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MALTA 2012

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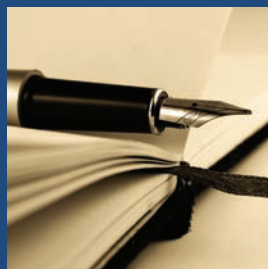
Legislation and custody service safeguards

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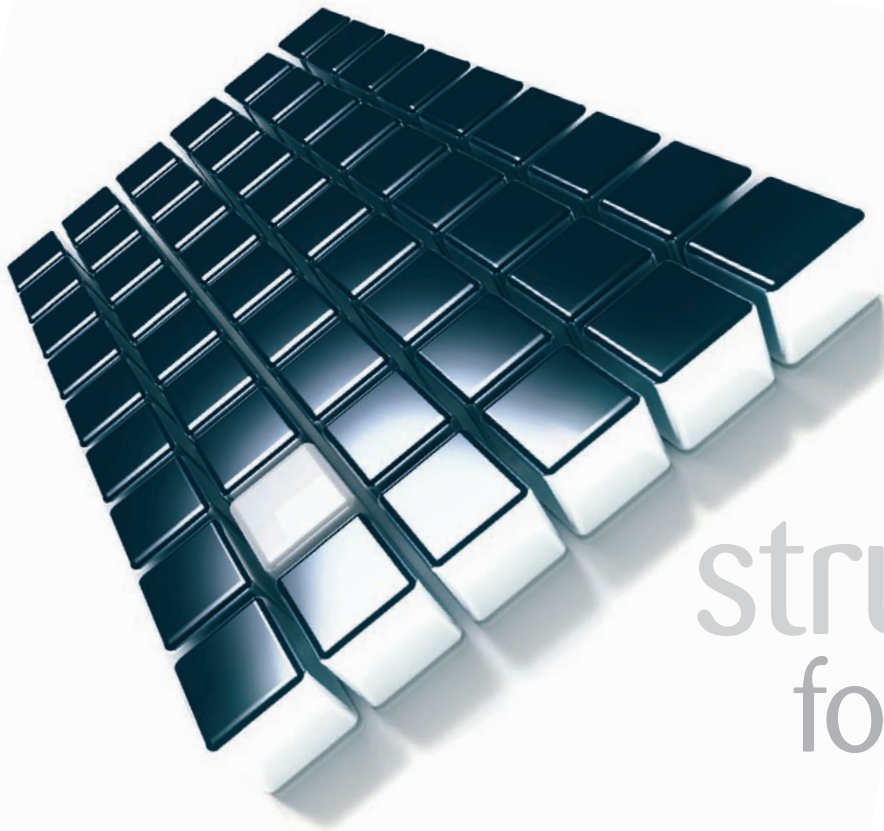
Fund, strategy and service provider numbers rise

REPUTATION

Favourable taxation and proactive regulators ensure loyalty



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The Malta Financial Services Authority's proactive approach is a key factor in the success of the island's financial services industry, and with ever-increasing reporting requirements, it has ensured the required levels of transparency have been studiously adhered to.

By talking to a range of funds and a host of service providers, this *HFMWeek Malta 2012* report takes a look at how Malta has adapted to change and is continuing to bolster its enviable position.

Jon Yarker
REPORT EDITOR

HFMWEEK

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LONDON

1 East Poultry Avenue, EC1N 9PT
T+44 (0)20 7029 4000

NEW YORK

240 West 37th Street, New York, NY 10018
T+1 (212) 268 4919

REPORT EDITOR Jon Yarker T: +44 (0)20 7029 4066 j.yarker@pageantmedia.com

HFMWEEK EDITOR David Beattie T: +44 (0)20 7029 4038 d.beattie@pageantmedia.com **PRODUCTION EDITOR**

Claudia Honerjager **SUB-EDITORS** Rachel Kurzfield, Eleanor Stanley **DESIGNER** Matt McLean

COMMERCIAL MANAGER Lucy Guest T: +44 (0)20 7029 4052 l.guest@hfmweek.com **SENIOR PUBLISHING**

MANAGER Sarah Halton T: +44 (0)20 7029 4036 s.halton@hfmweek.com **SUBSCRIPTIONS MANAGER**

Richard Freckleton T: +44 (0)207 029 4012 rfreckleton@hfmweek.com

CIRCULATION MANAGER Fay Muddle T: +44 (0)20 7029 4084 f.muddle@pageantmedia.com

CHIEF EXECUTIVE Charlie Kerr

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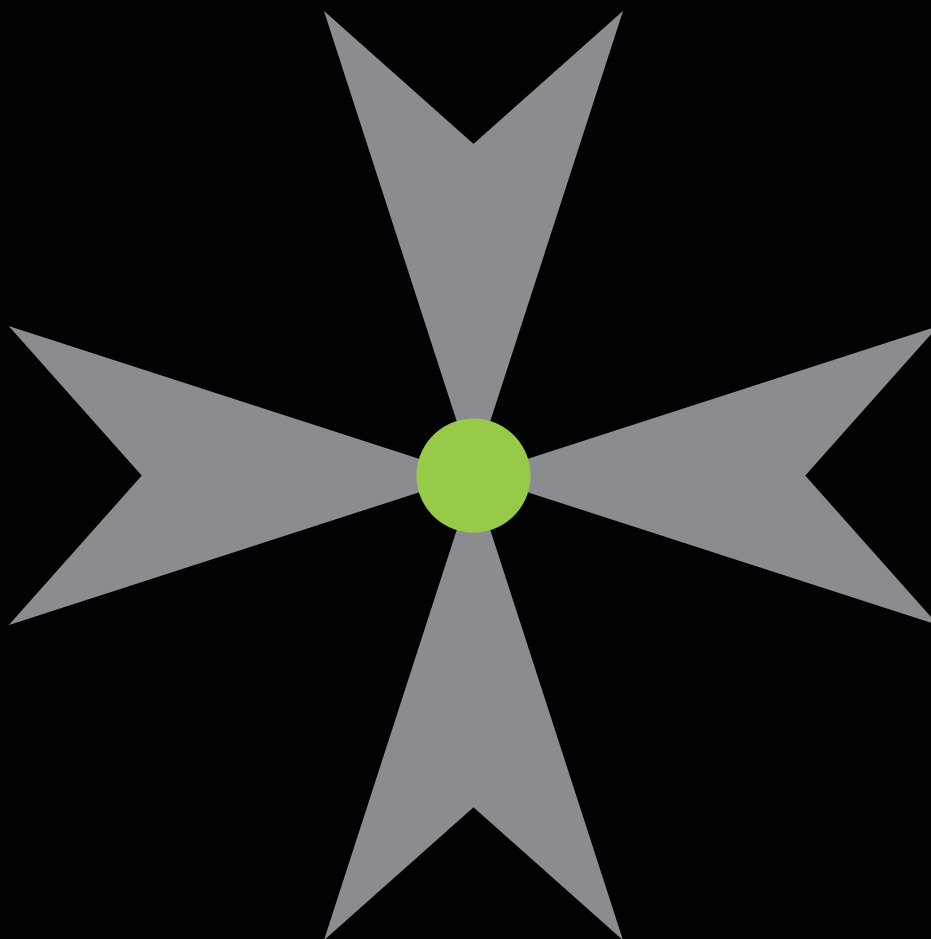
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MALTA AND THE LEVEL II AIFMD RULES

WITH THE LEVEL II IMPLICATIONS OF THE AIFMD SET TO BE INTRODUCED SOON, **LARAGH CASSAR**, OF **CAMILLERI PREZIOSI**, DISCUSSES THE POSSIBLE AFFECTS THIS WILL HAVE ON MALTA



Laragh Cassar is a partner of Camilleri Preziosi, one of Malta's leading law firms. Laragh, together with Louis de Gabriele, heads the Corporate and Finance Group. Laragh specialises in investment funds, asset management, banking and corporate finance.

Malta has distinguished itself from the traditional hedge fund jurisdictions and the recent developments in the regulation of hedge funds in the European Union (EU) are expected to ensure that Malta will continue to offer an attractive legal and regulatory framework for hedge fund managers to operate within the EU, as well as internationally.

The legal structures available under Maltese law have been praised for their ability to accommodate various alternative investment strategies while offering complete segregation of the risks and returns pertaining to each strategy pursued. Fund vehicles are easily recognisable and familiar to industry participants and regulators, as these range from the widely used Sicav to the Unit Trust. Coupled with the flexible regulatory framework of the Professional Investor Fund (pif) regime, fund managers have a world of opportunities to structure their operations in and from Malta.

Although the island is increasingly attracting an interest from a broad spectrum of managers, the strong British influence in its work ethic and legal system, together with its proximity to London, have increased Malta's popularity with London-based managers. Its strong European identity has played an important role in giving Malta credibility and a reputa-

tional edge over offshore centres. Being a full member of the EU since 2004, Malta's regulatory landscape has long been modelled on EU law.

The Alternative Investment Fund Managers Directive (AIFMD) introduced an EU marketing passport for hedge fund managers to market their funds in all 27 member states of the EU through a single authorisation process, similar to that under the Ucits directive. However, the EU marketing passport will, at first, only be available to EU managers in the course of marketing EU funds. It is only in 2015 that the EU marketing passport will be available to non-EU managers and their funds, and such opportunity will only exist if they effectively become subject to the AIFMD. This feature of the AIFMD has sparked a number of offshore managers to establish a base in European jurisdictions, such as Malta, in order for them to benefit from the EU passport from an earlier date. Although during the intermittent period of 2013 to 2015, national private placement regimes will still be an option – albeit the only one – for non-EU

managers and non-EU funds to be marketed in the EU, such national regimes are expected to be phased out completely by 2018. Offshore managers may therefore be faced with the stark choice of either establishing an EU base and comply with the AIFMD in order to access the European market, or not to market their funds in the EU.

Much of the speculation in the industry during the last few months has focused on the way in which the level II measures, that is, the secondary legislation that will flesh out the provisions of the AIFMD, are going to give a better

picture of the effects of the directive. Some of the mist surrounding the level II measures has been lifted by the European Securities and Markets Authority (Esma) in its final advice to the European Commission last November. Although the final rules are expected to be published later this year, Esma's advice gives the industry an indication of the direction in which the practical implications of the directive for fund managers are likely to steer.

Although certain aspects of Esma's final advice are a cause for concern, various parts of Esma's advice introduce rules that are, to a large extent, workable. In the local context, the rules regulating managers in Malta are already based on the Markets in Financial Instruments Directive

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THE DIRECTIVE
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(Mifid) standards. This is reassuring for EU managers given that the thrust of the AIFMD level II implementing measures are likely to use Mifid as their benchmark.

Mifid regulated managers, as well as those that have adapted their alternative investment strategy to suit a Ucits structure, will generally already be familiar with the level II measures proposed by Esma on operating conditions. Similarly, the conflicts of interest requirements already apply to Mifid regulated managers. The adoption of the proportionality principle for determining the appropriate risk management process is another welcomed feature of the proposed rules. This means that fund managers are not required to appoint separate dedicated persons to carry out the risk management function in each and every case.

Outsourcing and delegation requirements are broadly based on the Mifid material-outsourcing concept, as well as concepts borrowed from the Ucits regime. The criteria for the selection of delegates of the fund manager are broadly similar to those currently required under the three-pronged “fit and proper” test applied by the MFSA, assessing the integrity, competence and the solvency of the fund’s service providers. The third-country test for the delegation of portfolio management to non-EU managers has been relaxed, as Esma has abandoned its previous stance that required regulators to carry out “equivalence” tests. This means that self-regulated funds established in Malta may continue delegating portfolio management to Swiss and US managers whose regime may not necessarily be equivalent. In line with the scope of the AIFMD, that imposes further reporting obligations on managers and the funds they manage, Esma has facilitated reporting by preparing a standard form reporting table based on the

International Organisation of Securities Commissions (Iosco) hedge fund reporting standards and the proposals under Dodd-Frank in the US. The frequency of reporting to the regulator is determined according to the total assets under management and can either be quarterly, semi-annual or annual.

Esma has introduced a degree of flexibility for the coverage of professional negligence claims by fund managers, allowing them to combine a mixture of own funds together with coverage under a professional indemnity insurance policy. An incentive mechanism now rewards managers for creating effective operational risk management systems, as they may be permitted to hold less own funds when they can justify lower thresholds on the basis of a three-year historical loss period. With regards to the valuation of assets, Esma has acceded to the industry’s request to permit the adoption of different valuation arrangements across all funds managed by the same manager.

Although the AIFMD requires the depositary for EU funds to be located in the same EU member state of the fund, when implementing the AIFMD, Malta is expected to make use of the transitional provision under the directive that will allow funds established in Malta to appoint a credit institution situated in another member state until 22 July 2017. This should further facilitate the process for fund managers to establish a presence in Malta.

Even though the hedge fund regulatory landscape is still evolving, the exponential growth in the number of hedge funds operating from Malta over the recent years is not only promising but attests to Malta’s active role in the development of the hedge fund industry in Europe and beyond. ■



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ATTRACTING THE 'BEST OF BREED' FOR MALTA'S FINANCIAL SERVICES INDUSTRY

ANDREW ZAMMIT OF THE CSB GROUP GIVES AN OUTLINE OF THE HIGHLY QUALIFIED PERSONS RULES, 2011



Andrew J. Zammit

is managing partner of Zammit & Associates – Advocates and chief legal officer of the CSB Group, practicing company law, financial services regulation, hedge fund registration, internet law and ship and yacht finance.

Malta has attracted much media attention as an up-and-coming onshore financial centre, particularly since the 2008 economic slowdown. It has become widely acknowledged as an EU jurisdiction where things get done efficiently and with the right balance between prudential supervision and pragmatic regulation, enabling businesses to develop lasting and meaningful relationships with their regulators and better business for the regulated operators, while also offering a quality Mediterranean lifestyle with a strong Anglo-Saxon work ethic. This development has most recently been extensively covered by Bloomberg and the Financial Times, both of which have extensively praised Malta's virtues.

The surge in the number of international businesses establishing some or all of their operations in Malta, particularly in the regulated industries of financial services and internet gaming, has created a marked shortage in the supply of certain specialised skills within these industries. These growing pains have been managed by the Maltese government through various initiatives including the incentivising of advancement into tertiary education and ongoing training. However, besides such incentives, the government has also acknowledged the value of attracting additional human capital possessing the technical knowledge and experience to advance these industries and secure Malta's position as a centre of excellence in the international financial arena.

With this objective in mind, in 2011 the Malta government introduced specific tax rules targeted at highly qualified persons performing particular functions within Malta-based operators duly licensed by the Malta Financial Services Authority (MFSA) or the Lotteries and Gaming Authority (LGA). These rules are contained in the Highly Qualified Persons Rules, 2011, (the HQP Rules).

The HQP Rules are effective in respect of income earned by qualifying individuals in and from 1 January 2010.

THE PROPOSITION

In terms of the HQP Rules, a 15% flat rate of tax would be chargeable on employment income derived by duly qualified, experienced and senior personnel holding an "eligible office". This favourable tax rate applies in respect of such income up to a maximum of €5,000,000 per annum. Any income in excess of the €5,000,000 threshold is exempt from Malta tax altogether.

The "eligible offices" enumerated in the HQP Rules are the following:

- Actuarial professional
- Chief executive officer
- Chief financial officer
- Chief commercial officer
- Chief insurance technical officer
- Chief investment officer
- Chief operations officer
- Chief risk officer (including fraud and investigations officer)
- Chief technology officer
- Chief underwriting officer
- Head of investor relations
- Head of marketing (including head of distribution channels)
- Head of research and development; (including search engine optimisation and systems architecture)
- Portfolio manager
- Senior analyst (including structuring professional)
- Senior trader/trader
- Odds compiler specialist

CONDITIONS AND EXCLUSIONS

In general terms, anyone seeking to benefit from the 15% tax rate must satisfy all of the following conditions:

1. derive employment income of at least €75,000 (exclusive of the annual value of any fringe benefits and adjusted annually in line with the domestic retail price index), which is subject to tax in Malta
2. be employed by a company licensed by the MFSA or the LGA (as the case may be) to hold an eligible office in terms of an employment contract, which is subject to the laws of Malta
3. satisfy the MFSA or the LGA (as the case may be) that
 - the relevant contract of employment relates to work genuinely and effectively performed in Malta;
 - he/she is in possession of professional qualifications in terms of the HQP Rules; and
 - he/she performs activities of an eligible office
4. declare and confirm, inter alia and in the prescribed application form, that he/she:
 - is not and has not been domiciled in Malta and does not intend to reside in Malta permanently;
 - has not benefited from the special domestic tax rules applicable in respect of investment services and insurance expatriates with respect to relocation costs and other expenses (under article 6 of the Income Tax Act);
 - is in receipt of stable and regular resources,



which are sufficient to maintain him/herself and the members of his/her family without recourse to the social assistance system in Malta;

- resides in accommodation regarded as normal for a comparable family in Malta and which meets the general health and safety standards in force in Malta;
- is in possession of a valid travel document; and
- is in possession of sickness insurance in respect of all risks normally covered for Maltese nationals for him/herself and the members of his/her family.

The favourable 15% tax rate prescribed under the HQP Rules would apply for a maximum consecutive period of five fiscal years in favour of EEA (including EU) nationals and for a maximum consecutive period of four fiscal years in favour of third country nationals (i.e. nationals of non-EEA countries).

It is important to state that the HQP Rules do not apply in respect of any person employed in Malta prior to 1 January 2008. On the other hand, an individual employed in Malta on or subsequent to 1 January 2008 would be entitled to benefit from the favourable flat tax rate but the said benefits would nevertheless be limited to five years from the date of commencement of the qualifying employment. Thus, for example, a Swiss chief investment officer employed with a Malta-licensed asset management company and having a qualifying contract of employment in an “eligible office” starting in 2008 (basis year) will be able to benefit from the HQP Rules 15% tax rate for a period of three years, i.e. basis years 2010 (the first year in respect of which the HQP Rules became effective), 2011 and 2012, while a third country national will benefit from one year less.

The rules also provide for certain circumstances that would effectively exclude the application of the favourable 15% rate, such as where the employer receives any direct or indirect benefits under certain business incentive laws,

or if the individual holds more than 25% (directly or indirectly) of the company licensed and/or recognised by the relevant authority, or if the individual is already in employment in Malta before the coming into force of the scheme either with a company not licensed and/or recognised by the respective authority or not holding an “eligible office” with a company licensed and/or recognised by the relevant authority.

The rules provide that any person abusively seeking to claim benefits under the Rules without entitlement may face a penalty equal to the amount of benefit claimed together with additional tax imposed at a rate of 7% per month or part thereof.

REACHING OUT FOR THE FUTURE

With the HQP Rules complementing Malta’s fiscal, professional and infrastructural framework, international financial operators have been provided with an additional incentive to consider establishing or expanding their Malta operations. Operators already established in Malta have the benefit of being in a position to attract top talent from within the EEA and beyond, providing prospective employees with an attractive net remuneration package. In addition, operators looking for an alternative or complementary base for their operations may benefit from Malta’s attractive corporate tax system and also facilitate the relocation of staff falling into the eligible office categories set out in the HQP Rules.


It is expected that the introduction of the HQP Rules will inject new talent, knowledge and skill into the Maltese financial services industry, further contributing to the government’s target to increase the country’s GDP derived from financial services from the existing 12% to 20%. And with continuing efforts being made, both in the public and the private sector, to improve Malta’s international service offering, this ambitious objective appears clearly within reach. ■



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ENTERING MALTA

NIAL BROOKS AND ROGER BUCKLEY, OF CASTLEGATE FUNDS SERVICES, TALK TO HFMWEEK ON ITS RECENT ENTRANCE TO THE MALTA FUND INDUSTRY AND OTHER CURRENT INDUSTRY TOPICS



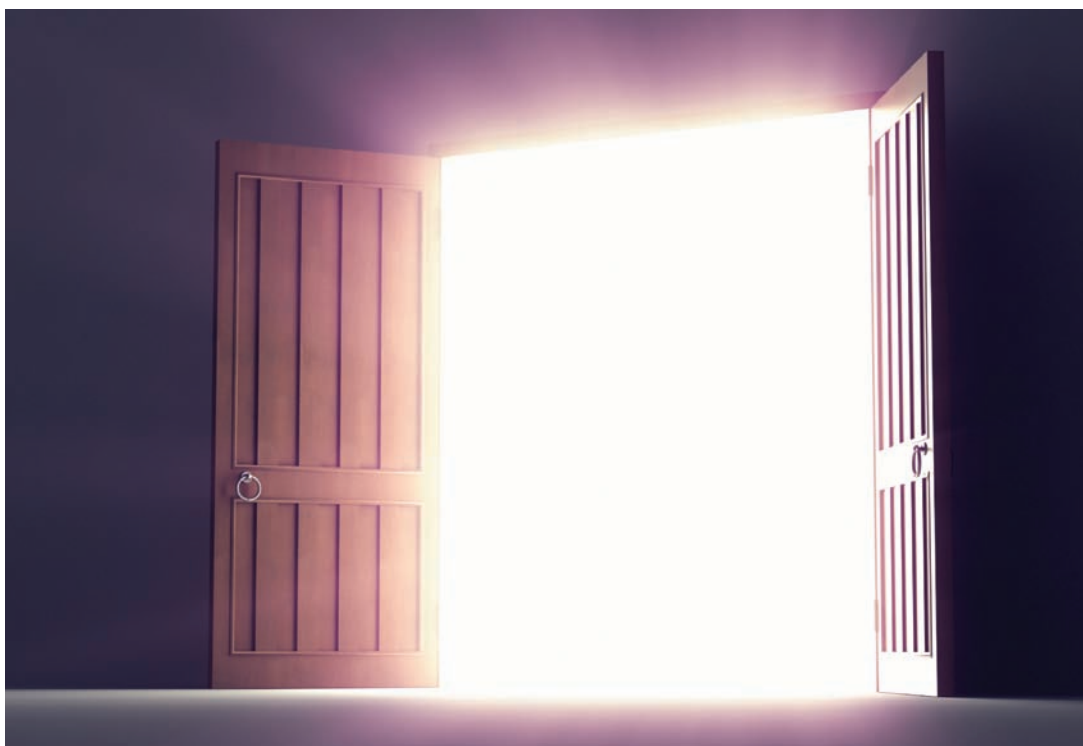
Niall R. Brooks

is a director and co-founder of Castlegate Fund Services Ltd., Malta and managing director and founder of Castlegate Investment Services Limited, BVI. Brooks has more than 19 years' experience in the structuring, administration, compliance and provision of directorship services for investment vehicles.



Roger G. Buckley

is the general manager of Castlegate Fund Services Ltd., Malta and manages the day to day operations. Buckley was formerly the manager of Castlegate Investment Services Limited in the BVI and also previously worked with Citco Fund Services in Ireland.



With an ideal geographical location and advantageous regulations, Malta has become an attractive alternative to Ireland and Luxembourg in the European fund industry. Accordingly, more and more companies are entering the Maltese market and establishing a physical presence on the island. Castlegate is one of the relative new comers, and Niall Brooks and Roger Buckley discuss with *HFMWeek* how its choice came as evidence of this and how beneficial this decision has been so far.

HFMWeek (HFM): Can you provide some background on Castlegate?

Niall Brooks (NB): After obtaining Malta Financial Services Authority (MFSA) approval and recognition, Castlegate established a physical presence in Malta in July 2011 with the aim of delivering a professional, quality driven and customer focused administration service. The founders and principles of Castlegate, having previously worked in the Cayman Islands, British Virgin Islands (BVI) and Ireland, hope to utilise their wealth of experience and knowledge, not only in the administration and delivery of corporate services to Maltese fund structures but also to those in the aforementioned jurisdictions. Castlegate first became aware of the advantages and benefits of Malta as a potential jurisdiction in 2010, when I

was lecturing a course I co-authored, the Diploma in Fund Administration, in Malta. I witnessed first-hand the high calibre of knowledgeable students and prospective employees eager to enter and advance in the fund industry. Castlegate also had the opportunity of launching its Maltese operation in conjunction with an existing client who was looking to take advantage of the Ucits legislation and establish their own management company on the island.

HFM: Why did Castlegate choose Malta as a jurisdiction to establish a physical office?

Roger Buckley (RB): Although the advantages of Malta as a fund jurisdiction are well documented, it was a meeting with the MFSA and witnessing first-hand the regulator's responsiveness and willingness to attract new business to the island that ultimately influenced Castlegate's decision. The management of Castlegate saw many similarities to the BVI: especially in its attractiveness for smaller start-up funds while still being able to attract the large fund groups, the relatively low cost of both establishing and maintaining fund structures and flexible, yet robust investment fund legislation. These together with a sound infrastructure and the availability of reputable service providers such as the big four accounting firms, well regarded banks and law firms, made the decision to establish a physical office in Malta a straightforward proposition.

HFM: How did the Alternative Investment Fund Managers Directive (AIFMD) and the potential redomiciliation of funds effect your decision?

NB: The geographical location and target market for funds domiciled in Malta also played an important role. With an affiliate office already established in the BVI, servicing what can be described as typical offshore fund structures and with the ever looming AIFMD coming into effect in 2013, Castlegate was keen to solidify a European operation for existing clients, as well as new clients wishing to enter the European market. As a result of the implementation of the AIFMD, investment funds domiciled in Malta should benefit from the pan-European passport offered to professional investor funds. Castlegate believes that Malta's cost-competitiveness and flexibility should appeal to managers looking for a viable and attractive alternative to say Ireland and Luxembourg. In this regard, Malta has all the necessary attributes to be a successful jurisdiction.

With Malta also seeking to benefit from funds looking to redomicile from jurisdictions such as Cayman or the BVI, the management of Castlegate believe they are in a unique position to provide assistance to such funds by, leveraging off their past experience in both jurisdictions. The benefits of choosing the redomiciliation route for a fund include the maintenance of a fund's track record, no need to redeem existing investors and the maintenance of the fund's existing portfolio and stock exchange listings. However, redomiciliation is often only really feasible for the larger funds as the entry and exit costs (particularly in relation to legal cost) can be prohibitive. Accordingly, some of Castlegate's clients have chosen instead to establish completely new and separate funds in Malta rather than go down the redomiciliation route and Castlegate anticipates this will be the preferred route of most managers.

HFM: What other factors do you believe influence fund managers looking to establish Maltese funds?

RB: Many managers are setting up European based funds following demand from both institutional and retail investors. Retail investors in particular have become more prudent and are more cautious about the safekeeping of their assets within regulated markets. Institutional investors are also seeking robust regulation and transparency for investors. Moreover, many investment managers feel that increased reporting obligations, regulation and compliance burdens, in particular from the FSA in the UK, towards offshore retail funds are overshadowing the benefits of such vehicles and as such are seeking a viable alternative. Malta is in a good position to offer a 'near-shore' alternative and with easy access to the main European cities, which allows managers to regularly conduct business and board meetings in Malta. Furthermore, another recent phenomenon is that many investment managers are choosing to keep parallel onshore and offshore structures in place to meet the requirements of their different investors.

NB: Also with the ever increasing demand from regulators, managers and investors alike for members of the

board to have a degree of independence, the Maltese requirement for at least one of the fund's directors to be independent of the manager, may be seen by some as offering an additional layer of investor protection and comfort. This, married with the flexible requirements on the choice and location of service providers that a fund can appoint, certainly adds to Malta's attractiveness. The principles of Castlegate have considerable experience in the provision of personal directorship services to Malta (including UciTs), Cayman and BVI investment vehicles and hope to leverage off this expertise.

HFM: How do you see Malta's current standing and growth potential?

RB: From my previous experience of working in the fund's industry in both Ireland and the BVI, I can see that Malta has many of the same advantages that led to the rapid growth of Ireland's fund industry. As a small island, Malta fosters an outward looking mentality and one of its greatest assets is its English-speaking, well educated workforce, which harbours a work ethic similar to that of the UK and northern Europe. It is located in an ideal time zone that overlaps the opening of markets in both the US and Asia.

Malta as a fund jurisdiction is still emerging when compared with some of its European and Caribbean competitors and as such the local industry and regulator must make a concerted effort to ensure that Malta continues to offer distinctive competitive and strategic advantages. Ultimately, it must look to make the transition from being a cost effective alternative of the larger jurisdictions to becoming an equal competitor. It should continue to develop and strengthen existing niche links with the Middle East and Africa as well as continuing to attract leading industry custodians. Castlegate has experienced continued interest in Malta among its existing clients and contacts both in the Americas and Europe, and, given Malta's unique advantages, Castlegate sees no reason why this trend should not continue in the foreseeable future. ■

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MALTA: A SAFE ALTERNATIVE

WITH SECURITY AND TRANSPARENCY OF HEIGHTENED IMPORTANCE IN TODAY'S FUND INDUSTRY, **JEAN FARRUGIA**, OF **DF ADVOCATES (MALTA)**, DISCUSSES THE SECURE NATURE OF MALTA AS A FUND DESTINATION



Jean C Farrugia

is a partner at DF Advocates (Malta) and heads the financial services department of the firm. He is also a director of Quantum Services Limited, a multidisciplinary organisation that provides regulatory compliance and support services to investment services firms and funds.

Notwithstanding the current global financial crisis, Malta has experienced considerable growth in its investment services industry. Such growth has been augmented by the system of safeguards and remedies that permeate Malta's investment services regime as implemented by the Malta Financial Services Authority (MFSA) with a view to maximising the protection afforded to investors.

LICENSING

The requirement to obtain an investment services licence constitutes the very foundation of investor protection in Malta, from which stems a rigorous system of monitoring and reporting requirements.

When considering whether to grant or refuse an investment services licence, the MFSA prioritises, among other things, the protection of investors and the general public as a whole. Confirming the reputation and suitability of the investment services licence applicant, and the fitness and properness of all involved parties therein, is of paramount importance to the MFSA. To this end, the MFSA applies a "fit and proper test" in respect of all involved participants, each of whom is reviewed on the basis of three criteria, namely, integrity, competence and solvency. Furthermore, the MFSA will also scrutinise the nature of the proposed investment services business, with particular emphasis being made on business continuity.

ACCOUNTABILITY AND TRANSPARENCY

The MFSA's insistence on a licence holder's operational structure being based upon a clear and proper allocation of functions and responsibilities, together with a system of internal checks and balances, is geared towards increasing each involved party's accountability towards the other involved parties within the structure, the MFSA and, ultimately, the investor. All this, coupled with the implementation of a sound system of proper record-keeping and accounting policies, contributes towards achieving an optimal level of transparency in the conduct of the licence holder's business.

CLIENT CLASSIFICATION AND BEST EXECUTION

A licence holder is required to implement appropriate client classification policies and procedures in the course of providing its investment services. Accordingly, as part of its internal assessment process of suitability and appropriateness of investment products for any of its clients, and in accordance with the principle of best execution, a licence holder is expected to recommend to its client such investment products that are suitable and appropriate for the investor class to which the client belongs. To this end, a licence holder is required to

gauge the client's investment experience, financial situation and ultimate objectives, and to thoroughly explain the nature of any recommended investment product. In this regard, the MFSA also emphasises full disclosure of a product's nature and risks through offering documents, the contents of which satisfy a number of minimum disclosure requirements imposed by the MFSA.

RISK MANAGEMENT AND CONFLICTS

The MFSA also emphasises the implementation by a licence holder of sound risk management policies with a view to identifying any risks inherent in the service being provided by the licence holder to an investor, to whom such risks must be disclosed so as to enable the investor to make an informed decision. A licence holder is also required to establish and maintain an effective conflicts of interest policy so as to ensure that all persons involved in its business activities carry on such activities with an appropriate degree of independence.

SEGREGATION OF ASSETS AND RECORD-KEEPING

In order to safeguard its clients' assets, a licence holder is obliged to segregate its clients' assets, both from its



own assets and from its other clients' assets, and to maintain appropriate records and accounts to enable him to identify and distinguish such assets. The maintenance of comprehensive and updated records of all transactions, payments and receipts relating to each of its clients is also of fundamental importance in increasing the licence holder's transparency vis-a-vis its clients and the MFSA.

DISCLOSURE AND REPORTING

Adequate accounting and reporting is another fundamental pillar of the investment services industry in Malta, which is geared towards increasing a licence holder's accountability and, ultimately, increasing the protection afforded to investors. Besides providing each client with adequate reports on the services provided to such client, a licence holder is required to maintain and procure the auditing of its financial statements, and to regularly submit financial returns to the MFSA. Moreover, as part of the regulatory disclosure requirements imposed by the MFSA, a licence holder must also publicly disclose information on its own funds, its risk components, its risk management and internal capital adequacy assessment policies, and its remuneration policy and practices.

As part of the disclosure obligations imposed upon licence holders, the MFSA also requires immediate prior notification of any organisational or operational change to be undertaken by a licence holder, and this also with a view to ensuring that such proposed changes would not be detrimental to the investor.

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THE MFSA PRIORITISES,
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COMPLIANCE

Another fundamental contributor to investor protection is embodied in the system of policies and procedures that the MFSA requires a licence holder to design and implement in order to detect any risk of failure by the licence holder to comply with its obligations, particularly its licensing and anti-money laundering reporting obligations.

The appointment by a licence holder of a competent compliance officer and a money laundering reporting officer respectively assume paramount importance in the implementation of such a system, particularly in the supervision of the licence holder's activities and the detection of risks inherent therein. Particular mention should also be made of the MFSA's own monitoring and compliance role, which is periodically exercised through compliance visits at the business premises of licence holders.

COMPLAINTS AND SANCTIONING

The preventative measures outlined above are complemented by a system of remedies that are available to aggrieved investors. Access to such remedies is typically triggered by means of the investor's complaint, first to the licence holder – which is required to have effective and transparent internal complaint handling procedures – and subsequently to the Consumer Complaints Unit of the MFSA.

The MFSA has various investigative and sanctioning powers that may be exercised against a defaulting licence holder, including the issuance of orders for the freezing of funds or other assets pertaining to the defaulting licence holder, and the power to suspend or revoke a licence and impose restrictions or variations to the relative licence conditions.

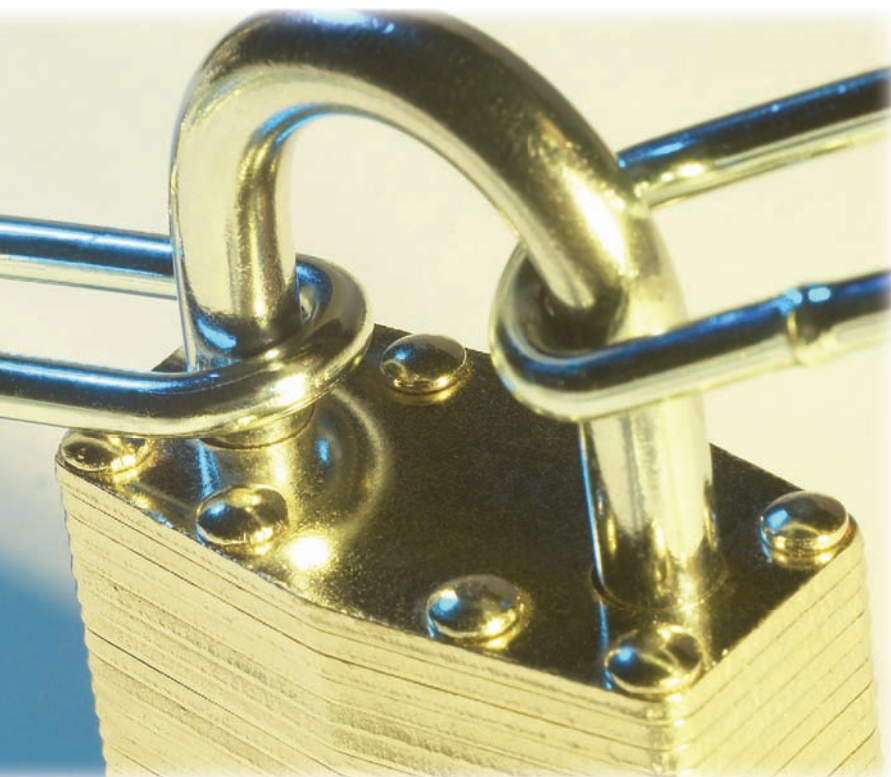
Moreover, the contravening or failure to comply with any applicable licence conditions or rules may also lead to the imposition by the MFSA of administrative penalties and other disciplinary sanctions, or the institution of criminal proceedings.

INVESTOR COMPENSATION SCHEME

Investment services providers are required to contribute to the Investor Compensation Scheme, which is another remedial tool that is intended to promote confidence not only in licensed investment firms, but more importantly, in the Maltese financial system as a whole. It draws its justification from the fact that an investor is not generally in a position to make a comprehensive assessment of the risks affecting a licensed investment firm with which such investor deals.

CONCLUDING REMARKS

Malta's investor protection strategy is preventative as well as remedial in that it encapsulates both restrictive regulatory measures for licence holders and remedies in the event of breach of such measures. Apart from Malta's attractive tax regime as a main contributor of its growth into a financial and international business centre, investor protection is another key contributor in Malta's success in the financial services industry. ■



AIFMD: CHALLENGES AND OPPORTUNITIES FOR MALTA'S HEDGE FUND INDUSTRY

BEING ONE OF THE POTENTIALLY MOST INFLUENTIAL PIECES OF LEGISLATION TO BE INTRODUCED TO EUROPEAN HEAD FUNDS, DR CHARLES CASSAR, OF CHETCUTI CAUCHI, EXPLAINS WHAT THIS WILL MEAN FOR MALTA



Dr Charles Cassar

is manager of the financial services regulatory team at Chetcuti Cauchi, a leading Maltese commercial law firm. Charles has advised fund managers, funds, financial institutions, FOREX operators and insurance businesses with respect to their Malta set-ups.

Over the last few years, Malta has worked hard to position itself as a domicile for hedge funds (in the sense of collective investment schemes marketed exclusively to investors meeting certain minimum sophistication criteria) and has achieved considerable success in this regard, such that one may well speak of the country as an established jurisdiction in the sector. Between 2004 and June 2011, a total of 661 new funds were licensed, and the net asset value of all Malta domiciled funds was €7.8bn at the end of June 2011. Much of this growth is the result of the set up in Malta of a large number of Professional Investor Funds (Pifs), the local hedge fund product; 407 Pifs were domiciled in Malta at the end of June 2011.

Given the industry's importance to the Maltese economy (and to the ecosystem of support service providers that it has generated), it will not surprise anyone to learn that when the directive was first announced in April 2009, it attracted keen interest from local stakeholders. It is also safe to say that the Directive did not win any popularity contests when it was first unveiled, although its proposal for an EU-wide fund passport garnered many approving nods.

The initial April 2009 proposal was controversial for many reasons. The draft had apparently been put together in a hurry. This resulted in a text that was occasionally unclear and seemed to indicate insufficient familiarity with the industry, by, for example, not including provisions addressing the self-managed fund structures (quite popular in Malta). More damagingly, the directive was accused of being protectionist by a variety of stakeholders, largely due to its third country provisions apparently being intended to create an impenetrable Fortress Europe. It was unclear what the directive's impact on the Maltese industry could be, and the possibility of it being negative was real.

THE DIRECTIVE TAKES ON A MORE SENSIBLE SHAPE

Thankfully, during the months following the initial announcement, the directive gradually took on a more sensible shape. The final text of the Directive is now less protectionist and far more in tune with the realities of the funds industry than the original April 2009 text. The drafting of the text is much clearer and it appears that Fortress

Europe will not materialise. Best of all, the one proposal that the industry welcomed fully from day one, the passport, has been retained.

IMPACT ON THE MALTESE INDUSTRY

What does this mean for Malta? A number of factors need to be borne in mind when considering the likely impact of the directive on the Maltese industry, namely:

- The De Minimis Rule
- The nature of the current hedge funds regime
- The local depositary infrastructure

THE DE MINIMIS RULE

The first thing that needs to be noted is that, in Malta, the Directive's edge is likely to be blunted quite considerably by the application of the De Minimis rule. The jurisdiction has primarily succeeded in attracting interest from smaller fund managers with total assets under management inferior to the €100m threshold established in the Directive.

This is important because it means that many of the fund managers that are established in the jurisdiction will not need to bear the additional regulatory burden the Directive introduces. The other side of the bargain is that such AIFs will not benefit from the passporting rights. This has fairly limited importance as a disadvantage: these funds are already in a position where they do not have passport rights and, should they consider it beneficial to obtain a passport, they can opt in by assuming the higher levels of regulation.

THE NATURE OF THE CURRENT HEDGE FUNDS REGIME

Those funds that will fall to be regulated under the Directive (or choose to be so regulated) will take comfort from the fact that many of the Directive's rules are rather familiar. Malta has built its reputation as a hedge funds domicile by emphasising "firmness" as well as "flexibility" and thus many of the provisions contained in the Directive are already present and correct in the Maltese rulebook. Thus the rules on, for example, fund administration, already have their counterparts in local legislation. Other rules, such as those regarding remuneration, may pose some kind of challenge but are unlikely to have a significant impact.

THE DEPOSITARY INFRASTRUCTURE

One AIFMD provision that may have a negative impact on the local funds industry is the rule that every AIF must appoint a depositary in the same jurisdiction in which it [the AIF] is established. Malta's success in attracting funds and their managers has generally been matched by an equivalent growth in the network of funds services providers, which constitutes the essential infrastructure required for any funds jurisdiction to thrive. A fairly wide choice of big name fund administrators and auditors, as well as lawyers specialising in the funds and financial regulation, can now be found in the jurisdiction. The same cannot be said of providers of depositary services. Only a limited number are present at the moment and not all are internationally recognised brand names.

This may be problematic for the continued growth of the industry. Because of the AIFMD provision in question, if the local depositary infrastructure cannot support a fund, the AIFM in question may have no choice except to domicile its AIF elsewhere. This may funnel business towards more mature fund domiciles that host service providers having the required know-how or specialisation.

AIFMD: AN OPPORTUNITY FOR THE MALTESE HEDGE FUNDS INDUSTRY

The final text of the Directive is less protectionist and more in tune with the realities of the funds industry than then original April 2009 text. Nevertheless, many AIFM, both EU as well as non-EU, are likely to be re-evaluating their domiciliation options in the coming years. Non-EU fund managers may find that an EU domicile gives them easier access to EU investors; others may deem an EU domicile to be unnecessary but will need to identify a suitable reference jurisdiction; both EU as well as non-EU AIFMs may start looking for a jurisdiction they can use as a central hub from where to passport their services and funds into the rest of the EU; all of these scenarios are likely to arise.

Malta already has various characteristics that make it attractive as a hedge fund domicile, such as the attitude of the regulator, the general cost-effectiveness of the country, a competitive fiscal regime and an English speaking workforce. These characteristics have led to the growth that the country has achieved so far. During the various reviews of domiciliation status which the AIFMD will inevitably trigger, these characteristics are likely to place Malta among most shortlists.

It must be said that the situation is still somewhat fluid. The Directive's level II implementing measures (which I have excluded from this discussion) are still being developed. Bold predictions are therefore likely to end in embarrassment for the would-be clairvoyant. Nevertheless, it is quite clear that the Directive will not, as may have initially been feared, threaten the survival of the local hedge funds industry. On the contrary, the coming into force of the Directive is likely to generate an important window of opportunity, which will help to further cement Malta's position as a leading fund domicile. ■

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HERITAGE OF EXCELLENCE WEALTH OF OPPORTUNITIES



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198, Old Bakery Street
Valletta VLT1455, Malta
tel: (+356) 2124 1232
fax: (+356) 2599 0640
email: info@fenlex.com



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CLEARING THE MIST

BILL SCRIMGEOUR, OF HSBC SECURITIES SERVICES, DISCUSSES THE ISSUE OF THE CURRENT REGULATORY CONFUSION HANGING OVER EUROPE, AND HOW MALTA IS WELL PLACED TO TAKE ADVANTAGE OF THIS



Bill Scrimgeour, global head of regulatory and industry affairs, HSBC Securities Services, is the primary interface between HSS and regulators, financial market infrastructures and industry bodies covering custodian, trustee, fund administration and financial market infrastructure issues.

It is sometimes difficult to look through the regulatory fog and see the end result but it's in times like these that the words: "When the going gets tough, the tough get going" may seem apt. There is plenty of opportunity on the other side, once the fog clears – and Malta is one country that can take advantage of the changes.

Macroeconomic conditions and politics are driving regulation of the 'shadow' banking world, a phrase coined during the 2008 credit crunch to collectively describe non-bank financial institutions perceived to be outside mainstream regulation such as hedge funds, directly impacting the industry's broker/dealer and investment management client base. The G20 agenda set in Nov 2009 is aimed at de-risking and de-leveraging markets while at the same time providing adequate protection for investors' long-term savings. Regulators are acting swiftly to prevent further systemic risks still inherent in the financial markets and which could be triggered by an event such as a default on Greek bonds or similar.

In Europe, a slew of regulation has been introduced to control market risks and the shadow banking system, much of it introduced as Directives by the EU Commission. In America, the Dodd Frank Act sets out to achieve much the same. Regulators have set 2014 as the date for full implementation of the measures. This places enormous cost and operations pressure onto back offices within a very narrow time window – especially when much of the detail is still being debated.

Implementation of the measures in Europe and the US over the next two to three years is mandatory. There is little room for flexibility despite intense lobbying by the post-trade and fund servicing industry. This is the most serious and comprehensive set of regulations to hit the industry since the US Banking Act of 1933 commonly known as the Glass-Steagall Act (repealed in 1999), which introduced radical banking reforms and tried to reduce speculation. Implementation will require dedicated resources and large product change programmes to meet the demanding schedule. The confluence of all this activity around 2013

to 2014 will tax even the largest financial institutions but many banks have already deployed specialist teams to throw light on the problem.

The de-leveraging of the securities industry will have a direct impact on securities and derivative volumes. The shift from principles-based supervision to prescriptive regulation driving a need for greater transparency may result in fund managers exiting the business, merging among themselves or returning money to investors. Some will choose to run family offices rather than operate a hedge fund under the new paradigm. Non-compliance will incur punitive penalties designed to "send a signal" to others in the industry. Many smaller managers may migrate to far off jurisdictions but they will face challenges if they wish to access the EU or US investor market, given the third country provisions in the regulations. The disposal of non-core bank divisions due to capital restructuring, particularly in Europe, will create both opportunities and challenges for custodians and depositaries.

The major impacts for the post-trade and fund servicing industry, particularly from the AIFMD and Ucits V, are:

- The total cost of meeting regulatory imposition across multiple national markets will increase, specifically due to the need to appoint a depositary for each alternative fund. The depositary will carry additional safe keeping, cash monitoring and oversight responsibilities with a greater liability for errors;
- Potential regulatory capital in each jurisdiction in which they operate: the level of capital is not discussed in the AIFMD and remains a major concern to the industry;
- Strict liability for safe-keeping of assets with a narrow ability to discharge liability;
- Increased operational procedures and controls for oversight of alternatives funds;
- Increased regulatory reporting on behalf of clients.

Market participants will have to make sure their clients understand that the service relationship currently in place has shifted significantly from administration to one of

Q&A: CHRIS BOND



Chris Bond, head of global banking and markets for HSBC Malta, has responsibility for treasury and capital markets, custody and fund administration businesses. He has over 25 years' experience in the global investment banking industry, having previously worked in London, Paris, New York and Bermuda.

Chris Bond, head of global banking and markets (HSBC), also took time out to talk to *HFMWeek* about his view of these regulations.

HFMWeek (HFM): Bill talks about the change in regulations; how do you think this will affect Malta?

Chris Bond (CB): Being part of the EU and the eurozone, Malta will be highly impacted by the tsunami of regulations that will impact the funds business. The costs of regulatory compliance will continue to rise as new regulations are introduced. In this regard, Malta will be well placed for further growth as it continues to enjoy a robust legal, fiscal and regulatory infrastructure and from a cost viewpoint it remains highly competitive compared to other jurisdictions.

HFM: Bill also talks about opportunities once the fog clear. What is HSBC Malta doing

to ensure they are ready to grab those opportunities?

CB: HSBC Malta continues to invest heavily in its fund servicing business as it sees strong potential for growth. Investment in client management teams, custody and fund administration is being carried out at an accelerated pace as HSBC Malta continues to enhance its product and service offering.

The recently established client management team will draw upon the expertise of multi-disciplinary product specialists from our global businesses including global markets, investment banking, asset management and financing to support institutional clients in achieving their overall strategies. Funds will benefit from the global client management approach, which ties in relationship managers and product specialists in all the jurisdictions where they operate.

oversight/control. Custodians and depositaries are still grappling with the intricacies of what the extra liability will mean, in terms of the risk/reward relationship. Until now, alternative funds have not typically employed such a service, rather looking to their prime broker for custody and reporting. In future, the depositary will appoint the custodian.

There will be a mandatory cost to raise the standards of service to the new regulated levels. Although custodians and fund administration companies already operate to high standards, regulation will introduce a standard level of investor protection across all HSBC Securities Services jurisdictions in Europe. This could potentially have an impact on an unwilling client and particularly to institutional investors who are assumed to be cognisant of the risks already, and may not be ready to pay for additional protection. Most of the regulation must be implemented by the end of 2013. As third party service providers they will need to provide their clients with a clear direction of intentions well before this date. Contracts generally stipulate that providers will meet normal changes in regulation in the provisions of service.

The additional costs of contractual renegotiation or repapering of contracts, recruitment of skilled staff and time to market in the new regulatory environment should not be underestimated. This is particularly so as there will be

a limited pool of people capable of dealing with such exotic portfolios. It is fair to say that in this new paradigm, the whole value chain will be affected and business models will have to change as liability and responsibility moves along the value chain.

The opportunity for Malta is clear. In terms of fund administration, every country in Europe will be playing to the same tune. There will be a level playing field for all to operate in and with Malta's existing presence in a fast expanding regional market, it provides a good base from which to expand. But with increased risks, liabilities and oversight responsibilities the challenges are large.

As a leading provider of fund administration and related services in Malta and other European countries, HSBC Securities Services has been monitoring the onset of the regulatory tsunami and planning for eventual implementation. In a tried and tested business cycle, HSBC's regulatory experts assess the potential impact of regulation, and ensure that the business is ready to support our clients through any changes. Whether it be Ucits, Solvency II or the AIFMD legislation, clients can be assured that HSBC will be compliant in time.

This is the toughest it has ever been but in inimitable style, the tough are already well underway. Opportunity awaits, once the fog clears. ■

CURRENT TRENDS IN THE MALTESE FUND INDUSTRY

WITH THE EUROPEAN HEDGE FUND INDUSTRY EXPERIENCING SUBSTANTIAL CHANGE, DR JAMES MUSCAT AZZOPARDI, OF CREDENCE, EXAMINES THE CURRENT TRENDS IN MALTA



Dr James Muscat Azzopardi is a director at Credence and a partner in Muscat Azzopardi & Associates, Advocates. James advises a wide international portfolio of banks, managers and law firms on legal issues related to investment funds.

This article will focus on current trends in the Maltese fund industry – an industry that is rapidly becoming more flexible and even more attractive to fund managers.

UMBRELLA FUNDS

First of all, managers are increasingly setting up umbrella funds with different sub-funds set up for different clients and different purposes. Under Maltese law, the assets and liabilities of one sub-fund are segregated from the assets and liabilities of the scheme and from those of any another sub-fund within the same scheme, and may be treated as a separate patrimony altogether.

FUND PLATFORMS

As a consequence of this, particularly in recent years, we have been witnessing a growing interest in ‘renting’ a sub-fund within an existing platform. In this scenario, the service provider acts as investment advisor to the existing scheme directly or otherwise indirectly by acting as advisor to such a scheme’s manager. The investment advisor does not need to be licensed by the Malta Financial Services Authority (MFSA) and does not need to be based in Malta. This prospect offers a solution to those clients who do not have sufficient human resources to satisfy the MFSA’s substance and due diligence requirements and/or would like to save operating costs in the long-term, thereby allowing them to exploit the benefits of an already-established platform. We have a number of clients that offer this option and we will be happy to make the necessary introductions to anyone wishing to know more about this possibility.

REDOMICILING INTO MALTA

Malta is also a very attractive choice when redomiciling existing funds from an offshore to an onshore jurisdiction within the European Union (EU). In this respect, Malta offers an added advantage when compared to certain jurisdictions such as Luxembourg, in so far as, unlike Luxembourg, Malta conceives of the possibility of redomiciliation. The redomiciliation procedure envisaged by Maltese legislation is a seamless process, as a result of which a fund continues to exist in Malta and becomes licensed in Malta as soon as the fund ceases to exist in the other jurisdiction.

UCITS IV SCHEMES

In terms of UCITS schemes, Malta also offers added flexibility as regards the location of the service providers to the scheme. Although it is mandatory for a Maltese UCITS scheme to have its custodian located in Malta, it is possible for such a custodian to enter into sub-custody arrangements with regulated institutions located outside Malta. Moreover, the authority may also permit a Maltese UCITS scheme to appoint a foreign administrator. UCITS IV (which was implemented in Malta with effect from 1 July 2011 save for some provisions – namely those relating to the Key Investor Information Document, which replaces the need for a Simplified Prospectus – in relation to which a transitory period of one year is allowed) has also introduced the notion of a European passport for UCITS management companies – a reality that

was unknown under the UCITS III regime – by virtue of which a UCITS management company need no longer be licensed in and regulated by the same jurisdiction in which the scheme is based.

We have set up the first UCITS management company for Swiss clients in Malta and this has proved to be considerably successful – the manager is attracting new funds on an ongoing basis and has built up an impressive

portfolio of funds, usually set up for smaller managers who wish to offer a UCITS fund without setting up a fully-fledged UCITS manager.

ACQUIRING A MANAGEMENT LICENCE

Finally, yet another interesting option is the prospect for EU/non-EU managers and family offices to relocate to Malta and/or acquire a fund management licence. This entails a licence to act as investment manager, which also allows such entities to benefit from the European passport principle that permeates the European financial services landscape. Among the main attractions enticing fund managers to base their operations in Malta is the favourable tax regime present in Malta, which embraces more than 50 double taxation agreements and allows non-resident shareholders to benefit from tax refunds. Furthermore, industry professionals are offered tax incentives as “highly qualified persons” holding eligible offices within the financial services sector via a special flat rate income tax of 15%. ■

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FOR MORE INFORMATION PLEASE CONTACT:

Castlegate Fund Services Ltd.

Daniela House
1st Floor, 197 Marina Street
Pieta, PTA9041,
Malta

Tel: (+356) 2122 6608

Contact: Niall Brooks – Director
nbrooks@castlegatefundsolutions.com

Roger Buckley – General Manager
rbuckley@castlegatefundsolutions.com

www.castlegatefundsolutions.com

MALTA – A JEWEL IN THE MEDITERRANEAN

WITH TAXATION OF FUNDS ON EVERYONE'S MINDS, **WALTER CUTAJAR**, OF **AVANZIA**, DISCUSSES THE TAXATION BENEFITS OF CHOOSING MALTA AS A DOMICILE



Walter Cutajar

is managing director of Avanzia Tax and has more than 20 years' experience in international tax. Walter maintains a reputation of adopting a commercial approach to his advice. Working with predominantly multinational companies, he provides structuring and transactional consultation on corporate tax activities, including M&As, reorganisations and cross-border restructurings.



Malta is one of the few countries whose income tax regime is based on the full imputation system. This ensures that dividends are taxed only once since any income tax paid by the Maltese company on the profits being distributed are credited in full to the shareholder, irrespective of whether the shareholder is a resident person or not, an individual, a corporate entity or any other body of persons. Indeed, if the shareholder's income tax rate is less than the tax paid by the company or he is not subject to income tax at all, then the shareholder is entitled to a tax refund of the excess tax paid (by the company on the profits so distributed). Apart from the tax refund resulting from the full imputation system, shareholders may also claim certain tax refunds, which vary according to the source of income from which the dividends are distributed. It is therefore obligatory for companies to keep proper tax accounting records, allocate income to the proper tax account and indicate from which tax account the profits are being distributed. There are five tax ac-

counts, namely the Maltese Tax Account (MTA), the Foreign Income Account (FIA), the Immovable Property Account (IPA), the Final Tax Account (FTA) and the Untaxed Account (UA). The tax refunds vary according to the source of income and also depend on whether the distributing company has claimed any double taxation relief. It is therefore important that all this information is shown on the dividend warrant or dividend certificate to enable the shareholder claim the correct tax refund. The tax refunds may be equivalent to two-thirds, five-sevenths, six-sevenths or even 100% of the tax paid by the company on the profits so distributed. This mechanism ensures that the overall effective tax rate is reduced to a maximum of 10%, which is applicable to passive interest and royalties, 6.25% applicable to foreign source income and capital gains, 5% applicable to trading profits or even 0% in the case of dividend income and capital gains originating from a participating holding investment.

The conditions to be satisfied for an investment to qualify as a participating holding investment are not very onerous. For example, an equity investment of



10% or more in an EU company (or any other company that is subject to tax at 15%) qualifies as a participating holding investment. If the equity investment is less than 10% it is still possible to have a participating holding if the investment is of at least €1,164,000 and is held for six months. Even if the target company is not in the EU or is not subject to tax, it is still possible to have the investment qualify as a participating holding if the company does not derive more than 50% of its income from passive interest or royalties.

Income and capital gains from a participating holding investment may also qualify for a full participation exemption. These provisions make Malta extremely attractive for holding companies and conduit holding companies. The provisions or incentives related to research and development, patents, royalties and interest make Malta very attractive for companies holding intellectual property rights, treasury companies and finance companies. Tax deductions and credits, and the absence of any

withholding taxes on dividends, interest and royalties, all contribute to Malta's attractiveness as an international financial centre of repute.

Malta does not have thin cap rules, debt to equity ratios, CFC legislation, capital duties or transfer pricing legislation, and the absence of similar restrictive measures are all advantageous to a pro-business approach. However, Malta still boasts itself of having a robust legislative framework, which is in line with the EU directives and international principles dictated by international organisations and bodies. This has also been recognised by several countries with whom Malta has entered into a tax treaty. Indeed, Malta's tax treaty network has expanded exponentially over the past few years and continues to contribute to attract foreign direct investment, establish Malta as one of the leading financial services centres and therefore add to Malta's economic growth.

Over the past few years Malta has also attracted a number of professional investor funds, hedge funds and other funds, trusts, captive insurance companies, online gaming companies, pharmaceutical companies, research and development centres, software companies etc. The list goes on and the momentum does not seem to dwindle, even at times when several countries around the globe are facing themselves with a financial crisis or an economic crisis or both. Indeed, Malta has faced the economic turmoil with resilience and although not unscathed, the financial services industry grew substantially and contributed to a positive growth in real terms to Malta's gross domestic product. The same can be said of the tourism industry and the hospitality sector, which is the other main pillar of the Maltese economy.

Apart from the nice weather and an attractive tax regime, there are a number of other factors that make Malta attractive and interesting. These include a highly professional and skilled workforce, multilingual with an aptitude to work, comparatively low cost base, a single regulator that is approachable and a 'one stop shop' concept to reduce bureaucracy. Malta has an advanced telecommunications network and a high degree of computer literacy and internet usage, which also facilitates business. Various government departments offer their services online. Compliance reporting to the Registry of Companies, the Inland Revenue Department and the VAT Department may all be done electronically, thus reducing valuable time and energy, and costs.

Malta is also renowned for having created an environment that is highly attractive to investors wishing to invest or set up in Malta, as well as attracting highly skilled expatriates. Recent rules aimed at attracting high-net-worth individuals and professionals having a "qualifying contract of employment" should prove very interesting to these high-net-worth individuals who end up paying an attractive tax rate of 15% (on income remitted to Malta) and to the Maltese economy with additional expertise and more revenue. Such persons are not only attracted by the favourable tax regime but also a good standard of living, good level of education, excellent health facilities and a safe environment. Maltese people are also renowned for their friendliness.

No wonder some people refer to Malta as a jewel in the centre of the Mediterranean! ■

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LAYING THE ANCHOR IN A SEA OF REGULATORY CHANGE

WITH REGULATION SWEEPING THE HEDGE FUND INDUSTRY, FUNDS ARE HAVING A HARD TIME REMAINING COMPLIANT AND KEEPING UP WITH CHANGE. DR DAVID BORG-CARBOTT, OF GANADO & ASSOCIATES, EXPLAINS HOW MALTA CAN PROVE TO BE AN OASIS OF CALM



Dr David Borg-Carbott

is a senior associate in the Investment Services and Funds Group at Ganado & Associates, Advocates. He regularly advises investment fund promoters, fund managers, investors and fund service providers on the establishment, authorisation and ongoing operation in or from Malta.

There is no denying that fund managers, fund promoters and their service providers are facing and will, over the next two years (at the very least), continue to face an onslaught of new legislation, both within the EU and in other jurisdictions (Switzerland and the US, in particular).

As a knee-jerk reaction to past scandals, high profile insolvencies and perceived abuses, European politicians and super-regulators continue to churn out new regulations, directives and guidance affecting operators in the funds industry.

Much has already been said about the EU Alternative Investment Fund Managers Directive (AIFMD) and how this will impact fund managers (in the Directive, AIFMs) with some link to Europe (be it because they are registered in an EU member state, because they manage an EU-based fund or merely because they wish to raise money from EU investors) and much more will be said once the European Commission reveals its highly anticipated Level II implementing measures.

On the Ucits front, before the proverbial ink dried on the fourth reincarnation of this directive, work was already underway on Ucits V with a draft directive now expected to be published in April of this year. Two consultations later, the focus of Ucits V has been broadened to cover the role of the Ucits depositary and Ucits managers' remuneration arrangements; one can only speculate whether there will be any further additions. Ucits III (2001/108/EC) and the Eligible Assets Directive (2007/16/EC) gave the world the so called 'Newcits', structured Ucits as well as synthetic ETF Ucits, each of which continue to attract hedge fund managers' and regulators' attention in equal measure.

Following a policy orientation discussion paper published in July 2011, the European Securities and Markets Authority (Esma) has now published a 77-page consultation paper setting out its proposed guidelines for these products, which, although not going as far as many had

feared, probably marks a first step towards slowly reclaiming the Ucits brand as the retail product it was conceived to be.

Also related to the increasing calls (particularly from non-European regulators) for purging the brand or, at the very least, reinstating a distinction between complex and non-complex Ucits is the proposed redraft of the Mifid Directive (Mifid II). Besides aiming to exclude structured Ucits from the definition of non-complex instruments, Mifid II and its accompanying regulation will undoubtedly impact investment services operators

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REMUNERATION
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(both EU-based and not) that fall outside the scope of the AIFMD or the UCITS Directive, as well as many of their service providers (there are other legislative initiatives in the offing applying to many of the others).

In the midst of this reboot of EU investment services regulation, there is little doubt that certain business models or fund strategies will require revisiting or lose out on access to EU investors. Short of opting to follow George Soros into early retirement, opportunities abound for those fund managers, fund promoters and other operators that instead embrace the new regimes.

The AIFMD will offer fund managers authorised as EU-AIFMs the right to market shares in their respective funds across the EU by means of the EU's single passport on the strength of their authorisation in an EU member state by following a tried and tested regulator-to-regulator notification procedure. Two proposed AIFMD related regulations, the European Venture Capital Fund Regulation and the European Social Entrepreneurship Fund Regulation, also offer a similar opportunity for AIFMs. With private placement in the EU, the preferred route to date for fund managers, becoming even more burdensome under the AIFMD (and potentially ended in 2019) and the AIFMD's requirements in the main still

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THE HARBOUR IN MALTA'S
CAPITAL CITY, VALLETTA,
HAS OFFERED SEAFARERS
A SHELTERED PLACE TO LAY
ANCHOR FOR HUNDREDS
OF YEARS
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applying, the choice is obvious. Although still too early to tell, Mifid II and its new third country regime also looks set to offer a similar obvious choice to non-EU investment firms: either set-up an EU entity or be required to set up a branch or, if eligible, navigate a registration with Esma.

Increasingly, non-EU fund managers are examining co-domiciliation (the setting up of an EU-based fund manager and/or fund structure alongside their pre-existing structure) options or setting up an EU fund manager and either looking to delegate certain activity to the non-EU entity or limit the latter's role to advisory, back office or research. Start-ups too are increasingly opting for an EU-based fund manager and, more often than not, an EU-based fund in order to benefit from the single passport from July 2013 (EU-AIFMs marketing non-EU funds will need to wait until late 2015, if at all, for such passport). A self-managed EU fund (catered for under both the AIFMD and UCITS) is also an option being actively considered.

In need of no introduction, the UCITS regime offers fund managers with 'UCITS friendly' strategies an investment product that is both easily marketed to (UCITS benefit from a similar passport) and well received by EU investors beside being craved by Asian and South American institutional investors. The UCITS manager passport (the right to manage UCITS funds in other EU member states) introduced by UCITS IV coupled with a simplified regime under the AIFMD for fund managers authorised as UCITS managers, makes authorisation as a UCITS manager in an EU member state an interesting option both for fund managers managing only UCITS or looking to run parallel UCITS and alternative fund structures.

With EU legislation and Esma pushing for further harmonisation of EU member state implementing measures, choosing an EU domicile in which to set up shop is set to become less focused on which domicile offers the more favourable implementation or interpretation of the relevant regime and more on which offers the most savings. Although a necessary evil, compliance is costly, and the costs are borne in equal measure by investors and the fund manager. EU fund or fund manager domiciles promoting themselves as the "gold standard" for their respective offering are seen as having equally expensive set-up and running costs that eat away at precious performance. It is here that Malta is clearly shining.

Over the past decade, Malta and its single regulator, the Malta Financial Services Authority (MFSA), have developed an enviable reputation for fund managers and funds. Offering efficiency, knowledgeable advisers and staff and the presence of major service providers that easily matches (and often surpasses) that available in gold standard domiciles but with set-up costs, running costs, key service provider fees and salaries available at a fraction of the cost in other domiciles, Malta is and will continue to feature as the first option of all impartial domicile advisers.

The harbour in Malta's capital city, Valletta, has offered seafarers a sheltered place to lay anchor for hundreds of years, so it is only fitting that fund managers navigating the markets can lease prime premises with a view of Valletta's harbour at a realistic price. ■





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Malta Stock Exchange is a member of leading organisations, including the Federation of European Securities Exchanges, the World Federation of Exchanges. It is also a signatory to the EU Code of Conduct on Clearing and Settlement.

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SAFE AS HOUSES

PAUL MIFSUD, OF SPARKASSE BANK MALTA PLC, TALKS TO *HFMWEEK* ABOUT HOW WELL PLACED MALTA IS WHEN IT COMES TO SAFEGUARDING AN INVESTOR'S ASSETS



Paul Mifsud is managing director at Sparkasse Bank Malta plc. He has successfully steered the bank in becoming a reputable provider of investment and fund support services, as well as a reliable custodian to the fund industry.

With investor's increasing emphasis on the transparency of a fund, additional scrutiny is being placed on all aspects of the alternative investment industry. Custody has not escaped this, as asset protection has developed to be such a key talking point in the aftermath of several high-profile liquidations. Paul Mifsud, of Sparkasse Bank Malta plc, discusses what makes assets in Malta so well protected.

HFMWeek (HFM): In today's turbulent times, investors are becoming more critical of all aspects of how their investment is being handled. How has this affected the custody side of things?

Paul Mifsud (PM): Investors are indeed paying more attention to the custody of their investment. Indeed, anyone who has followed the recent regulatory issues facing the "missing client funds" in the MF Global debacle, may begin to think or start to appreciate the relevance and importance of the back office function of custody and safekeeping. However, more investors need to seriously take into account how the custody is being handled. Unfortunately, the notion and importance of proper safekeeping and custody is often overlooked by the private investor who is normally more concerned and focused on their manager's ability to manage their portfolio and provide performance and yield. While investors are understandably focusing attention on this aspect, it pays to keep an eye on the safeguarding and custody of one's assets. Regrettably, this only seems to become a relevant issue when a client's fund or assets go missing, as in the case of MF. Questions then begin to surface, which should ideally be asked before problems occur. Investors should be asking:

- Where exactly are my investments held?
- Who has ultimate signing authority on the account where they sit?
- Are my coupon and maturity payments being credited on time?
- Is my account properly segregated from that of my broker's own funds and/or other customers?

Keeping a comprehensive and updated record of assets

is never a simple task, especially as the industry continues to grow with an increasing number of funds starting up and greater amounts of capital being handled. This is why at Sparkasse Bank we consider this part a core service – providing our private customers with a holistic solution to asset safekeeping. The bank has actually seen a niche service in this area and is today proud to be in a position to provide such expertise to both institutional and fund customers, as well as to private customers. In fact, since 2009, the bank has invested heavily in this area of service by developing a dedicated team of professionals and regulatory experts, making Sparkasse Bank one of three banks in Malta to provide similar services.

HFM: What trends have you noticed from investors, regarding the custody of their assets?

PM: In today's turbulent times, not only are we getting asked more questions about the exact details of the custody arrangements of assets, but we have noticed customers revisit the manner in which they hold cash, deposits and investments with their banks and brokers overseas. With this, we have seen that Malta (due to its robust banking systems and regulatory framework and strong work ethic) is gaining in popularity as a safe haven.

HFM: How have recent high-profile regulatory introductions affected the custody side of the hedge fund industry?

PM: It is clear that custodians have significant challenges ahead of them, dealing with increased liability and legal obligations stemming from recent and forthcoming directives and legislations brought along by the Alternative Investment Fund Manager Directive (AIFMD), Ucits IV/V, Fatca and Dodd Frank in the US. In fact, one of the main challenges possibly facing custodians at the moment is the interpretation and implementation of the aforementioned directives. As can be witnessed from recent replies to Esma's consultation paper on possible implementing measures of the AIFMD, it is clear that several important issues, definitions and procedures are still in a state of flux. The new rules have introduced the much debated issue of depositary's loss of assets liability as well as definitions as to what constitutes safekeeping,

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report keeping and monitoring obligations. The issue as to what constitutes loss of an asset still seems to be attracting much debate. It seems that industry and regulators are trying to strike a workable balance between the Directive's objectives of ensuring a high level of investor protection while mitigating the entire responsibility on depositaries.

This is of further practical relevance when considering the relationships between the depositary versus prime brokers, online trading venues, TAs and sub-custodians. Under the new rules, depending on the option selected in relation to the financial instruments that can be held in custody, cus-

todians will find themselves in a position, where, for example, a prime broker will be viewed and deemed to be acting as a sub-custodian to the fund when holding assets as collateral. This in itself presents a massive challenge and will inevitably lead to hybrid solutions of "prime-custody" between these service providers.

HFM: What regulations are there regarding asset custody within Maltese legislation?

PM: Of interest to the more academic among us, it is noteworthy that the fundamental aspects of custody find their roots in the Civil Code (Chapter 16 of the Laws of Malta), whereas custody of assets as an investment service is principally regulated by the Investment Services Act (Chapter 370 of the Laws of Malta) and regulations made there under, in particular the Investment Services Act (Control of Assets) Regulations (S.L. 370.05), as well as rules and guidance notes issued by the Malta Financial Services Authority (MFSA) relating to such functions. Apart from the basic rules on deposit, the Civil Code determines the fiduciary obligations of custodian banks, which fiduciary duties are then more specifically regulated by the Investment Services Act;

Custodians are required to hold a Category 4 Investment Services Licence (ISL) issued by the MFSA in terms of the Investment Services Act and are subject to a set of standard licence conditions entrenched in the Rules for Investment Services Providers issued by the MFSA;

Assets held under custody are held solely for and on behalf of and in the interest of the customer, who enjoys a right of ownership in such assets, notwithstanding their registration or investing in the custodian, the custodian may not make use of such assets except as previously approved or agreed with the customer.

Assets held under custody constitute a distinct patrimony, separate from that belonging to the custodian and from that of other customers, and are ring-fenced from, and protected against, claims or right of action of creditors of the custodian and are not subject to attachment by the courts at the instance of such creditors, including in case of insolvency or bankruptcy of the custodian.

The regulations also prescribe rigorous record and account keeping obligations on the custodian, aimed at

ensuring the separate identification and attribution of the assets of and to each customer. Furthermore, the regulations also impose a duty of segregation of assets to the extent reasonably possible, subject to limited derogations by agreement between the parties. The custodian shall be liable for any loss or prejudice suffered by the customer due to the custodian's fraud, willful default or negligence including the unjustifiable failure to per-

form in whole or in part its obligations. In this respect, Maltese legislation and governance is keeping custody services under a microscope, something which investors can take comfort in. ■

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MALTESE LEGISLATION AND
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A MICROSCOPE
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A DOMICILE OF CHOICE

KENNETH FARRUGIA, CHAIRMAN OF THE BOARD AT FINANCE MALTA, DISCUSSES WITH *HFMWEEK* THE GROWTH OF MALTA'S HEDGE FUND INDUSTRY AND HOW IT IS PREPARED FOR MORE OF THE SAME IN THE NEAR FUTURE



Kenneth Farrugia,

chairman of the board at Finance Malta, is a director on the board of Valletta Fund Management and chief officer on the executive committee of Bank of Valletta plc. Kenneth also serves as chairman of the Committee of the Malta Funds Industry Association.

Malta has experienced phenomenal growth to become one of the most popular fund domiciles within the EU, developing not only in size but also in the variety of what can be found on the island, with many qualified service providers calling Malta their home. Kenneth Farrugia, chairman of the board for Finance Malta, describes this evolution.

HFMWeek (HFM): As the funds industry continues to develop in Malta, is the variety of funds and strategies on the island expanding as well?

Kenneth Farrugia (KF): Yes, we have definitely seen this. With any new financial services or funds jurisdiction, you start getting traction in terms of fund managers from different locations and in the case of Malta they are really diverse – from core European countries, US and even Asian countries we have managers who have evaluated Malta as a domicile (looking at the regulatory framework and oversight, application process and infrastructure). And then they proceed to set up their fund in Malta.

If we look at the various strategies that we play host to so far, they are as diverse as the locations their managers come from. Even as an operator in the market myself, there are funds that are long/short, global macro, arbitrage, Ucits – so it is a diverse domicile and is expanding well. We are also seeing the development of private equity and pension funds on the island; however, the thrust of the industry has been driven by alternatives followed by Ucits and then specialist funds.

HFM: Some offshore fund destinations have seen their popularity waning in recent years as some investors are starting to favour onshore environments for their investments – is Malta experiencing the same trend?

KF: I think this offshore/onshore interplay is bad enough in itself. I feel that every domicile has its own role to play. Ultimately, before choosing a domicile you look at a

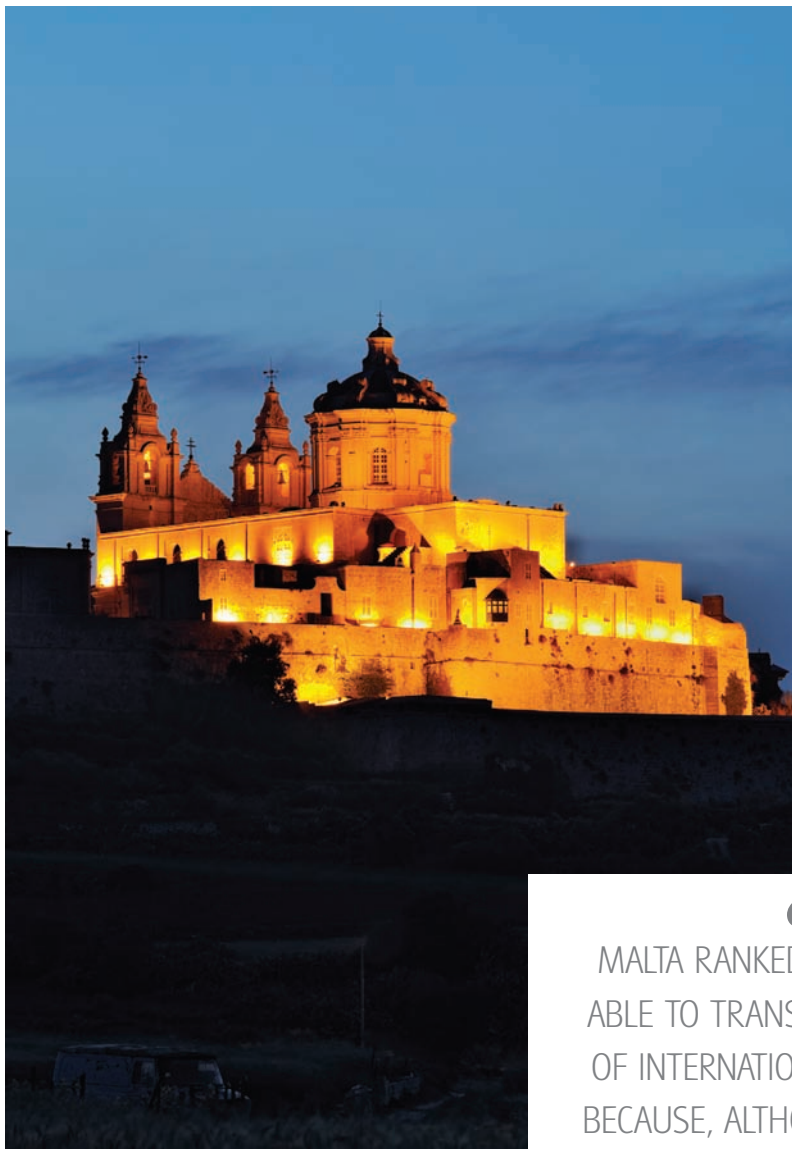
number of factors – again regulatory framework, regulatory oversight, general standing of the domicile and the quality of life, for example. Each domicile in my view has its own merits. However, we have seen increasing interest in using onshore EU domiciles. That may be driven by a number of factors, such as with the onset of the Alternative Investment Fund Managers Directive (AIFMD) or investor demand. Malta has admittedly benefited from that, as we have seen a number of fund platforms from offshore jurisdictions that were redomiciled to Malta over the past few years. The reason behind the choice of Malta is because our redomiciliation legislation, which is a continuation of the Companies Act, goes way back to 2002 so this is not a piece of legislation that we have drafted and enacted on the back of a trend. It is instead a tried and tested piece of legislation.

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ADVANTAGES THAT MALTA
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IS HIGHLY COMPETITIVE
WITH OTHER DOMICILES
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HFM: What opportunities does Malta hold for emerging fund managers?

KF: I think that Malta has a unique success factor because it emerged as a fund domicile only in the past five years and we have seen a paradigm shift in the industry – if you look at the genesis of fund industry, Malta's goes way back to the 90s (when the island's offshore label was shed). Malta's membership in the EU has contributed to this and, in my view, was a catalyst for the increased visibility of Malta as a fund domicile.

Definitely the fact that Malta is an EU member state means that the island benefits from the same passporting that other such domiciles can extend to fund managers wanting to set up in a new domicile. We have made sure that we have a comprehensive legal and regulatory framework to support the growth of the industry and the MFSA has done an excellent job of supporting this and ensuring this framework development kept up with the European industry as it grew. One of the clear advantages that Malta has is that the cost of setting up a fund here is highly competitive with other domiciles. Set-up costs in Malta normally range between €20,000 and €30,000 depending on the fund platform and strategy involved. So for emerging fund managers this is very welcome as with the current state of the market, capital raising



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ABLE TO TRANSPOSE DIRECTIVES
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CAN ACT VERY QUICKLY
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for funds and hitting the ground running has become a considerable challenge, it is very important to keep start-up costs contained – at least in the very early years of the fund's life-cycle. This is extended past the launch stage for a fund as far as audit fees are concerned, which are also highly competitive with other jurisdictions.

This is coupled with the fact that Malta has a very strong and capable operational fund infrastructure with very good service providers based on the island. And most important of all, we have a very accessible regulator who it is very easy to meet. This level of communication ease is comforting for those who are new to Malta.

HFM: How has Malta coped with the new regulations introduced into the European fund industry?

KF: While Malta is in a good position, there are of course challenges. We are a small island and it can be challenging keeping up with these new regulations being introduced into the market. Malta has been obliged to abide with a number of directives in the past few years, which is a challenge for any small country.

But on the other hand, being small means that we are relatively nimble. If you look at the EU scoreboard, Malta ranked first in being able to transpose directives of international legislation. Malta has been able to do this because, although small, we can act very quickly – turning this challenge into an advantage.

HFM: What rate of redomiciliation is Malta seeing?

KF: There is more hype about redomiciliation than is actually taking place in my view. The reason I say this is because redomiciliation is not easy, there is a lengthy process involved – not even mentioning the legal and regulatory requirements in doing so. But there are other options available, such as setting up a mirror fund and creating a master-feeder structure without the need to redomicile. There has been a lot of talk about redomiciliation but it has to be remembered that it is not the only option.

That said, Malta has domiciled a number of funds from different jurisdictions (including the Channel Islands and the British Virgin Islands) and, while it isn't driving the growth of the business, it is certainly contributing to the growth of its size. What is also helping is that our regulator, the MFSA, has excellent links with a number of foreign counterparts which makes the process even smoother.

HFM: What do you see the next 12 months holding for Malta in terms of challenges and opportunities for growth?

KF: In terms of Malta as a fund domicile, clearly we have seen very strong growth – not only in the number of funds in the island but also with the onset of operators in Malta. This growth has given the island an advantage,

making it more tangible – not just as a destination for funds, but as somewhere where these funds can be serviced to an excellent standard. You can see this in the amount of international industry players that are now based in Malta, the number having overtaken the number of indigenous players.

Clearly the challenges are related to the current troubles in the market which have permeated throughout Europe. Then there is the challenge of keeping up with the plethora of regulatory changes that are sweeping through the industry and ensuring that fund structures are compliant with these new legislations. But Malta is not alone, as indeed all other European domiciles are undergoing the same stresses. ■

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THE MALTA STOCK EXCHANGE

EILEEN MUSCAT, OF THE MALTA STOCK EXCHANGE, EXPLAINS THE EXCHANGE'S HISTORY AND HOW IT HAS HELPED GROW THE ISLAND'S ATTRACTIVE REPUTATION WITHIN THE FINANCE INDUSTRY



Eileen V Muscat

joined the Malta Stock Exchange in 1991 as its first employee and has held various positions during these years. Today she occupies the position of chief executive officer and also represents the exchange on various local and international financial industry committees.

The Malta Stock Exchange became a reality upon enactment of the Malta Stock Exchange Act in November 1990 and the appointment of the first Council in early 1991. Trading operations commenced in January 1992: this year, therefore, marks the 20th anniversary of the Exchange's core activities.

During the past 20 years, the fledgling Exchange of 1992 has developed into an internationally accredited, regulated market, which has successfully fulfilled its primary role as an effective venue through which to raise capital finance. The Exchange performs this role by providing a robust, flexible and cost-effective structure for the admission of financial instruments to its recognised lists and the infrastructure for their trading on a transparent and orderly market. This regime has successfully led to a diversity of financial instruments being admitted to the Exchange's recognised lists – all government paper including money market instruments, equities, corporate bonds and investment funds. Since the start of its operations, the Exchange has operated a Central Securities Depository, which offers a wide range of services that enable the Exchange to provide the whole

value chain of a transaction. Since 2007, depository services, including clearing and settlement and custody arrangements, have become licensed activities in their own right, resulting in a very strong and transparent legal and regulatory framework within which such services may be provided.

The Exchange has always been at the forefront to help develop in Malta into an international financial sector, in line with the government's stated policy to develop the financial sector as the third pillar of the economy by 2015, a goal that is well on the way to being achieved. On its part,

therefore, the Exchange's future strategy is now clearly focused on attracting international business, both from a market perspective and also in respect of back-office services. Notwithstanding its international focus, the Exchange remains very committed to servicing its domestic users, which remain a mainstay of its operations. However, it is acknowledged that given the demographics of a very small country with a small population, the local market can only achieve a finite growth. In order to continue to achieve sustainable growth, it must, therefore, widen its horizon to attract more international business.

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OF SERVICES
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In light of this, one focus of the Exchange's international strategy has been to achieve connectivity with other markets. In this context, the first interoperable link was set up between one of the largest international depositories, Clearstream Banking and the Exchange's own depository, which has also led to the launch of the Exchange's custody business. This has already produced dividends insofar as an increase in cross-border transactions in Maltese securities, as well as participation by international investors in the Maltese market.

The Exchange has also launched a number of major technological upgrades designed to bolster and support its internationalisation strategy, chief among which is replacement of the current trading system by the XETRA trading platform, supplied by Deutsche Boerse AG, which is expected to go live in June 2012. This state-of-the-art technology will serve as an effective business enabler, facilitating internationalisation of our market. The Exchange's effort to attract international companies to its market, while having still a long way to go, is slowly but surely proving to be successful, particularly in attracting small to medium sized companies to the market as primarily a listing venue. Developing a niche of the Exchange is increasingly important if meaningful internationalisation is to be achieved, an objective that in the present circumstances may appear difficult but which the Exchange believes is achievable. Opportunities lie in projecting the Exchange as a venue of choice for niche issuers looking for a cost effective platform that enables them to tap into the European capital market.

The listing regime for investment funds was established in the mid-nineties when the first locally set-up fund manager approached the market to list a domestic bond based collective investment scheme. During the following years, the Exchange saw a steady influx of investment funds onto its main listing board, particularly with international funds that choose Malta as their venue of choice for secondary listing attracted by low operating costs and an attractive tax

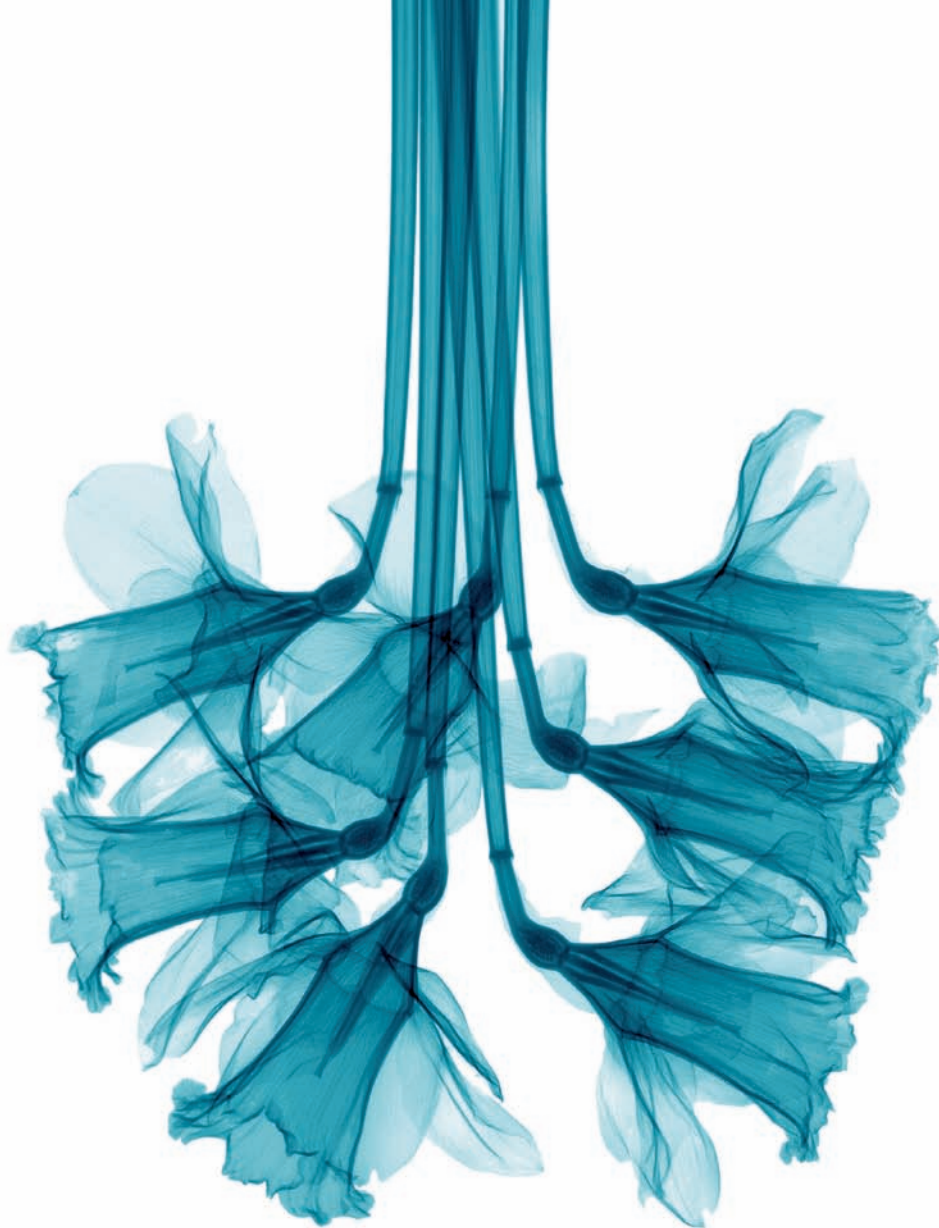
regime. The fund industry has undergone seismic changes during the past years, like any other sector of financial markets. As investors demand increasing transparency and robust regulation, Malta has begun to compete with and win business from more long-established fund jurisdictions. The fund industry is the fastest growing financial sector in Malta, with annual growth far outstripping any other sector. Just in the last two years, Malta has established itself as a domicile for funds of international repute, serving both domestic and international markets, and is the domicile of choice for a considerable number of both retail and non-retail funds, fund administrators and managers, as well as other service providers whose number is steadily growing in tandem with the burgeoning fund industry.

The key reasons for Malta's success as a leading on-shore fund domicile are regulation, transparency and good governance, while at the same time providing a less costly domicile for the establishment of funds investing in emerging and established markets (and for the fund administration and global custody services that support these funds). Malta's market-driven regulation has also enabled the establishment of a portfolio of fund options, as well as allowing Maltese registered funds to be established in an array of possible forms including open- and close-ended entities, trusts and limited partnerships and also allows funds to opt for the self-managed route as an alternative to external third-party management.

The Exchange is confident that there is great opportunity and potential in synergising with the rapidly expanding fund industry, not only from the perspective of offering a well-regulated listing venue but also by providing a whole range of support services and international connectivity through its depository. For investment funds seeking a listing, the Exchange provides an excellent regulatory framework with a high level of transparency, very competitive fees, fiscal and tax benefits (including exemptions from capital gains tax and stamp duty), a fast listing process with a simplified listing process for secondary listing, and a personal approach to issuers from skilled and professional staff.

The Exchange's Depository has considerable experience and a very strong reputation with regard to maintenance of registers and related services. The close link with the Exchange's trading arm also makes the Depository an ideal local to locate fund registers, while its link with Clearstream Banking provides international access which is conducive to increasing the level of liquidity of the assets while fund managers can also obtain a competitive advantage through the use of the Exchange's low-cost depository operations.

The Malta Stock Exchange is a well-positioned and well-regulated Exchange, enjoying the confidence built up over the years of all its issuers and benefiting from Malta's excellent reputation as an international financial centre. It offers a full spectrum of operational and support services in a cost effective and efficient economic environment where regulation and reputation are accompanied by a flexible 'can-do' attitude. These factors, together with a concentrated effort on a national scale to continue to entrench ethics in economic and corporate behaviour, coupled with an excellent quality of life, make Malta a formidable and competitive alternative for financial services operations. ■



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