MFSA

MALTA FINANCIAL SERVICES AUTHORITY

ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE
- FREQUENTLY ASKED QUESTIONS –

List of Topics

Preliminary Remarks

This FAQ aims to provide answers to the questions that the Authority has been receiving with regards to the implementation of the provisions of the Alternative Investment Fund Managers Directive (or the "AIFMD"). The contents will be updated to reflect further requests for clarification/ information as deemed appropriate by the Authority.

The Authority's position as outlined in this FAQ may be subject to change in the light of any guidance on the AIFMD which may be issued in the future by the European Commission or European Securities and Markets Authority.

The answers provided in this document are not necessarily definitive and are not intended to replace or substitute legal or professional advice. This document is not meant to be an industry standard or a guide to best practice. Anyone wishing to clarify any matter relating to the content of this document may contact the MFSA.

Licence Holders and practitioners are welcome to submit any question relating to the Alternative Investment Fund Managers Directive to the Authority. These will be reviewed and included in a future copy of this document. Any queries are to be addressed to Mr Jonathan Sammut (JSammut@mfsa.com.mt) or Ms Martha Chetcuti (MChetcuti@mfsa.com.mt).

APPLICABLE EU LEGISLATION AND GUIDANCE

Q1) ***What are the EU laws and guidance currently applicable to Alternative Investment Fund Managers ("AIFMs")?***

A1) The EU laws and guidance currently applicable to AIFMs are as follows:

- **Directive 2011/61 EU** of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (the "AIFMD"/"Directive");
- **Commission Delegated Regulation (EU) No 231/2013** of 19 December 2012 supplementing Directive 2011/61 EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (the "AIFMR");
- **Commission Implementing Regulation (EU) No 447/2013** of 15 May 2013 establishing the procedure for AIFMs which choose to opt in under the Directive 2011/61/EU of the European Parliament and of the Council;
- **Commission Implementing Regulation (EU) No 448/2013** of 15 May 2013 establishing a procedure for determining the Member State of reference of a non-EU AIFM pursuant to Directive 2011/61/EU of the European Parliament and of the Council
- **Commission Delegated Regulation (EU) No XXX/2014** of 17 December 2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to regulatory technical standards determining types of alternative investment fund managers[1].

ESMA Guidelines:

- Guidelines on sound remuneration policies under the AIFMD [ESMA/2013/232];
- Guidelines on key concepts of the AIFMD [ESMA/2013/611];
- Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD [ESMA/2013/1339 (revised)].

From a local point of view, the provisions of the Directive were in part transposed in:

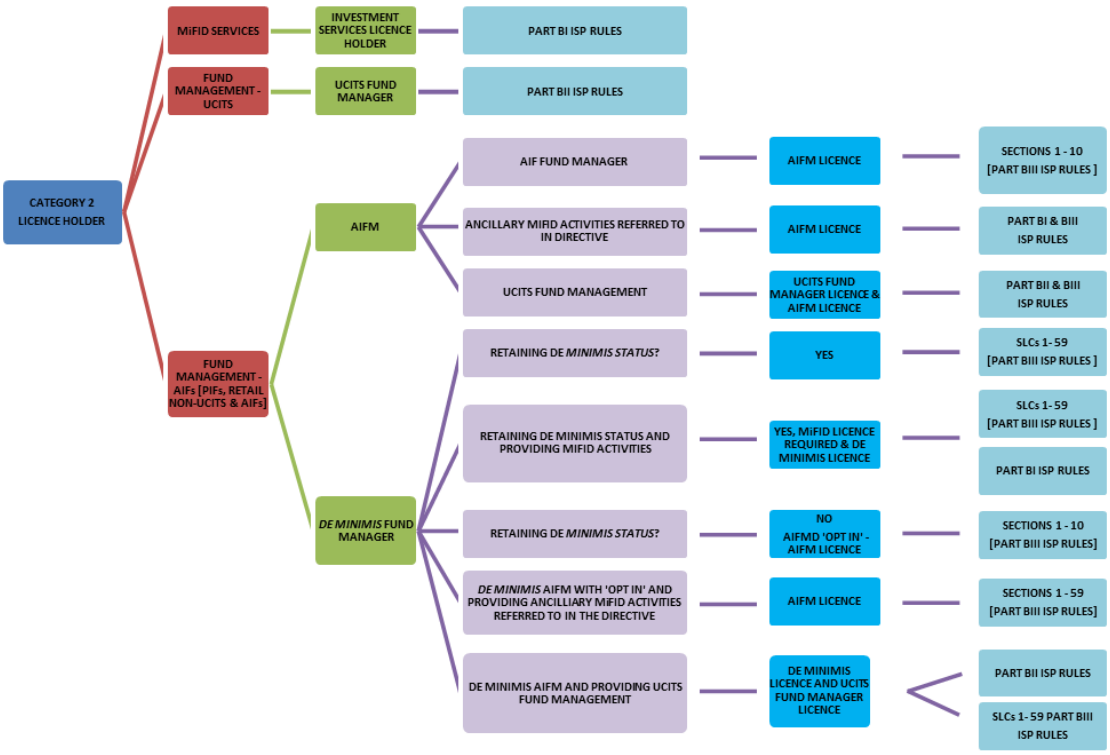
i. The Investment Services Act;
ii. Investment Services Act (Alternative Investment Fund Managers) Regulations, 2013 [Legal Notice 115 of 2013];
iii. Investment Services Act (Marketing of Alternative Investment Funds) Regulations; [Legal Notice 113 of 2013];
iv. Investment Services Act (Alternative Investment Fund Manager)(Passport) Regulations; [Legal Notice 114 of 2013];
v. Investment Services Act (Alternative Investment Fund Manager) (Third Country) Regulations. [Legal Notice 116 of 2013].

[1] Awaiting publication in the Official Journal of the European Union.

The amendments to the Investment Services Act and the new Regulations (with the exclusion of the Investment Services Act (Alternative Investment Fund Manager) (Third Country) Regulations (hereinafter referred to as 'Third Country Regulations') came into force on 22 July 2013. A Commencement Notice was issued on 19 July 2013 with regards to the Third Country Regulations identifying the selected provisions which will come into force namely those providing for the private placement regime.

Furthermore, the Investment Services Rulebooks were enormously affected by the transposition of the AIFMD. The revised/ new Investment Services Rulebooks came into force on 22 July 2013.

The table being reproduced hereunder illustrates the manner in which the provisions of the AIFMD were transposed into Maltese law.



INVESTMENT SERVICES ACT (EXEMPTIONS) REGULATIONS

Q2) ***Will the Investment Services Act (Exemptions) Regulations be amended so as to include the exemption provided for in article 3(1) AIFMD? How will entities that fall outside the scope of AIFMD be treated under Maltese law?***

A2) The Investment Services Act (Exemptions) Regulations have been amended through Legal Notice 252 of 2013[2] so as to cater for the entities falling outside the scope of the Directive namely:

i. Holding companies;
ii. institutions for occupational retirement provision which are covered by Directive 2003/41/EC, including, where applicable, the authorised entities responsible for managing such institutions and acting on their behalf referred to in Article 2(1) of that Directive or the investment managers appointed pursuant to Article 19(1) of that Directive, in so far as they do not manage AIFs;
iii. supranational institutions, such as the European Central Bank, the European Investment Bank, the European Investment Fund, the European Development Finance Institutions and bilateral development banks, the World Bank, the International Monetary Fund, and other supranational institutions and similar international organisations, in the event that such institutions or organisations manage AIFs and in so far as those AIFs act in the public interest;
iv. national central banks;
v. national, regional and local governments and bodies or other institutions which manage funds supporting social security and pension systems;
vi. employee participation schemes or employee savings schemes;
vii. securitisation special purpose entities.

In addition to the above list, the Authority has included a specific exemption for:

- AIFMs in so far as they manage one or more AIFs whose only investors are the AIFM or the parent undertakings or the subsidiaries of the AIFM or other subsidiaries of those parent undertakings, provided that none of those investors is itself an AIF; and
- Investment undertakings, such as family office vehicles which invest the private wealth of investors without raising external capital.

[2] Investment Services Act (Exemption) (Amendment) Regulations, 2013

Q3) ***With regards to exemptions, what is the MFSA's intention in connection with the exemption for foreign fund administrators of collective investment schemes as per regulation 4 of the Investment Services Act (Exemption) Regulations?***

A3) The AIFM may appoint an administrator to carry out the administration functions. The administrator must not necessarily be based in Malta. However any person who, in Malta or from Malta, provides to Licence Holders in Malta or to equivalent authorised persons and schemes overseas, administrative services which do not themselves constitute licensable activity under the Act, shall require the issuance of a recognition by the MFSA in terms of Article 9A of the Act.

Q4) ***What is the MFSA's intention in connection with the exemption for foreign custodians/trustees of collective investment schemes as per regulation 3(1)(h) of the Investment Services Act (Exemption) Regulations?***

A4) This exemption may be retained for custodians appointed by third country AIFMs, *de minimis* AIFMs and self-managed *de minimis* AIFs.

However a Licence Holder in possession of a full AIFM Licence must appoint a fully licenced custodian as outlined in SLC 1.02 and 1.03 of Part BIV of the Investment Services Rules for Investment Services Providers (the "ISP Rules") in relation to each Malta-based AIF it manages. Furthermore, any entity wishing to provide custody services to an AIF managed by an AIFM must comply with the SLCs prescribed in Part BIV of the aforementioned Rules.

APPLICABILITY OF THE INVESTOR COMPENSATION SCHEME DIRECTIVE

Q5) ***In terms of Article 12(2)(b) AIFMD, AIFMs also authorised to provide portfolio management services are subject to the Investor Compensation Scheme Directive (the "ICS Directive"). The ICS Directive allows Member States to exclude certain firms which only service exempt investors, which exemption was applied in Malta to professional clients. Will AIFMs also authorised to provide portfolio management services solely to professional clients continue to be exempt from the ICS?***

A5) Yes, AIFMs authorised to provide portfolio management services solely to professional clients will continue to be exempt from the requirement to participate in and contribute to the Investor Compensation Scheme. This exemption emerges from Regulation 11 of the Investor Compensation Scheme Regulations, which exempts firms licenced to provide investment services solely and exclusively to persons not falling within the definition of "investor" in terms of the Regulations. The definition of "investor" in turn excludes the persons referred to in the First Schedule of the Regulations, including professional and institutional investors.

Q6) ***Will participation in the Investor Compensation Scheme as prescribed in Article 12(2)(b) AIFMD also apply to self-managed funds****?*

A6) No, self-managed funds will not be expected to participate in the Investor Compensation Scheme. Article 12(2) of the AIFMD refers to "*each AIFM the authorisation of which also covers the discretionary portfolio management services referred to in point (a) of Article 6(4)...*" Since Article 6(4) of the AIFMD, which refers to discretionary portfolio management services, is applicable exclusively to external AIFMs, the Investor Compensation Scheme will not be applicable to self-managed AIFs.

TRANSITIONAL PROVISIONS

Q7) ***When will the legal obligation for compliance with the AIFMD become effective?***

A7) Article 66 provides that by 22 July 2013, Member States shall adopt and publish the laws, regulations and administrative provisions necessary to comply with the AIFMD. Member States shall also apply such laws, regulations and administrative provisions from 22 July 2013.

Therefore, the revised/ new Investment Services Rules came into effect on 22 July 2013 and were immediately effective for new AIFMs established from that date onwards. Licence Holders already having been in existence as at 22 July 2013 must comply fully with the provisions of the Directive by 22 July 2014.

Q8) ***How is the transitional provision contained in article 61(1) to be interpreted?***

A8) AIFMs are expected to comply on a "best efforts basis" with the requirements of national law transposing the AIFMD, and are further required to seek authorisation by 22 July 2014. In order to be in line with the European Commission's interpretation that all managers should fully comply with the Directive by 22 July 2014, these Licence Holders should ensure that their Self-Assessment Form[3] is submitted to the MFSA by 31 March 2014 at the latest.

Q9) ***Article 61(3) exempts from the scope of the AIFMD managers of closed-ended AIFs which do not make any "additional investments" after 22 July 2013. What do "additional investments" comprise?***

A9) The term "additional investments" should be interpreted in such a way as not to create opportunity for circumvention of the AIFMD. However, contractual commitments to make an investment entered into prior to 22 July 2013 will not amount to "additional investments" simply by virtue of the fact that the investment is made after July 2013.

[3] The Self-Assessment Questionnaires are available for download from the MFSA website at the following link: http://www.mfsa.com.mt/pages/viewcontent.aspx?id=262

Q10) ***Will the current PIF regime and relative tripartite distinction between Experienced Investor Funds, Qualified Investor Funds and Extraordinary Investor Funds continue or shall it be repealed?***

A10) The PIF regime will continue alongside the AIF regime. The tripartite distinction currently existing under the PIF Regime will be retained in the AIF Regime.

Q11) ***If a Maltese AIFM benefits from the transitional period until 22 July 2014 to comply with the AIFMD, will this transitional period be affected by the launching of new AIFs or sub-funds of existing AIFs (investment compartments) by the AIFM?***

A11) Yes, the transitional period will continue to apply. However, since the AIFM would be required to work towards full compliance with and authorisation under the AIFMD by 22 July 2014, any new AIFs or sub-funds of existing AIFs launched during the transitional period would be required to be AIFMD compliant by this date.

Q12) ***Can the depositary for the AIF be domiciled outside Malta during the transitional period until 2017? If so, what are the applicable rules regulating the depositary and to which regulator should any breaches be reported?***

A12) The AIFMD imposes on AIFMs the requirement to appoint a depositary for the AIFs it manages. As a service provider of a Malta based fund, the depositary (or "custodian", as the office is referred to in the local legislation) would be expected to comply with the provisions of Article 21 AIFMD and those supplementing the said article prescribed in the Delegated Regulation No. 231/2013. The provisions of Article 21 have been transposed in Section 4 of Part BIV of the ISP Rules. Part BIV requires the custodian to have an established place of business in Malta; however, during a transitional period ending in 2017, it will indeed be possible for an AIFM to appoint a custodian domiciled outside Malta. Any breaches of the Investment Services Rules in particular to the AIF's investment restrictions under the Rules and the AIF's offering documents, as part of the custodian's oversight obligations under Article 21(9) of the Directive, are to be addressed to Securities and Markets Supervision Unit at the MFSA.

Q13) ***When can a custodian be held liable for lost assets in terms of the strict liability provisions prescribed in the Directive?***

A13) Existing Licence Holders wishing to convert their licence to an AIFM Licence have a one year transitional period within which to come in line with the provisions of the Directive and obtain a full AIFM Licence. This one year transitional period expires on 22 July 2014. Until then, the Authority expects Licence Holders to comply with the provisions of the Directive on a "*best efforts*" basis. Once the Licence Holder has a Category 2 AIFM Licence, it will be subject to the obligations prescribed in the Directive, amongst which the obligation to appoint a custodian for each AIF managed and to evidence the appointment of the custodian by a written contract. Therefore, until the custodian enters into the written agreement with an authorised AIFM, it cannot be bound by the strict liability provisions prescribed in the Directive.

Q14) ***Does the six month submission deadline indicated in SLC 1.87 of Part BI, SLC 1.61 of Part BII and SLC 1.63 of Part BIII of the Investment Service Rules for Professional Investor Funds apply from 22 July 2013?***

A14) The six month submission deadline of the audited financial statements is applicable from 22 July 2013. Consequently, PIFs whose reporting period ends after 22 July 2013 will be required to submit their annual report and audited financial statements within six months from the end of the reporting period concerned. During the one year transitional period running from 22 July 2013 to 22 July 2014, the Authority may consider extension requests to the annual report and audited financial statements' submission deadline in the case of exceptional circumstances of the case presented.
However, **after** 22 July 2014, the Authority will be obliged to adopt a less flexible approach and failure to meet this deadline may trigger regulatory action in terms of Article 16A of the Investment Services Act.

Q15) ***If a licenced investment manager were to transition to an AIFM licence before July 2014, would the custodian requirements in respect of the AIFs it manages be immediately applicable?***

A15) The requirements of the AIFM, including the appointment of a custodian, are applicable as soon as the fund manager becomes a fully licenced AIFM.

CURRENT CATEGORY 2 LICENCE HOLDERS

Q16) ***What is the distinction now to be applied to the different regulated collective investment schemes, namely:***

- ***i. UCITS;***
- ***ii. Retail non-UCITS;***
- ***iii. PIFs targeting Experienced/Qualifying/Extraordinary Investors;***
- ***iv. Private collective investment schemes; and***
- ***v. AIFs?***

In particular, would the schemes listed in (ii) to (iv) be considered to be AIFs, provided that their external manager is an AIFM or, in the case that the fund is self-managed, provided that the manager/fund does not benefit from the de minimis exemption or any other exemption under the AIFMD?

A16) The Directive defines an "AIF" as meaning "*a collective investment undertaking, including the investment compartments thereof which, (i) raise 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 (ii) do not require authorisation pursuant to Article 5 of Directive 2009/65/EC"*. Therefore, retail non-UCITS schemes and PIFs are classified as "AIFs".

Private Collective Investment Schemes are not classified as AIFs given that the Directive excludes such schemes from its scope.

Q17) ***Should existing authorised PIF managers apply for a new licence as fully compliant AIFMs or de minimis Licence Holders (where applicable) in order to continue providing asset management services or will the existing licence be automatically classified and modified accordingly? How will the transition take place?***

A17) Where the PIF manager qualifies as a full AIFM because its assets under management exceed the thresholds prescribed in Article 3(2) of the AIFMD, the PIF manager is required to ensure that it becomes AIFMD compliant by completing the Self-Assessment Questionnaire for Fund Managers and Self-Managed Collective Investment Schemes applying for an AIFM Licence and consequently complying with all the obligations prescribed by the AIFMD concerning AIFMs by 22 July 2014.

PIF managers which do not exceed the *de minimis* thresholds would similarly have to complete the Self-Assessment Questionnaire for Fund Managers and Self-Managed Collective Investment Schemes applying as de minimis Licence Holders and the Investment Services Licence will be classified as a Category 2 *De Minimis* Fund Manager licence.

In both instances the cut-off date for submission of the Self-Assessment Questionnaires to the Authority is **31 March 2014** at the latest.

Q18) ***How will the licences of existing Category 2 Licence Holders who are currently authorised to provide portfolio management services to non-UCITS retail collective investment schemes be modified in order to qualify as de minimis Licence Holders? Is it possible for a de minimis Licence Holder to obtain MFSA approval in order to provide portfolio management services to non-UCITS retail collective investment schemes?***

A18) Once a Licence Holder which currently manages non-UCITS retail schemes files with the Authority a duly completed Self-Assessment Questionnaire for Fund Managers and Self-Managed Collective Investment Schemes applying as a de minimis Licence Holder, the Authority will proceed to classify the licence as a Category 2 *De Minimis* Fund Manager Investment Services Licence. From that moment onwards, the *de minimis* fund manager will be bound by the SLCs contained in Part BIII of the ISP Rules applicable to *de minimis* AIFMs.

Q19) ***Will the MFSA apply the requirements prescribed in Article 25(3) AIFMD[4] to AIFs which are already licenced prior to the coming into force of the AIFMD?***

A19) Once a fund manager upgrades its licence to an AIFM Licence, the MFSA expects that the funds managed by the said fund manager will all be AIFMD compliant funds. The fund manager would therefore be expected not only to upgrade its processes but to bring the funds in line with the requirements prescribed in the AIFMD. The requirement prescribed in Article 25(3) will be made applicable from the date of granting of the AIFM Licence.

[4] Article 25(3) AIFMD provides that *"The AIFM shall demonstrate that the leverage limits set by it for each AIF that it manages are reasonable and that it complies with those limits at all times."*

Q20) ***Will current PIF managers that do not fall below the de minimis threshold need to restructure the PIF into either a self-managed structure or appoint an AIFM?***

A20) As the AIFMD applies to both self-managed funds and external managers which exceed the *de minimis* threshold, these entities are both obliged to become AIFMD compliant by completing the applicable Self-Assessment Questionnaire issued by the Authority and by complying with all the obligations incumbent on AIFMs prescribed by the AIFMD. They must also ensure that the funds under their management are AIFMD compliant. The decision whether to restructure the PIF into a self-managed structure or appoint an AIFM is a business decision which rests entirely in the hands of the Licence Holder.

Q21) ***In exceptional cases where an EU country has not yet transposed the AIFMD, and hence the Investment Manager is unable to register as an AIFM with the respective regulator, would the MFSA have any objection with such manager acting as an Investment Manager of a newly licenced Maltese PIF which will not be marketed in the EU with a passport?***

A21) In the case where an EU country has not yet transposed the provisions of the AIFMD, the Authority finds no objection to the manager's proposed appointment as Investment Manager of a newly licenced Maltese PIF. However, the Authority will only accept such arrangement for the period until the manager obtains its authorisation as an AIFM from its home regulator. Thereafter, the PIF would have to be AIFMD compliant.

MIFID SERVICES

Q22) ***Which MiFID services can an AIFM undertake?***

A22) Article 6(4) of the AIFMD lists the ancillary activities which an external AIFM may undertake. These consist of:

a) discretionary portfolio management; and
b) non-core services comprising (i) investment advice; (ii) safe-keeping and administration in relation to the shares or units of collective investment schemes; and (iii) the reception and transmission of orders in relation to financial instruments.

These are subject to the conditions prescribed in Articles 6(5) and (6) of the AIFMD.

Q23) ***What is the MFSA's position vis-a-vis those Licence Holders which have passported MIFID services and which fall within the AIFMD?***

A23) In relation to the MiFID ancillary services, the European Commission is currently of the view that such activities cannot be passported under the AIFMD. The Commission has also stated that entities which receive authorisation as an AIFM under the AIFMD cannot also acquire an authorisation under another piece of EU legislation (e.g. the MiFID).

Therefore, there will currently be no option to passport MiFID services from Malta to other EU countries in reliance on a passport under EU law. The one exception to this will be where AIFMs also manage UCITS and are in a position to obtain authorisation under the UCITS Directive, whereby they will be free to offer Article 6(4) services cross-border under the UCITS passport. However, the Authority would be ready to consider the passporting of MiFID services from other jurisdictions.

ASSETS UNDER MANAGEMENT

Q24) ***Should derivative instruments used for currency hedging purposes and that do not add any incremental exposure, leverage or other risks be included in the assets under management calculation?***

A24) In order to determine whether a fund manager qualifies for the exemption prescribed in Article 3(2) AIFMD, all assets acquired through the use of leverage must be included in the initial calculation of the assets under management. When dealing with derivative instruments, these must be converted into the equivalent position in the underlying asset and it is the absolute value of this equivalent position that should be used for the calculation of the total assets under management in accordance with Article 2(3) [5] of the AIFMR.

The Authority considers that the exclusion of *"derivative instruments used for currency hedged purposes and that do not add any incremental exposure, leverage or other risks"* should only be applied in the ongoing reporting of leverage under the commitment method and in terms of Article 23(5) of the AIFMD.

Q25) ***Would the assets of a self-managed scheme which delegates part of its management functions in relation to those assets to an external de minimis Licence holder be considered as forming part of the assets under management of the de minimis Licence holder?***

A25) No, the delegated assets would still form part of the portfolio of the self-managed scheme. In this regard, Article 2(2) [second subparagraph] of the AIFMR provides that *"…. AIFs managed by the AIFM for which the AIFM has delegated functions in accordance with Article 20 of Directive 2011/61/EU shall be included in the calculation. However, portfolios of AIFs that the AIFM is managing under delegation shall be excluded from the calculation."*

[5] Article 2(3) AIFMR provides that "*For the purposes of calculating the total value of assets under management, each derivative instrument position, including any derivative embedded in transferable securities shall be converted into its equivalent position in the underlying assets of that derivative using the conversion methodologies set out in Article 10. The absolute value of that equivalent position shall then be used for the calculation of the total value of assets under management."*

Q26) ***Should other AIFMs in the same group as an AIFM be taken into account when calculating assets under management?***

A26) Yes, the assets under management of other AIFMs under common management and control must indeed be taken into consideration when calculating assets under management.

Q27) ***Does the phrase "portfolios of AIFs" in Article 3(2) of the AIFMD include portfolios of EU AIFs only?***

A27) No, in the calculation of the value of assets under management, an AIFM would be required to include all AIFs under management, irrespective of the jurisdiction of the AIF and whether or not the AIF is marketed in the EU.

Q28) ***Will the MFSA be requiring a de minimis AIFM to regularly check the status of such other companies and to be regularly updated of any take-on of new AIFs by regulated entities?***

A28) Yes, Article 3 of the AIFMR deals with ongoing monitoring of assets under management. It provides that AIFMs shall establish, implement and apply procedures to monitor on an on-going basis the total value of assets under management. Monitoring shall reflect an up-to-date overview of the assets under management and shall include the observation of subscription and redemption activity or, where applicable, capital draw-downs, capital distributions and the value of the assets invested in for each AIF.

Any proximity of the total value of assets under management to the threshold set in Article 3(2) of the AIFMD and the anticipated subscription and redemption activity shall be taken into account in order to assess the need for more frequent calculations of the total value of assets under management.

Article 4 of the AIFMR further deals with occasional breaches of the threshold.

DE MINIMIS

Q29) ***Does the de minimis exemption in Article 3(2) of the AIFMD apply to internally managed AIFs?***

A29) Yes, the *de minimis* exemption applies to both external and internal AIFMs. As a matter of fact, Recital 20 of the AIFMD provides that *"where the legal form of the AIF permits internal management and where the AIF's governing body chooses not to appoint an external AIFM, the AIF is also AIFM and should therefore comply with all the requirements for AIFMs under the Directive and be authorised as such."* This concept is further reiterated in Article 5(1) AIFMD.

Q30) ***Article 3(4) AIFMD states that de minimis Licence Holders shall not benefit from any of the rights granted under the AIFMD unless they choose to opt in. Which are the rights that may be benefited from by a fully licenced AIFM Category 2 Licence Holder but which may not be benefited from by a de minimis Licence Holder?***

A30) A fully licenced AIFMD is bound by compliance with the provisions of the Directive but also benefits from the passporting rights prescribed in Chapter VI thereof. A *de minimis* Licence Holder which does not choose to opt in under the AIFMD does not benefit from any of the passporting rights prescribed in the Directive.

Q31) ***Is it possible for a de minimis Licence Holder to also provide other services such as investment advice, individual portfolio management, receipt and transmission of orders and execution of orders?***

A31) Yes, a *de minimis* Licence Holder may provide other services such as investment advice, individual portfolio management, receipt and transmission of orders and execution of orders subject to it holding a MiFID Licence.

Q32) ***Would the Authority authorise the appointment by a Professional Investor Fund of a de minimis fund manager registered in another EU jurisdiction?***

A32) The Authority would be ready to consider the appointment by a Professional Investor Fund of a *de minimis* AIFM registered in another EU Member State subject to the satisfaction of the Authority's due diligence checks, competence assessments and checks on the organisational structure of the said fund manager.

Q33) ***For de minimis funds, can an authorised person hold multiple positions within a fund until the fund has grown significantly such that additional personnel can fill the roles?***

A33) The appointment of authorised persons involved in multiple positions for a temporary period will have to be considered as part of the holistic assessment of the Licence Holder's operational structure. While the Authority would be willing to exercise a certain level of flexibility with regards to small set-ups, the company would nonetheless be required to provide details regarding the safeguards that the company has in place in order to mitigate any conflicts of interest that may arise in this regard.

COMMON MANAGEMENT AND CONTROL

Q34) ***What is the scope of application of the de minimis regime, in particular the meaning of the following phrase: "directly or indirectly, through a company with which the Licence Holder is linked by common management or control or by a substantive direct or indirect holding"? Where reference is made to "a company", would this include SICAVs organised as self-managed AIFs?***

A34) Yes, where reference is made to "a company'", this includes self-managed AIFs since the Directive treats these as AIFMs for all intents and purposes.

With regards to the term "**common management**", reference should be made to Article 1(3) of the AIFMR which defines "senior management" as meaning "*the person or persons who effectively conduct the business of the AIFM in accordance with Article 8(1)(c) of Directive 2011/61/EU and, as the case may be, the executive member or members of the governing body*."

The AIFMR also defines in Article 1(4) the concept of "governing body" as meaning "*the body with ultimate decision making authority in an AIFM, comprising the supervisory and the managerial functions, or only the managerial function if the two functions are separated*."

Consequently, common management would usually be determined by representation on the Governing Body/ Board of Directors. Therefore AIFMs would generally be deemed to share common management where the same governing body or the majority of the members of the governing body preside over different AIFMs.

Where an AIFM has an Investment Committee, the members of which sit on another Investment Committee of another AIFM, the two entities would not be deemed to be linked by common management because ultimately the Investment Committee reports to the Governing Body of the Licence Holder. However, where the members of the Investment Committee are also members of the Governing Body, the Licence Holders could be deemed to be linked by common management.

Q35) ***In what manner can an AIFM be linked by "common control" with another AIFM?***

A35) The AIFMD defines "control[6]" by reference to Article 1 of Directive 83/349/EEC[7] which in turn refers to the relationship between a parent undertaking and a subsidiary, or a similar relationship between any natural or legal person and an undertaking.

[6] Article 4(1)(i) AIFMD
[7] Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54(3)(g) of the Treaty on consolidated accounts

Article 1 of Directive 83/349/EEC lists the instances where one undertaking i.e. a parent undertaking may be deemed to **control** another i.e. a subsidiary undertaking. The instances are namely where a parent undertaking:

i. has a majority of the shareholders' or members' voting rights in a subsidiary undertaking; or

ii. has the right to appoint or remove a majority of the members of the administrative, management or supervisory body of a subsidiary undertaking and is at the same time a shareholder in or member of that subsidiary undertaking; or

iii. has the right to exercise a dominant influence over a subsidiary undertaking of which it is a shareholder or member, pursuant to a contract entered into with that undertaking or to a provision in its memorandum or articles of association, where the law governing that subsidiary undertaking permits its being subject to such contracts or provisions. A Member State need not prescribe that a parent undertaking must be a shareholder in or member of its subsidiary undertaking. Those Member States the laws of which do not provide for each contracts or clauses shall not be required to apply this provision; or

iv. is a shareholder in or member of an undertaking, and:
   (a) a majority of the members of the administrative, management or supervisory bodies of that subsidiary undertaking who have held office during the financial year, during the preceding financial year and up to the time when the consolidated accounts are drawn up, have been appointed solely as a result of the exercise of its voting rights; or
   (b) controls alone, pursuant to an agreement with other shareholders in or members of that subsidiary undertaking, a majority of shareholders' or members' voting rights in that undertaking.

Therefore AIFMs would be deemed to be linked by common control when they fit in one of the scenarios prescribed above in relation to the same parent undertaking.

However, when interpreting the provisions of Article 3(2), the Authority will review each application on a case-by-case basis and examine the structures/relationships of licence holders/ applicants in the context of the above criteria.

Q36) ***In the case where one or more directors of a fund management company determining its qualification or otherwise as a de minimis Licence Holder are also directors of another fund management company which is a full Category 2 Licence Holder, would this be deemed to constitute "common management", thus requiring all assets under management of both fund management companies to be taken into consideration in calculating assets under management?***

A36) Yes, it is possible that this could be a consequence, subject to the proportionality test/total number of such common directors in relation to the size of the Governing Bodies concerned.

Q37) ***In the case that one or more Investment Committee members of a self-managed scheme are also Investment Committee members of another independent unrelated self-managed scheme, would the different self-managed schemes be deemed to be linked by "common management" for the purpose of the de minimis rules, thus requiring all assets under management of both self-managed schemes to be taken into consideration in calculating assets under management?***

A37) The management of a self-managed scheme is usually carried out by the Governing Body or Board of Directors. The Governing Body establishes the Investment Committee which is tasked *inter alia* with making recommendations to the Governing Body/Board of Directors of the Scheme. The Investment Committee has no executive function. Therefore, the fact that the same individuals are members of different investment committees of unrelated self-managed schemes does not make the schemes linked by common management or control.

DELEGATION

Q38) ***Can an AIFM delegate any of its functions? If so, which functions can be delegated?***

A38) Yes, Article 20 provides for the delegation of the functions of the AIFM. Specific requirements are included in Article 20 dealing with instances where the AIFM intends delegating portfolio management **or** risk management to third parties. An AIFM may not delegate both functions in their entirety.

Q39) ***Can an AIFM delegate functions to a third country entity?***

A39) With regards to delegation, an EU AIFM is bound by the requirements on delegation prescribed in Article 20 of the AIFMD as well as Articles 75 to 82 of the AIFMR.

In particular Article 20(1)(d) provides that delegation arrangements with third country managers can only be entered into where there is a cooperation arrangement between MFSA and the relevant third party supervisory authority. When outsourcing to third parties irrespective of where these are established, the EU AIFM is prohibited from outsourcing the entirety of its functions to the extent that it can no longer be considered to be the AIFM of the funds ("letter box entity"). As long as these requirements together with all the other requirements on delegation are observed, an EU AIFM delegating portfolio management to a third country manager may passport the units or shares of the EU AIF with effect from 22 July 2013.

Q40) ***If a third country AIFM which manages a third country AIF with EU investors fails to comply with the AIFMD is there any liability which arises? If so, which are the provisions in the AIFMD which lay down this liability?***

A40) The scenario contemplated is regulated differently in accordance with the different timeframes as indicated hereunder:

i. ***Timeframe 1: From 22 July 2013 to Mid-2015***:

During this period, the third country AIFM would be regulated by Article 42 AIFMD. In this regard, by 22 July 2014, the third country AIFM must file a notification with the MFSA to market the AIF to professional investors in Malta. Thereafter, the third country AIFM would also be bound to comply with Articles 22 to 24 and Articles 26 to 30 AIFMD as prescribed in Article 42. In this regard, reference must also be made to ESMA's Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD [ESMA/2013/1339 (revised)]. These Guidelines *inter alia* provide details on the reporting obligations to be complied by third country AIFMs.

ii. Timeframe 2: From Mid-2015 onwards:

During this period, subject to the issue of the relevant Delegated Regulation by the Commission as provided in Article 67, a third country AIFM which intends to exercise the third country passport, would be bound by the conditions prescribed in Article 37 and would therefore be required to choose a Member State of Reference. Once a third country AIFM appoints a Member State of Reference and is authorised in terms of the AIFMD, the provisions of the Directive would be applicable in their entirety.

The provisions of the Investment Services Act (Alternative Investment Fund Manager) (Third Country) Regulations apply in respect of breaches, particularly regulations 23 and 24 thereof. The Authority is also vested with wide ranging powers in respect of breaches of other relevant provisions of Maltese law, including EU law transposed into Maltese law.

Q41) ***Would an AIFM remain liable to the AIF it manages, irrespective of sub-delegation for investment management and risk management?***

A41) Yes, the liability of an AIFM remains unchanged notwithstanding any delegation arrangements which the AIFM may have concluded with regards to investment management and risk management. Article 20(3) AIFMD is clear in stating that the liability of the AIFM towards the AIF and its investors shall not affected by the fact that the AIFM has delegated functions to a third party.

Q42) ***Which are the entities to which delegation may be effected?***

A42) Article 20(1)(b) of the AIFMD provides that the delegate must dispose of sufficient resources to perform the respective tasks. Where the delegation concerns portfolio management or risk management it must be conferred on:

i. undertakings which are authorised or registered for the purpose of asset management;
ii. another entity, subject to prior approval by the competent authority; or

Where delegation is conferred on a third country entity, in addition to (i) or (ii), cooperation between the competent authority (where the AIFM is Maltese) and the supervisory authority of the delegate must be ensured.

Reference must also be made to Article 78(2) AIFMR which further specifies which entities shall be deemed to be authorised or registered for the purpose of asset management. Article 78(3) prescribes additional conditions which must be complied with where the delegation is conferred on a third country undertaking.

RISK MANAGEMENT FUNCTION

Q43) ***In application of the principle of proportionality as prescribed in Article 15(1) [second subparagraph] AIFMD, will certain AIFMs be able to request a derogation from the requirement of an independent risk management function?***

A43) Article 15(1) of the AIFMD provides that AIFMs shall functionally and hierarchically separate the functions of risk management from the operating units, including from the functions of portfolio management. Article 15(1) also provides that the functional and hierarchical separation of the functions of risk management shall be reviewed by the competent authority in accordance with the principle of proportionality, on the understanding that the AIFM, shall in any event, be able to demonstrate that specific safeguards against conflicts of interest allow for the independent performance of risk management activities and that the risk management process satisfies the requirements of Article 15 and is consistently effective. In accordance with the principle of proportionality, the Authority may grant a derogation from having a functionally and hierarchically separate risk management function. However the Licence Holder must demonstrate that the process still fulfils the requirements prescribed by Article 15.

Q44) ***Does the Risk Management and Internal Capital Adequacy Assessment Process ("RMICAAP") apply to AIFMs?***

A44) AIFM licence holders will not be required to implement the RMICAAP. Nevertheless, they will be required to establish and have a risk management function and proper policies and procedures in place.

Q45) ***Who can qualify as a Risk Manager?***

A45) For the appointment of an individual as a Risk Manager, the Authority must carry out a due diligence exercise upon submission of a signed Personal Questionnaire and Competency Form. The MFSA would consider the work experience and academic background of the proposed person as well as the type of funds to be managed and particularly the proposed risk management function structure of the company.

Q46) ***How is the risk management function affected if the fund is de minimis or a fully compliant fund?***

A46) In both cases, the licence holder would be expected to establish, implement and maintain adequate risk management policies and procedures in respect of the AIFs under management. Nevertheless, this requirement applies in proportion to the nature, scale and complexity of the AIFs managed. If the fund manager is a *de minimis* licence holder, the requirements of the Directive and the Delegated Regulation on the risk management function do not apply. As a consequence, the Authority would not be bound by the strict considerations concerning the delegation of the risk management function prescribed in the Directive if the fund manager decides to outsource part of the function.

Q47) ***What are the requirements when it comes to reporting risk exposures to the MFSA?***

A47) The licence holder is required to submit the information outlined in Appendix 13 of the ISP Rules in accordance with the manner established in ESMA's Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD [ESMA/2013/1339 (revised)].

Article 60 (6) of the AIFMR provides that regular reports should be submitted to the supervisory function on *inter alia* risk management. To date, the MFSA has not prescribed specific reporting requirements on risk exposures. However, the type and frequency of reporting to the regulator should be one element of the documented risk management policy which is established by the licence holder in relation to the fund it manages. The results of stress tests must be submitted at least on an annual basis in accordance with Articled 48(2)(b) of the AIFMR.

Q48) ***How frequently should the risk manager monitor the risk statistics and exposures of the fund?***

A48) It is the Licence Holder's responsibility to decide on matters such as frequency of monitoring and tests to be performed and include details in the relevant risk management policy.

Reference should also be made to Article 45(2) of the AIFMR which provides that the arrangements, processes and techniques referred to in Article 45(1)[8] of the AIFMR shall be proportionate to the nature, scale and complexity of the business of the AIFM and of each AIF it manages and shall be consistent with the AIF's risk profile as disclosed to investors.

[8] *Article 45(1) provides that "AIFMs shall adopt adequate and effective arrangements, processes and techniques in order to: (a) identify, measure, manage and monitor at any time the risks to which the AIFs under their management are or might be exposed; (b) ensure compliance with the limits set in accordance with Article 44 (risk limits)."*

Q49) ***After how long should the MFSA be notified in the case of a breach in risk parameters established by a fund?***

A49) The Licence Holder is responsible to decide on such matters and reflect them in the relevant risk management policy. This is without prejudice to any specific information which the Authority may request depending on the circumstances of the case presented.

AUTHORISATION

Q50) ***During the authorisation process, will the MFSA be requiring two individuals as a minimum to effectively manage the business of the AIFM or will it insist on there being more than two individuals fulfilling this role?***

A50) At least two individuals will be required to effectively direct and manage the investment services business of the Licence Holder. However, the MFSA usually recommends that there be more than two individuals carrying out these activities to avoid situations where, following the resignation of a director, the Licence Holder is left with just one director effectively running its business.

Q51) ***What is the interplay between SLC 1.10 [Part BIII ISP Rulebook] which provides that the AIFM must commence its business within twelve months of the date of issue of the licence, and SLC 1.17(m) [Part BIII ISP Rulebook] which binds the AIFM to notify the Authority where it has not provided any Investment Service for the preceding six months?***

A51) These SLCs refer to different time periods. SLC 1.10 refers exclusively to the first year of business of a Licence Holder. Meanwhile, the reporting obligation stemming from SLC 1.17(m) is not applied during the first year of business since the AIFM is granted leeway to commence business within the first twelve months from the date of issue of its licence.

Q52) ***Can an authorised AIFM also act as a UCITS management company?***

A52) Yes, fund managers may have dual authorisation under both the UCITS Directive and the AIFMD. However, it must be ensured that any activities carried out in respect of a UCITS under the UCITS Directive or an AIF under the AIFMD are carried out in accordance with and subject to the applicable licence.

Q53) ***Does the reference in Article 8(1)(d) AIFMD to regulators being satisfied as to the suitability of "shareholders or members of the AIFM" also apply to self-managed AIFs?***

A53) Yes, the suitability check prescribed in Article 8(1)(d) does apply to shareholders of an AIFM which is a self-managed AIF, however only to the extent that the shareholders have a management role in the AIF since the checks are intended to take into account "*the need to ensure the sound and prudent management of the AIFM*."

Q54) ***How will the MFSA handle the scenario envisaged in Article 8(4) AIFMD, namely that of restricting the scope of the authorisation as regards the investment strategies of AIFs which the AIFM is allowed to manage?***

A54) The AIFM must prove that it has sufficient knowledge and experience through its Investment Committee Members to handle the investment strategy of the various AIFs managed by it. However, this does not preclude the AIFM from having external experts to complement its Investment Committee.

Q55) ***Article 21 of the AIFMR refers to "collective knowledge, skills and experience" with respect to the governing body of an AIFM. Does this mean that the Governing Body as a whole should have the necessary mix of knowledge, skills and experience, as opposed to each director individually?***

A55) Article 21(a) refers to "*the governing body of the AIFM [possessing] collective knowledge, skills and experience*." This means that the Governing Body as a whole should have the requisite knowledge, skills and experience.

At application stage, when assessing the proposed Board of Directors of an AIFM, the Authority will assess the PQ of each Director and in particular the previous employment history of the individual. In the case where a Director is also appointed as an Investment Committee Member, the Authority will carry out a full due diligence assessment together with a Competence Assessment of the individual.

INITIAL CAPITAL AND OWN FUNDS

Q56) ***Do the own fund requirements in Articles 9(3) to 9(6) AIFMD apply to self-managed AIFs as well as external AIFMs?***

A56) Yes, the own fund requirements in Articles 9(3) to 9(6) apply to both self-managed AIFs as well as external AIFMs.

GENERAL OPERATING CONDITIONS

Q57) ***What is the meaning of the term "undue cost" as referred to in Article 17(2) of the AIFMR? Does disclosing a charge make it a due cost?***

A57) ESMA's technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive [ESMA/2011/379] provides that, in line with the UCITS approach,[9] AIFMs should take appropriate measures to avoid malpractices that might reasonably be expected to affect the stability and integrity of the market. Examples of such malpractices are market timing and late trading. Furthermore, AIFMs should establish appropriate procedures to ensure efficiency in the management of the AIF and act in such a way as to prevent undue costs (e.g. excessive trading costs) being charged to the AIF and its investors.

REMUNERATION

Q58) ***What position has the Authority adopted with regards to remuneration?***

A58) The Authority has transposed the provisions of Article 13 and Annex II of the AIFMD on Remuneration in Part BIII and in Appendix 12 to Part B of the ISP Rules. Furthermore, ESMA's Guidelines on sound remuneration policies under the AIFMD [ESMA/2013/232] have been transposed in the aforementioned Appendix 12. The Authority has opted not to transpose and apply Paragraph 18 of the ESMA Guidelines on the applicability of such Guidelines to delegates.

VALUATION

Q59) ***Will the MFSA be issuing rules on the valuation of assets by Maltese AIFs/AIFMs in terms of Article 19 of the AIFMD?***

A59) No, the Authority is not planning to issue rules on valuation of assets for the time being. However, Article 19 of the AIFMD is further supplemented by Articles 67 to 73 of the AIFMR.

[9] (Article 22 (2) and (4) UCITS Level 2)

Q60) ***What is the meaning of the term "mandatory professional registration" as referred to in Article 19(5)(b) of the AIFMD with respect to external valuers?***

A60) The MFSA already requires a collective investment scheme to appoint an independent valuer for the purposes of valuing unlisted securities or any other assets which are not dealt on a regulated market and/or where prices are not readily available. Such valuer would need to satisfy the following criteria, which criteria must be detailed in the scheme's offering memorandum:

i. the valuer must be a person independent from the scheme, its officials or any service providers to the scheme;
ii. the valuer must be of good standing with recognised and relevant qualifications and an authorised member of a recognised professional body (such as EVCA for PEs) in the jurisdiction of the assets; and
iii. the valuer must be appointed by the directors of the scheme (ideally in consultation and with the approval of the auditors).

The same standards will also be applied by the MFSA with respect to the appointment of external valuers pursuant to Article 19 AIFMD.

Q61) ***In what instances would the MFSA allow the valuation procedures and/or valuations to be verified by an auditor rather than an independent external valuer?***

A61) Both methods are deemed acceptable depending on the resources at hand and the nature of the relevant assets. However, the AIFM is ultimately responsible for the proper valuation of all assets and remains fully liable to the AIFs and to its investors.

Q62) ***Can the AIFM appoint the fund administrator of the AIF to act as an external valuer?***

A62) The AIFMR distinguishes between the valuation of investments and the calculation of the NAV, the latter being considered as an administrative function. The AIFMR also outlines that as long an external party does not provide subjective judgement in the valuation of assets, it won't be considered as being an external valuer. Accordingly, merely using values provided by the AIFM or other pricing sources and external valuers in order to calculate the NAV, does not qualify such party to be considered as an external valuer.

An AIFM may opt to appoint the fund administrator of the AIF in order to act as an external valuer. However, such party would need to demonstrate how it will satisfy all the criteria applicable for external valuers as prescribed in Article 19 of the AIFMD.

CUSTODIAN

Q63) ***Is an entity in possession of a Category 2 and Category 4 Investment Services Licence with capital of €730,000 (or more) eligible to act as a custodian of an AIF in terms of Article 21?***

A63) Yes, this is possible. Article 21(3)(b) as transposed in the ISP Rules refers to the possibility of having as a depositary an investment firm having its registered office in the Union and subject to capital adequacy requirements in accordance with Article 20(1) of Directive 2006/49/EC (including capital requirements for operational risks and authorised in accordance with Directive 2004/39/EC,) and which also provides the ancillary service of safe-keeping and administration of financial instruments for the account of clients in accordance with point (1) of Section B of Annex I to Directive 2004/39/EC. Such investment firms shall in any case have own funds not less than the amount of initial capital referred to in Article 9 of Directive 2006/49/EC.

Q64) ***Is it possible for a MIFID Category 2 licence holder to apply and obtain a Category 4b Depositary lite regime licence?***

A64) A Category 2 licence holder (other than a fund manager) shall be eligible to apply for a Category 4b licence in accordance with SLC 1.03 of Part BIV of the ISP Rules.

Q65) ***With effect from 22 July 2013, should Category 4 licence holders disregard Part B of the old ISP Rules and comply with Part BIV of the new Rules?***

A65) Part BIV of the new ISP Rules consolidates the requirements applicable to custodians of Collective Investment Schemes. Part BIV became applicable with effect from 22 July 2013. All custodians are expected to comply with the requirements prescribed in Sections 1 and 2. Sections 3 and 4 should be complied with to the extent that these are relevant to the business which is being carried out by the relevant custodian.

Section 9 of Part BI of the old Rules remains applicable with regards to the carrying out of custody business to collective investment schemes in the instances where the fund manager has not yet been authorised in terms of AIFMD.

Q66) ***Does Article 21(8)(a) of the AIFMD dealing with financial instruments that can be held in custody apply to financial derivative instruments?***

A66) No, financial derivative instruments are not deemed to be "instruments that can be held in custody" but are deemed to be "other assets" which are usually held by the counterparty and are only subject to record-keeping.

Q67) ***With regards to Article 21(8)(b) of the AIFMD dealing with "other assets", is it sufficient for the custodian to rely on the documentation provided by the AIF/AIFM?***

A67) Yes, Article 21(8)(b) of the AIFMD refers to the custodian's obligations with regards to other assets as follows:

i. verification of the ownership of the AIF/AIFM acting on behalf of the AIF of such assets;
ii. maintenance of a record of those assets for which it is satisfied that the AIF or AIFM acting on behalf of the AIF holds the ownership of such assets;
iii. an assessment by the custodian based on information or documents provided by the AIF/AIFM acting on behalf of the AIF and, where available, external evidence; and
iv. maintenance of records in an up-to-date form.

Therefore Article 21(8)(b) confirms that it shall suffice for the custodian to rely on the documentation provided by the AIF/ AIFM acting on behalf of the AIF. Reference should also be made to Article 90 of the AIFMR which deals with safekeeping duties regarding ownership verification and record keeping and further enhances the obligations of the AIFM.

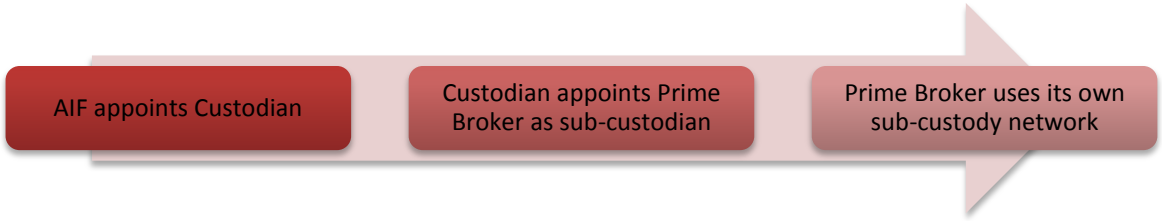
Q68) ***Can the measures specified in Article 21(8)(b) be considered sufficient due to the increased liability on the custodian for the "loss" of an asset? May the custodian additionally enter into a tripartite agreement with the AIF/AIFM and Prime broker which specifies the ownership and the manner in which such assets will be held as well as effectively transferring the liability for loss of such instruments from the custodian to the prime broker?***

A68) In this regard, reference should be made to Article 90 of the AIFMR which deals with safekeeping duties regarding ownership verification and record keeping and Article 91 of the AIFMR which deals with the reporting obligations for prime brokers.

Tripartite agreements could be a solution; however, any development in the area of data sharing will need to be rigorously controlled to ensure that integrity and segregation are maintained. A robust and efficient flow of information must be in place whilst at the same time maintaining appropriate Chinese walls to ensure that there is the necessary degree of independence. Therefore, particularly when an entity provides a plurality of services or has in place direct systems for sharing information to reduce duplication of work, such entity must be very careful to ensure that compliance with the relevant legal provisions is still ensured.

With regards to custodian arrangements and liability issues in terms of Article 21(8)(c), the Authority will consider any model proposed by the applicant, amongst which the following models:

Model 1: Fund appoints custodian. The custodian appoints prime broker as sub-custodian. Prime broker uses its own sub-custody network.

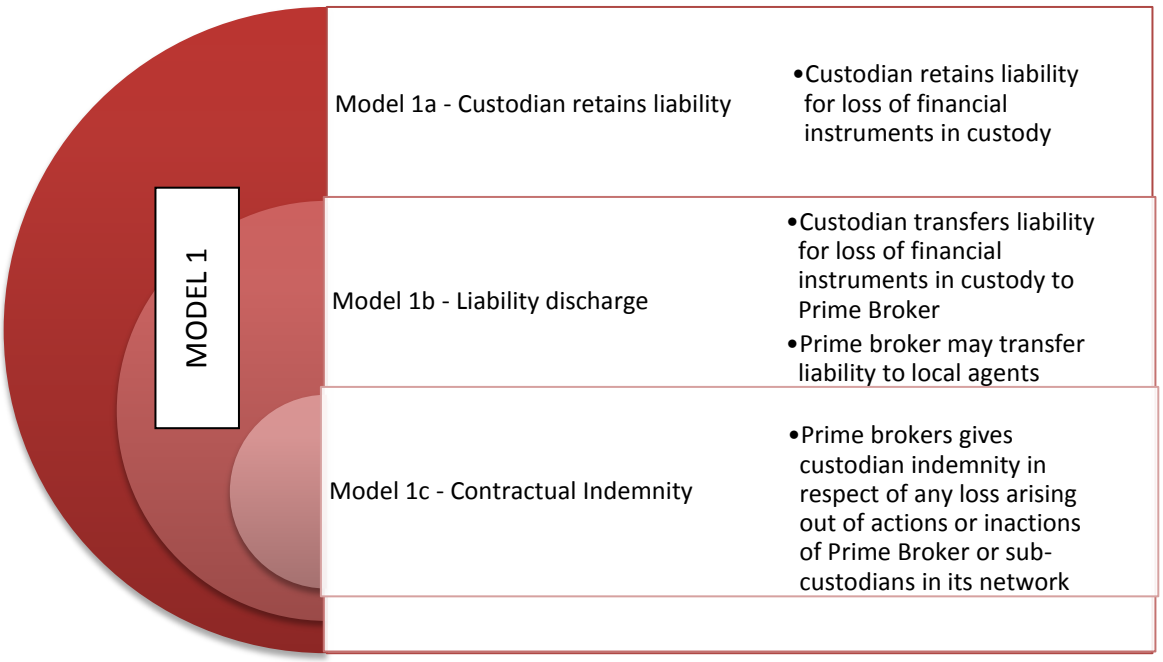


There are three possible structures:

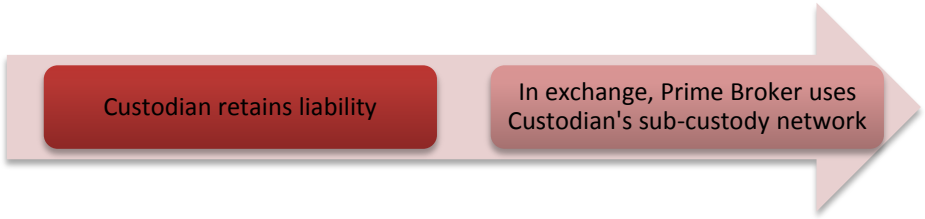
a. *Custodian retains liability.*
Under model 1a, the custodian retains liability for the loss of financial instruments held in custody.

b. *Liability discharge.*
Under model 1b, the custodian transfers liability for the loss of financial instruments held in custody to the Prime broker who may also transfer liability to its local agents.

c. *Contractual indemnity.*
Under model 1c, the custodian retains liability for the loss of financial instruments held in custody but receives a contractual indemnity from the prime broker in respect of any loss arising directly out of the actions or inactions of the prime broker or sub-custodians within its network.



Model 2: The custodian retains liability in exchange for prime broker using the custodian's sub-custody network.

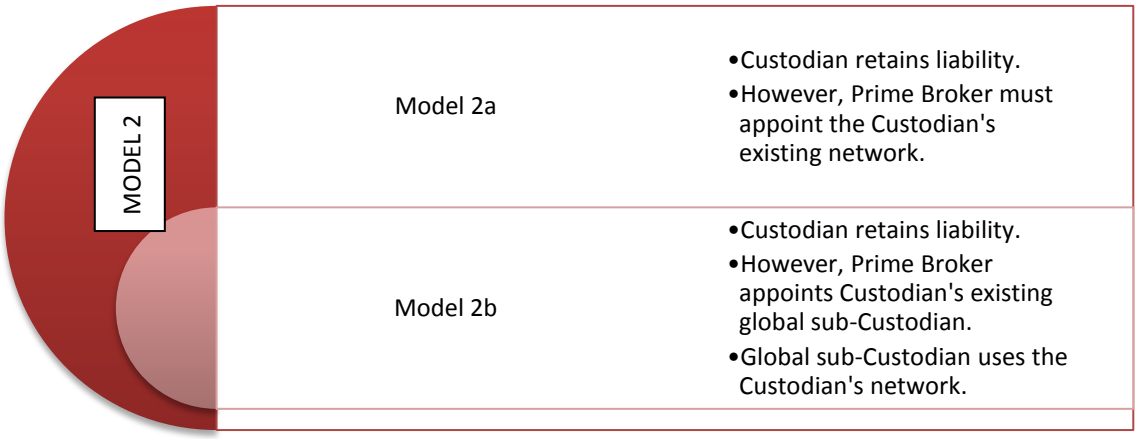


There are two possible structures in this case:

a. The custodian retains liability on the condition that the prime broker directly appoints the custodian's existing network.

b. Same as 2a, save that the prime broker appoints the custodian's existing global sub-custodian which, in turn, uses its network.

The advantage of this approach is that the custodian can retain strict liability as it has control over the sub-custody network. Model 2b creates some additional timing and settlement inefficiencies due to the additional of a global sub-custodian.



Model 3: The custodian holds long assets in custody. Financing is done on swap (the "UCITS model")

The custodian holds all long assets of the fund. Financing is achieved via collateralised derivatives.

Q69) ***With regards to Article 21(9)(b), is it sufficient for the custodian to rely on the valuation provided by the external valuer appointed by the AIF or is the custodian obliged to appoint a separate valuer?***

A69) Reference should be made to Article 94 of the AIFMR which supplements Article 21(9)(b) AIFMD. Article 94 provides that, in order to comply with Article 21(9)(b) AIFMD, the custodian shall:

i. verify on an on-going basis that appropriate and consistent procedures are established and applied for the valuation of the assets of the AIF in compliance with Article 19 AIFMD and its implementing measures and with the AIF rules and instruments of incorporation; and
ii. ensure that the valuation policies and procedures are effectively implemented and periodically reviewed.

Article 94(2) provides that the custodian's procedures shall be conducted at a frequency consistent with the frequency of the AIF's valuation policy as defined in Article 19 of the AIFMD.

Where the custodian considers that the calculation of the value of the shares or units of the AIF has not been performed in compliance with applicable law or the AIF rules or with Article 19 of the AIFMD, it must notify the AIFM and/or the AIF and ensure that timely remedial action is taken in the best interest of the AIF's investors. Where an external valuer has been appointed, a custodian must check that the external valuer's appointment is in accordance with Article 19 of the AIFMD and its implementing measures.

Q70) ***Article 90(2) of the AIFMR requires the depositary to, inter alia, ensure that it has procedures in place so that the registered assets cannot be assigned, transferred, exchanged or delivered without the depositary or its delegate having been informed of such transactions. Would it be sufficient for such procedures to provide that the custodian be informed of transactions in registered assets as soon as possible on a post trade basis?***

A70) It would be sufficient for the AIFM's and the custodian's procedures to provide that the depositary should be informed of transactions concerning the Scheme's assets (no explicit consent required). Nonetheless, to ensure that any anomaly is promptly addressed, the custodian is required to have proper escalation procedures in place as per the provisions of Article 90(4) AIFMR.

Q71) ***Does the MFSA intend to amend the Investment Services (Control of Assets) Regulations to reflect the additional requirements and liability for custodians of AIFs?***

A71) The Investment Services (Control of Assets) Regulations was last amended by Legal Notice 425 of 2013. The MFSA, however, does not exclude further amendments to the regulation.

REPORTING OBLIGATIONS OF AN AIFM

Q72) ***Is the obligation to compile an annual report and to provide disclosure also applicable to non-EU AIF investors?***

A72) Article 22(1) of the AIFMD provides that "*an AIFM shall for each of the EU AIFs it manages and for each of the AIFs it markets in the Union make available an annual report*…" Similarly, Article 23 provides that "*AIFMs shall for each of the EU AIFs that they manage and for each of the AIFs that they market in the Union make available to AIF investors*…" Therefore this obligation focusses on the country of registration of the AIF and the Member State or EEA State where the marketing/management is taking place rather than on the nationality of the investors.

Q73) ***Which Reporting Guidelines are AIFMs expected to follow during the one-year transitional period?***

A73) Prior to July 2014, authorised AIFMs are to comply with ESMA's Guidelines on Reporting Obligations under Article 3(3) and Article 24 of the AIFMD [ESMA/2013/1339 (revised)] on a best efforts basis.

Q74) ***When is the first AIFMD reporting submission for AIFMs and non-EU AIFMs relying on national private placement to market in Malta required?***

A74) In terms of paragraph 12 of the ESMA Guidelines revised on 15 November 2013, *"AIFMs should start reporting to their NCAs as from the first day of the following quarter after they have information to report until the end of the first reporting period".* The same deadline applies for non-EU AIFMs.

Q75) ***What are the reporting submission dates for AIFMs and AIFs under transitional arrangements?***

A75) The first reporting deadline for AIFMs relying on the National Private Placement Regime will be 31 July 2014 or 15 August 2014 for EU-AIFs established as fund of funds. AIFMs that fall under Article 3(3) AIFMD will be required to submit their first reports by 31 January 2015 or 15 February 2015 as applicable. Such reports are expected to cover the period from 1 January 2014 or from the first day of the full quarter after the licence date until 31 December 2014.

AIFMs will be required to submit either quarterly, half-yearly or annual periodic information in accordance with the Guidelines in the following manner:

i. Where the assets under management ("AUM") of the AIFs are below the thresholds specified in Article 3 of the AIFMD, it will be required to submit a condensed set of information on an annual basis;
ii. AIFMs managing portfolios or marketing AIFs whose AUM is larger than the thresholds outlined in Article 3(2) of the AIFMD and is less than EUR 1 Billion will be required to report to the National Competent Authority ("NCA") information on a half-yearly basis;
iii. AIFMs managing portfolios or marketing AIFs whose AUM exceeds EUR 1 billion are requested to report to the NCA on a quarterly basis;
iv. AIFMs subject to semi-annual reporting requirements will be required to report to their NCA on a quarterly basis for each AIF whose AUM exceeds EUR 500 million; and
v. AIFMs managing or marketing unleveraged AIFs that invest in non-listed companies and whose issuers are in control such as Private Equity AIFs will be required to report to their NCA on an annual basis.

The MFSA would ordinarily request a confirmation from AIFMs when a change in AUM and the reporting period provided in the revised Guidelines issued by ESMA occurs.

Q76) ***When is the reporting deadline of Appendix V of the Investment Services Rules for Professional Investor Funds (the "PIF Rulebook") relating to the specific information to be provided to the MFSA by de minimis self-managed funds in terms of Article 3(3)(d) of the AIFMD?***

A76) In terms of Part BIII of the ISP Rules, a *de minimis* AIFM shall submit to the MFSA the information prescribed in Annexes 1 and 2 to Part B of the Rules and shall further comply with the applicable provisions of the AIFMR.

Article 5(5) AIFMR further specifies that the information required for registration purposes shall be updated and provided on an annual basis. Article 110(1) AIFMR provides that the information would have to be submitted within one month following the end of the reporting period, except for funds of funds for which the requirements stipulate one month plus 15 days.

Q77) ***Will MFSA require any additional information for AIFMD Reporting that is not currently included in the ESMA XML Schema or covered in the ESMA guidance? What is the system that the MFSA will be using to receive the AIFMD Reporting information?***

A77) The MFSA does not intend to request any additional information which is not included in the ESMA Guidelines. However, the MFSA reserves the right to request additional information on an *ad-hoc* basis.

It is the MFSA's intention to allow AIFMs to submit data through an Excel spreadsheet similar to the AIFM reporting template published by ESMA on 15 November 2013. The MFSA would then be converting the relevant file into XML Schema Definition and sending them to ESMA in a secure manner.

AIFMs will be required to provide both qualitative and quantitative information and would be required to file the following two files:

i. An aggregated file at AIFM level reporting information concerning AIFs managed and/or marketed in the EU; and
ii. A file at AIF level for each AIF managed and/or marketed in the EU.

The Authority is currently considering the specific content of each file together with the necessary validation checks and will be in a position to confirm this content in due course.

Q78) ***In the context of an externally managed AIF, are the reporting obligations vis-à-vis investors in terms of Article 23 of the AIFMD imposed both on the AIF and the AIFM?***

A78) The obligation to provide information to investors prior to investing is to be borne by the AIF in the event where the AIF is self-managed. In the case where the AIF is third-party managed, the AIFM will provide the information to investors.

Q79) ***Should the information listed in Section 6 of Appendix 4 of the Investment Services Rules for Alternative Investment Funds (hereinafter referred to as the 'AIF Rulebook'), being information to be made available prior to investing in the AIF, be exclusively and exhaustively included in the fund documentation?***

A79) The different disclosures and matters prescribed in Section 6 of Appendix 4 are not to be exclusively and exhaustively included in the fund documentation. However, the AIFM or self-managed AIF must ensure that the AIF's Constitutional Documents and/or Offering Document provide a reference to the manner in which the information described in SLC 6.01 is made available to investors.

Q80) ***What is the frequency required with respect to the Reporting obligations under SLC 6.05 and SLC 6.06 of Appendix 4 of the AIF Rulebook?***

A80) SLCs 6.05 and 6.06 transpose the provisions of Article 23(4) and (5) AIFMD. These two sub-articles are further supplemented by the provisions of Articles 108 and 109 of the AIFMR which deal with periodic and regular disclosure to investors respectively. The AIFMR does not set any periodic reporting obligation but rather states in both instances that the information shall be disclosed as part of the AIF's periodic reporting to investors as required by the fund's rules or instruments of incorporation or at the same time as the prospectus and offering document. As a minimum, the information shall be provided at the same time as the annual report is made available to the investors.

AIF STRUCTURES AND STRATEGIES

Q81) ***Should the term "Alternative Investment Fund"/"AIF" be interpreted as referring to the collective investment scheme or should it be interpreted as referring to each individual sub-fund of multi-fund investment companies with variable share capital? If the latter, can a SICAV have an AIF sub-fund and a non-AIF sub-fund?***

A81) The AIFMD defines "AIFs" as meaning "*collective investment undertakings, including the investment compartments thereof…"*

ESMA's Guidelines on key concepts of the AIFMD [ESMA/2013/600] seem to adopt a "bottom-up" approach and provides that where an investment compartment of an undertaking exhibits all the elements in the definition of "AIF" in Article 4(1)(a) of the AIFMD (i.e. "collective investment undertaking", "raising capital", "number of investors" and "defined investment policy") this should be sufficient to determine that the undertaking as a whole is an "AIF" under Article 4(1)(a) of the AIFMD.

Therefore the term "AIF" should be understood as referring to the collective investment scheme.

Q82) ***Are dedicated funds (funds for one investor) to be considered AIFs?***

A82) In line with the definition of 'AIF' prescribed in Article 4(1)(a) of the AIFMD, the MFSA considers that in principle established AIFs are expected to raise capital from a number of investors. The Authority also refers to Paragraph 17 of the ESMA Guidelines relating to key concepts of the AIFMD [Ref No. 2013/600] which provides that "*an undertaking which is not prevented by its national law, the rules or instruments of incorporation or any other provision or arrangement of binding legal effect, from raising capital from more than one investor should be regarding as an undertaking which raises capital from a number of investors in accordance with Article 4(1)(a)(i) of the AIFMD. This should be the case even if it has in fact only one investor."*

Q83) ***Can the exemption under Reg. 5(d) of the Investment Services Act (Exemption) Regulations be applied or disapplied on a case-by-case basis by the MFSA such that it would still allow the setting up and licencing of a family office vehicle as a PIF?***

A83) A family office structure may be licenced as a PIF, if at law the fund is open for investment by investors who are external to a pre-existing group of investors. The PIF structure would be required to comply with the AIFMD unless it falls within the parameters of the *de minimis* thresholds.

Q84) ***Are the below proposals acceptable structures under the RICC regime:***

i. A mix of Incorporated Cells which are self-managed funds (or Incorporated Cells set up as multi-fund SICAVs with all sub-funds being self-managed) and Incorporated Cells which are externally managed (or Incorporated Cells set up as multi-fund SICAVs with all sub-funds thereunder being externally managed); and

ii. A mix of Incorporated Cells which are externally managed by an AIFMD authorized manager under the AIF Rulebook (or Incorporated Cells set up as multi-fund SICAVs with all sub-funds thereunder managed by AIFMD authorized Managers) and Incorporated Cells which are externally managed by non-AIFM Managers under the PIF regime (or Incorporated Cells set up as multi fund SIC'AVs with all sub-funds managed by non-AIEM Managers under the PIF regime)?

A84) The Authority is of the view that both structures as proposed can be set up in terms of the Companies Act (Recognised Incorporated Cell Companies) Regulations. Nevertheless, each incorporated cell would have to comply with the provisions of the Investment Services Act.

Q85) ***Does the MFSA accept a mix of sub-funds which are self-managed and sub-funds that are externally managed within the same Incorporated Cell set up as a multi-fund SICAV?***

A85) No, the Authority does not accept a mix of sub-funds that are self-managed and sub-funds which are third party managed.

Q86) ***Does the MFSA accept a mix of sub-funds which are managed by AIFMD-authorised Managers and sub-funds managed by non-AIFMD-authorised Managers under the PIF regime within the same Incorporated Cell set up as a multi-fund SICAV?***

A86) No, the structure is not acceptable particularly in view of the fact that in terms of paragraph 11 of the ESMA guidelines on Key Concepts of the AIFMD *"where an investment compartment of an undertaking exhibits all the elements in the definition of 'AIF' in Article 4(1)(a), this should be sufficient to determine that the undertaking as a whole is an 'AIF' under Article 4(1)(a) of the AIFMD."* Therefore, in terms of the aforementioned definition, the sole presence of one sub-fund which presents the characteristics of an AIF is sufficient to make the entire fund an AIF. As a consequence, the fund manager should necessarily be an AIFM.

Q87) ***If a Maltese AIFM is the manager of a non-EU Master Feeder AIF and the AIFM will be marketing in the EU without a passport the non-EU Feeder AIF in terms of Article 36 of the AIFMD, do the depositary lite provisions referred to in Article 36 apply to both the non-EU Feeder and the non-EU Master AIF as a single structure?***

A87) It is the spirit of the AIFMD to recognise the particularities of master-feeder arrangements which, due to their operational nature, cannot be seen completely in isolation as two separate funds. In this context, the Directive requires certain information in relation to the master AIF when applying certain requirements to a feeder AIF (e.g. Article 7 on authorisation, Article 23 on disclosure to investors, Articles 31 and 32 on the right to market EU AIFs).

In this regard Article 32(1) [second sub-paragraph] provides that *"Where the EU* AIF *is a feeder AIF the right to market referred to in the first subparagraph is subject to the condition that the master AIF is also an EU AIF and is managed by an authorised EU AIFM."*

In view of the above, the Authority recognises the case made for distinguishing between the master and feeder funds for the purposes of marketing pursuant to Article 36.

Q88) ***Does the MFSA consider managed accounts as investment pools and hence collective investment schemes, thereby falling under the provisions of the AIFMD?***

A88) A managed account is understood to refer to an individual account for an individual investor and is therefore akin to individual (as opposed to collective) portfolio management. Individual portfolio management is not within the scope of the Directive. Recital 9 provides that investment firms authorised under Directive 2004/39/EC should not be required to obtain an authorisation under the Directive in order to provide investment services such as individual portfolio management in respect of AIFs.

Q89) ***Are side-letter agreements considered as constituting preferential treatment and hence resulting in overall material disadvantage to other investors in the same scheme in cases where the provision of information (i) does not impact the fund's liquidity terms; and (ii) is not placing other investors in an unfavourable situation or prejudicing them in any way?***

A89) Side-letter agreements constitute preferential treatment in terms of the AIFMD and that they should be disclosed in the AIF's rules or instruments of incorporation.

Article 23(1)(j) of the AIFMD provides that in making disclosures to investors the AIFM should provide *"a description of how the AIFM ensures a fair treatment of investors, and whenever an investor obtains preferential treatment or the right to obtain preferential treatment, a description of that preferential treatment, the type of investors who obtain such preferential treatment and, where relevant, their legal or economic links with the AIF or AIFM."* Such disclosure should be made in full and providing complete details.

The Authority is of the view that the issue of whether preferential treatment could constitute a material disadvantage is subjective and depends on the nature and detail of the preferential terms. There could be instances where the additional information made available to the "preferred" investors provides them with a material advantage on other investors, particularly if the information is of a price-sensitive nature. Ultimately, it is the AIF's Board of Directors together with the AIFM which must determine and put on record the reasons as to why any preferential treatment of investors would not constitute a material disadvantage to the other investors.

Q90) ***To which types of Collective Investment Schemes does Regulation 345/2013 on European Venture Capital Funds ('the Regulation') apply?***

A90) The Regulation applies *inter alia* to *de minimis* AIFMs of collective investment schemes whose assets under management do not exceed EUR 500 million, are established in the EU, are subject to registration as *de minimis* AIFMs, and manage portfolios of qualifying venture capital funds. There is the possibility that the provisions of the Regulation will be extended to full AIFMs in the future. However, this is subject to Commission review. Notwithstanding, the Regulation provides that *de minimis* managers registered in accordance with the Regulation whose assets under management subsequently exceed the EUR 500 million threshold may continue to market venture capital funds in accordance with the Regulation subject to their fulfilling the conditions of the AIFMD.

Q91) ***Would de minimis AIFMs be precluded from managing other types of PIFs that do not qualify as European Venture Capital Funds?***

A91) Managers of qualifying venture capital funds may indeed manage other types of funds (including UCITS) provided that they are external managers (i.e. a self-managed Venture Capital Fund may not be the external manager of any other type of fund). However, PIFs are, by definition, also AIFs and would need to be taken into consideration when calculating assets under management.

Q92) ***Is the redemption lock-in period imposed in terms of Article 3(2)(b) of the AIFMD applicable in respect of European Venture Capital Funds? Moreover, can the manager use leverage under the Regulation?***

A92) With regards to leverage and redemptions rights in the context of the EUR 500 million threshold stipulated in Article 3(2)(b) AIFMD, it should be understood that this threshold is intrinsically linked to an underlying portfolio of AIFs that are unleveraged and which do not feature redemption rights for the period of 5 years following the date of initial investment. Any European Venture Capital Funds comprised within the manager's portfolio would also have to comply with these requirements.

Article 5(2) of the Regulation allows leverage up to the level of the committed capital of the Scheme. Negotiations at EU Council level indicate that the rationale behind Article 5(2) was to confirm that exposures within the parameters of that article will not be considered as leverage, thereby allowing the Manager of the fund to qualify for the *de minimis* exemption contained in Article 3(2)(b) of the AIFMD, provided that all other conditions are met.

Q93) ***Is the requirement to report positions in non-listed investments made by the AIF applicable to non-EU AIFs?***

A93) Yes, the requirement is applicable to non-EU AIFs. The Directive provides that "*subject to the exceptions and restrictions provided for, this Directive should be applicable to all EU AIFMs managing EU AIFs or non-EU AIFs...*" Therefore, unless expressly stated, the relevant articles of the AIFMD apply to all AIFs, regardless of whether they are EU AIFs or not.

Q94) ***Has Malta imposed any stricter requirements with regards to Article 26(7) AIFMD?***

A94) Article 26(7) provides the MFSA with the option to apply stricter rules with respect to the acquisition of holdings in issuers and non-listed companies in Malta. In this case, the MFSA has decided not to apply stricter rules.

MARKETING

Q95) ***What constitutes an EU investor – active residence or nationality?***

A95) The Authority is of the view that the test applied to assess whether an investor is an EU or non-EU investor may be based on the residence of the relevant individual.

Q96) ***If permitted to market to retail investors under Article 43 AIFMD, must an AIFM go through the marketing approval process in Article 31?***

A96) Yes, an AIFM which markets AIFs to retail investors must comply with all the other requirements of the AIFMD, including the approval process under Article 31.

OTHER FUNCTIONS OF THE AIFM

Q97) ***As per SLC 1.03 of Part BIII of the ISP Rules, an AIFM once licenced can provide investment management functions and other functions including administration, marketing and activities related to the assets of AIFs. Would the AIFM licence holder require an additional authorisation or recognition from the MFSA to provide such other functions?***

A97) Section 4 of Schedule A2 of the ISP Rules stipulates that *"where the Applicant intends to* provide *Administration services, a Recognition Certificate in terms of Article 9A of the Investment Services Act is required"*. Accordingly, an application to be able to provide fund administration services is necessary. For "Marketing", no specific authorisation is required by the Authority (this does not relate to marketing passport of AIFs). As regards "Activities related to the assets of AIFs", additional authorisation or recognition depends on the intentions of the applicant.