Loan vehicles grow in popularity within finance industry

Various options on offer to alternative fund managers

Attracting new custodians with room for growth
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Photographs: Viewing Malta
Published by: GFM Ltd, Floor One, Liberation Station, St Helier, Jersey JE2 3AS, Channel Islands
Tel: +44 (0)1534 719780 Website: www.globalfundmedia.com
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Malta keeps all options on the table

Interview with Kenneth Farrugia

FinanceMalta was set up in 2007 to holistically promote the various sectors of Malta’s financial industry. FinanceMalta not only focuses on the fund management industry but also covers the insurance sector, trust and foundations sector and wealth management and as Kenneth Farrugia, Chairman of FinanceMalta confirms: “We are also exploring ways for FinanceMalta to support Islamic Finance and Capital Markets in Malta through various initiatives.”

Malta has come a long way as a fund jurisdiction since it joined the EU in 2004. FinanceMalta has played an important role in this regard, and whilst more can always be done from a promotional standpoint, the organisation is not resting on its laurels.

“We will be hosting a funds conference in London on 5th November 2015, which will look at fund structuring opportunities in Malta, the new rules governing loan funds, as well as servicing operations such as Custody and Asset Management. The event will be held at the Corinthia Hotel in London,” notes Farrugia.

Through June 2015, Malta had 146 licenced entities holding Category 1A (advisory), Category 3A and Category 4A licences. In terms of growth trends, one interesting observation is that the number of retirement schemes being established in Malta is on the rise. There are 35 such retirement schemes currently, compared to 11 in 2013. In addition, Malta is home to some 14 retirement scheme administrators, illustrating that the international pensions space is gaining traction.

With respect to the fund management operational infrastructure, Malta is today is home to 27 fund administrators and is well represented by the main international accounting firms as well as multiple first-class law firms.

“In terms of the number of funds, we’ve predominantly seen traction in PIFs,” states Farrugia. “We’ve had 35 new PIFs licenced through June 2015. In addition, we’ve seen four AIFs licenced this year and, interestingly, eight UCITS schemes licenced in the first six months compared to 11 in total for 2014. So we’re seeing good growth across a range of fund categories.”

This is no doubt helped by the flexibility of Malta’s fund structuring framework: fund promoters have the choice of complying with the PIF rulebook, the AIF rulebook under AIFMD, or the UCITS rulebook. Farrugia says that retaining the PIF regime, following the introduction of AIFMD two years ago, “was an important policy decision taken by the MFSA as some promoters want to remain de minimis and out of scope of the Directive.

“That said, we are seeing fund managers with AUM below EUR100 million still opting to be regulated under the AIFMD. Being regulated under the Directive infers a degree of quality and good governance within the fund structure, which institutional investors will likely favour.”

Farrugia says he felt it was important for Malta to keep all options on the table for managers: “Why shut down the ability for small managers to remain out of the Directive? With the PIF regime, we are able to support fund managers who don’t necessarily want to be fully registered under AIFMD from day one.”

“Managers need clarity, and this depends on having access to the regulator to get unequivocal information on what is required when setting up a fund operation. Malta stands out highly in this regard with the accessibility of the MFSA being one of the pivotal and critical success factors to Malta’s success, so far,” concludes Farrugia.
Loan vehicles could become integral part of burgeoning funds industry

By James Williams

Malta’s financial services industry has been continuously evolving since it joined the EU in 2004. The island has a buoyant banking and insurance sector, a trust and pensions sector, and along with its funds industry, has been growing in the region of 25 per cent per year, based on the MFSA’s latest figures.

With respect to setting up funds, the licensing process is very thorough. “We conduct extensive due diligence on everybody,” comments Professor Joseph Bannister, Chairman of the MFSA. “In certain cases, we go a step further and involve security agencies. The first step is not the business plan and determining what a manager plans to do. The first step is always to pass our due diligence process. No due diligence, no licence.”

Bannister says that the advice offered by the MFSA to prospective fund managers is “to come and talk to us, regardless of whether you are thinking of coming to Malta to establish a management company or a fund. We believe in always being open and transparent and knowing exactly what is going on. There’s no such thing as simply filling in a form and sending it. We like to be proactive and meet with managers before they make a formal application.”

The MFSA’s accessibility is one of Malta’s many advantages. That it is an English-speaking island, with good availability of trained labour, is another. A third factor is cost. “We remain a cost-competitive jurisdiction. The average costs are about a half to a third lower than other European jurisdictions based on the managers we speak with,” says Bannister.

Funnily enough, he notes that the manager dynamics have started to shift slightly since the introduction of the AIFMD two years ago. Prior to that, Malta was seen as just a funds domicile. Now, increasingly, managers are establishing an AIFM to take...
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Fund structure ecosystem continues to grow

Interview with Dr Stefania Grech

Following Malta’s implementation of the Alternative Investment Fund Managers Directive (AIFMD), it is possible to set-up Alternative Investment Funds (AIFs) in Malta in accordance with the AIFMD.

Nevertheless, the existing Professional Investor Fund (PIF) regime has been retained in parallel with the AIF Regime, thus enabling de minimis fund managers and third country managers to set up collective investment schemes under the Investment Services Act, regulated by the Investment Services Rules for Professional Investment Funds.

Even though the PIF regime has remained popular with fund managers, fund platform structures have also gained momentum. According to Dr Stefania Grech, Financial Services Associate, Chetcuti Cauchi Advocates, Malta, one fund structure in particular has attracted interest from promoters: the Recognised Incorporated Cell Company (‘RICC’).

“Typically you have a SICAV fund structure that can be used to ‘plug & play’ sub-funds. The RICC works in a more advantageous manner since different SICAVs – not just sub-funds – can be plugged into the RICC. Agreements are put in place with the underlying incorporated cells (‘ICs’) which are fund structures in themselves. Typically these would be umbrella funds with their own underlying sub-funds. This provides better segregation between different ICs,” explains Dr Grech.

One of the key advantages that Malta offers is the range of fund structuring options available. This year eight UCITS funds have already been established, with Dr Grech confirming that Chetcuti Cauchi Advocates is currently working on two more UCITS applications. “There is a trend towards having a marketable brand to offset the additional costs that come with fund structuring. This same mind-set might, going forward, also be applied to the AIF structure as the AIFMD regime becomes more familiar,” suggests Dr Grech.

The number of AIFs in Malta remains small; only four have been structured thus far in 2015. New managers, it seems, prefer to go down the PIF route, which might be more cost-effective whilst still being a regulated fund product.

“From our experience, the AIF model is resorted to more frequently when it comes to setting up a self-managed structure. In this scenario, there is also the possibility that portfolio management can be delegated elsewhere within the EU,” says Dr Grech.

“Even though the AIF rulebook is not mandatory under the Directive for each EU Member State, Malta took the responsibility to transpose it and this has proven to be a very sensible decision. In addition, the fact that the MFSA decided to regulate de minimis fund managers ensures that there is a certain adequate degree of supervision in place.”

The PIF regime is seen as striking the right balance for small funds in that it is cost-effective, and although not fully compliant with AIFMD, it still abides by the regulatory requirements of transparency and good corporate governance, ensuring a good level of investor protection.

Malta’s decision not to implement Guideline 18 of the ESMA Guidelines on Remuneration has also helped to attract AIFMs.

The remuneration obligation stops with the Malta AIFM. What this means is that if, for example, portfolio management of the AIF is delegated from the Malta-based AIFM to a London-based manager, there would be no look-through undertaken and the London manager would not be subject to the remuneration principles.

“This is regarded as an additional benefit to anyone setting up an AIFM in Malta,” concludes Dr Grech.
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Despite Malta introducing a legal framework for securitisation in 2006, the financial crash meant that it was rarely used until around 2012. But there are signs that securitisation is gaining some momentum locally. This is being helped by a dedicated regulated market for wholesale securities, the European Wholesale Securities Market (‘EWSM’); a joint venture between the Irish Stock Exchange and Malta Stock Exchange established in 2012 that allows the listing of wholesale-denominated debt securities to trade on an EU-regulated market.

“The revival of securitisation in the EU is now considered to be one of the priorities of the Capital Markets Union, in particular for the refinancing of SME loans and to reduce reliance on bank funding,” comments Paul Mifsud, Managing Director, Sparkasse Bank Malta. “We believe that securitisation as well as private placements of bonds through Maltese vehicles could fit well within the scope of the European Commission’s initiatives in this regard, and that Malta is well placed to offer cost-effective solutions for companies to raise non-bank financing.”

The Maltese Securitisation Act covers three main types of securitisation: asset securitisation, synthetic securitisation and whole business securitisation. A securitisation vehicle set up as a Maltese company has to appoint a local auditor; otherwise, the appointment of external service providers is optional. “The securitisation vehicle may delegate the day-to-day administration function to a third party, including the originator of the securitisation assets,” explains Mifsud.

To further strengthen Malta’s position, an innovative piece of legislation - the Securitisation Cell Companies Regulations - was enacted on 28th November 2014. This improves investor protection by formally recognising the segregation and protection of assets allocated to segregated accounts, compartments or units within the same company. A securitisation cell company (‘SCC’) may be established for the purpose of either entering into securitisation transactions or assuming risks as a reinsurance special purpose vehicle.

“The SCC is a company that creates one or more segregated cells by means of a board resolution. The cells do not have separate legal personality – only the SCC does – but do have separate patrimony status: the assets and liabilities of one cell are treated as being separate from the assets and liabilities of any other cell within the SCC, and from the assets and liabilities of the SCC itself. Assets attributable to a cell are only available to the creditors of that cell and are ring-fenced from other creditors,” explains Mifsud.

Mifsud notes that in terms of financing the securitisation transactions for each cell, the SCC would issue financial instruments in respect of the relevant cell, in one or more tranches: “Typically, these would be debt securities but it is also possible to issue shares in respect of a particular cell. Debt securities may be listed and admitted to trading on a regulated market such as the EWSM, or can be offered on a private placement basis.

With the legal and regulatory framework in place, Sparkasse Bank is starting to see interest build among asset managers for tailor-made solutions in alternative asset classes such as real estate and corporate loans.

Mifsud concludes, “While it is possible to set up so-called “loan funds” in Malta, investment in asset backed securities, issued by a securitisation vehicle, may be a more appropriate and efficient means for asset managers or their clients to take advantage of credit opportunities, depending on the circumstances.”
advantage of Malta’s favourable tax regime, as well as launch funds.

“Whereas previously we would be getting two or three new managers a year, since the AIFMD was introduced we’ve been getting on average 15 new managers a year,” confirms Bannister. “Those moving here to operate the AIFM are typically risk management and research staff. The portfolio management tends to remain in London. It is a good development for Malta and its economy that such a trend is underway.”

With respect to tax, Felicity Cole, Head of the Funds Department at Maltese law firm, Mamo TCV Advocates, explains: “If a private equity manager, for example, sets up a carry vehicle in Malta as a corporate it can be structured in such a way that it would be subject to an effective tax rate of 5 per cent. Malta also has what is known as the “Highly Qualified Expatriate” tax regime, which applies to senior management involved in Malta’s financial services industry. This tax regime allows individuals to pay a tax rate of 15 per cent; an enticing proposition for senior management wishing to escape the big city lifestyle – and higher tax bracket – of the UK.”

Private equity is one segment of Malta’s funds market that has room for expansion, especially given the fact that the flexibility underpinning the Maltese PIF and AIF structures makes them suitable to accommodate private equity strategies.

The MFSA is aware of this. On 19th November 2014, it introduced “Proposed Rules” that make it possible for PE funds to be structured either as PIFs or AIFs.

Under the Proposed Rules, specific rules will apply to PE schemes that invest in non-listed companies or issuers. The Proposed Rules are truncated into seven sections and cover: (i) general requirements; (ii) service providers; (iii) investment objectives; (iv) policies and restrictions; (v) disclosure to investors; (vi) reporting requirements; and (vii) supplementary conditions for self-managed schemes.

Another development that could attract private equity managers is the introduction of Investment Services Rules for Loan Funds; the first of their kind to be issued by a European supervisory authority.

“This has removed the danger that a loan fund would require a licence under the Financial Institutions Act (Cap. 376 of the Laws of Malta).

“The introduction of the Rules places Malta in an almost unique position of having an ad hoc regulatory framework addressing the requirements of loan funds. We expect this to lead to a sharp increase in the number of funds establishing themselves in Malta,” says Dr Louis de Gabriele of law firm Camilleri Preziosi.

Bannister confirms that the first such loan fund has just been licenced.

“In total we have four applications. We have licensed one, we’re in the process of finalising the second one, and for the other two we have decided that they can operate outside of the new rules. We are certainly applying more stringent due diligence to these funds. We don’t allow leverage, for example,” says Bannister.

Loan funds must also be closed-ended and have may only target specified professional investors. It may not invest more than 10 per cent of its capital in a single undertaking and the fund manager is also obliged to implement a number of policies, including a credit risk policy in order to establish the framework for lending.

Being able to structure loan funds could well help Malta attract private equity and real estate managers. The fact is, Europe’s banking system is undergoing structural change. The capital requirements of Basel 3 means that banks are pulling back their financing activities in support of SMEs, requiring them to find alternative sources. Alternative fund managers and institutional investors are increasingly becoming that alternative source, just as is seen in the US.

“Bank loans are reaching maturity and a lot of SMEs just can’t get them renewed.”

**Professor Joseph Bannister, MFSA**
The Recognised Incorporated Cell Company

By Dr Louis de Gabriele

In recent years, the Maltese jurisdiction has continued to consolidate its reputation as a fund domicile of choice for fund promoters and managers alike. Having emerged as a cost-effective jurisdiction for funds, Malta boasts a comprehensive yet flexible regulatory framework, together with attractive rates of taxation. The Malta Financial Services Authority (“MFSA”) has also played a considerable role in the strengthening of Malta’s position as a fund domicile, particularly due to its accessibility, responsiveness, and expediency in the processing of applications.

Malta’s sophisticated fund sector provides a broad repertoire of structuring solutions; one of the more innovative – providing promoters with an increased level of flexibility – being the Recognised Incorporated Cell Company (“RICC”). Building upon the multi-fund SICAV and SICAV Incorporated Cell Company (“SICAV ICC”) structures, the Maltese regulations applicable to RICCs (the “RICC Regulations”) introduce a platform-type model, which enables the RICC to provide services of a purely administrative nature, against a platform fee, to its incorporated cells (“ICs”). The RICC will not require a CIS licence, but will need to obtain a recognition certificate from the MFSA. Each IC, however, will require a CIS licence in its own right.

Notably, ICs established under a RICC each enjoy separate legal personality – their assets and liabilities are thus ring-fenced from one another and accordingly creditors of each individual IC may not have recourse to the assets of any other IC. The RICC’s ICs may comprise a mix of PIFs, UCITS and AIFs; the choice of which will depend, ultimately, on whether the promoters are after a retail product, or a hedge fund. Moreover, it is important to point out that the RICC’s ICs may have segregated sub-funds; and, advantageously, the RICC can have ICs which are either self-managed or externally managed.

The RICC entertains further positive points. By way of the RICC Regulations, a body corporate carrying out similar activities to a RICC outside Malta may be continued as a RICC within Malta, thus allowing for uninterrupted business progression. It is also noteworthy that, because the RICC itself is a company, it will benefit from the favourable fiscal regime applicable to companies. Furthermore, the RICC model also provides for cost-savings that may be attained through centralisation and standardisation – indeed, standardised fund documentation with service providers will be in place upon the establishment of a RICC – this allows ICs to be incepted in shorter time periods as functionary agreements with service providers will already have been approved by the regulator.

In view of the enhanced compliance costs occasioned by new regulation under the umbrella of the AIFMD, the RICC model – due to its unique qualities, as explained above – is beginning to look increasingly attractive as a structure of choice for fund promoters.

The uptake of RICCs looks set to increase in 2015 and beyond.
This has played into the hands of alternative asset managers who are setting up direct lending vehicles in the “shadow banking” space,” says Cole. “For Malta to have this loan fund regime where managers have certainty as to what these entities can and cannot do, is a positive development. The MFSA has also issued guidance on loan funds, in conjunction with the Investment Services Rules, which should prove helpful to fund managers.”

This reflects the evolution of Malta’s funds industry. “The introduction of the new loan fund rules in May 2014 has brought about marked interest in setting up loan funds in Malta. This development will further complement the existing range of fund strategies in the industry going forward,” comments Kenneth Farrugia, Chairman of FinanceMalta.

Aside from loan funds, another aspect of Malta’s funds industry that could attract PERE managers over the next few years is the introduction of the Securitisation Cell Companies Regulations, enacted on 28th November 2014. There are some that think Malta could become Europe’s leading securitisation centre.

“The SCC offers interesting structuring possibilities for securitisation transactions, and can be used to create securitisation platforms,” explains Paul Mifsud, Managing Director, Sparkasse Bank Malta, plc.

“The SCC may enter into one or more securitisation transactions in respect of a cell, but the securitisation assets allocated to such a cell must originate from the same originator. The originator for a particular cell could be a special purpose vehicle holding the underlying assets or even a securitisation vehicle in its own right. The Maltese Securitisation Act actually recognises the use of two-tier structures whereby an issuing vehicle and acquisition vehicle are created.”

Securitisation vehicles, whether in the form of an SCC or a simple company, are not subject to particular conduct of business rules or risk management requirements at present. Nevertheless, a securitisation vehicle that does not offer securities to the public is required to notify the MFSA that it intends to enter into one or more securitisation transactions.

Public securitisation vehicles, namely securitisation vehicles which issue financial instruments to the public on a continuous basis, are required to obtain a license from the MFSA “but to our knowledge, there are no licensed public securitisation vehicles in Malta yet,” states Mifsud. He adds:

“One of the reasons why managers are increasingly interested in securitisation is that, in essence, it allows asset managers to turn real estate and other alternative investments into book-entry securities that can be held in an investor’s or fund’s portfolio with a custodian or directly with a central securities depositary.”

It is still early days. For some, securitisation remains a dirty word following the 2008 financial debacle. The more important point to make here is that Malta continues to look ahead and make adjustments to its legal and regulatory framework to support as wide a range of fund structuring possibilities as possible.

From a fund structuring perspective, the rather unique self-managed PIF (or AIF for those wishing to freely market it across Europe) is one that continues to attract certain promoters to the island.

These structures are ideal for those wishing to avoid setting up as their own AIFM. Rather than then establish a standalone fund structure, appoint a board of directors to the manager, and take full discretionary control of the fund strategy, a self-managed PIF is more of a collaborative affair whereby the fund strategy is controlled by an investment committee; typically this will be a small number of select investors including the promoter, to whom the portfolio management could be delegated. In all instances, there is no management company involvement.

As such, a self-managed PIF cannot appoint an existing third party manager to
provide the portfolio management in a sort of quasi sub-advisory arrangement. The most it could do would be to second certain people to the investment committee to provide, for example, research and advisory services.

“The self-managed PIF license would authorise the investment committee members to manage the fund or funds set up under the scheme. Whilst the investment management function may not be totally outsourced to a third party manager, they may be delegated specific portfolio management or be appointed to act as investment advisers to the fund,” comments Dr Jean Farrugia, senior partner with DF Advocates, who goes on to say:

“Although the self-managed PIF regime allows the scheme to internally manage the investment operations of the funds set up under the scheme via the investment committee, a self-managed PIF license is of course not equivalent to and should not be confused with a fund management license. Nonetheless it is quite popular and works for certain promoters who are solely interested in launching and managing their own funds.”

If, a year or two into running the self-managed PIF, the decision is made to restructure it as a third-party managed PIF, a separate fund licence would need to be acquired. One cannot just switch the SICAV – the most common legal structure for self-managed PIFs – to sit underneath the fund management company.

First, one would need to apply for a fund manager license. Then, they would switch the scheme from a self-managed PIF to a third-party managed PIF, do away with the investment committee at the fund level and put it in place at the fund manager level. At that point, one would be appointed as the investment manager to the fund and could transfer the track record of the self-managed PIF to the new fund structure.

“It must be said however that such conversion is not so common,” says Farrugia. “The reason being, that in the event that the fund promoters wish to attract different type of investors to their fund with a different investment profile, they would generally set up the scheme as a multi-fund/umbrella scheme and therefore set up different sub-funds under the same scheme catering for different type of investment strategies and different categories of investors without having to become a licensed fund manager. The assets and liabilities of each sub-fund would be considered as legally segregated from the assets in the other sub-funds.”

The SICAV legal structure has long been used for platform umbrella structures and Incorporated Cell Company structures. But as a concluding observation it is worth noting that Recognised Incorporated Cell Company (‘RICC’) structures are becoming a viable alternative. A RICC can be operated in a purely administrative way, against a platform fee, to support each incorporated cell, each of which enjoys its own separate legal personality.

“The RICC works in a more advantageous way to a SICAV in that different SICAVs – not just sub-funds – can be plugged in to the RICC as incorporated cells,” comments Dr Stefania Grech of Chetcuti Cauchi Advocates. “The RICC will have legal agreements in place with each underlying incorporated cell, which will be fund structures in and of themselves; multi-fund SICAVs with their own underlying sub-funds for example. This provides better segregation between each IC and protects the end investors.

“There are four RICCs registered here at the moment. We are currently working on one RICC application at the moment and we are seeing interest build from outside the EU.”

Camilleri Preziosi’s Dr de Gabriele believes that uptake in the RICC looks set to increase: “Indeed, in view of the enhanced costs occasioned by new regulation under the umbrella of the AIFMD, the RICC model is looking increasingly attractive as it allows several funds to co-exist under the RICC, whilst benefitting from the ‘administrative’ services thereof.”

All told, it would appear that Malta is prospering under the AIFMD.
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The gateway of choice for emerging investment managers

Interview with Derek Adler

The emergence of complex rules and regulations such as AIFMD and FATCA means that any new manager with visions of running their own hedge fund business must think carefully about the best route to market.

For managers who wish to market outside of Europe, then all of the current well established jurisdictions are fine. However, should they wish to market within the EU, then the choice becomes more limited. Luxembourg and Dublin do a fine job of regulating funds but they are predominantly retail and tend to be managed by large institutions.

Malta, by contrast, offers a well regulated choice of jurisdiction that fully supports the AIFMD passport for marketing purposes and is, crucially, a cost-effective option for the aspiring fund managers of this world.

The Maltese speak both Maltese and English despite the fact that it is a sovereign state within the EU, making it the gateway of choice for those emerging investment managers wishing to promote their funds across Europe.

Derek Adler is a director and founder member of International Financial Administration Group (‘Ifina’) - a firm that provides turnkey fund services to managers via its Primary European Fund SICAV in Malta and its Primary Development Fund in Cayman.

“We are still championing the smaller managers. As of September 2015, we are offering to set up a fund, within our umbrella structure, for under USD10,000, fully inclusive. On an ongoing basis, our minimum annual costs will stay the same at USD26,500 but we are now offering a fee of USD20,000 for the first year. We are really trying to help start-ups get up and running,” states Adler.

Like Ifina’s Primary Development Fund in Cayman, the Primary European Fund SICAV provides a turnkey solution for managers wishing to launch in Europe and build a track record without the burden of establishing a standalone fund. Ifina takes care of everything, from setting up corporate bank accounts, dealing with lawyers, appointing service providers, getting service level agreements in place; basically all the heavy lifting.

“We can help an emerging manager get up and running at very competitive pricing. This is a good thing and ensures that there is still a place for innovative and entrepreneurial talent to develop, despite the initial barriers that appeared to be in place,” says Adler.

In terms of the structure, the Primary European Fund SICAV is effectively a holding company composed of multiple sub-companies. Each sub-fund that sits beneath the umbrella structure is a separate legal entity. If there were 10 funds on the structure and one imploded, it would not impact the other nine funds at all. Each manager on the platform has full control of the fund’s name, branding, and track record.

“Our umbrella structure helps to accommodate the little guy that would ordinarily find it difficult to get off the ground in Europe. We’ve now got a few sub-funds up and running in Malta. Hopefully the Bloomberg campaign that we run in September to raise people’s awareness that it really doesn’t need to cost the earth to establish a fund will help to build interest and grow the pipeline even further,” concludes Adler.
DF Advocates is a Malta based law firm providing advice to international and local clients in day-to-day operations, local and cross border transactions and a multitude of complex issues spanning various industries with a specific focus on financial services.

Advisory & Support Services
Legal & Tax Advisory | Fund Structuring & Licensing
Asset/Fund Management: Licensing | Fund Re-Domiciliation
Trust Banking & Finance | Corporate & Fiduciary | Compliance & MLRO
Directorship | Company Secretarial | Back & Middle Office Services
Regulatory Compliance
Malta’s PIF regime allows the setting up of three different types of PIFs each based on the profile of the participating investors’ taking into consideration their overall wealth and investment experience. The regulations governing each type of fund vary and are lighter in case of PIFs which are intended for promotion to more sophisticated investors.

The three PIF categories are as follows:

- PIFs promoted to Experienced Investors – minimum investment threshold of EUR10,000;
- PIFs promoted to Qualifying Investors – minimum investment threshold of EUR 75,000;
- PIFs promoted to Extraordinary Investors – minimum investment threshold of EUR 750,000.

A PIF may be self-managed or third party managed. The self-managed PIF option is quite niche to Malta, yet it is gaining some traction. In this instance, all investment management decisions are controlled by an investment committee rather than have them delegated to an external fund manager.

This is useful for individuals who wish to avoid the costs of applying for, and becoming, a licenced fund manager in their own right, yet understand the benefits of using a regulated fund vehicle via which they may invest investors monies by implementing predetermined investment strategies; a self-managed PIF must be authorised by the MFSA. The key difference between a self-managed PIF and a standalone PIF, therefore, is that investment decisions are taken at Investment Committee level as opposed to the investment function being outsourced to a third party fund manager.

“Those who consider the self-managed PIF route tend to be well-connected with professional investors,” explains Dr Jean Farrugia, senior partner at DF Advocates.

“They will know their profile and investment appetite, and therefore model the fund architecture and investment strategy around the needs of such investors. Moreover the possibility of setting up the self-managed scheme as a multi-fund scheme and that of varying the composition of the investment committee or creating sub-committees of the same investment committee renders the self-managed PIF structure very popular.”

Depending on the strategy of the fund, the investment committee would retain all investment decision powers or delegate all or part of the investment management functions to one or more members of the investment committee.

Typically, such delegation occurs where the fund strategy requires daily or frequent trading. For less actively traded funds, such as private equity-type funds, the investment decisions are taken at investment committee level during quarterly investment committee meetings.

The savings which may be made on management fees which would typically be paid out to a third party manager in case of third party managed funds are also an important consideration in opting for the self-managed PIF structure.

The AIF status of a self managed-fund would not entitle the investment committee of the fund collegially or any member thereof to provide fund management services to third party funds, “as with a self-managed PIF the management functions of the investments committee and its members would be restricted to the AIF itself,” explains Farrugia.

“The right to manage EU AIFs established in other Members States under Article 33 of the AIFMD is restricted to EU-authorised AIFMs and does not extend to the members of the investment committee of a self-managed AIF. This notwithstanding, the self-managed route remains attractive for fund promoters whose scope is to manage their own funds without the need to market and distribute the units of these funds across the EU.”
“One cultural attraction that I recommend people to visit is St John’s Co-Cathedral where they can view Caravaggio’s ‘The Beheading of St John the Baptist’ and ‘St Jerome Writing’,” comments Joseph Zammit Tabona, Special Envoy to the Malta’s Prime Minister, Dr Joseph Muscat. “A bit of culture is important to understand where Malta is coming from.”

With a barely negligible crime rate, a growing AIFM community, some 3,000 hours of sunshine a year, an English-speaking business community and an approachable regulator, Malta is fast becoming an attractive option for fund managers wishing to enjoy a more Mediterranean, and cultured, island lifestyle.

Currently, Malta’s well-diversified financial services industry contributes approximately 15 per cent, although the aim, says Zammit Tabona, is to see that rise to 25 per cent.

Zammit Tabona spends a lot of time in London, meeting with managers and arranging 36-hour business trips to the island. In his role as Special Envoy for Investment Promotion, and having previously been the Chairman of the Malta Stock Exchange – among many other high profile positions – Zammit Tabona is well placed to get prospective managers in front of Malta’s key service providers.

“I help organise a detailed itinerary with the MFSA, the law firms, banks and accounting firms, sometimes the Prime Minister and the Governor of the Central Bank of Malta (Professor Josef Bonnici) to help them make a decision on whether to start a fund in Malta, or indeed relocate.

“One manager who visited recently is now looking to set up a head office in Malta - we are seeing more operations teams and senior management coming to Malta;
Malta’s regulatory framework is just as flexible

Because the Maltese regulatory regime is so robust and adaptable, it allows promoters to innovate and develop new products that meet their investors’ changing needs. Moreover, the flexible, proactive accessibility of the Malta Financial Services Authority is highly appreciated by the industry. As a result, Malta is developing a viable jurisdiction for hedge funds and private equity, and a stable environment to support innovative strategies and solutions, especially for start-ups.

At VFS, we help to deliver specialist fund administration solutions to create tangible value for your clients and to help you to better respond to those market challenges.

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Valletta Fund Services Limited is recognized to provide fund administration services and licensed to provide company services by the Malta Financial Services Authority.
When it comes to the formation process, funds in Malta may take different legal forms and with respect to hedge funds, the most popular structure is the SICAV. The formation process is two-fold:

- The fund licensing process, handled by Malta’s financial regulator, the Malta Financial Services Authority (‘MFSA’) and;
- The constitutive process, handled at the Registry of Companies level.

Perhaps unsurprisingly, the former represents the greater challenge. A formal application for a fund license is filed with the MFSA, whereby a full suite of application documents, plus application fees are presented.

“The application pack comprises, amongst others, an application form, draft M&A, draft offering documentation, board resolutions, and due diligence documentation on all functionaries and appointees,” explains Joseph M Camilleri, Chief Officer of Valletta Fund Services, the fund administration arm of Bank of Valletta and Malta’s largest administrator. “This would lead to the receipt of MFSA’s “Initial Comments” letter, whereby the regulator makes observations on the various documents presented to it.”

Once all issues in the documentation are addressed by the turnkey contractor (which might be a law firm or even a fund administrator) and meet the MFSA’s satisfaction, this would lead to the issuance of an “In Principle Approval” letter.

“At this stage, the SICAV is incorporated and all outstanding and any pre-licensing conditions as listed in the MFSA’s letter are addressed. Following which the SICAV is effectively issued a license to operate,” confirms Camilleri.

As Malta’s fund industry is fully regulated, all hedge funds that are established as AIFs are subject to the full scope of the AIFM Directive.

However, de minimis fund managers – those with less than EUR100 million in AUM – or self managed de minimis AIFs may opt out of this regulation and be structured as per the regulatory provisions of the EU Member State where the fund is to be set up. Malta opts to regulate this segment too, notwithstanding it is out of scope for AIFMD.

“As such, these AIF structures lend themselves perfectly for promoters of smaller sized funds, putting Malta in an enviable position of not pursuing a “one size fits all” approach to out of scope hedge funds,” says Camilleri.

This is certainly a useful differentiator for Malta. When asked how he feels the island will continue to evolve going forward, Camilleri confirms that, aside from fund formation, the setting up of AIFMs is “developing nicely”. Here, the core business model is to carry out the risk management function from Malta and the designated management company, and delegate the investment management function to licensed entities in other domiciles such as London.

“A number of EU-based entities, particularly UK-based ones, have set up subsidiary operations in Malta to act as the AIFM, precisely for this purpose. By doing so, they benefit from a lower cost base, a friendly regulatory climate and an EU-approved advantageous fiscal regime,” adds Camilleri, noting that both de minimis AIFs and fund managers have also found fertile ground in Malta.

One other positive development in Malta, which is likely to continue providing growth opportunities to the sector, is the rent-a-cell concept.

“Platforms hosting other parties’ sub-funds – the plug and play model – is again a very encouraging trend that is picking up and which is likely to enhance its presence further in Malta,” concludes Camilleri.
Mamo TCV Advocates is ranked as one of Malta’s tier-one law firms. It has a strong local and international practice in various specialised practice areas, including funds and financial services, corporate law, banking and finance, intellectual property, shipping, aviation, litigation and alternative dispute resolution.

The firm’s Funds and Financial Services Department has a dedicated team of lawyers involved principally in structuring, licensing and on-going regulatory and transactional advice to an array of collective investment schemes (including Professional Investor Funds, Alternative Investment Funds and UCITS) investing in various asset classes, and to fund service providers, including fund managers, administrators, prime brokers and custodians, as well as to a variety of investment firms, payment service providers and other financial institutions in the different licence categories.

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“Malta provides an outstanding opportunity for private equity and venture capital managers. It has a flexible LP structure, an extensive network of double tax treaties, a favourable local tax regime and experienced service providers who can provide a cost-effective solution,” comments Felicity Cole, Head of the Funds Department at Maltese law firm, Mamo TCV Advocates.

Of particular importance says Cole, are recent changes made to the Maltese Companies Act, which governs limited partnerships, including changes which set out the extent to which limited partners can participate in the management of the partnership without losing their limited liability. This is important in the context of investment committees. In many other jurisdictions the law is less clear than it is in Malta, and for large institutional investors, inclusion on the investment committee is imperative.

Maltese law also clarifies that an LP is able to sit on the board of the GP without losing its limited liability. “This can be important for investment management companies who might have subsidiaries as limited partners and also want representation on the board of the GP,” adds Cole.

Another benefit to private equity managers is that a Maltese limited partnership has a separate legal personality. This is advantageous when the partnership is looking to get financing, for example.

The recent introduction of the Maltese loan fund regime in 2014 brings a further advantage to the private equity space in Malta. It provides a framework within which Maltese funds can provide finance to unlisted companies and SMEs and acquire portfolios of loans, and several loan funds have already been set up.

Malta also has an extensive tax treaty network with 69 tax treaties in force while Luxembourg, so often the go-to choice for PERE managers, has 74 tax treaties in place; a few countries in Southeast Asia and Central Asia, such as Kazakhstan, being the principal differences.

Some of the important countries with which Malta has tax treaties in place include: South Africa, India, Mexico, Israel and the Middle East, including Morocco, Qatar, UAE, Turkey and Bahrain.

Malta’s tax environment is attractive, both for funds and management companies. Malta’s holding company tax regime works particularly well for funds which take advantage of Malta’s tax treaty network to invest in a third country through a Maltese holding company.

For example, say a private equity manager invests in a portfolio company in Morocco. When the Moroccan company remits either income or gains to the Maltese holding company, provided the Moroccan company qualifies as a “participating holding of the Maltese holding company, there will be no Maltese tax on the income or gains. “In addition, there are no withholding taxes when the Malta holding company distributes to its shareholders,” explains Cole.

Malta’s membership of the EU means that the Parent-Subsidiary Directive and the Interest & Royalties Directive offer further opportunities for tax planning.

There are many advantages to private equity managers who choose Malta but in Cole’s view, the tax treaty network is a key point, given that structuring a private equity fund is largely tax-driven:

“Private equity managers should be aware of how much of an overlap there is with regards to the jurisdictions with which Luxembourg and Malta have tax treaties. However, it is a more cost-effective and quicker process to set up funds in Malta.”
the number of AIFMs is growing,” confirms Zammit Tabona.

This is helped by the fact that Malta’s service provider infrastructure continues to expand. The rapid growth in the number of funds domiciled in Malta has led to a proportionate growth in the number of service providers servicing such funds over the years. “About 35 per cent of funds (including sub-funds) domiciled in Malta are now managed by Malta-based fund managers and approximately 75 per cent of such funds now use local fund administrators,” confirms Kevin Valenzia, Territory Senior Partner, PwC. “Furthermore, there are approximately 50 legal firms established in Malta and all the major audit and accounting firms (including the ‘big four’) are all present and active in the sector.”

Malta’s upbeat and dynamic environment is proving ever more attractive to fund managers, and as the trend to move onshore into well-regulated jurisdictions accelerates, Valenzia says that “many in the industry expect Malta’s rapid pace of expansion will continue to accelerate”.

Indeed, PwC has created an international Asset Management industry network to share business ideas and cross border industry developments. This network is one of PwC’s most distinguishing features—spanning 157 countries and including more than 500 partners worldwide, including Malta.

“In PwC Malta, the Asset Management practice is led by a dedicated team of professionals in Audit, Tax, Regulatory and Business Advisory Services. We are able to help and assist fund promoters across the whole value-chain of their business proposition,” confirms Valenzia.

In addition to seeing more investment managers setting up their own management companies in Malta, some existing management companies have upgraded their capabilities and licences to function as AIFMs under the AIFMD.

“Under AIFMD, AIFs will be required to appoint a local custodian by July 2017. This is both a significant challenge and an opportunity for a maturing jurisdiction like Malta,” comments Joseph Camilleri, Chief Officer, Bank of Valletta Fund Services, one of Malta’s most established fund administrators.

“We are seeing more operations teams and senior management coming to Malta; the number of AIFMs is growing.”

Joseph Zammit Tabona, Special Envoy to the Malta’s Prime Minister

This is something that the MFSA is aware of. Last December, it published A Guide to the Establishment of Custody Operations (Depositaries) in Malta, providing practical steps and considerations. “The custody issue is a challenge for Malta, but the MFSA document shows that it is high on the agenda. It is one area that we will be touching upon when FinanceMalta hosts an event in London on 5th November 2015,” says Kenneth Farrugia, Chairman of FinanceMalta.

It is nevertheless worth noting that roughly 70 per cent of Malta’s funds are de minimis with less than EUR100 million and as such do not exactly offer an enticing business opportunity for tier one custodians. For Malta to attract bigger custodians, it needs bigger funds.

“Banks are under fire at the moment and are retrenching to some extent,” says Derek Adler, a director and founder member of International Financial Administration Group (‘ifina’). “But we do need more banks in Malta. In many respects, it is a chicken and egg situation because you need sufficient business volume (i.e. large funds) to justify setting up in these jurisdictions, yet at the same time, without having enough custodians it’s hard to attract big fund managers.”

Professor Joseph Bannister, Chairman of the MFSA, confirms that the situation is being dealt with and on the way to being resolved.

“We have two Swiss banks coming to the island – Swissquote and REYL Bank – besides Sparkasse Bank, which has been here for some time, and we are currently in discussion with another two banks. In view of the fact that we might start seeing more larger funds in Malta, we are looking at big custodians to deliver the necessary services.”
Developments and opportunities in Malta

By Dr Michael Xuereb

Following several years of fund platform developments, the MFSA has more recently been focusing its efforts on upgrading and enhancing the product structuring framework.

The Securitisation Act, which came into effect in 2006, introduced important legal changes which greatly improved the scope for structuring new investment products under Maltese law. This legislation was followed by other important developments including the setting up of the European Wholesale Securities Market ('EWSM'), a specialised market for debt securities targeting institutional and professional investors in Europe.

Following a settling in period the Securitisation Act was earmarked for further development aimed at integrating securitisation into the financial services value chain. This would also involve the introduction of certain add-ons that would render the Act more amenable to specific types of product structuring and give it an edge over comparable frameworks elsewhere.

Given the inroads the jurisdiction had made in the insurance sector, particularly captive insurance, the first initiative was to explore ways in which the Malta could meaningfully tap the insurance-linked securities (ILS) market.

Typical ILS instruments are those linked to property losses due to natural catastrophes. The issue of ILS requires the transfer and securitisation of risk via special purpose vehicles that may be set up under the Act.

Reinsurance Special Purpose Vehicle (RSPV) Regulations published at the beginning of 2014 enabled the MFSA to regulate this type of activity. They were the first legislation of its kind in the EU and had the added advantage of being aligned with the Solvency II draft implementing measures. The Regulations are therefore already in line with the corresponding Solvency II regime allowing operators to position themselves in this market at an early stage.

The ability to purchase a securitised risk instrument (in the form of bonds, notes or other securities) issued by an authorised RSPV helps institutional and professional investors diversify their investment portfolios. It is also possible to structure the product in different tranches based on proximity to the underlying risk thus providing investors with even more choice.

The next logical step in the development agenda was to introduce the cell concept in the area of securitisation. Protected cell companies were already very well established in the Maltese financial sector when the Securitisation Cell Company Regulations came into effect at the end of 2014. The introduction of Securitisation Cell Company (SCC) was founded on well-trodden ground.

The cell structure allows securitisation vehicles making use of multiple compartments to establish these within a legally entrenched framework that recognises and protects different sets of assets or risks placed in separate cells of the same company. Thus, investors in instruments issued through one cell of an SCC are protected from any claims arising from other creditors of the same SCC.

In essence, cell legislation provides a ring fence around contractual arrangements placed within a securitisation cell of a securitisation company. This may be replicated in other cells of the same company allowing unlimited scaling up of securitisation activity within a single special purpose vehicle. This makes the SCC an excellent vehicle for the launching of asset backed securities and similar types of instrument. It is also possible to structure a Reinsurance Special Purpose Vehicle as an SCC.

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CTAs. With respect to government bond futures, Article 54 of the UCITS IV Directive relates to Single Issuer Concentration Risk. It states that securities from “any single issue shall not account for more than 30 per cent of its total assets”.

“There is a serious gap in UCITS IV regulation in relation to single issuer concentration. ESMA defines all Exchange Listed futures as free of counterparty risk, and whilst equity indices are not subject to concentration risk parameters, for bond futures they want managers to apply the full commitment rules, irrespective of their licensed risk model. This means that because the implied leverage of bond futures is so high, you struggle to run a balanced portfolio of government bond futures in a UCITS fund; and by struggle I mean it’s nearly impossible. The alternatives (certificates and swaps) can cost an active fund 2 to 3 per cent in performance per year,” states Gebhardt. “This is a very important issue in my view because it will block any active US Managed Futures funds from coming to Europe and establishing UCITS. It is the single biggest impediment to any US-based CTA that wants to trade bond futures in a balanced UCITS programme.”

It’s an important point, as some US managers prefer the more established UCITS wrapper to the AIF wrapper. Malta has already seen a good number of UCITS funds structured throughout the first half of 2015. If and when these regulatory kinks are ironed out by ESMA, Malta could see UCITS fund numbers rise further.

That aside, one important area of momentum – in response to AIFMD – is that of the AIFMD fund platforms being established to provide a turnkey solution for those managers wishing to establish an AIF. One of the most recent firms to acquire its AIFM license to provide both third party management company services to existing standalone funds, as well as offer a fully hosted AIFM and fund platform solution to newly established funds, is Portcullis Asset Management.

“We received our AIFM authorisation in November 2014 and we are planning to launch our first client sub-fund at the start of October,” confirms David Barry, CEO of Portcullis Asset Management. “It’s a sizeable
One firm that offers a slightly different option is Cordium, a leading compliance specialist, who recently established the Cordium Total AIFM Solution (‘CTAS’) in Malta. Where CTAS differs is that the manager retains full ownership of the Malta AIFM, whilst Cordium takes care of all the operational and compliance demands.

“This is relatively new but it’s generating a lot of interest. Our MiFID hosting solution run by Mirabella Financial Services has been working well for 10 years; while AIFMD required a necessary evolution of that business line which is why we created CTAS. It’s still early days but we’re optimistic,” says Bobby Johal, Managing Consultant at Cordium.

The idea of the Malta platform as a hosted solution would be to support people looking to launch funds in Europe, including non-EU managers who currently are unable to avail of the fund passport, but which could become available in the next year or two; though this remains a politically charged issue.

“The premise of CTAS is that the client owns the AIFM and we operate it. CTAS is not a fund platform solution on which managers can launch sub-funds. We don’t get involved in the distribution side of things at all; that’s the front-office responsibility of the manager,” adds Johal.

Barry believes that there will be a wide range of strategies joining its fund platform – known as Mdina SICAV – to reduce the time to market and to have access to greater distribution channels via the EU marketing passport and those who simply opt to use Portcullis Asset Management to handle the operational heavy lifting to comply with the Directive. Our vision is to build a multi-asset platform that we can market to all types of investors.

“I think the issue that managers sometimes have with platforms is control. Who has the voting shares? Some managers like to have their own fund structure in order to be able to appoint their own service providers and directors. Both business models we offer are attractive to different sub-sets of managers. Ultimately, it will depend whether the manager is comfortable with the platform infrastructure, the service providers and directors being used, and the control element,” concludes Barry.