on Malta’s strategic position, not only geographically but as a gateway to Europe for fund promoters from the Middle East wanting to establish a presence in the EU.

“They know there is a huge market in Europe and that Ucits is the most recognised investment brand worldwide. More than 40 per cent of Ucits sales are now outside the EU, and Asian countries are trying to emulate the Ucits model. But Ucits funds are not the only route because they will never be able to accommodate all investment strategies. Some managers want flexibility for hedge funds strategies that Ucits cannot provide.”

According to Apex Fund Services managing director Anthony O’Driscoll, relationships with the Middle East and North Africa may not yet be resulting in a great deal of concrete business but it is likely to grow in the long term. “Efforts are underway to build a Shariah-compliant fund structure here, something we should benefit from over time,” he says.

Dermot Butler of administrator Custom House believes that instability and conflict in the Middle East, which has already damaged Beirut’s position as an Arab financial capital and could affect Bahrain’s role in the Gulf, could play in Malta’s favour. “A lot of investors today wouldn’t consider investing in the Middle East and North Africa because of these upheavals, which could well continue for a decade or even a generation.

“Take Lebanon – it may now be at peace and more people are investing there, but they are doing so through external vehicles. Very few people are brave enough to invest directly into Lebanon. I can see people investing through vehicles set up in Malta for North Africa, and maybe for other parts of the Middle East. There could be competition from other centres such as Singapore, but Malta has thrived on competition for years.”

The South African background of the IDS Group has already brought its Maltese operation business from managers investing in other regions of the continent, according to Andrew Frankish. “We are getting quite a few African-focused funds, although some launches have been postponed because of the uncertainty in North Africa,” he says. “We had one fund licensed in January that was ready to invest in Egypt when the Cairo Stock Exchange closed down.”

Sparkasse Bank Malta, says that in general the core skills required by fund administrators, custodians, accountancy firms and law practices are readily available, although specialists in areas such as asset management, which the authorities have targeted for future growth, are thinner on the ground. “We suffer in terms of the most specialised function, for example experienced traders and risk analysts, but we are well provided for entry-level positions,” he says.

Encouraging highly-skilled expatriates to bring their talents to the country is crucial if it is to expand the share of higher added value services within its financial industry, according to George Gregory, a partner and head of tax and corporate services at professional services firm RSM Malta, which has carved out a substantial area of expertise among fund management companies domiciled in the island. “The fund managers established here face a major issue in finding resources,” he says.

However, Gregory believes that the government’s scheme to offer a special tax regime for expatriates in the financial industry, first announced in November 2009 and implemented earlier this year, will help to remedy this deficiency. “For up to five years, expatriates in certain positions at the top end of the industry will be charged a flat 15 per cent tax rate starting from salaries of EUR75,000, and anything above EUR5m will be tax-free. This should help to expand the industry and transfer expertise to local people.”

The potential appeal of Malta to fund management companies has already increased following the implementation in July of the Ucits IV Directive, which provides a legal framework allowing fund firms...
the uncertainty. Says Ghio: “Since the directive was first proposed, firms that were considering setting up funds within the EU or redomiciling existing ones there have been sitting on the fence because of uncertainty about the treatment of non-EU jurisdictions. They adopted a wait-and-see approach: will it be approved, will it be shelved?

“To some extent that caused a lull in activity, although in fact last year was one of the most active yet in terms of the licensing of new hedge funds here. But the delay in approving the directive [it formally became law on July 21] has given time for Malta to get more firmly on the map as an alternative to existing jurisdictions.”

Ghio argues that the benefits of Malta’s decade of experience will not be lost under the AIFM Directive. “All member states will be on the same starting line, but we have the advantage of having been in the hedge fund business since the late 1990s, when the first legislation was introduced in Malta regulating collective investment schemes for professional investors, and we have generated the critical mass to be credible as a jurisdiction,” he says.

But some industry members are less certain about how much Malta will benefit from the creation of a level playing field across Europe, arguing that the advantages the island has derived from its regulatory regime may no longer apply – although its cost structure and English-speaking workforce will still help it to compete.

Smaller countries have long exploited their small size and fast decision-making processes to create a favourable tax environment for the fund industry, which explains why Ireland, Luxembourg and Malta have benefited most, while other would-be domiciles such as the UK have struggled to get their regulatory and tax regimes pulling in the same direction. But the flexibility of Malta’s regime for non-retail funds may not stand out so far from other jurisdictions once the directive comes into force.

The other concern is that with so much responsibility and potential liability being shifted to the fund’s depositary under the directive, fewer institutions may wish to participate in the market. This could complicate Malta’s efforts to attract more custodians.
Malta’s appeal as a European financial services jurisdiction has been demonstrated over the past few years not only by choice of the island as a fund domicile but also by the number of fund management companies set up in the jurisdiction providing services to both locally-established and foreign funds. That trend can only be further encouraged by Malta’s new tax regime, unveiled earlier this year, aimed at highly qualified expatriates.

The new regime, applicable to income earned from the beginning of 2010, introduces a 15 per cent flat tax rate on employment income derived in Malta by individuals in the financial services sector that are not ordinarily resident or domiciled in the country. The minimum qualifying annual income is EUR75,000 (excluding fringe benefits), implying a minimum tax payable of EUR11,250, and the 15 per cent rate applies up to EUR5m, above which income is tax-free.

Individuals covered by the regime are not eligible for any tax relief, deduction, credit or set-off. The benefit is limited in time, applicable for the first five years of residence in Malta for European Economic Area and Swiss nationals, and four years for nationals of other countries.

Qualifying individuals must have an employment contract with a company licensed or recognised by the Malta Financial Services Authority for a specified high-level position: chief executive, chief risk officer, chief financial officer, chief operations officer or chief technology officer; portfolio manager, chief investment officer, trader/senior trader, senior analyst, actuarial professional, chief underwriting officer or chief insurance technical officer; head of marketing or of investor relations.

They must receive income from duties carried out in Malta, any related activity outside the country or leave. They must be protected as an employee under Maltese law, demonstrate expertise and qualifications, and the performance of duties relating to a qualifying position, to the satisfaction of the MFSA. They must not benefit from tax exemptions on certain fringe benefits, and must make full disclosure of qualifying income for tax purposes. Individuals must demonstrate their and their families’ ability to support themselves without social assistance, live in appropriate accommodation and have suitable health insurance for themselves and their families.

Anti-abuse provisions are designed to prevent the use of artificial arrangements to qualify for the 15 per cent rate. Anyone claiming the rate when not entitled to it faces repayment of the benefit they had received, plus an additional tax of 7 per cent per month in question unless they can demonstrate good faith.

The new tax regime is poised to increase the appeal of Malta as a domicile for fund management companies and other financial service providers by making it easier for the country to attract the highly skilled and experienced professionals required to win and handle international business and to share their expertise with other industry members.
At Sparkasse Bank, one of the established custodians, Mifsud is less alarmist about the implications of the directive (and of Ucits V, the mooted next iteration of the retail fund regime, which is likely to set similar levels of responsibility for depositaries), but he acknowledges that greater vigilance will be required. "There are many grey areas with the depositary function," he says. "In some areas the directive is fairly vague."

"We understand that the legislator is trying to protect investors, but it is naïve simply to throw all the liability onto depositaries without recognising that they have to work with a range of other service providers including global custodians, sub-custodians and prime brokers."

"We will probably have to increase fees, because the monitoring role of the custodian will in the future have to cover the sub-custodian as well as the asset manager. But the legislators and regulators responsible for finalising the legislation in detail should drill down into what safekeeping really means and what a custodian is and is not allowed to do. Some of the matters are being addressed in Esma’s consultation papers, but I believe there are still some grey areas."

Greater clarity will probably be required if Malta is to attract more institutions, especially big global names, to its custody sector, yet industry professionals say that without a bigger choice of depositaries, the island’s ability to compete effectively for Ucits business will remain hobbled and its appeal to international fund managers once the AIFM Directive regime takes effect will be compromised.

"Custodians have been trickling in, but there is room for plenty more," says Katya Tua, head of investment services at Simon Tortell & Associates. "That is something we have been pushing for especially because of the need for Ucits to have a local custodian. It would increase the competitiveness of the jurisdiction to have more service providers, especially custodians that are well-recognised global names."

The line-up currently includes HSBC, local institution Bank of Valetta and Sparkasse Bank, part of the Austrian savings bank group. Anthony O’Driscoll, managing director of Apex Fund Services Malta, adds: "Not having the custodian infrastructure limits the growth of the Ucits market. The arrival of Deutsche has added to Malta’s competitiveness, but we need a few more players to increase the options available to investment managers."

"The island is less appealing for Ucits funds if managers’ choice is limited to a couple of custodians. They want to know that if the relationship with a one custodian doesn’t work, there are other possibilities in the marketplace. That’s not the case in Malta at present, which is why the sector isn’t growing as fast it could be. Given the current popularity of Ucits, they should be growing much quicker in Malta."

However, Mifsud is not convinced that lack of choice is solely responsible for the slow growth of the Ucits sector. "We will see..."
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Gregory also sees costs rising, albeit slowly, and he also believes that Malta may find greater competition from centres such as Dublin, where a seemingly inexorable cost spiral has been abruptly halted by the financial crisis. “We should be careful about how we advertise ourselves as a low-cost jurisdiction because salaries and other costs are increasing, and you have to throw in the extra cost of travel,” he says.

“In the past service providers in Ireland were probably more reluctant to take on smaller funds, and countries like Malta benefited from that. But now Ireland will take whatever it can, and it is a bigger threat.”

Andrew Frankish, a director of IDS Fund Services Malta, also reports that interest in Malta-domiciled Ucits is growing, but he does not expect them to exceed PIFs in popularity any time soon. “Only a handful of the funds registered last year were Ucits,” he says. “This year we will probably see more, but it’s won’t be anywhere near the PIF regime. The latter is where Malta is really competitive, even with Ucits IV provisions such as management passporting and mergers.”

The other big area of concern for industry members is cost – right now a big plus for the jurisdiction, but one that it would hurt to lose. According to Ghio, some erosion of Malta’s advantage is inevitable. “The more successful we are in attracting fund business, the more likely it is that costs will rise as people move around and are poached by other firms,” he says. “That would simply reflect our success, as it does with Luxembourg and Dublin today. However, we have to be careful not to increase our cost base too quickly. Some things we can’t control, but others we can. I would be very concerned if legal and other