

MALTA'S PIF & DE MINIMIS RULEBOOKS: BOOTSTRAPPING YOUR START-UP

DR. CHRISTOPHER MALLIA OF GANADO ADVOCATES TALKS TO HFMWEEK ABOUT HOW TO START-UP A HEDGE FUND



Starting a hedge fund is easy. Rent a one-room office, rope in a couple of analysts, spread the word in the right circles and before you know it you'll have more seed capital than your strategy can house. Workable ideas and elbow grease quickly become competitive advantages, absolute returns abound and performance fees will pretty much make themselves.

Except that's not how it works at all.

Building a hedge fund requires a commitment: to regular refining strategies, to locating opportunities, and to building a team capable of exploiting both. Finding your feet, much less thriving, in the hedge fund sector is no mean feat. Falling victim to the business cycle is (almost) par for the course.

Hedge fund start-up primers stress the importance of identifying "advantages" over others in that space, translating advantages into a "strategy", adequately capitalising the start-up, identifying target investors and tailoring marketing/sales plans. Investor domicile is often the principal determining factor in selecting a jurisdiction – both in terms of demographics and regulatory infrastructure complementary to a start-up's needs. Getting all these right is important.

Selecting legal advisors that understand how to navigate a jurisdiction's challenges, however, is particularly valuable for a start-up. They should be picky. The wrong structure can leave them dead in the water.

The AIFM Directive ushered in robust regulation and compliance costs are rising accordingly. Commentators have (correctly) criticised one of its outcomes: while purportedly aiming to mitigate systemic risks, the current regulatory infrastructure is less hospitable for smaller, less systemically relevant funds with contributions south of €300m. Some have gone as far as to say that funds with seed capital south of this benchmark are not viable.

This need not be the case. True, the economics of the

hedge fund industry have changed dramatically. Compliance costs have soared. Fee appetites, predictably, have not. Nonetheless, this constantly evolving sector need not exclude the survival of smaller, agile players. Arguably, they can thrive.

START-UP STRUCTURES AND THE AIFM

A start-up AIFM's compliance and operational costs should be minimised as a matter of necessity during the operator's first foray into this space. Until the benefits of the AIFMD take shape, any small operator aiming to grow their fund organically might best try to evade the strictures of full AIFMD compliance.

There are various options for lightening the regulatory load woven into the text of the Directive itself, allowing new operators to legitimately operate outside the full scope of the AIFMD including (1) 'Fund of One' solutions, (2) securitisation special purpose entities, (3) group AIFMs, and (4) the holding company exemption. These particular exemptions/scenarios might not be ideal to accommodate a new venture. The most important feature of the AIFMD for a hedge fund start-up is the de minimis exemption.

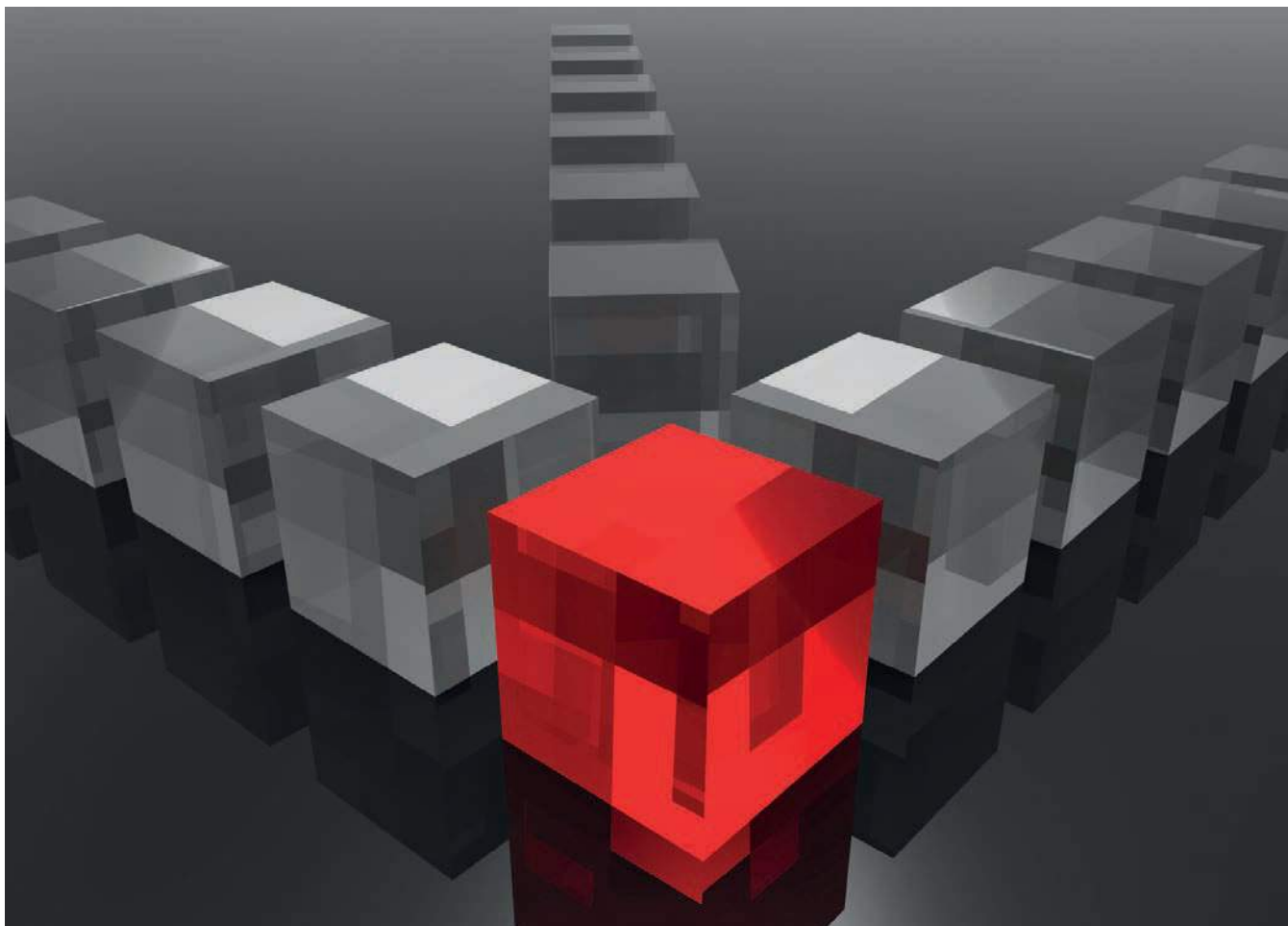
De minimis AIFMs will be subject to a lighter regime, but are not afforded access to the AIFMD Marketing Passport (unless they opt-in to the full regime).

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MALTA'S DE MINIMIS RULEBOOK AND PIF REGIME

In line with industry practice, the AIFMD formalises the split hedge fund operation between the fund (the AIF) and the manager (the AIFM) – unless a self-managed structure is opted for.

Malta's offering is well placed to service both markets. By harnessing the de minimis provisions in the AIFMD and marrying these with elements of Malta's pre-AIFMD regime, Malta has created a light-touch offer attractive for asset managers looking to get off the ground fast.



With respect to the management company, the MFSA opted to retain and enhance its successful pre-AIFMD fund management authorisation regime for de minimis AIFMs (as opposed to opting for registration). This licensing regime, which is based on MiFID requirements, seeks to strike a balance between providing a flexible regime for smaller/start-up fund managers and protecting Malta's standing. Indeed, with the exception of a potential reduction in the minimum capital requirements and other simplifications, the Rulebook broadly reflects the successful pre-AIFMD regime in Malta for non-Ucits fund managers. Experience has shown that authorisation and supervision in an aptly regulated jurisdiction such as Malta benefits promoters when targeting potential investors.

To qualify for the de minimis exemption an AIFM must either manage leveraged AIF(s) with combined (notional) assets of less than €100m, or unleveraged AIF(s) with combined assets below €500m, provided in the latter case that the AIF(s) have locked investors in for the first five years from initial investment.

With respect to the fund regime, before the current torrent of regulation, Malta was favoured by start-ups. A non-retail system by design, Malta's Professional Investor

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Fund (PIF) regime attracted hedge fund promoters with its expedited approval, less prescriptive rulebook, and a flexible supervisory philosophy.

The need for an AIFMD compliant AIF regime created the assumption that the MFSA would scrap the old PIF regime. The MFSA did not – it was retained in parallel with the new AIF regime. A PIF is essentially an AIF, but one with a proven record of successful application to various strategies, an ad hoc regulatory regime, and one that need not be fully AIFMD compliant when managed by a de minimis or non-EEA manager.

It is proving a valid onshore proposition for start-ups. De minimis and third country AIFMs that need not fully comply with the strictures of the AIFMD can opt for Maltese vehicles offering old world (pre-AIFMD) charms.

The PIF niche was well exploited in the pre-AIFMD context. Post AIFMD it is experiencing a re-birth, and is an interesting option to pair with a de minimis AIFM or as a de minimis self-managed fund. If growth warrants full AIFMD compliance, this can be tackled at the appropriate time. Until then, promoters will benefit from onshore credibility without unduly oppressive compliance obligations. ■