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Malta in a post-Brexit world

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By James Williams

Introduction

With Brexit due to be finalised in the next nine months, picking the right EU jurisdiction has become a key strategic consideration, both for established hedge fund managers and start-up managers, who need a “Plan B” to ensure continued use of passporting rights to distribute their funds to EU investors.

This is likely to prove beneficial to EU fund jurisdictions such as Malta, which continues to experience growth of its funds industry, not just on the fund licensing side but, increasingly, the number of AIFMs being set up on the island. As the following report will detail, managers need to get a clear sense of what Malta can offer and why it should be regarded as a viable solution to EU fund structuring and distribution. What, for example, does Malta’s service provider network look like? What client service levels

can UK managers expect? What does it offer from a fund structuring and distribution perspective and what is it like working with the Malta’s financial regulator, the MFSA?

Malta is not only a fund jurisdiction but also an asset management jurisdiction, perfectly capable of providing all the necessary passporting rights to market and distribute Maltese funds across the EU.

It is a small island with a population of 430,000 people and sits 50 miles south of Sicily in the Mediterranean Sea. Its capital city is Valetta, and is the primary nexus of its financial funds industry. Malta’s economy continues to go from strength to strength, recording 6.6 per cent year-on-year growth in 2017 and is, according to the European Commission, among the fastest growing economies in the EU. Inflation last year was 1.3 per cent, while the unemployment rate was a lowly 4 per cent. Some 8,000

new employees were added to the island's workforce last year.

Malta joined the EU in 2004 and its fund services industry has been steadily growing ever since. It currently employs around 10,000 people and contributes approximately 8 per cent to Malta's GDP. The aim now is to see Malta continue on this growth trajectory and to support UK managers who as they seek out a back-up plan in response to Brexit.

Malta's financial services ecosystem is split into five main areas: pension schemes, private wealth and stockbroking services, banks and credit institutions, insurance companies and asset management services.

The fact there are 26 fund administrators, alone, is evidence that there is plenty of service provider choice on the island. It's a very competitive market, with different fund administrators specialising in different areas of expertise, making it well suited to support both traditional and alternative fund managers as they develop new investment strategies.

There are 160 asset management companies on the island with just over 550 registered funds. Fund regimes range from the Professional Investor Fund ('PIF') to UCITS funds, Alternative Investment Funds ('AIFs') and Notified AIFs ('NAIFs'), the latter not requiring MFSA approval provided an authorised full-scope AIFM is appointed to the fund.

Looking ahead, Malta is aiming to become one of the first European jurisdictions that opens its doors to crypto assets and blockchain. The Maltese government has just published three bills, which will seek to regulate this space and illustrates well Malta's continued commitment to innovation; the hallmark of any high-quality fund jurisdiction.

Legal & regulatory considerations

With Brexit looming, understanding what are the main legal structuring solutions that Malta can offer will likely be at top of any CEO's 'to do' list, when assessing EU jurisdictional options.

The Maltese jurisdiction allows the use of a variety of legal vehicles in the context of hedge funds. In fact, a Maltese hedge fund can be structured using the following legal vehicles:

- An Investment company, with variable share capital (SICAV) or with fixed share capital (INVCO). The most popular form of Maltese investment vehicle is a corporate variable capital fund (SICAV), usually established as an open-ended fund. SICAVs also can be established as umbrella funds. A SICAV that is established as an umbrella fund may have segregation of the assets and liabilities of each of its sub-funds. The variability of a SICAV's capital allows for significant flexibility in shareholder operations. The general information relating to any company incorporation also will apply to closed-ended funds. A SICAV may also be established as a Recognised Incorporated Cell Company (RICC), enabling each sub-fund within the structure to be established as a separate incorporated cell (IC) having separate legal and juridical personality from the other sub-funds. An INVCO is a closed-ended fund to which particular rules on distribution and capitalisation of profits apply.
- A Collective Investment Scheme (CIS) also can take the form of a unit trust that is governed by Maltese law or the laws of any other jurisdiction. A unit trust is a contractual agreement entered into between the management company and the trustee.
- A fund also can be set up as a limited partnership. Limited partnerships benefit from more structural and operational flexibility.
- A CIS can also be setup as a contractual fund. Contractual funds are CISs that are set up by a deed of constitution (entered into by the fund manager and the custodian of the fund) and consequently do not have legal personality and may be an open-ended or closed-ended scheme.

Although the final Brexit deal is still uncertain, if the UK leaves the single market then UK fund managers will be regarded as third country fund managers, which will have implications depending on the regulatory status of the individual fund manager.

From a UCITS perspective, the implication is relatively straightforward. The law is clear that both the fund and the fund management company need to be set up within the EU. As such, UK fund managers would have no



choice other than to find a European home to continue marketing their UCITS funds.

With respect to alternative investment fund managers ('AIFMs'), the situation is slightly more complex. Under the AIFM Directive, UK managers can avail of a manager passport to manage funds on a cross-border basis and also avail of a fund passport, which allows them – as current EU AIFMs – to market EU-based AIFs across the EU.

In the event that the UK were to become a third country, it would significantly impact the way UK AIFMs manage and market their EU AIFs in the EU.

Take the management company passport as an example. If a UK AIFM is managing an Irish or Luxembourg AIF, come Brexit it is uncertain whether that manager could continue to manage that fund, as the management company passport would no longer be available.

From a marketing perspective, the UK manager would need to avail of national private placement rules under Article 42 of AIFMD as they would be deemed a third country AIFM. To clarify, under AIFMD, Article 42 relates to non-EEA AIFMs marketing either EEA or non-EEA AIFs into Europe.

If, however, the UK manager is marketing a non-EEA fund, i.e. a Cayman fund, in a post-Brexit scenario their obligations would shift from Article 42 to Article 36, as they would become a non-EU AIFM managing a non-EEA AIF.

Under Brexit, one possible outcome is

that the UK will be awarded third country equivalence status and allow managers to continue passporting their funds freely. There is no certainty that this will happen, however.

UK AIFMs managing EU-based AIFs could simply choose to comply with Article 42 and be content with private placement, which will limit their reach from a distribution perspective.

Alternatively, they could think about setting up an EU AIFM to continue marketing their EU AIF under the passporting rules; which is where a jurisdiction like Malta comes into play.

Malta has a compelling case for attracting UK managers to the island. That there are now over 160 fund managers licensed and operating in Malta is indicative of the growing interest in this space.

Some UK managers, in particular those who are running UCITS funds, have decided to redomicile their funds to Malta, from where they run them as self-managed UCITS. This is where the fund itself is considered as the manager and it requires the establishment of an investment committee. The risk management procedure becomes a document of the SICAV rather than of the manager (typically this would be the same as the RMP used by the UK manager) and the self-managed UCITS would then outsource the day-to-day investment management to the UK firm.

Another option, which is a fully outsourced option, is to avail of third party ManCo services in Malta. This is popular among start-up alternative fund managers, and smaller established managers, who regard Europe as a key market for their fund marketing activities and who do not wish to be limited by private placement.

There are a number of Super ManCo platforms in Malta providing management company services to UCITS and AIFs. In such an arrangement, the appointed ManCo carries out all the risk management and compliance functions and delegates portfolio management activities back to the UK manager.

The third option, or Goldilocks option, is where UK managers set up their own AIFM in Malta and use the hosting services of locally based AIFMs. In this arrangement, they are physically housed within the local AIFM's offices and avail of the local AIFM's



entire operational infrastructure and human resources. This removes the burden of going solo and staffing their own office to run the show.

But why choose Malta to do this? Well, it's legacy relationship with the UK goes some way to differentiating it from other EU jurisdictions. Malta is not trying to aggressively take business away from the UK - it wants to build a bridge to cooperate effectively with the UK. This legacy relationship is based on mutual trust and understanding. Malta is an active member of the Commonwealth, it is an English speaking island, all its laws are published in English, so there is no risk of misinterpreting Maltese law.

Redomiciliation legislation allows the transfer of a seat of a foreign company to Malta. Where you have a regulated fund company two processes would need to be undertaken in tandem. First, a number of documents would need to be filed with the Registry of Companies in Malta (equivalent to Companies House in the UK) evidencing

that the necessary corporate steps have been taken for the transfer. And secondly, a process would need to be undertaken with the MFSA to license the new management company and/or the fund.

For *de minimis* managers, Malta has a light touch regime known as the Professional Investor Fund regime. Benefits include no need to appoint a custodian, no investment restrictions, no restrictions on borrowing. However, the PIF cannot be freely passported to EU investors.

Previously, the PIF regime had Experienced, Qualifying and Extraordinary Investors. It now has one category: the Qualifying Investor Fund. The same is also true of the AIF.

Both the PIF and the AIF are regulated products, whereas the NAIF, which can only be established by an authorised AIFM, is unregulated and offers managers a faster route to market; typically within 10 business days of submitting the NAIF application to the MFSA.

Operational/infrastructure considerations

With respect to Malta's funds ecosystem, following Malta's accession to the EU in 2004 its financial services industry has really grown, including service providers. Most of Malta's fund administrators, like Apex Fund Services, are international firms, it is home to the Big 4 audit and tax firms, while local law firms have specialised teams focused on financial services.

The experience Malta's service provider community has built over the last 14 years is substantial, covering vanilla as well as highly technical structures. Malta has good quality service providers at a lower cost than those in larger European jurisdictions.

There is a solid foundation of knowledge and expertise, everyone in the service provider community speaks the same language (figuratively speaking). There is a common goal towards helping the client, especially fund managers who want to demonstrate to investors that the fund's service providers are reliable and trustworthy.

The Maltese Government is committed to being in the EU and is committed to making the jurisdiction work for fund managers. That's evidenced over the years by the

growth of service providers – Dolfín Asset Services just received a custodian license and is the latest example.

As Malta's service provider is a small community, people know everyone and fund managers can get an answer pretty quickly to any operational concerns they might have.

Still, the MFSA is not always the most efficient regulator. If they need further information in relation to their due diligence process, when reviewing a fund application, they won't email, they'll send something in the post. So it's a little bit old fashioned in that respect. The rules are very straightforward though, much the same as one would expect in Guernsey, or Jersey.

Having the support of the right providers from the outset will help managers during the fund application process, making sure the right information is in place to speed up the approval process with the regulator.

Anyone considering Malta will need to understand what the service provider can bring to the table; what experience do they have servicing similar fund strategies? The best service providers will help UK managers in appointing other entities to the fund; banks, custodians, compliance experts who can be appointed to the fund's board of directors, etc.

Where are you going to market the fund? How big is it going to be? What is the strategy? What type of investors do you intend to approach? All of these considerations will go into the business plan. Then, it will be a case of selecting the right service providers to help you achieve your business objectives, and support the fund's activities on an ongoing basis. The ongoing costs should be clearly defined as this will impact the fund's TER.

In Malta you can set up both the fund and the fund manager and that can help significantly reduce costs; the same service providers can be used across both entities and you can manage your time, and your costs, more efficiently.

Cost isn't everything, however, it's the quality of people you are dealing with. For most of the middle- and back-office services, UK fund managers will find a deep pool of talent in Malta. The Big 4 have 500-plus employees, fund administrators and Maltese AIFMs are growing rapidly, so there's no



shortage of specialised people to draw on. Also, when it comes to risk management, the talent pool is growing. People are aware that risk management is very important under AIFMD and Malta continues to attract risk officers and operations support to run Malta-based AIFMs.

You won't find front-office talent on the island though; there aren't portfolio managers walking down the streets as if it were Mayfair. These activities remain in London. Still, the fact that Malta has over 300 days of sunshine a year is helping Malta's service provider community to successfully attract overseas talent. This is helping to consolidate Malta's talent pool, which now boasts a good mix of local talent (including graduates from the University of Malta) and overseas talent.

One area of importance for UK managers is the local AIFM community. Under Brexit, some UK fund managers will wish to set up their own AIFM and have someone staff it and operate it for them on a day-to-day basis. A third party AIFM has the infrastructure in place for a UK manager to use from the get-go.

For new managers in particular, time to market is an important consideration. If they have investors already lined up, they will want to get to market as quickly as possible. That is where using a third party AIFM can be beneficial, as it would otherwise take six months or more to wait for their own AIFM authorisation. Joining a third party AIFM can take as little as four weeks.



Under AIFMD, one cannot operate a brass plate entity. What substance is required will depend on the business structure and the fund strategy. Malta has always allowed an element of flexibility from an outsourcing perspective. Substance per se, has always been in Malta's DNA and a pretty straightforward issue to deal with – the MLRO, compliance officer and fund directors can all be outsourced as opposed to requiring full-time employees.

However, from an AIFMD perspective, an AIFM cannot outsource both the portfolio management and risk management functions. One has to remain internally. A third party AIFM will therefore typically retain all risk management activities and outsource the portfolio management activities back to the UK manager.

Malta has a good network of high quality independent directors but it could probably do with a few more directorship firms, although the fund administrators and law firms offer a wide range of skills. The island could probably also do with a few more globally recognised depositary firms as this will help attract larger managers to the island, but overall, Malta's service provider is thriving and continues to attract talent.

As the effects of Brexit kick in over the next few years, Malta will likely go from strength to strength and become known as a fund management jurisdiction as much as a funds jurisdiction.

Marketing & distribution considerations

Having the Euro as a currency and being a full member of the EU allows managers who choose Malta to fully passport their license to other European jurisdictions. Its regulator, the MFSA, does a good job of continuing a relationship with the fund manager, once they have been approved and their fund has launched.

Malta's workforce is well trained, everyone speaks English, making it easy for UK managers to do business. They also tend to speak a third language – Italian, French, German – which again helps managers when they are looking to distribute their funds and do business in these countries. Malta's workforce is also more cost efficient than other fund jurisdictions.

Pre-Brexit, some of the larger UK managers initiated the process of setting up in Luxembourg as it is Europe's most established onshore funds jurisdiction. However, Malta continues to attract smaller and mid-sized managers who are looking at the jurisdiction to distribute funds into Europe as well as beyond, in places such as South Africa, Asia-Pacific. When distributing UCITS funds beyond Europe, there is less bias towards the bigger jurisdictions of Luxembourg and Ireland; Maltese UCITS are no different to Luxembourg UCITS, in the eyes of non-EU investors.

There was a consolidation of the funds framework in Malta in 2016, which outlined that the main fund products now available are retail funds (AIFs or UCITS), PIFs and AIFs. The benefits to passporting AIFs and UCITS across Europe are well known. The PIF and NAIF are, however, two interesting options available to UK fund managers.

Following the introduction of AIFMD, most promoters in Malta felt the PIF regime would become defunct. However, the MFSA decided to retain the PIF regime alongside the AIF regime and this has proven to be very popular. The main benefits are that a PIF can have non-Maltese service providers subject to a local representative being appointed as a liaison to the MFSA, and it does not need to have a depositary in place. This means less cost and less onerous obligations from a fund operation perspective.

Fund promoters who are sub-threshold (less than EUR100 million, EUR500 million unleveraged) have tended to still opt for the

PIF regime if a license is required (in the eyes of investors). If not, they have started to use the NAIF, which is an unlicensed fund product but which has a fully licensed AIFM in control of it. The MFSA maintains a register of all NAIFs.

The main difference, from a marketing and distribution perspective, is that the PIF regime, while being a licensed fund regime, cannot be passported throughout the EU and can only be offered on a private placement basis. The NAIF, on the other hand, is fully AIFMD-compliant and can be distributed throughout the EU.

The NAIF, which was launched by the MFSA midway through 2016, offers cost-efficiency and time to market. Once the due diligence on the service providers to the intended NAIF has been completed by the fund manager, and the SICAV is incorporated, the manager along with his legal advisers submits the NAIF application to the MFSA, which will include the Offering Memorandum.

From that point, the MFSA takes a maximum of 10 working days to review and approve the application; typically, the MFSA will list the NAIF in less than 10 days.

NAIFs have now been opened up to other asset classes including real estate, and other non-financial assets (artworks, precious metals). Going forward, it is conceivable the MFSA may also extend permissible assets to include crypto assets.

The passporting of a NAIF is very straightforward. One simply submits a notification to the MFSA with respect to the market the NAIF intends to be sold in to. It's important to note, however, that a NAIF can only be marketed to what the MFSA refers to as 'qualified investors'. The marketing to non-qualified investors can only happen depending on whether the particular jurisdiction caters for this in their local regulation.

Converting an AIF to a NAIF is a possibility, going forward, but currently it is not possible for a fully licensed AIF to scale back to a NAIF. A NAIF cannot be self-managed, as an AIF can.

If a manager has a strategy in mind and wants to take it to the market quickly, but doesn't want to go through a laborious due diligence and approval process, they can now use an appointed AIFM to get a Notified AIF off the ground within 10 working days.

Breakdown of last month's GFM Malta event at the Reform Club, London

MALTA IN A POST-BREXIT WORLD: EVENT AGENDA

Opening remarks

Michael Bianchi, Director, Financial Services Industry, Deloitte Malta

Panel discussion 1: Legal & fund structure considerations

What are the different legal vehicles and fund products available to use in Malta - both regulated and non-regulated?

Chair: Nicholas Warren, Senior Manager, Financial Services, Blockchain & Fintech, Chetcuti Cauchi

- Jean Farrugia, Partner, DF Advocates
- Joseph Camilleri, Executive Head, Business Development & Corporate Services, BOV Fund Services
- Dr Andrew Caruana Scicluna, Associate, Camilleri Preziosi Advocates

Panel discussion 2: Operational considerations

How does Malta's service provider infrastructure stack up and what are the benefits of appointing a third party AIFM?

Chair: James Williams, Managing Editor, Global Fund Media

- Paulianne Nwoko, Managing Director, Apex Fund Services
- Adam de Dominicco, Founder & CEO, Cordium Malta Ltd
- George Nicolaou, Senior Manager, Finanz Fund Services
- Brian Horsepool, Group Partner and Managing Director of Malta, Active Offshore

Panel discussion 3: Marketing & distribution

How to best utilise Malta's distribution network to promote Malta funds across the EU.

Chair: Dr Mark Caruana Scicluna, Associate, GANADO Advocates

- Christian Manicaro, CEO, AQA Capital
- Nicholas Micallef, Associate Director, KPMG
- Nicholas Calamatta, Co-CEO, Calamatta Cuschieri Group

That is a big plus for managers where timing is of the essence.

The NAIF is a great example of close collaboration between Malta's funds industry and the MFSA, so far as addressing the licensing requirements of fund products.

Conclusion

In conclusion, Malta's pragmatic approach to regulating its funds industry, its growing economy, its deep pool of talent (both local and overseas), its small but well connected ecosystem of high quality service providers, all of whom understand the cost pressures and demands of hedge fund managers, and its range of fund structuring options to meet the different distribution and marketing needs of managers, are all key ingredients. And as UK fund managers look for a Plan B in response to Brexit, all the signs would appear to be that Malta is primed and ready to welcome UK managers with open arms. ■