The Asset Management Review

Second Edition

Editor
Paul Dickson

Law Business Research

The Asset Management Review

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THE PRIVATE COMPETITION ENFORCEMENT REVIEW

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CONTENTS

EDITOR'S PREFACE

Twelve months on from the first edition of *The Asset Management Review*, it is clear that these are still challenging times for the asset management industry. While the past year has witnessed signs of recovery from the damage wrought by the global financial crisis, the crisis continues to make its mark on the industry. A backdrop of continuing economic uncertainty and volatile markets constrains new investment and limits returns. Meanwhile, responses to the crisis by regulators and investors present their own challenges.

The financial crisis has drawn attention ever more acutely to the activities of the financial services industry, and the consequences of this focus are manifest in regulatory responses around the globe. Driven by a desire to avoid a further financial crisis, regulators have sought to address perceived systemic risks and preserve market stability through a wave of new regulation, including the Alternative Investment Fund Managers Directive, which has recently been implemented in Europe. For what is a global industry, the challenge of regulatory compliance is complicated by jurisdictional disparities and the introduction of legislation with potentially extraterritorial effects. It is not only regulators who have placed additional demands on the financial services industry in the wake of the financial crisis; a perceived loss of trust has led investors to demand greater transparency around investments and risk management from those managing their funds.

This continues to be a period of change and uncertainty for the asset management industry, as funds and managers act to comply with new regulatory and investor requirements and adapt to the changing geopolitical landscape. There is, however, perhaps some limited cause for optimism. While fundamental issues persist in the eurozone, the prospect of collapse seems less likely than in the recent past, and more positive assessments of the global economic outlook, albeit cautious, raise the prospect of increased investment and returns. Although the challenges of regulatory scrutiny and difficult market conditions remain, there have also been signs of a return of risk appetite; in addition, international expansion continues with an increasing focus on opportunities in emerging markets. The industry is not in the clear, but prone as it is to innovation and ingenuity, it seems well placed to navigate this challenging and rapidly shifting environment.

The second edition of *The Asset Management Review* includes coverage of a number of additional jurisdictions, reflecting the global importance of the industry and this practice area. The publication of the second edition is a significant achievement, and I continue to be grateful for the support of the many lawyers and law firms who have contributed their time, knowledge and experience to the book. I would also like to thank Gideon Roberton and his team at Law Business Research for all their efforts in bringing the second edition into being.

The world of asset management is increasingly complex, but it is hoped that the second edition of *The Asset Management Review* will continue to be a useful and practical companion as we face the challenges and opportunities of the coming year.

Paul Dickson
Slaughter and May
London
September 2013

Chapter 18

MALTA

André Zerafa and Stephanie Farrugia[1]

I OVERVIEW OF RECENT ACTIVITY

Over the past year a number of asset management firms and investment vehicles have been set up in Malta, and the main areas of activity concerned the authorisation by the Malta Financial Services Authority (the MFSA) of fund management companies and professional investor funds (PIFs). The latter are the vehicle of choice for structuring alternative investment strategies such as private equity, hedge and real estate. According to the MFSA's Annual Report for 2012:

> *The Authority licensed 128 new Collective Investment Schemes (including sub-funds) in 2012, representing an increase of almost 19 per cent over 2010 but a decline of about 28 per cent from 2011. Of the new funds' licenses issued in 2012, 117 were Professional Investor Funds (PIFs), nine UCITS funds, and two Retail Non-UCITS funds.*

The main legislative and regulatory development in the asset management space during the past year was the implementation of the Alternative Investment Fund Managers Directive (the AIFMD), which is intended to create a regulatory and supervisory framework for alternative investment fund managers (AIFMs) in the EU. The MFSA launched a consultation exercise in September 2012, and issued various consultation papers until June 2013. The AIFMD was implemented through new subsidiary legislation and Investment Services Rules issued by the MFSA, and amendments to existing legislation and rules. These legislative instruments came into full force and effect on 22 July 2013.

1 André Zerafa is a partner and Stephanie Farrugia is an associate at Ganado Advocates. The authors would like to acknowledge Matthew Mizzi's contribution to the original version of this chapter.

During 2012 a new vehicle was added to Malta's repertoire of cellular fund vehicles: the recognised incorporated cell company (RICC). Directly targeting fund platform providers, regulations issued under the Maltese Companies Act permit the creation of (or conversion into) an incorporated cell company type vehicle where the core or RICC's activities would be limited to providing, in exchange for payment of a platform fee, certain administrative services to its incorporated cells. While falling short of fully fledged fund administration services, the range of permitted administrative services for RICCs covers the typical platform type services. RICCs are required to apply for a recognition certificate in terms of the Investment Services Act, 1994 (the ISA) and, in this regard, the MFSA issued a new subset of rules outlining the recognition requirements and application documentation required, as well as setting out the ongoing requirements for RICCs.

II GENERAL INTRODUCTION TO THE REGULATORY FRAMEWORK

Legislation introduced in October 2002 provided for a single regulator, the MFSA, to be responsible for the regulation and supervision of the capital markets, the banking industry, insurance businesses, trust businesses, fund businesses and investment services. The MFSA is established under the Malta Financial Services Authority Act (the MFSA Act). The MFSA has the legal status of a body corporate having a distinct legal personality, and is able to:

a enter into contracts;
b acquire and dispose of property of any kind for the purposes of its functions under the MFSA Act or any other law;
c sue and be sued; and
d undertake all such things and enter into all transactions as are incidental to or conducive to the exercise or performance of its functions.

The two main organs of the MFSA are the Board of Governors, which establishes the MFSA's policy, and the Supervisory Council. The function of the Council is licensing, monitoring and supervising all activities relating to financial services in Malta. The Council is made up of a director-general and the directors of each unit within the MFSA, namely:

a the authorisation unit (responsible for licensing and authorisation of all regulated businesses falling within the remit of the MFSA);
b the insurance and pensions supervision unit (responsible for the regulation of insurance and pensions business);
c the securities and markets supervision unit (regulating investment services);
d the banking supervision unit (responsible for banking regulation); and
e the regulatory development unit).

The MFSA can also impose administrative penalties on licence holders if they do not comply with any licence conditions, applicable law, or directives and regulations. The MFSA Act contains exchange of information provisions whereby the MFSA, while legally bound to treat as confidential any information acquired during the discharge of its duties, may disclose information to foreign regulators to assist them in matters relating to the regulation and supervision of financial services. The MFSA is bound to disclose the requested information if such a duty to disclose falls within the terms of Malta's international commitments, or if required within the terms of understanding assumed in bilateral or multilateral agreements relating to the exchange of information and other forms of collaboration with foreign regulators (including requests arising under a memorandum of understanding (MoU)).

The MFSA has also been designated as the listing authority under the Financial Markets Act, 1990 (the FMA), and is therefore responsible for the regulation of Malta's capital markets and of any investment exchanges operating in Malta in terms of the FMA.

The ISA lays down a licensing regime for persons acting in or from Malta as principals or agents arranging deals, managing investments or acting as trustees, custodians or nominees, or providing investment advice in respect of a number of financial instruments.

Collective investment schemes (CISs) are issued with a CIS licence by the MFSA. CISs are extensively regulated by *ad hoc* rules issued by the MFSA pursuant to the ISA. Different rule books apply to the different types of CISs that can be established. Hedge funds, private equity funds, real estate funds and other types of alternative investment funds (AIFs) would typically fit within the category of PIF, which are discussed in further detail in Section VI.iv, *infra*. These rule books were amended during the past year as part of the implementation of the AIFMD. On the other hand, UCITS funds and non-UCITS retail funds are subject to different sets of rules, which in the case of UCITS funds reflect EU-harmonised directives and regulations.

CISs can be established as companies (either closed-ended investment companies or open-ended variable share capital companies), unit trusts, common contractual funds or partnerships; however, the private law in regard to these latter three forms is in the process of development, and consequently CISs have rarely been structured as unit trusts, limited partnerships or common contractual funds. The Companies' Act, 1995 (the CA) contains the corporate rules applying to CISs that are structured as limited partnerships and companies, while the Trusts and Trustees Act (Chapter 331 of the Laws of Malta) provides for the general trust principles that apply to unit trusts.

The following categories of collective investment scheme are exempt from licensing, subject to advance ruling from the MFSA:

a a scheme involving participants, each of which carries on a business other than that which constitutes an investment service and enters into the arrangement for commercial purposes related to that business;

b a scheme that operates according to the principle of risk spreading, or in respect of which the contributions of the participants and the profits or income out of which payments are to be made to them are pooled, but only if the general purpose of the scheme is commercial and not for investment purposes; and

c a scheme operated by a company for its own employees, former employees and their dependants, or for employees, former employees and their dependants of companies in the same group, in instruments issued by the company or other companies in the group, and any other instruments as may be approved by the MFSA.

It is also possible to obtain a recognition certificate as opposed to a fully fledged authorisation if the collective investment scheme is able to be classified as a private fund that has to satisfy the following criteria: the total number of participants is limited to 15 persons, and the MFSA is satisfied that the participants are close friends or relatives of the promoters; the scheme is essentially private in nature and purpose; and the scheme does not qualify as a PIF.

III COMMON ASSET MANAGEMENT STRUCTURES

The most popular forms of Maltese investment vehicles are corporate variable capital funds (SICAVs). Usually established as open-ended funds, SICAVs can also be established as umbrella funds. A SICAV established as an umbrella fund may opt to have the assets and liabilities of each of the sub-funds forming part of the umbrella structure treated as a patrimony separate from the assets and liabilities of each other sub-fund of the same SICAV. Accordingly, the liabilities incurred in respect of each sub-fund must be paid out of the assets forming part of its patrimony. If these assets are insufficient to satisfy the creditors' claims, such creditors shall have no claim or right of action against the other assets of the SICAV.

The CA regulates SICAVs by restating certain rules that are normally applicable in the context of a limited liability corporate structure (in particular, those relating to share capital and distribution of profits) to render such rules more appropriate for investment vehicles. Several other rules in the CA are also not applied to a SICAV structure. The objects of a SICAV are limited to the collective investment of its funds in moveable or immoveable property with the aim of spreading risk and giving the shareholders the benefit of the management of its funds. The variability of the SICAV's capital allows for significant flexibility in shareholder operations. Following recent amendments to the CA, an issue of shares by a SICAV for a cash consideration that is subject to full payment by a settlement date will be considered to be a lawful issue of fully paid-up shares, provided that the SICAV is authorised to issue shares in such manner by its memorandum or articles of association, the settlement date and terms of payment are clearly disclosed in the offering document issued by the SICAV, and the person acquiring the shares undertakes in writing to pay the full subscription price no later than the settlement date.

The MFSA would typically recommend that a corporate CIS should have three directors, one of whom should be independent from the manager and the custodian. A corporate CIS is subject to an annual audit by a Maltese firm of auditors in accordance with International Financial Reporting Standards. It must also have a registered office in Malta, and keep its corporate records and the register of officers and directors at the registered office. The memorandum and articles of association of the corporate CIS are kept on the public file maintained by the Registrar of Companies. The names of the fund's officers are available to the public. The register of shareholders of the fund is not public, although any member and officer has access to the register of members.

IV MAIN SOURCES OF INVESTMENT

There are no comprehensive statistics on the size of the asset management industry in Malta. However, a rough estimate of the amount of funds that are either invested through Maltese regulated investment vehicles or managed by asset management firms in the jurisdiction would place the size of this industry at anywhere between €100 to €120 billion. Most of these assets are managed by Maltese-domiciled fund or asset management firms through offshore vehicles. Indeed, only around €10 billion is invested in Maltese investment vehicles, which includes all UCITS funds, non-UCITS retail funds and PIFs. The vast majority of the client base of Maltese-domiciled asset managers and of the investors in Maltese investment funds are professional investors made up of a mix of, predominantly, non-resident pension funds, financial institutions, insurance companies and, to a lesser extent, funds of funds, family offices and high net worth individuals. It is estimated that less than 5 per cent (going on the basis of assets under management) of investors in Maltese investment vehicles or in structures managed from Malta are retail investors. Once again, there are no statistics on the types of investors, so these estimates are based on the types of funds that are domiciled in Malta or managed from Malta, since the fund type would be very indicative of the kind of investor who can be targeted.

V KEY TRENDS

The global financial crisis has generally had an impact on the whole asset management industry, and Malta's financial services industry has felt this impact indirectly since Malta is fast becoming one of the EU onshore financial centres considered by fund promoters as a domicile of choice for their investment firm or vehicles. The size of fund launches seen over the past year has reduced, and the typical launch size of a Malta-domiciled fund tends to be around €20 to €50 million, or even less. Generally speaking, the cost of Maltese service providers, such as legal advisers, auditors, custodians and administrators, has not seen any particular shift for better or worse, and the costs of setting up in Malta have remained competitive when compared with other more established financial centres. It is a reality that fundraising has become very challenging. The euro crisis has also drawn the focus away from new fund launches. Fund promoters are taking longer to consider all the options available, and it is now much more important to ensure a product is right from the start, rather than launching it quickly and then focusing on refining the details after the capital is raised. This change in priorities is the result of more scrutiny by investors of fund terms, more involvement of investment and legal professionals (especially asset allocators) and enhanced due diligence. Some investors also now expect the fund promoter to co-invest in his or her strategy together with his or her outside investors. The developments that occurred around the AIFMD have also contributed to more consideration of the regulatory framework, not only by the fund promoters and their investors, but also by the regulators themselves.

Meanwhile, Malta is still working on increasing the number of custodians with an operation in the jurisdiction. The main custodians with an operation in Malta are Deutsche Bank, HSBC, Bank of Valletta and Citco Custody Limited (licensed earlier this year). Three other smaller custodians also have an operation on the island: Custom House (which is now part of the TMF group), Mediterranean Bank (owned by Anacap, a US private equity house) and Sparkasse Bank (a subsidiary of Erste Bank, the Austrian financial institution). The authorities are hopeful that more custodians will set up operations in Malta in view of its competitive offering, its connectivity, the availability of human resources and the approachability of the regulator.

A recent trend has seen a handful of fund administrators seeking to also obtain a custody licence to enable them to provide custody services to closed-ended structures (typically private equity funds and real estate funds). This trend is expected to increase the number of custodians in Malta, potentially making Malta a jurisdiction where boutique custody services are offered within limited parameters.

VI SECTORAL REGULATION

i Insurance

Investments by insurance undertakings authorised to carry on the business of insurance in terms of the Insurance Business Act are made in accordance with generally applicable criteria for the sound and prudent management of insurance undertakings.

Insurance undertakings are required to keep assets in satisfaction of a minimum guarantee fund, technical provisions and margin of solvency requirements. Assets held by an insurance undertaking are invested in accordance with an investment strategy that is pre-approved by the MFSA upon application. The investment strategy contains a description of the applicant's proposed investment strategy, including details of the diversification, currency and types of investments that are expected to represent the insurance or reinsurance funds, the estimated proportion that will be represented by each type of investment, and the arrangements for the maintenance of adequate liquidity.

During the application stage, the applicant undertaking is also required to provide details on the rationale for the chosen investment methodology, with full details of any proposed use of derivatives or other non-standard investments.

The investment committee of the insurance undertaking is vested with the responsibility to confirm or amend the investment strategy of the undertaking. The investment management function of the insurance undertaking is normally outsourced to an investment manager approved by the MFSA.

Assets used to meet the technical provisions may only be composed of items listed in and valued in accordance with the requirements of the Insurance Business (Assets and Liabilities) Regulations. In this case, strict investment restrictions, diversification and permitted counterparty exposure limits apply. Assets in excess of the technical provisions are not subject to the same investment and valuation restrictions, provided that investments are made in accordance with the general governance criteria applicable to insurance undertakings.

It should be noted that Maltese insurance undertakings are not required to hold assets in Malta. Currency matching rules apply in instances where the undertaking's liabilities in any particular currency exceed 5 per cent of its total liabilities. Insurance undertakings may be required to post collateral with approved institutions.

Furthermore, unit-linked policies of life insurance written by insurance undertakings authorised by the MFSA may only be notionally linked to permitted assets as listed on the Insurance Business (Linked Long Term Contracts) Regulations.

Upon the implementation of the Solvency II Directive, insurers are expected to invest their assets in accordance with the prudent person principle, in the interests of their policyholders and in a manner that ensures the security, profitability, liquidity and quality of their investments.

ii Pensions

Malta's pension sector is regulated by the MFSA in accordance with the provisions of the Special Funds (Regulation) Act (the Special Funds Act). The Special Funds Act empowers the MFSA to issue rules applicable to retirement scheme administrators and retirement funds. Part B – Standard Operational Conditions – of the Directives issued under the SFA contain the investment guidelines for retirement scheme administrators, while Appendix 9 of the Directives issued under the SFA outlines the investment restrictions applicable to retirement funds. Broadly, assets held by retirement scheme administrators are to be invested in the best interests of members, ensure adequate diversification and limit concentration levels to not more than 10 per cent of scheme assets. Assets forming part of retirement funds are to be predominantly invested in regulated markets and must adhere to concentration restrictions. The rules referred to above were drafted for occupational pension schemes. However, the MFSA has, over the years, registered several retirement scheme administrators offering personal pension plans. In this case, the rules outlined above apply, but with significant relaxations primarily relating to dispensations with certain investment restrictions. The MFSA has proposed new rules that are to apply to retirement schemes in Malta and that clarify the position in relation to investment restrictions for personal pension plans. However, these new rules should not change the position in relation to investment restrictions for the above-mentioned personal pension plans.

iii Real property

Certain types of funds set up in Malta, such as UCITS funds or non-UCITS retail funds, are not allowed to invest directly in real property. On the other hand, a fund that qualifies as a PIF (see subsection iv, *infra*) is able to invest directly or indirectly in real estate investments subject to certain restrictions arising from a policy paper issued by the MFSA in May 2007. There are leverage restrictions on real estate funds that are structured as PIFs available to experienced investors in particular.

iv Hedge funds

Hedge funds are typically set up within the PIF regulatory framework. PIFs are categorised according to their target investors as:

a experienced investor PIFs, where the minimum investment is €10,000, and the investor has to certify compliance with certain criteria requiring experience in the financial markets;

b qualifying investor PIFs, where the minimum investment is €75,000, and the investor is eligible on the basis of experience or a net asset test of €750,000; and

c extraordinary investor PIFs, where the minimum investment is €750,000, and the investor has to fulfil a net asset test of €7.5 million or more.

Only PIFs targeting experienced investors are subject to certain investment and leverage restrictions.

The rules of the MFSA on PIFs contain a schedule listing the matters that must be disclosed in the PIF's offering document. The focus of the list is on full disclosure of all relevant facts, terms and conditions that would enable an investor to make an informed decision on its investment in the PIF. The MFSA gives particular importance to disclosure of conflicts of interest, fee terms, identification of service providers, risk factors, valuation policy, and redemption and subscription terms.

PIFs targeting qualifying or extraordinary investors are not subject to any investment, borrowing or leverage limits other than those specified in the offering documentation. However, PIFs targeting experienced investors are subject to detailed investment, borrowing and leverage limits. The MFSA requires PIFs to disclose, in their offering documentation, the risks associated with investing in the PIFs.

A PIF is not subject to any own funds or initial capital requirements, and is able to commence business with minimal capital sufficient to cover its set up costs. The only exception to this general rule arises when the PIF has not appointed an external manager (i.e., it is self-managed), in which case it must have an initial capital of €125,000.

A PIF may appoint any service provider it deems necessary. Notwithstanding, PIFs promoted to experienced investors are required to appoint a custodian responsible for the safe custody of the assets of the PIF, and for monitoring compliance by the manager with the investment policies and restrictions of the PIF.

The MFSA's rules provide that all service providers appointed directly by a PIF should be established and regulated in a recognised jurisdiction. Recognised jurisdictions include:

a EU and EEA Member States;
b signatories to a multilateral MoU with the MFSA;[2] and
c countries that are signatories to the IOSCO multilateral MoU.

The MFSA may, in the following scenarios, also accept service providers that may not be established and regulated in a recognised jurisdiction:

a where the service provider is the subsidiary of a firm that is regulated in a recognised jurisdiction, retains control of its subsidiary and undertakes to provide all the necessary information to the MFSA; or
b where the MFSA considers that the service provider is subject to regulation to an equal or comparable level in the jurisdiction concerned.

None of the service providers appointed by a PIF are required to be based in Malta.

The MFSA has recently introduced the concept of cross sub-fund investment for PIFs targeting qualifying or extraordinary investors. A sub-fund of a PIF may invest up to 50 per cent of its assets in units of one or more sub-funds within the same PIF, subject to this being permitted in the offering document of the PIF. The memorandum

2 Jersey, Isle of Man, Turkey, Gibraltar, Mauritius, Guernsey, China, South Africa, Cayman Islands, the Emirate of Dubai and Switzerland.

of association of the SICAV must elect to have assets and liabilities of each sub-fund comprised in that SICAV treated as a patrimony separate from the assets and liabilities of each other sub-fund in the SICAV. The target sub-fund may not itself invest in the sub-fund that is to invest in the target sub-fund. Where the manager of the sub-fund is the same as, or an affiliate of, the manager of the target sub-fund, only one set of management, performance, redemption and subscription requirements would apply. For purposes of compliance with capital requirements, cross-investments are counted once. Furthermore, any voting rights acquired by the sub-fund in the target sub-fund would be disapplied.

AIFs

As part of the implementation of the AIFMD, the MFSA has issued rules (the Rules) applicable to AIFs[3] and to AIFMs. The Rules provide that an AIF may be managed by an external manager, which must be an AIFM,[4] or may opt to be a self-managed AIF. A self-managed AIF must have an initial capital of at least €300,000, which must be increased once the portfolio of the AIF exceeds €250 million. A self-managed fund is also subject to a number of additional rules that are similar to those applicable to AIFMs. In this respect, a self-managed fund is required to:

a purchase professional liability cover or have own funds to cover liabilities;
b have an in-house investment committee;
c separate the risk management function from the portfolio management function;
d adopt a liquidity management policy;[5]
e adopt a remuneration policy; and
f comply with conduct of business, conflicts of interest and delegation rules.

A self-managed AIF is also subject to additional transparency requirements, including extra reporting obligations for leveraged AIFs.

An AIF, whether self or third-party managed, is also required to appoint a custodian,[6] an auditor, a compliance officer, a money laundering reporting officer and an external valuer in respect of valuation or, if appointing the AIFM to value assets, ensure that the valuation task is functionally independent from the portfolio management function.

Since PIFs fall within the definition of AIFs, they may also be subject to the Rules applicable to AIFs. PIFs licensed prior to 22 July 2013, have the option to remain classified as PIFs and subject to the PIF regime if they are managed by an investment

3 An AIF is defined as a collective investment scheme, including sub-funds thereof, which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and which does not qualify as a UCITS scheme in terms of the UCITS Directive.

4 Which may either have an established place in Malta or be a European AIFM.

5 The rule does not apply to unleveraged closed-ended funds.

6 The custodian must be either licensed in Malta, or a credit institution having its registered office in the EU and authorised in accordance with Directive 2006/48/EC.

manager that falls within the *de minimis* exemption of the AIFMD, or are self-managed funds availing themselves of the *de minimis* exemption. A new fund may also be set up as a PIF and subject to the PIF rules if the PIF is managed by an investment manager that falls within the *de minimis* exemption of the AIFMD, or is a self-managed fund availing itself of the *de minimis* exemption. It is also possible for a fund to comply with all the rules applicable to AIFs, but be marketed as a PIF.

v Private equity

Malta's current regulatory framework does not provide for bespoke rules that apply solely to private equity funds, and the rules outlined above that apply generally to all PIFs are flexible enough to also apply to private equity funds. There are, however, some basic rules on drawdowns and commitments that are typical methodologies applied by private equity funds. Although the current regulatory framework contains embedded flexibility, the authorities have recognised the importance of issuing more detailed guidance on private equity funds, particularly in view of the impact that the AIFMD will have on this industry. The MFSA is currently working on improving and clarifying both the regulatory framework and the corporate rules applying to limited partnerships (the vehicle of choice of private equity managers). New rules principally targeting the private equity sector were due to be in place by the end of summer 2013; however, this has not yet occurred.

vi Other sectors

The approach taken by the Maltese legislator has always been to issue rules of general application to all forms of professional investor fund irrespective of their strategy. As explained in subsection iv, *supra*, there are some differences between the different types of PIFs (experienced, qualifying and extraordinary) that are linked to the investor type and eligibility criteria. However, Malta has so far backed away from regulating specific sectors in detail.

VII TAX LAW

Funds incorporated in Malta that are investing in assets situated outside Malta are generally exempt from tax. The same exemption applies to non-Maltese resident investors who hold equity or other interests in Malta-domiciled funds. On the other hand, if operating companies such as fund managers and fund administrators are incorporated under the laws of Malta, then they are deemed to be tax-resident in Malta. Companies incorporated outside Malta may still be considered to be tax-resident in Malta if they are managed and controlled in Malta.[7]

Malta adopted the full imputation system concurrently with the introduction of income tax legislation in 1948.[8] Accordingly, a Maltese company has to deduct tax at a flat rate of 35 per cent of the taxable profits or chargeable income from which a dividend

7 Article 2(1) of the Income Tax Act, 1948 (Chapter 123 of the Laws of Malta).

8 Articles 59 and 60 of the Income Tax Act, 1948.

payment is made, and the shareholders will then be able to claim a tax credit for the tax payable by the company. In this manner, double taxation in the hands of both the company and its shareholders is avoided. Since Malta applies the full imputation system of taxation, shareholders of Maltese companies (irrespective of whether the shareholders are Maltese) are entitled to a tax credit for the tax suffered by the company paying the dividend. The shareholders' tax liability in respect of the dividends is offset by the amount of tax withheld by the company when making the dividend payment. Thus, no further tax is payable by the shareholders. Indeed, individual shareholders do not need to declare the dividend in their tax return.

Shareholders of Maltese companies are also entitled to refunds of all or part of the tax paid by the Maltese company. To qualify for the refunds, the shareholders must be registered with the Malta Commissioner of Inland Revenue in the prescribed manner.

In the appropriate circumstances, there are four types of tax refunds that are available to shareholders of a Maltese company when they receive a dividend from a Maltese company. The refund typically available to shareholders of operating companies such as fund managers and administrators is six-sevenths of the tax paid by the Maltese operating company, which means that the tax shed in Malta that is not recoverable by the shareholders totals 5 per cent of the total taxable income of the Maltese company. The net tax leakage can be lower than 5 per cent if actual foreign tax is suffered by the Maltese company in respect of its income. Depending on the extent of such foreign tax, the leakage in Malta might be reduced to zero.

Furthermore, individuals who are not domiciled in Malta and who hold an executive position in the financial services industry in Malta may opt to have their employment income derived from such office taxed at a flat 15 per cent rate of tax. This beneficial tax rate (Maltese-resident and domiciled persons are normally subject to tax on a pay-as-you-earn basis very easily reaching a capped 35 per cent tax rate) may only be availed of if the employee derives income from a qualifying contract of employment, has an annual income of at least €80,100 (for the calendar year 2013) as adjusted annually for inflation, and satisfies various conditions in relation to type of employment, professional qualifications and personal status. For persons already working in Malta, the 15 per cent rate is only available if they started working in Malta after 1 January 2009. The availability of the 15 per cent rate is for periods ranging between two to five years, depending on nationality and commencement date of employment.

VIII OUTLOOK

The biggest challenge going forward is the AIFMD and its impact on the industry (particularly on custodians), as well as the manner in which the AIFMD will be absorbed by the Maltese asset management industry. A number of PIFs domiciled in Malta are self-managed funds (i.e., they would not have appointed an external third-party manager where the investment management function is assumed by the board of directors or a committee thereof). The AIFMD will have a direct impact on such funds, since they will be treated in the same manner as the AIFMD deals with asset management firms, unless they can benefit from the *de minimis* exemption; however, this would mean that they cannot be marketed in the EU other than under the national private placement regimes.

The country is well placed to meet these challenges for a number of reasons: Malta has regulated fund management firms for decades, and has also regulated fund vehicles for a number of years on the basis of a regulatory framework based on transparency, disclosure, fitness and properness – all hallmarks of the AIFMD. In addition, Malta has in place a beneficial tax system for highly qualified individuals working with financial services firms. All these factors taken together should encourage the domicile, and those who have located their operations in Malta, to perceive future challenges as an advantage.

Appendix 1

ABOUT THE AUTHORS

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Dr André Zerafa is a partner at Ganado Advocates, Malta. He advises on corporate, regulatory and other legal issues involved in the setting up of management firms, as well as administrators, custodians, prime brokers and advisers. He specialises in the structuring and establishment of alternative investment funds, hedge funds and UCITS funds. He heads a multidisciplinary team of 10 professionals with a specific focus on the investment services area. He graduated doctor of laws (LLD) from the University of Malta in 1999 and furthered his studies in 2000 at Queen Mary & Westfield College, University of London, where he read for a master of laws in banking and finance law. His articles have appeared regularly in the specialised financial press. He also acts as an external examiner and tutor at the University of Malta and chairs the Investment Business Committee of the Maltese Institute of Financial Services Practitioners.

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