Malta Hedge Fund Services 2012

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Exceptional Growth for Malta’s Fund Industry

The number of collective investment schemes increased from 200 in 2006 to 525 in December 2011.

This success was made possible by Malta’s highly favourable business environment. This includes the role played by the island’s Single Regulator, renowned throughout the industry for its flexibility coupled with meticulous attention to detail.

The island’s highly competitive, cost-effective business environment and the presence of all the Big Four accounting firms adds even further advantage.

An onshore EU jurisdiction allowing passporting and redomiciliation of funds, with an efficient fiscal regime, a balmy Mediterranean climate and a multilingual, ethical and professional workforce, Malta offers a winning combination of advantages specifically designed to foster further growth and maximise success.

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Global fund industry drawn to Malta’s proven qualities

By Kenneth Farrugia

Malta’s fund industry is increasingly making the headlines in the financial media, which have highlighted the island’s attractiveness as a domicile. Journalists and finance analysts progressively see Malta as a complementary EU jurisdiction to traditional fund domiciles, where regulatory environment supports innovative strategies and solutions.

According to the country’s financial regulator, the Malta Financial Services Authority (MFSA), the number of Maltese-based funds has grown from around 130 in 2004 to more than 550 at the beginning of this year, with EUR8.3bn in assets under management. Much of this growth has taken place since the island joined the European Union. In 2011 alone, the country added more than 100 new registrations from fund managers primarily using the island to tap into EU markets.

But it is not only EU membership that gives Malta the edge over other fund domiciles. It also offers easy market access to non-EU countries through various tax treaties and other bilateral agreements, while the island’s geographic location makes it a convenient gateway for European and international financial services firms targeting North Africa and the Middle East.

Malta offers a number of fund options, including alternative funds under the Professional Investor Fund (PIF) regime, and UCITS (Undertakings for Collective Investment in Transferable Securities). Hedge, private equity and property funds are usually set up as PIFs, which make up three-quarters of all Malta-based funds.

Free from investment restrictions and targeted at financially-literate high net worth investors, PIFs can invest in a variety of assets, from financial securities and instruments to real estate. However, to protect the country’s reputation as a quality fund domicile, the MFSA has repeatedly refused to license funds focused on exotic investments, such as racehorses. Malta’s Investment Services Act provides for three categories of PIFs with different eligibility criteria for investors, based on their experience and knowledge.

Under the assumption that investors are familiar with strategies and markets and aware of risks, PIFs are not regulated as tightly as UCITS and other non-UCITS retail funds. UCITS currently play a relatively minor role in Malta’s fund sector with some 60 schemes currently registered, but their number is gradually increasing.

Full range of structures

PIFs or UCITS can be formed in a number of possible vehicles, including open-ended and closed-ended corporate entities, trusts, limited partnerships and contractual funds. The investment company with variable share capital (SICAV) is currently the most widely-used vehicle in Malta, especially by PIFs, and it can be structured to include master-feeder funds and umbrella funds with segregated sub-funds.

In 2011 the MFSA enacted new regulations making it possible for a fund to be constituted as an incorporated cell in an Incorporated Cell Company (ICC). While under the SICAV Regulations a fund and its segregated sub-funds form a single legal entity and the sub-fund has no separate identity, each incorporated cell is a limited liability company endowed with its own legal personality.

As a relatively new concept, the ICC regime is still under development, and in November 2011 the MFSA announced that it was considering extending it into a platform concept that would involve a Recognised Incorporated Cell Company (RICC) providing administrative services to any number of incorporated cells licensed as collective investment schemes.
INTRODUCTION

Malta’s legislation also scores highly in other areas, especially the appointment of service providers. Service providers to PIFs may be based in any jurisdiction in the world that is recognised by the MFSA, a non-protectionist approach that gives promoters the flexibility to work with institutions with which they have already established a business relationship.

However, a large number of funds choose to work with local service providers, especially in the field of fund administration. More than 70 per cent of Malta-domiciled funds have a Maltese administrator, a clear testament to the high quality of service offers by local providers.

Another competitive advantage for the island is that PIFs and UCITS can be set up with a self-managed structure as an alternative to external management, subject to the appointment of an investment committee. Around 10 per cent of Maltese funds follow this model, with 40 per cent managed from Malta and almost 50 per cent managed from outside the country.

Cluster of global leaders
Promoters looking for a local service provider are spoiled for choice. In tandem with the growing number of funds, more and more service providers have set up operations in Malta in recent years. Similar to the licensing process for collective investment schemes, managers, investment advisors, custodians and prime brokers establishing operations in Malta need to apply for a licence under the Investment Services Act, while firms intending to provide purely administrative services must apply to the MFSA for a recognition certificate.

Around 70 fund managers are currently operating in Malta, including Liongate Capital Management, Clive Capital, Comac Capital, and BlueGold Investments, while 24 fund administrators such as Valletta Fund Services, HSBC, Apex, Custom House, Praxis, TMF and Valletta Fund Services have been recognised by the MFSA. Six global custody providers have a presence in Malta, including HSBC.

Malta has the capacity and expertise to help the fund industry continue to expand, with the ‘Big Four’ accounting firms all established on the island, adding weight to the small and medium-sized accountancy firms and large number of law firms servicing the fund sector. Having developed a versatile industry cluster, Malta is keen to attract further service providers – particularly custodians – to increase its share of UCITS business.

Interest in Malta is also set to grow as the implementation of the EU’s Alternative Investment Fund Managers Directive in July 2013 draws closer. Many offshore fund managers are currently assessing whether it might be more cost-effective to establish a permanent base in the EU.

With its generally lower cost structure and a track record in the management of alternative funds, Malta offers an attractive base for alternative managers in this new environment. The first firms to have relocated include managers from traditional offshore centres such as the Cayman Islands and the British Virgin Islands.

Increasing competitive edge
Effective oversight and a highly personalised approach have helped Malta to establish itself as a fund domicile of international repute. In the coming years, the industry expects a further boost when the full impact of regulatory developments such as the AIFM Directive will become apparent.

The island has already seen a significant inward migration of funds and service providers. Funds from other jurisdictions can easily be transferred to Malta, where the fund undertakes the licensing process with the MFSA concurrently with the corporate redomiciliation procedure. Maltese legislation allows redomiciliation from all EU, EEA and OECD countries as well as from most offshore centres.

Malta has already proved it is well suited as a base for fund operations, serving not only domestic clients but also European and international markets. With low costs, efficient regulation, beneficial tax treatment and a flexible and accessible regulator, the island is an attractive domicile for both funds and managers. Competition may be increasing in the fund industry, including between jurisdictions, but as long as Malta maintains its competitive advantages, it is well placed to capture an even bigger share of the world’s fund business.

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Collective Investment Schemes: Tax implications

By Laragh Cassar, Partner, Camilleri Preziosi

Collective Investment Schemes
Collective Investment Schemes (CIS) offer various benefits and enable participants to pool in their investments under the principle of risk spreading. Furthermore, CIS enable the individual investor to benefit from investment opportunities which are generally not viable or available to them, due to cost, regulatory and licensing restrictions. The number of CIS licensed in Malta has grown significantly over the past decade and, due to various factors (including a favourable fiscal regime), is continuing to increase at a steady rate. CIS generally take the form of investment companies with variable share capital or limited liability partnerships. Other vehicles that are also used include common contractual funds and units trusts.

The beneficial fiscal regime
The taxation of a CIS depends on whether the CIS and its sub-funds are each classified as a prescribed fund or a non-prescribed fund. A prescribed fund is defined as a fund of a Malta-based scheme where its assets situated in Malta are equal to at least 85% of its total assets. A non-prescribed fund is a fund which is not a prescribed fund.

Generally, the income of prescribed and non-prescribed CIS is exempt from tax in Malta, unless the income is derived from immovable property situated in Malta. Investment income received by a prescribed fund is subject to a withholding tax of either 15% (if such income is domestic bank interest) or 10% (with respect to any other investment income, including certain interest, premium or discounts received, certain profits distributed by a foreign CIS).

Investors participating in a CIS
Any distribution to any person, whether resident in Malta or otherwise, is not subject to further tax in Malta. However, certain distributions made to a resident person (whether directly or indirectly as beneficial owner of such income) would generally be subject to withholding tax at the rate of 15%.

Capital Gains for non-residents
Capital Gains derived by a non-resident person from the transfer of units in any fund are exempt from tax in Malta whilst a transfer of units in a CIS by a resident person is generally subject to tax, subject to certain exemptions.

Switching of funds
Should an investor switch any units from one sub-fund to another sub-fund within the same CIS, no gain or loss is deemed to arise for income tax purposes and therefore no tax will be charged. However, upon disposal of the final securities, tax will be charged on any capital gains. Conversely, if such disposal relates to a disposal of units held in a non-prescribed fund, the capital gains may be calculated by deducting the original cost of acquisition from the proceeds derived on disposal, provided that no units were switched from a prescribed fund. On any other disposal of final securities, any chargeable gains or losses arising throughout the switches of units are aggregated when calculating the capital gain or loss.

Securities may also be switched from a sub-fund of a CIS to a sub-fund of another CIS. However for such a transaction to qualify as a switch and benefit from the above treatment, various conditions are satisfied. For instance, the latter sub-fund must have investment objectives, which are identical to those of the first-mentioned sub-fund.

Value Added Tax (VAT)
Activities involving the management of a CIS are exempt from VAT. Furthermore, a CIS is not required to be registered for VAT purposes.
Malta’s expertise attracts managers as AIFMD looms

By Simon Gray

As though a mediocre investment climate and a difficult environment for fundraising weren’t enough to deal with, the alternative fund industry in Europe is now facing up to the home straight of implementation of the European Union’s Alternative Investment Fund Managers Directive, which is due to take effect as of July 22 next year. But while many professionals may see the legislation as a threat, or at least a distraction for urgent investment and operational issues, Malta and its fund service providers tend to see it more as an opportunity.

No-one can yet be absolutely sure how the directive is going to impact their business because it is still shrouded in uncertainty. The final wording of the directive itself may have been signed off by the EU institutions last year, but the so-called Level 2 measures - the directly applicable regulation from the European Commission setting out the detail of how the legislation is to be implemented in practice - are not only running later than expected but may differ in significant ways from the advice the Commission was given last year by the European Securities and Markets Authority.

Nowhere is the uncertainty more alarming than among investment managers or funds based outside the EU, who have in theory been offered a route to obtain authorisation and the same cross-border marketing passport as their European-based counterparts, but not before July 2015, and only subject to subsequent decisions by the EU institutions that are by no means guaranteed.

It’s an ill wind that blows nobody any good, and industry professionals in Malta say the Mediterranean island could be a major beneficiary of the desire by managers abroad to ensure they retain access to the European market once the AIFM Directive is in force. The jurisdiction may have a valuable
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advantage over rival EU fund centres Luxembourg and Dublin in its significantly lower cost structure, a more important consideration when fundraising is slow and managers may be starting out with a relatively small pool of assets.

At first sight Malta’s fund industry does not seem to represent much of a threat to its bigger European rivals. At the end of June the Malta Financial Services Authority reported a total of 439 funds and sub-funds in locally-domiciled collective investment schemes with EUR10.33bn in assets under management, including 348 Professional Investor Funds (including sub-funds), the regulatory structure used by the alternative investment industry, with assets of EUR7.15bn. By contrast, at the same time Luxembourg was home to 3,867 funds (13,407 separate portfolios including sub-funds) with EUR2.22trn in assets, including 1,445 Specialised Investment Funds with assets of EUR259.17bn).

But these numbers do not necessarily tell the whole story. For one thing, the MFSA’s figures do not include funds and assets domiciled in the Cayman Islands or other traditional offshore fund domiciles but managed and/or administered by Maltese firms. For another, the island’s fund industry has grown extremely rapidly over the past few years despite a highly inhospitable global economic climate. At the end of 2006, just before the dawn of the financial crisis, Malta had just 153 funds with EUR2.09bn in assets, including 78 PIFs with EUR1.28bn.

The island has not been immune to the impact of the financial firestorms racing around the world in recent years, but by any standards it has performed impressively, capitalising on developments including the wave of spin-off fund management firms established in recent years under the impact of regulatory shifts such as the Volcker Rule, the increased preference of investors for fund vehicles established in regulated onshore European jurisdictions, and the growing appeal of once-exotic investment specialities such as Shariah funds.

By and large it has escaped blow-ups, bar the 2008 collapse of the La Valette Multi-Manager Property Fund, which resulted in a long-running row between disgruntled investors, the regulator and the fund’s manager, Bank of Valetta, which still continues. On September 5 the international accounting firm Mazars was appointed by the MFSA to examine investor files for evidence of mis-selling. However, the case has not affected international perceptions of Malta because the investors were overwhelmingly domestic.

So far the growth in domiciled funds has been driven mostly by smaller vehicles. “The typical size of fund launches we are seeing ranges from smaller launches with assets of between EUR10m and EUR20m, which constitute perhaps around 40 per cent of the Maltese fund market, to a handful of launches above the EUR500m mark, but these are only between 2 and 3 per cent of the total,” says Dr André Zerafa, a partner with law firm Ganado & Associates.

“So far Malta, with these few exceptions, has failed to attract big fund platforms. That is our next challenge now that Malta is on the map as a fund domicile of choice in the same way as Luxembourg or Ireland.”

Dr André Zerafa, Ganado & Associates

“Higher-profile clients are starting to come in. Whereas previously business was largely dominated by middle-tier funds that needed a favourable environment, the bigger players are now considering Malta as it becomes better known and more popular.”

Laragh Cassar, Camilleri Preziosi
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Mediterranean Bank is a relatively new banking institution. Now, having focused on building out its infrastructure to meet its own business needs, the bank is looking to leverage this to support smaller funds domiciled in Malta.

As a local custodian, the bank is well placed to service funds that will be required to register with the AIFM Directive, and despite catering mainly to savers, Med Bank is already carving out a niche in capital markets. As Ximo Vicent, Head of Credit & Investments, confirms: "Our infrastructure is able to support both retail and institutional clients looking to access these markets."

One of the biggest developments that the bank has been involved in is the establishment of ‘segregated segregated accounts’, in partnership with Clearstream, the clearing and settlement division of Deutsche Borse.

As Vicent explains: “These are segregated accounts, as is typical of all custodians, but most importantly they’re not omnibus accounts where the client is commingled with everybody else. Even a client with a small account – say EUR2 million – can have their own segregated account where they can see their own assets in their own account in Clearstream.”

Crucially, by working directly with the ultimate custodian – Clearstream – and cutting out the global custodian middleman, Med Bank is able to save on intermediary fees. This allows it to provide a lean service to small funds and as Vicent says: “Being a fairly new entrant we can provide direct segregated accounts to these clients in Clearstream, which may not necessarily be offered by other custodians, most of whom typically only consider accounts of over EUR100 million.”

This is an important development in light of the recent Lehman Brothers and MF Global incidents where clients thought their assets were being fully segregated, but in fact weren’t. All a client has to do is log on to Clearstream’s system and hey presto, they have peace of mind that their assets are being clearly segregated.

“We put ourselves in the shoes of potential clients and said ‘What would we like to see? If I can see my assets in Clearstream I don’t need to take anyone’s word for it’,” states Vicent.

The partnership with Clearstream only commenced this summer. Nevertheless, the bank is already working with a number of clients to get them signed up, focusing on those to whom Med Bank knows it can provide the right value.

Such a solution fits well with the new regulatory paradigm evolving in Europe but having a robust custodian is only part of the equation for hedge fund managers; they will also require expertise and support in areas such as leverage, access to derivatives products, which are typical of the prime brokerage domain, but which remain thin on the ground in Malta.

Aware of this, Vicent says that over the next few years “we think there is going to be a need for more prime brokerage services on the island, which we are well positioned to provide. Capital markets are part of what we do on a daily basis, so we can provide that access to the markets and things like leverage to our clients.”

There are, no doubt, added pressures and costs on custodians and banks in terms of how they operate under the Directive. Rather than get carried away, Vicent says that the bank will take its time developing its prime brokerage services, remaining vigilant on costs: “We hope to start offering execution capabilities in the coming months, and some additional capabilities shortly thereafter. We’re only interested in ever offering the right product in the right format. We want to develop these additional services in the right manner.”
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In order to get a regulatory license, an asset management company must guarantee a fit and proper organisation. Most recognised jurisdictions have set similar standards, including (i) a level of independence between shareholders and board members; (ii) a level of ‘chinese wall’ between operations, risk management and compliance; (iii) dual control and four eyes principles; (iv) good monitoring of conflict of interests. The Malta Financial Service Authority (‘MFSA’) controls the issuing of licenses and supervising asset managers and advisors operating in or from Malta. While the 1994 Investment Service Act sets core legal conditions required to get a license, the MFSA has also implemented specific requirements which are not necessarily available in writing, summarised below:

**Shareholders:** An asset management company cannot be established as a single member company and thus must have at least two founding shareholders at all times.

**Directors:** The MFSA stresses the principle of ‘Dual Control’ and the ‘Four Eyes Principle’, thus requiring a minimum of two directors. In order to establish and maintain jurisdiction in Malta, at least one of the directors must be a Maltese resident.

**Investment committee members:** A minimum of three investment committee members are to be appointed yet not necessarily as employees of the entity. At least one member must be a local resident. The investment committee must meet physically in Malta at least once every quarter. Where the entity prefers not to employ a local IC member before the license is issued, the MFSA allows that the Business Plan be submitted containing a detailed description of the position to be held by a local person. Once the license is granted, the founders may start looking for a proper employee and present their credentials to the MFSA for review and approval.

**Business conduct and risk management requirement:** A Code of Business Conduct and a Risk Management Policy must be established and maintained. Proper documentation must be available and be aligned to the manager’s activity. The MFSA reviews in detail the risk management policy. Exemption: A request may be made to the MFSA to be exempt from having an independent risk management function on the basis that it is not proportionate in view of the nature, volume and complexity of the business, and the range of investment services and activities undertaken by the management company.

**Internal audit function:** An internal audit function independent from the other responsibilities of the asset manager is to be established. Exemption: Derogation may be requested where the nature, scale and transaction volumes of the entity justify it.

**Minimum number of employee required:** If all exemptions are granted, a start-up manager may start with one employee only.

**Due diligence process:** This is a crucial stage in the licensing process whereby the MFSA, following an assessment of all the documentation provided, determines whether a person is fit and proper. This requisite is to be fulfilled by every qualifying shareholder (i.e. direct or indirect holder of ten percent or more of the capital or voting rights of the entity); director, IC members and any other person proposed to hold a key position within the applicant entity.

**Business plan:** The MFSA necessitates a detailed Business Plan of the asset management company’s business, contemplated scope of activities, future goals and the manner in which these goals will be achieved, three years of forward-looking financial statements, and any other relevant details.

With a well-prepared application, an in-principle approval should be expected within three months of submission.
reputation, because they have been around for a lot longer, but we are fast catching up.”

Laragh Cassar, a partner with law firm Camilleri Preziosi, believes that a change in the jurisdiction’s stature and the background of its fund clientele is already underway. “Higher-profile clients are starting to come in,” she says. “Whereas previously business was largely dominated by middle-tier funds that needed a favourable environment, the bigger players are now considering Malta as it becomes better known and more popular.”

Cassar says some of the newcomers are funds groups that are establishing Maltese investment vehicles alongside existing offshore funds in order to ensure continued access to the European market under the AIFM Directive, or that have previously focused on markets such as North America or Asia but are now are seeking to attract European capital as well. “They know that they need an EU domicile to gain access to the market here, but with the passport mechanism, they see the directive not so much as a threat as an opportunity,” she says.

The cost of doing business in Malta is a significant benefit for smaller and start-up managers; some industry members put total set-up costs, including regulatory fees, at between one-third and half the level in Luxembourg. Fears that costs might rise as the industry grows, a problem for Dublin in the early 2000s, have so far proved needless. However, Zerafa argues that in any case this is no longer as substantial a driver for the choice of a Maltese domicile as it may have been in the past.

“American managers are watching developments very closely, but they feel they still don’t have all the information they need about the AIFM directive to take decisions.”

Joseph Ghio, Fenech & Fenech

“Costs are still important, but they have gone down the list of priorities for the typical fund promoter,” he says. “Today they are looking at the capability of service providers in Malta, the capacity of the industry here, and an approachable regulator. Time to market may not be as fast as in the Cayman Islands, where funds are not regulated in the same way that they are in EU member states, but it is still reasonable at around 10 weeks to launch. All these factors have militated in favour of Malta.”

At this point, most industry members are reluctant to hazard a guess about the extent to which these advantages may be compromised by the AIFM Directive. However, the authorities are determined that the island will be ready for the July 2013 implementation deadline – even if, as is increasingly conjectured, a significant proportion of the EU membership will not.

At the beginning of September the MFSA published a consultation paper outlining its plans for transposing the directive into national law. Says Zerafa: “There will be a revamp of Malta’s main funds law, the Investment Services Act, but the bulk of the obligations stemming from the directive will be implemented through rules and regulations. This would give the MFSA the flexibility to adapt the rules according to what comes out of the Level II measures, rather than having to go back each time to change the main law through an act of parliament.”

Says Cassar: “We currently have a very concise rulebook regarding non-retail funds, which will have to be substantially changed in the light of the directive. For example, right now there is no differentiation between a passportable non-retail fund that would fall within the scope of the directive and one that would not. They will need to distinguish
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industry professionals acknowledge that some fund managers are uneasy at having a relatively limited choice, and that this issue is one factor in Malta’s more sedate growth in the UCITS market.

The authorities have made attracting more custodians a priority; two well-known – but still anonymous – industry names are reported to be in the pipeline. In the meantime, Malta plans to use its option to exercise a derogation to the local custody requirement until 2017, by which time it is possible that progress on the vexed issue of an EU passport for depositaries could render the question moot.

“I’m not aware of new players coming into the market as yet, but Malta is certainly actively trying to attract larger custodians,” says Paul Mifsud, managing director of Sparkasse Bank Malta, the subsidiary of an Austrian savings bank that has carved out a significant custody market share.

However, he believes it may be difficult to attract global players while new business in Malta remains dominated by small and start-up fund businesses. “Larger custodians normally require larger business, and they normally charge fairly elevated minimum fees,” Mifsud says. “I don’t see the market being ready for that, because some of managers coming here are relatively small. A big custodian would start off by asking for EUR25,000 or EUR30,000 as a minimum annual fee.”

His view is shared by Ximo Vicent, head of credit and investments at Mediterranean Bank, which was established in 2005 and is now owned by UK private equity firm Anacap Financial Partners. “Many players here in Malta are focused on bigger funds, but we offer a cost-efficient custody solution designed for small funds,” he says.
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Malta and corporate governance

By Roger Buckley

As an emerging funds jurisdiction Malta is in a strong and perhaps enviable position to mould its future as a domicile and fund administration centre with enhanced corporate governance standards. Together with compliance and risk management, decent corporate governance is a crucial pillar of fundamental importance in the investment funds industry. Moreover, shortcomings in corporate governance have been a main contributor to the majority of the recent high profile international fund scandals. The appointment of independent non-executive directors and an independent administrator strengthens and improves governance, which is of paramount importance to the integrity of an investment fund and maintenance of investor confidence.

To date, the Malta Financial Services Authority (“MFSA”) has adopted a cautious hands-on approach to the establishment and authorisation process for both funds and regulated service providers. Face-to-face meetings with potential new entrants is encouraged, this fulfils a dual role for the MFSA of safely gatekeeping the industry and welcoming new business. So far, the MFSA has avoided any stringent specific rules or guidelines on corporate governance, such as directorship limitations or service provider requirements, thereby allowing a great deal of flexibility in the structuring of new funds.

For funds that choose to domicile in Malta, with the exception of certain circumstances there are no local resident director or local service provider requirements. When this is the case, the minimum requirement of a fund is the appointment of a “local representative”. This light-touch approach has fared well in attracting funds to Malta, particularly in the small to medium size range. However, the continued long term success of Malta as a jurisdiction will rest with a quality over quantity approach.

Accordingly, change may be on the horizon and having now established Malta as a jurisdiction of merit, the MFSA has signalled that it’s exploring ways to further enhance corporate governance, which ultimately should lead to increased transparency and market confidence.

Many other fund jurisdictions have already established regulations and best practice guidelines in corporate governance, especially in relation to the appointment of independent service providers and non-executive directors. For example, all Irish investment funds are required by law to appoint an independent Irish based fund administrator and more recently the Irish Funds Industry Association (“IFIA”) under the supervision of the Irish Central bank, introduced a voluntary “corporate governance code” for funds. Similarly Luxembourg has established a “conduct for investment funds” and Jersey a “fund governance regime”.

Castlegate Fund Services Ltd. ("Castlegate") specialises in fund administration and the provision of independent directors for funds domiciled in Malta and elsewhere. Industry leading fund administration software married with a management team with over four decades of multi-jurisdictional fund experience gives Castlegate unique competencies. Castlegate has a strong focus on compliance and risk management which ensures that all aspects of a funds operation are individually examined in detail and attended to with a high level of thought and care.

With the advent of these changes, now is an ideal time for investment managers and promoters to examine the corporate governance of their funds, specifically with regard to the level of transparency and independence. Ultimately the cost of an independent administrator and director will be offset by risk reduction and enhanced reputational benefits.
The success of Malta in becoming established as an alternative to the established European Union domiciles for both traditional and alternative cross-border funds, Luxembourg and Ireland, is underpinned by the growing breadth of capacity and depth of expertise of service providers to the industry, from law firms and accounting and audit practices to fund administrators and custodians.

The administration sector has grown substantially in recent years and still has plenty of room for further development, given that the net assets of funds domiciled in Malta, EUR8.3bn at the end of 2011, was larger than the volume of assets administered on the island, at EUR6.2bn, even though the latter included 164 non-Maltese funds with assets of EUR1.4bn, mostly from the Cayman Islands and other offshore jurisdictions in the Western hemisphere.

There are currently 26 recognised fund administrators active in the Maltese market, including a global financial services player in HSBC and the headquarters of the Custom House group, a number of specialist service providers active in various European and offshore fund centres including Abacus, Alter Domus, Apex, Folio, Heritage, and Trident, and various local firms such as the fund services arm of Bank of Valetta.

Some of the firms in the sector have come to Malta with an existing client base, such as IDS Fund Services, which specialises in serving South African managers that are offering funds to a global market. “We have enjoyed booming business this year, mostly from South African fund managers looking to mirror their domestic fund offerings or to launch completely new products in Europe,” says director Andrew Frankish.

“Because of the AIFM Directive, managers from outside are scrambling to establish a presence in the EU, which opens up opportunities for local providers to provide services to managers, helping them obtain an investment management license and setting up...”

By Simon Gray
Ganado & Associates Advocates, a leading law firm with a predominantly international practice, provides integrated legal services across all practice areas. Our multi-disciplinary team takes a constructive hands-on approach to deliver a bespoke service to our international business clients.

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Private equity funds and the AIFM Directive

By Dr Stephanie Micallef, Ganado & Associates, Advocates

Malta has become an attractive jurisdiction for funds, due in part, to the flexible regime for professional investor funds (“PIFs”). Under this regime, private equity funds are structured as PIFs. Currently the Malta Financial Authority (the “MFSA”), through supplementary rules, regulates only one aspect of private equity funds; drawdowns on investors’ committed funds. Requests on committed funds must be effected on a pro-rata basis amongst all relevant investors in the fund and further calls can only be made by the fund once all outstanding commitments from existing investors have been requested. The fund is also obliged to retain copies of written agreements concluded with investors committing to invest in the fund, at its registered office.

Local regulation also provides for the issuing of units at a discount to investors who have committed to subscribe for units, by written agreement. The discount must apply exclusively to any outstanding commitment arising under the agreement and must be provided for in the constitutive document of the fund. The nature of such discount must be disclosed in the fund’s offering documentation. The regulations also impose a cap on the value of the units to be issued at a discount and if such discount is in excess of that permitted by the regulations, the investor is bound to pay the fund the difference plus interest.

Although the PIF regime is flexible enough to cater for private equity funds, the rules specific to such funds are currently limited. The MFSA has therefore recognised the need to consider additional regulation to facilitate the establishment of local private equity funds and in this regard will shortly introduce bespoke rules for these types of funds. The introduction of the rules will also serve as a means to align the current rules with the AIFM Directive.

The AIFM Directive includes disclosure rules which require a private equity fund manager to notify involved parties when the fund it is managing acquires a major holding or control of a non-listed company or an issuer. The Directive also obliges the fund to produce an enhanced annual report of the portfolio company or of the fund itself. The annual report must include a fair review of the development of the portfolio company’s business, its future plans for development and must highlight any significant events which have occurred since the end of the last financial year. Although these measures will increase transparency, the disclosure of sensitive information might disadvantage private equity bidders. To control this effect, the Directive includes confidentiality provisions, however it leaves it up to each Member State to implement its own rules to address confidentiality issues.

In order to protect companies from short-term investments and prevent asset stripping, the AIFM Directive has also sought to regulate buy-outs of companies. The Directive prohibits a fund which has acquired control in a company, from facilitating, supporting, instructing or voting in favour of any distribution, capital reduction, share redemption and/or acquisitions of own shares for a period of twenty-four months following the acquisition of control.

These requirements, together with the requirement for each fund to appoint a depository, have been criticised as increasing costs for private equity funds as well as impacting the drawdown process and closing procedures. A change in operating practice will inevitably be necessary. The introduction of new rules on private equity structures to the Maltese regulatory framework may address these issues and provide further clarity and solutions to private equity fund managers.
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Malta is not a small island of light touch regulation

By Adam de Domenico

There are many reasons why managers might decide to come to Malta; its favourable tax regime, climate, inexpensive costs and more. In the last few years there’s been a good push from both managers and funds looking to set up in Malta.

And whilst Malta may be considered less expensive when compared to other key fund jurisdictions, this shouldn’t be confused with the idea that its services are sub-standard. The quality of service providers here is at par with mainland Europe with a focus of professional services within the financial services industry.

When it comes to applying for a fund license in Malta, it is also critical to understand what’s needed post-approval. This is not a tiny island with minimum regulation. Indeed, in many ways the MFSA takes a similar stand to the FSA, so managers need to think clearly about how they plan to operate once the license has been obtained.

Promoters considering application for a management company may wish to consult the MFSA website which clearly lists out the regulatory rules on application and post licence. In general, the regulatory compliance requirements of Collective Investment Schemes (“Funds”) are similar to other key European jurisdictions including that the Fund is subject to the investment objectives, policies and restrictions as outlined in its offering memorandum. Furthermore, as one would expect, UCITS Funds are subject to additional specific limitations and investment restrictions from a risk management perspective.

Funds are also required to submit annual audited accounts and half-yearly reports to investors and to the MFSA within four and two months respectively.

The Rules applicable to Investment Managers include general requirements; conduct of business obligations; outsourcing rules; disclosure requirements to clients; financial Resources Requirements, Accounting and Record Keeping. The general rules require the Company to establish relevant functions including: a compliance function; risk management function; operational & Supervisory (Board, Investment Committee); internal audit functions & independent Risk function (if relevant); establish, implement and maintain policy and procedures; have measures in place to effectively monitor outsourced functions; monitor, control and maintain adequate capital resources requirement (eg. 2 BP on AUM > EUR250Mmin of EUR125K).

The Rules also require the Investment Manager to establish, implement and maintain appropriate policies and procedures, covering various conduct of business obligations such as best execution, conflicts of interest, and staff dealing to name a few.

From a practical perspective, the Company may delegate certain functions to third parties approved by the Board, however outsourced services remain the responsibility of the Board. Critical operational functions may not be outsourced in such a way as to impair materially the quality of its internal control and MFSA’s monitoring abilities and the Company shall have measures in place to effectively monitor outsourced functions.

Once the license has been approved, it’s not a case of sitting on one’s laurels. There’s a lot to think about. Whilst the MFSA are available to meet promoters, they have rules and they stick by them. The essence of the message here is that post-license things are easier said than done.

Zodiac Advisory Services Limited is an investment management advisory firm. The firm has been operating in Malta since 2009. With over 40 years of experience amongst its team, ZAS is able to support its clients in areas of regulatory compliance, accounting, directorships, as well as support services such as helping clients relocating to Malta with recruitment and housing.
up the sub-advisor relationship with the manager outside the EU. We have also seen plenty of new funds established over the past year, especially smaller launches from managers starting out with their personal seed capital.”

Malta’s focus on boutique-scale providers suits demand in the marketplace, Frankish argues. “The country offers lower set-up and ongoing running costs, and smaller managers don’t necessarily want to go to the brand-name providers that dominate in larger jurisdictions,” he says. “That is when Malta really competes at the moment, enabling it to nip at the heels of those longer-established centres.”

Anthony O’Driscoll, managing director of Apex Fund Services in Malta, says the number of local structures launched over the past 12 months has slowed somewhat, but the slack has been taken up by demand for the servicing of offshore vehicles. “We continue to get enquiries about Maltese funds, but the conversion rate is lower than it has been over the previous three years,” he says. “This year we have been doing more offshore business, traditional Cayman Islands and Bermuda structures, than Maltese PIFs and UCITS.”

One factor, he believes, is the continuing uncertainty surrounding the detailed AIFM Directive rules, but another is attitudes among Swiss managers, who have played a significant role in the growth of the Maltese fund industry. “Unless they have a large European investor base, a lot of managers will continue to look at offshore vehicles,” O’Driscoll says. “And then there’s the fundraising issue. Seed capital is still scarce on the ground for the launch of new funds.”

The test will come, he believes, once the directive and its implementing measures are fully in place. “Once it is operational, a lot of managers, even of the traditional US master-feeder structures, will have to decide whether they are going to cater for European investors, who may want their alternative investments to use an onshore domicile,” O’Driscoll argues. “They will have to look at how they access European money and whether they want to put in place European structures. Then the question will arise whether they want to be in Luxembourg, Dublin or a newer jurisdiction like Malta.”

“We have enjoyed booming business this year, mostly from South African fund managers looking to mirror their domestic fund offerings or to launch completely new products in Europe.”

Andrew Frankish, IDS

A couple of the island’s administration firms have been established by providers from the British Virgin Islands, another jurisdiction in which niche firms have carved out a market serving small and start-up managers. According to general manager Roger Buckley, Castlegate Fund Services was established in Malta after an existing client decided to restructure its offshore fund as a UCITS, but the firm’s main focus is on providing back office services in Malta for BVI funds, although it also administers locally-domiciled UCITS and PIFs.

He notes that an important source of growth in Malta has been the revamp of fund legislation in Switzerland, which is set to place an onerous compliance burden on managers of non-Swiss funds that up to now have not been regulated at all, even if they wanted to be. The AIFM Directive – the catalyst for the regulatory changes in Switzerland – has also prompted managers of offshore funds to examine the merits of different European centres.

“Malta has a number of advantages, starting with its location,” Buckley says. “It’s close to the Middle East and North Africa, and has marketed itself as a centre for Shariah-compliant funds, which is something we’re positioning to do further down the line. We decided on Malta for our European hub because it is an up-and-coming jurisdiction and well suited to smaller managers, our target market. We do a lot of hand-holding and walk managers through all the processes necessary to set up a fund.”

The newcomers from Switzerland include Geneva-based law firm Lecocqassociate, which decided to establish a Malta office two or three years ago when investors in funds run by Swiss managers became less comfortable with funds based in the Cayman...
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Interview with Gatis Eglitis

For integrated brokerage and fund platform firm, EXANTE, setting up in Malta last year was certainly a case of ‘New Kid on the Block’. Historically, the island has always been a nation of savers. The investment industry has necessarily developed to reflect this fact, where the general sentiment is one of long-term investing with low risk appetite.

When you consider that EXANTE prides itself on having cutting edge technology, a co-location infrastructure, and what is, to all intents and purposes, a highly sophisticated trading infrastructure well suited to high frequency traders, their establishment on the island was clear for all to see.

Speaking with Hedgeweek, Gatis Eglitis, one of EXANTE’s managing partners, says: “The main value EXANTE brings to Malta is really the fact that we offer something different: high frequency, trading-oriented. So really we are filling in the missing piece of the puzzle of Malta’s conservative investment environment.”

Attending a recent Finance Malta conference, Eglitis says he was surprised that very few of the investment managers he spoke to were investing in credit derivatives, statistical equity arbitrage strategies, futures etc; more plain vanilla investment strategies were the focus of their attention. This may start to change.

As the smart money continues to flow from other parts of Europe, the potential for Malta’s investment fund industry to get more sophisticated is high. Malta has never really had a cutting-edge global broker able to meet the needs of aggressive investment managers such as hedge funds, who rely on leverage, competitive prices and access to a range of derivative instruments; EXANTE plugs that gap.

And when you look at some of Finance Malta’s statistics, their timing seems good: 109 investment services licenses, 539 funds (179 new licenses) representing a 24 per cent year-on-year growth, and EUR8.3billion in NAV. Malta is now the fastest growing financial services sector in Europe.

Says Eglitis: “We can help companies that choose to domicile their funds here fulfil their potential by offering a global infrastructure. If they have to choose a broker or platform to trade global markets there’s literally no one in Malta except us that is able to provide all the tools.

“For a hedge fund considering a domicile like Malta, knowing that such a brokerage company existed would certainly add to its overall attraction.”

However, trade execution is only half the story. EXANTE also hosts a multi-asset fund platform, which operates solely online via the internet. Not only can funds trade global markets, they can also market themselves and their strategies to all of EXANTE’s global customers. “In that sense what we offer is truly a one-stop shop,” states Eglitis.

To emphasise, EXANTE is not only interested in high volume clients running sophisticated strategies: it is happy to deal with all kinds of clients, be they local or international, long-only equity or high frequency quant trader.

Says Eglitis: “Regardless of who the passenger is, they still get to enjoy riding in a Bentley. Whether clients are HFTs or long-term conservative money managers, the infrastructure is sound and gives them quality execution and affordable pricing.”

Right now, the firm has around 70 clients and 50 funds totalling in excess of EUR1.5billion in AUM. It has, confirms Eglitis, already established relationships with some of Malta’s market leaders including the island’s largest retail broker.

“Whether clients are making thousands of transactions a day or simply buying and holding instruments long-term makes no difference to our business model. All are welcome and the pricing is the same for everyone, regardless of whether they are high or low volume traders.”
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. The Financial Services Department within the firm is committed to providing bespoke legal solutions to credit and financial institutions, investment firms, family offices and other stakeholders in the financial services industry. Our mission is to deliver high-quality services in structuring and implementing investment proposals, operations and products in a pro-active, efficient and timely fashion. To this end, we continue to foster and develop our local and international network with a view to offering comprehensive and integrated services to clients.
In May this year, two draft versions of the Directive’s Level II measures came into circulation, with the European Commission’s draft differing in several areas compared to ESMA’s advice to the Commission. This is not helping managers, who are increasingly looking for clarity from their service providers.

Joseph Saliba is a partner at Malta-based law firm Mamo TCV Advocates. Whilst a lot of the firm’s clients (managers) are based in the EU and will be required under their domestic laws to align themselves to the Directive, other clients are established in Switzerland, and these are keen to understand its scope.

Swiss investment managers are facing the prospect of equally tough regulation at home and the Directive will eventually reach and hit those who manage or market funds in the EU. What might sway their decision on whether to restructure their operations in jurisdictions like Malta will inevitably hinge on whether the EU grants Swiss managers the right to market their funds with a passport akin to the Directive’s; a prospect of which Swiss clients seem to keep high hopes, says Saliba.

As for how the Directive will likely impact Malta’s existing regime, Saliba says: “There are no official pronouncements yet from the MFSA on changes to the island’s regime. The first round of consultations is expected to start after summer, when we’ll have more clarity of MFSA’s intentions.”

Saliba estimates that a material number of foreign managers of existing Maltese non-retail funds “will likely fall below the minimum thresholds (EUR100million increased to EUR500million for unleveraged funds)”.

Going forward, Saliba thinks the MFSA will need to consider whether to have two separate regimes running in parallel. Namely:

- A full version of the Directive for bigger managers and their funds.
- A similar version of the existing regime for managers falling below the threshold.

Another fundamental decision for the MFSA to consider will be whether to strictly follow the Directive’s approach of seeking merely service (manager) regulation without directly regulating funds or retain the existing product (fund) regulation.

“My suspicion is that regardless of whether the manager falls under the Directive or not, funds established in Malta will still require a license from the MFSA,” says Saliba “which seems a sensible approach, provided we manage to strike the right balance between adequate regulation and flexibility.”

Currently, managers have a choice to make in response to Europe’s shifting regulatory sands: staying out, fully in or partially in the EU. The Directive will allow them to continue to market their funds under national private placement regimes until 2018, with the potential danger, however, that some individual EU Member States (like France) might simply choose to close down these regimes before 2018.

Non-EU managers or managers running non-EU AIFs, will also be able to passport their funds into Europe possibly from 2015 onwards by getting authorised and fully complying with the Directive, but also subject to the satisfaction of additional conditions such as the establishment of cooperation and tax sharing agreements with the targeted Member State/s of distribution.

Saliba says that managers for whom European distribution is core business, the best solution will probably be to establish themselves an EU presence, and to concentrate their operations in one European domicile: “This will enable them to take full advantage of the fund passport without having to adhere to additional conditions. Malta should be an ideal candidate jurisdiction for these managers, given the tax, cost and other advantages it has to offer.”
“These investors wanted EU-domiciled, regulated funds,” says managing partner Dominique Lecocq. “The EU jurisdiction that offers funds most like those in Cayman is Malta, in the sense that they can use service providers based outside the jurisdiction. A lot of clients were banks happy to be able to keep custody of the fund assets in Switzerland, whereas with a Luxembourg fund they would have needed to use a custodian there.”

That advantage is set to disappear in 2017, when Malta’s derogation from the AIFM Directive’s local depositary bank rule expires, but for the time being this factor is a counterweight to the much-discussed impact, particularly on UCITS fund business, of the relatively small number of custodians on the island. As it happens, Lecocq says the firm has three applications for the establishment of UCITS in the pipeline.

Most clients are looking to set up PIFs, open-ended funds following hedge fund strategies, but the firm is seeing a variety of other business. “We have several gold funds in the pipeline, as well as a number of private equity funds as well, and we have just received a UCITS licence,” Lecocq says. “Malta is a good jurisdiction for UCITS funds because the total expense ratio of a fund here can be lower than in competing jurisdictions.

“A Maltese fund would probably pay between one-third and half of the fees paid by a Luxembourg fund – EUR10,000 to EUR15,000 in Luxembourg, but only EUR5,000 here. If you’re launching a fund with EUR100m, it may not be so important, but if you are having to build a track record with EUR5m to EUR7m in seed capital, it makes a difference. That said, we have also launched a EUR500m fund for a Swiss bank.”

Chris Casapinta, who joined the Malta office of Luxembourg-headquartered Alter Domus in 2010 after a decade with PricewaterhouseCoopers, says the advent of the AIFM Directive next year offers administrators the opportunity to expand their service offering into middle-office areas such as risk management.

“We’ve integrated our administration, IT and compliance systems so as to be able identify issues in the way portfolios are performing, how weightings of investments are leveraged and whether this is giving rise to any risk issues,” he says. “Information is coming straight from our accounting systems into our reporting platform, enabling us to monitor risk management processes in real time and report them to our clients and their investors as necessary.”

This year has been a successful one for Alter Domus in Malta with a dozen new mandate wins, even if the difficulties in the fundraising market continue to keep the island’s assets under management tally lower than the industry would hope. “We are getting significant numbers of fund managers interested in setting up funds in Malta,” Casapinta says. “I think we’re doing a good job of communicating the advantages and disadvantages of the island to the investment management world.

“People are currently finding it challenging to set up funds because of a variety of circumstances, including the general economic climate and the mood of investors, although this is something that every jurisdiction is facing. And while bigger players continue to attract new assets, most of the managers operating funds out of Malta are quite small, and therefore under greater pressure.”

Casapinta acknowledges that the additional burden of liability that will be placed upon custodians of EU-domiciled alternative funds places additional pressure on their working relationships with independent fund administrators. “Because of their myriad responsibilities under the AIFM Directive, custodians need to be more comfortable about other service providers,

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The role of fund administrators has changed quite substantially in recent times. In part because of increasing global regulatory pressures, but also in response to the larger array of products and target assets and also due to greater calls for transparency from institutional investors and managers. Administrators who want to continue servicing top managers have to shore up their operational structures to ensure that the new regulatory and market requirements are addressed efficiently.

As a group, Alter Domus services the top 10 global private equity firms so the AIFM Directive was always going to be of major importance. Most of our senior team have been involved in working groups for the Directive. They have also worked closely with their clients to understand their concerns.

The AIFM Directive is an opportunity to reassess our systems, renew our service offering and getting closer to our clients to understand the regulatory and operational implications.

The close collaboration with the industry and the regulators has ensured that our systems and procedures will support fund managers in various areas such as financial reporting and middle office functions.

Prior to the AIFMD era, we invested heavily in our systems. We have since integrated all our systems in order to offer our clients the support they will require under the Directive, going forward. All this data will be available on a 24/7 basis.

Apart from having the appropriate technology in place, administrators have to find ways of communicating the data and reports in an efficient way to the various stakeholders. AIFMD will result in more interaction between the different parties involved in the management of the fund. It will be essential for administrators to develop these best practices where transparency, accountability and robust processes are easily demonstrated.

External custodians and depositories will need to be completely comfortable with fund administrators’ work given the myriad responsibilities they will face under the Directive.

Administrators who have been able to reinvest in their technology, rethink their processes and revisit their service offering should be in a good position to address the new challenges and opportunities AIFMD will bring...
especially administrators,” he says.

Some analysts believe the cost of compliance with the directive will give an advantage to global financial service group that can provide both custody and administration as part of a one-stop shop package. However, this model does not particularly suit a Maltese clientele dominated by smaller funds and managers, many of which will not meet the minimum asset size requirements of some big players.

In addition, the experience of recent years show that having different service providers that are in a position to monitor each other’s activities as well as those of the fund manager can provide added protection and comfort to investors, too. Says Casapinta: “Not all fund managers and investors want the fund administrator and custodian to be the same.”

It’s a similar story at Sparkasse Bank, an independent custody provider that has taken advantage of the lack of providers in this sector to carve out a significant role in the Maltese fund industry. “The approach of the big institutions is that they will do everything from A to Z,” says managing director Paul Mifsud. “That way, they say, there is no leakage of risk, but we take a different approach.

“We specialise in custody, and concentrate purely on the key aspects such as risk management, monitoring of portfolios and record-keeping. We work hand-in-hand with independent fund administrators that may not necessarily be able to work with the larger custodians. Often their custody systems are not standalone; fund administration and custody are a single module in their IT system. So for independent administrators, we hit the sweet spot.”

It may also hit the sweet spot with some of the Swiss institutions that are now looking more closely at the Maltese market. Says Mifsud: “In special business cases we are sympathetic to requests from institutions that want to look after the assets through sub-custody arrangements - as long as we can control the risks, obviously.”

Katya Tua, head of the investment services department at law firm Simon Tortell & Associates, notes that in any case only one of the three types of PIF – the Experienced Investor PIF, which is designed

“The fact that the custodian does not have to be local, but like the manager and administrator can be from any approved jurisdiction, does give Malta some flexibility.”

Katya Tua, Simon Tortell & Associates

for more affluent and sophisticated retail investors and has a minimum investment level of just EUR10,000 - is currently required to have a depository bank.

“The other two types of PIF [Qualifying Investor PIFs, which have a investment minimum of EUR75,000, and Extraordinary Investor PIFs, which have a minimum of EUR750,000] are not obliged to use a custodian,” she says. “However, they must satisfy the regulator about their safekeeping arrangements, and in practice most of them do appoint a custodian anyway. However, the fact that the custodian does not have to be local, but like the manager and administrator can be from any approved jurisdiction, does give Malta some flexibility.”

Overall, however, Tua agrees that having a larger choice of custody providers would definitely bolster Malta’s competitiveness as a jurisdiction. “For operational reasons, it is often convenient to have a local custodian,” she says. “For example, the custodian of a Experienced Investor PIF has not only the safekeeping role but a monitoring function as well. This can be an important aspect of the custodian’s duties, and an area that would be strengthened by the arrival of more large providers.”

Frankel says this is essential if Malta is to challenge Luxembourg and Ireland more effectively as a UCITS domicile. “Although some new custodians have come in, I don’t think it’s anywhere near where it needs to be for the jurisdiction to become a competitive force in the UCITS market. Like any fund services jurisdiction, Malta has to offer potential clients a full range of options. From a UCITS perspective – and indeed of any business that requires a custodian - that is an area in which the country is lacking for now.”