Sharia-Compliant Funds

Malta's fund sector is developing at a remarkable pace and has become one of the finance centre's key engines for growth. Today, the country hosts almost 600 investment funds which have a combined net asset value of €9.7 billion.

Professional Investor Funds (PIF)

An overwhelming majority of funds in Malta are Professional Investor Funds (PIFs), which are typically in the form of open-ended public or private limited liability investment companies with variable share capital (SICAVs).

Types of Professional Investor Funds

A Professional Investor Fund (PIF) is a collective investment scheme in terms of the ISA. There are three different types of PIFs:

- **PIFs promoted to experienced investors**: with a minimum investment of €10k or equivalent, are subject to some investment restrictions, may be leveraged up to 100% NAV, must appoint a Custodian and issue an Offering Document.

- **PIFs promoted to qualifying investors**: with a minimum investment of €75k or equivalent, with no investment restrictions (other than in the case of property funds), unlimited leverage, appointment of a Custodian is not mandatory (provided assets are subject to adequate safekeeping arrangements), and must issue an Offering Document.

- **PIFs promoted to extraordinary investors**: with a minimum investment of €750k or equivalent, with no investment restrictions, unlimited leverage, appointment of a Custodian is not mandatory (provided assets are subject to adequate safekeeping arrangements) and can issue a simplified marketing document in lieu of a more detailed offering document.

The underlying assets in which these funds can invest range from transferable securities, private equity, immovable property and infrastructure, to the more complex asset classes pertaining to the world of debt financing and derivatives. Most Maltese PIFs are used for hedge fund set-ups.

Ijarah Funds, Commodity Funds and Murabaha Funds, which generally invest in non-conventional asset classes, may only be licensed in Malta as PIFs, whilst Sharia-compliant equity funds can be set up as Maltese UCITS schemes or as PIFs. Considering the restrictions that apply to UCITS funds, Islamic funds may face particular challenges in operating under the UCITS framework, and industry experts believe that Malta’s framework for PIFs provides a more attractive environment for Sharia funds to work in.
**Key Features of PIFs**

PIFs are regulated by the Investment Services Act and are mostly open- or close-ended investment companies, but unit trusts, contractual funds and limited partnerships can also be used. Self-managed PIFs are also allowed and the manager may also act as administrator.

<table>
<thead>
<tr>
<th>Minimum Investment</th>
<th>Experienced Investors</th>
<th>Qualifying Investors</th>
<th>Extraordinary Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Setup Time</td>
<td>€10,000</td>
<td>€75,000</td>
<td>€750,000</td>
</tr>
<tr>
<td>Investment Restrictions</td>
<td>Yes</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Borrowing Restrictions</td>
<td>Up to 100% of NAV</td>
<td>Up to 100% of NAV</td>
<td>Up to 100% of NAV</td>
</tr>
<tr>
<td>Offering Documents</td>
<td>Required</td>
<td>Required</td>
<td>Required or Marketing Document</td>
</tr>
<tr>
<td>Third Party Manager</td>
<td>Required or Self-Managed</td>
<td>Required or Self-Managed</td>
<td>Required or Self-Managed</td>
</tr>
<tr>
<td>Fund Administrator</td>
<td>Manager may delegate fund administration to third party administrator</td>
<td>Manager may delegate fund administration to third party administrator</td>
<td>Manager may delegate fund administration to third party administrator</td>
</tr>
<tr>
<td>Custodian</td>
<td>Required. Must be independent from fund manager.</td>
<td>Optional, provided adequate safekeeping measures.</td>
<td>Optional, provided adequate safekeeping measures.</td>
</tr>
<tr>
<td>Auditor</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Money Laundering Reporting Office (MLRO)</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Compliance Officer (may also act as MLRO)</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
<tr>
<td>Listing</td>
<td>Optional</td>
<td>Optional</td>
<td>Optional</td>
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</table>

**Self-Managed PIFs:** PIFs may be self-managed without the need to appoint a third-party manager. This means promoters have the option to use a self-managed fund without the need to have a presence in Malta. The management of the assets of the fund would be undertaken by an investment committee with the day-to-day management performed by one or more internal and/or external portfolio managers. Self-managed funds are subject to particular rules regarding the composition of the board members and the investment committee, as well as share capital requirements.

**Features applicable to all PIFs:**

- **Service Provider:** Must be based in Malta or in a recognised jurisdiction.
- **Local Representative:** Required if all officials and service providers are established abroad.
- **Reporting Requirements:** Half-yearly (PIFs sold to experienced investors only), annual and compliance reports.
- **Application Fees and Expenses:** Application fee for a preliminary indication of acceptability is €600.
- **Application for a Licence of a PIF:** €1,500 per scheme, €1,000 per sub-fund, €1,500 per incorporated cell.
- **Supervisory Fee:** €1,500 per scheme, €500 per sub-fund, €1,500 per incorporated cell.
The formal guidelines issued by the MFSA give advice to fund promoters on how the current funds regime, regulated by the Investment Services Act, applies to funds established under Sharia rules and clarifies a number of related issues for the benefit of fund promoters.

The principal categories of collective investment schemes that can be set up under this common framework are the following:

**Retail Investment Schemes** - which are in turn divided into:
- UCITS
- Non-UCITS

**Professional Investor Funds** – which are in turn divided into:
- Experienced Investor Funds
- Qualifying Investor Funds
- Extraordinary Investor Funds

The regulatory standards that underpin the regime as applied to the different types of funds relies mainly on the principles of disclosure and transparency as means of protecting investors’ interests as well as on the investor’s understanding of risk as a key motive for applying regulation in a proportionate manner. The regime is applied to a large variety of conventional and alternative investment funds.

**MFSA Licensing Framework**

As a general rule Sharia-compliant funds may be set up as Retail Investment Schemes and Professional Investor Funds, although the nature of the investment and the methods used may have a determining effect on the fund category under which the fund may be licensed:

- **Sharia-compliant equity funds**: can be set up as Maltese UCITS Schemes, Maltese non-UCITS Schemes or Professional Investor Funds (PIF)
- **Ijarah Funds**: which generally invest in non-conventional asset classes, may only be licensed in Malta under the Professional Investor Funds regime (PIF)
- **Commodity Funds**: which generally invest in non-conventional asset classes similar to Ijarah Funds, can only be licensed in Malta under the Professional Investor Funds (PIF) regime
- **Murabaha Funds**: can only be licensed in Malta under the Professional Investor Funds (PIF) regime. Sharia compliant funds shall abide by the Standard Licence Conditions that are applicable to funds established under the Act.

Due to the particular nature of Sharia funds, or certain types of Sharia funds, note should be taken of the following principles:

Sharia compliant funds will be expected to follow the risk-spreading principle except when this can be waived in terms of the proviso to the definition of ‘collective investment scheme’ in the Investment Services Act

The managing body of a Sharia fund (Board of Directors in the case of a corporate fund), will be responsible for ensuring that the fund satisfies the relevant Sharia principles and requirements as disclosed in the fund’s prospectus and other investor information documentation

Except for the applicability of this Guidance Note, Sharia funds set up as retail funds (UCITS or non-UCITS), or Professional Investor Funds (PIF), will be regulated in the same manner as non-Sharia compliant funds falling under the same category

The selected extra-financial criteria (Sharia Guidelines which the fund will adopt) must comply with all prevailing regulatory and statutory requirements. No specific difficulties arise provided that the extra-financial criteria do not infringe regulatory principles.