

# Funds in Malta

**Malta is gaining international recognition as a brand denoting excellence in financial services. Evidence of this is an increasing number of reputable international financial services firms that have identified the strengths that Malta has to offer, and have consequently set up their operations in Malta.**

The developments taking place in Malta's financial services industry contrast significantly with what is happening across much of Europe and the US, where economies are emerging from the grip of recession, taking stock and calculating the cost of a future recovery. The fallout has seen deficit and debt burdens soaring, requiring tough budgetary decisions. In fact, despite the challenging market environment, Malta's own financial system escaped the financial crisis relatively unscathed.

According to Kenneth Farrugia, Chairman of FinanceMalta, this was primarily driven by Malta's robust and stringent regulatory framework, as well as by the region's adherence to sound banking principles. These developments have not only been instrumental in attracting foreign financial institutions to Malta, but have also protected Malta from problems associated with the financial crisis. Indeed, the financial services industry in Malta grew by 30% in 2010. It is timely, therefore, to highlight the fact that in 2011 Malta was one of the top five performing EU economies in terms of GDP growth.

"Undoubtedly, the driver of these strengths is a well-trained and highly motivated workforce," said Mr. Farrugia. "The industry's growth is also being driven by the presence of a comprehensive legal and regulatory framework combined with a competitive fiscal regime with nearly 60 double taxation agreements.

"To these attractive factors, I would add: a sophisticated ICT infrastructure, English as an official language, an enviable climate, and Malta's unique strategic location – an EU country with strong Mediterranean links. Moreover, the presence of a single efficient regulator, the Malta Financial Services Authority, has built a reputation for being a meticulous yet accessible supervisory body – ensuring that operators are fully compliant with EU regulations."

## Changing legislation

When asked about the current state of Malta's investment funds industry, Mr. Farrugia explained that the MFSA and government are currently working on a number of legislative initiatives that will provide further scope for the setting up of alternative and other types of funds in Malta.

FinanceMalta is the official voice of Malta's financial services centre both domestically and internationally and, as such, its role is to act as 'brand ambassadors' communicating the Malta story to potential investors.

"As a public-private partnership [PPP], we act as a bridge between the government of Malta and the country's practitioners," said Mr. Farrugia. "Our vision is for the industry to be seen as a leader in strengthening its financial services brand globally. Our mission is to increase the visibility

of Malta as an international financial centre – thereby enhancing business opportunities for all our members.

"As with the other sectors that make up Malta's financial centre, the vision is to see the development of clusters. In fact, the industry today is already seeing this begin to occur; meanwhile, the continued growth in the global custody providers will support this, as will the variety of fund servicing operators available for investors to choose the most appropriate providers to suit their requirements. In the process – which I would say is an organic one – FinanceMalta is harnessing the resources available including those of practitioners, operators, the regulator and government, in order for the industry to grow and prosper."

## Future horizons

Looking to the future, Mr. Farrugia noted that the MFSA has made considerable efforts to ensure growth for the local industry. Recent developments include: the launch of guidelines for the redomiciliation of offshore funds to Malta, the publication of a guidance note on Shariah funds, the signing of a Memoranda of Understanding with the Chinese Securities and Banking regulator, as well as a similar agreement with the Singaporean Monetary Authority on Malta-domiciled funds.

"Malta's regulator is working hard to ensure that EU legislation is transposed into our laws in a timely manner," he said. "Further, the MFSA is participating in the European System of Financial Supervisors [ESFS], the European Supervisory Authorities [ESAs], and is a member of the European Systemic Risk Board [ESRB].

"Malta's membership of the EU will undoubtedly benefit the industry when the AIFM directive comes into full force. The implications of the directive for Malta are such that the market for setting up of EU funds is expected to grow, most probably driven by the appetite for an EU status."

Mr. Farrugia concluded: "We also believe that the transposition of UCITS IV into national legislation, and the upcoming AIFM Directive, will further strengthen the foundations of the European fund industry. My view is that the onshore fund domiciles will stand to benefit as a result of these developments, which will induce increased confidence and appetite in setting up fund platforms in onshore Europe. Malta's fund industry is set to experience exciting growth opportunities going forward – and is well on its way to strengthen its position in the European funds industry."

For more information please visit [financemalta.org](http://financemalta.org)



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## CHALLENGES FACING CUSTODIANS – *Present and Future*

**The European securities industry is, more than ever, facing a major transformation of its landscape as a result of the market requirement and move to more transparency, control and segregation of duties and responsibilities.**

Without a shadow of doubt, a major challenge facing custodians – and other fund providers for that matter – is the implementation of new legislation into real work flows and risk monitoring realities, and their willingness and capability to do so.

According to Paul Mifsud, managing director at Sparkasse Bank Malta, 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 legislation brought along by the Alternative Investment Fund Manager Directive (AIFMD), UCITS IV/V, the Foreign Account Tax Compliance Act (FATCA) and Dodd Frank in the US.

"One of the main challenges facing custodians over the next year is the interpretation and implementation of such directives," noted Mr. Mifsud. "As can be witnessed from recent replies to the European Securities and Markets Authority's (ESMA) consultation paper on the 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, 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," said Mr. Mifsud. He added that under the new rules, depending on the option selected in relation to the financial instruments that can be held in custody, custodians 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 huge challenge and will inevitably lead to hybrid solutions of 'prime-custody' between these service providers.

Mr. Mifsud said: "The challenge facing custodians will be the custodian's capability to establish robust enough sub-custody agreements with their sub-custodians, enabling them to obtain the same level of warranties and indemnifications the custodian would warrant

to the fund. Effectively, a custodian will be looking for relationships and agreements that would enable it, as depositary, to discharge its liability by transferring it directly to a sub-custodian – assuming sub-custodians are willing to entertain this risk too.

"Such service agreements and work arrangements will have to be validated by including their existence as an item in the fund supplements, clearly highlighting the relationships and risk involved. This in itself may present further challenges and costs."

Custodians face other potential challenges too, such as treatment of cash, margin accounts, pledges, segregation and designations, all leading to the need for sharper in-house risk management and compliance expertise.

At Sparkasse Bank Malta, it is believed that the success of a custodian in the current legislative environment will be dependent entirely upon the custodian's willingness to adapt and change internal procedures and risk measures to cater and manage new relationships.

Mr. Mifsud noted that this is why Sparkasse is investing strongly in human resources and IT. The idea, he explains, is to try – as realistically as possible – to automate and integrate work flows between them, and the various sub-custodians required, in order to provide a suitable platform that would allow a portfolio manager to execute his strategy effectively and within the regulatory boundaries.

He was quick to add that the real challenge will be for custodians to deliver all this in a cost-effective manner that will have as little impact as possible on total expense ratios.

**Sparkasse Bank Malta forms part of the Austrian Savings Banks and provides fund custody and settlement services in and from Malta.**





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## Maltese Real Estate Opportunity Funds Establish for the International Market

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**Traditionally, sponsors seeking to established real estate private and opportunity funds to invest in the EMEA region have looked towards domiciling them in the Channel Islands or Luxembourg. However, in recent years, Malta has begun to feature prominently as an onshore hub for investment vehicles due to the favourable legal, regulatory and taxation environment the jurisdiction has to offer. In particular, real estate opportunity fund promoters have found a well suited alternative investment vehicle in Malta, namely the Professional Investor Fund or PIF, which remains the most popular collective investment vehicle the Maltese regime has to offer. The number of licensed PIFs currently stands at 419.**

A Professional Investor Fund established in Malta is essentially a non-retail collective investment scheme which can be incorporated as either a private or public company. Just like Alternative Investment Funds, PIFs are considered to entertain a certain level of risk, which in turn limits their legitimate marketability to the general public. Consequently, only certain categories of investors, dubbed by applicable legislation to be 'Experienced Investors', 'Qualifying Investors' or 'Extraordinary Investors', qualify to invest in PIFs.

Whilst PIFs promoted to Qualifying or Extraordinary Investors are not subject to any restrictions on their investment powers, those targeted at Experienced Investors are subject to certain investment, borrowing and leverage limits. The majority of PIFs currently licensed in Malta are established as PIFs targeting Qualifying Investors.

As vehicles for investment in real estate assets, Maltese PIFs provide a number of advantages: Apart from the flexibility and rapidity of the registration and licensing process offered by the Malta Financial Services Authority ("MFSA"), the PIF structure is designed to embrace a panopoly of investment objectives and targets that would otherwise be restricted to schemes capable of being offered only to large institutional investors in unregulated funds.

The MFSA has taken a flexible approach towards outsourcing investment services allowing PIFs to use service providers in any reputable jurisdiction recognised by the authority. The Maltese regulatory framework allows a PIF to invest wholly or partly, directly or indirectly in real estate, whether through separate sub-funds or special purpose investment vehicles established either in Malta or the jurisdiction in which the property is located. Moreover, the special statutory treatment

of derivative contracts and netting arrangements to which Maltese funds or their investment vehicles are a party give financial counterparties significant comfort when dealing with Maltese vehicles.

A classic Maltese real estate PIF is established as an open ended SICAV or registered limited partnership structure with lock-in periods and staggered redemption rights. This form is favoured for its flexibility coupled with lack of leverage restrictions: A PIF marketed to Experienced Investors modelled as a closed-ended fund is generally allowed a maximum leverage of 100% of NAV, as are open-ended PIFs offered to Qualified Investors, whilst leverage is prohibited in open-ended structures marketed to Experienced Investors. Conversely, closed-ended PIFs offered to Qualified Investors, and all PIFs marketed to Extraordinary Investors, are free of any borrowing restrictions.

Closed-ended fund structures are formed for the purpose of benefitting from the passporting provisions of the Prospectus Directive. However, with the introduction of the AIFMD, PIFs will benefit from the advantages of the wider passporting provisions of the Directive, thereby enjoying swifter and more streamlined access to EU and EEA markets. It is expected that by final implementation of the AIFMD in 2013, the MFSA will experience a significant increase in applications by PIFs for licensing as AIFs and AIF Managers.

Apart from the benefits Maltese PIFs derive from the European regulatory framework, local investment vehicles are also afforded numerous tax advantages. Not least, PIFs investing predominantly in assets situated outside of Malta are considered to be non-prescribed funds and, as such, are exempt from taxation in Malta. A non-prescribed PIF is not limited to any particular kind of investment and may freely invest in real estate without subjecting its non-resident investors to capital gains or withholding tax – a factor that renders Malta a particularly attractive jurisdiction for establishing real estate opportunity funds targeting markets in Europe, the US and the Middle East as well as the Far East.

As for tax efficient profit extraction from investment assets, Malta is currently party to a comprehensive network of more than 50 double taxation agreements, principally modelled on the OECD 1977 Model Double Taxation Convention on Income and on Capital. Counterparties include various states from the North African and Middle Eastern region including the UAE, Lebanon and Turkey as well as Libya, Egypt and Tunisia; Asian countries such as India, China, Malaysia and Thailand; and most CEE countries including the Russian Federation.

Malta recently concluded a similar treaty with Hong Kong in the wake of the expanding financial opportunities emerging in the far eastern markets. Coupled with the advantageous tax treatment of investment vehicles in Malta, these DDAs offer advantages to promoters and their investors looking at opportunities in real estate markets – without suffering cumbersome withholding tax rates so often associated with immovable property assets.

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**During the first three quarters of 2011, the Malta Financial Services Authority has issued a total of 31 licences for new sub-funds of collective investment schemes (retail and non-retail collective investment schemes). The majority of these licences relate to Professional Investor Funds. These figures confirm that the Maltese investment funds industry continues to grow at a consistent pace.**

When asked how Malta's national legal and regulatory environment encourages the institutional investor community to take part in the investment funds industry, Dr. Simon Tortell, senior partner at Simon Tortell & Associates, provided comment.

"Malta has an ad-hoc regime for Professional Investors," he noted. "This regime is in turn divided into three categories: Professional Investor Funds targeting Experienced investors – as known as Experienced Investor Funds: Professional Investor Funds targeting Qualifying Investors – also known as Qualifying Investor Funds – and; Professional Investor Funds targeting Extraordinary Investors – also known as Extraordinary Investors Funds."

In a recent Global Competitiveness Report (2011-2012) published by the World Economic Forum, Malta was described as, 'an innovation-driven economy with notable advantages in financial services development and technological readiness'. In particular, the

strength of the country's auditing and reporting standards, as well as its regulation of securities exchanges, were two indicators of success.

In regards to Simon Tortell & Associates' service offering, Dr. Tortell added: "Investment funds are the firm's core practice area. We are involved in the fund's structuring, licensing process with MFSA, identification and co-ordination with fund's service providers, drafting of application and constitutional documents, and the provision of legal services on an ongoing basis. In recent years, the firm has distinguished itself for developing, licensing and implementing innovative fund structures."

Malta provides advantages including a transparent regulatory regime, which provides for both retail (UCITs and non-UCITs) as well as sophisticated investor funds. It also offers an approachable and proactive regulator in the shape of the Malta Financial Services Authority (MFSA).

The implementation of UCITS IV, which came into force in July 2011, has also created new considerations. Dr. Tortell noted that the key challenges that UCITS IV needs to address are administrative obstacles and delays in passporting UCITS, as well as the fragmented EU fund industry. Dr. Tortell highlighted that it is also important to maintain fair levels of protection for investors; for instance, by reinforcing protection in a cross border context where various supervision authorities interact.

He added: "Despite the initial success of the UCITS regime, additional changes were required to the UCITS framework in order to adapt the product to 21st century financial realities. The key objective of UCITS IV is to incorporate proposals that will tackle bottlenecks to industry efficiencies. On a business development level, UCITS IV enables fund managers to structure new products as well as consolidating existing fund structures."

"Meanwhile, we are expecting the MFSA to issue its regulatory response to the transposition of the Alternative Investment Fund Managers Directive (AIFMD). In its latest announcement on this subject, the MFSA referred to the recent document issued by ESMA on the AIFMD. This was a consultation document, laying down draft technical advice to the European Commission on possible implementing measures of the AIFMD in relation to the supervision of third countries."



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**Exciting times lie ahead for Malta as the country continues to register growth within the investment funds industry, notwithstanding turbulent economic times on a global level. Up until September of this year, the Malta Financial Services Authority (MFSA) had licensed more funds than it had throughout all of 2010.**

According to Ms. Laragh Cassar, a partner at Camilleri Preziosi, this finding is evidence of the fund industry's fast-paced growth. "We have noted the arrival of more service providers on the island," she explained. "A notable example being the presence of Deutsche Bank as a new custodian, among other service providers of international repute that have chosen to set up in Malta."

When asked if Malta's legal and regulatory environment encourages the institutional investor community to take part in the funds industry, Ms. Cassar said: "Most definitely. Suffice to say that until the introduction of UCITS III, the investments funds landscape in Malta was dominated by funds aimed at professional and institutional investors. It is only with the introduction of UCITS III and IV that a greater interest in retail funds is being shown."

UCITS IV came into force on 1st July 2011. Since then, Camilleri

Preziosi has assisted clients in complying with the related requirements. Ms. Cassar added: "We have also assisted the first UCITS fund in Malta, which had passported its units under UCITS III, to amend and update its constitutional and marketing documents on a cross-border basis under the UCITS IV procedure."

"Meanwhile, during 2012 we are expecting an increase in UCITS funds established by non-EU managers wishing to establish an EU footprint in order to benefit from the EU marketing passport."

The Maltese legal framework offers institutional investors a robust yet familiar framework, as it bears a strong British influence. Also, as members of the EU, Malta's regulatory framework is modelled on EU directives and regulations. The resulting legislation is in tune with the business world as it gives investors added certainty about the remedies available and their exposure to counterparty risk. This is seen in provisions regulating set-off and netting, as well as in the ability to create several investment compartments within a legal vehicle to ringfence the assets and liabilities of the different investment strategies pursued by each compartment.

Ms. Cassar concluded: "Also of note: the Alternative Investment Fund Managers Directive (AIFMD) has brought with it a wave of non-EU managers wishing to establish a European base in order to benefit from the EU marketing passport as from July 2013. The EU marketing passport will allow them to promote their funds in all 27 member states of the EU through the single authorisation procedure."

"Malta's favourable taxation regime continues to influence investors' decisions. The tax exemptions for investors, the fund and its service providers, as well as Malta's extensive double taxation treaties with around 58 countries, create attractive tax planning opportunities."

Camilleri Preziosi provides fund managers and other service providers with comprehensive legal advice covering the whole spectrum of the investment process, including licensing and launching of funds, agreements with service providers and outsourcing, passporting, and advice on compliance with ongoing obligations.



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**Malta is rapidly increasing its status as a significant financial centre within the European Union. A long history of fiscal and investment incentives for foreigners wishing to set up business in Malta has led to an attractive package for national investors, as well as for overseas investors looking to Malta for their international tax planning structures.**

There are many reasons why investors might wish to set up a company in Malta. These include the country's low cost base and low corporate tax rates; its inherent advantages for holding companies; practically no disallowed expenses; no withholding taxes on dividends; no stamp duty on transfer of shares; the possibility of a full refund on corporate tax incurred in Malta on dividend income received from abroad; as well as the possibility of an outright exemption on corporate tax, provided certain anti-abuse provisions are met. Additionally, income earned outside Malta which has been subject to foreign tax is also subject to several different tax credits, further lowering the net tax rate.

Other factors which prospective investors should consider include the large amount of investment incentives offered by the Maltese government to foreign investors. These can be summarised as: access

to finance, investment aid, SME development, R&D and innovation programs, enterprise support, and employment and training.

Moreover, Malta is an EU member and is situated within the Eurozone. Its tax system is fully compliant with EU regulations. Malta's laws are based on UK common law, and English is one of the two official languages in use. Subsequently, all laws and regulations are readily available in English.

Opening a company in Malta is relatively straightforward. Maltese companies need to have a Memorandum and Articles drafted and approved by the competent authorities. The approval takes only a few days, and after that, the company can commence to trade. Once this is approved, a bank account is opened and the share capital of the company has to be deposited. The minimum paid-up share capital for a company is EUR 1,200. These are not tied up and can be fully utilised by the company once it starts trading.

In addition, the company's representative, normally its auditor or lawyer, is required to ask for the usual KYC documentation prior to the company being approved by the authorities, and has to make an official declaration that all relevant KYC documentation has been gathered.

Maltese law also provides for the possibility of holding one's shares under fiduciary (nominee), thus providing complete confidentiality from all parties, including the Financial Services Authority and the tax authorities, among others.

In a recent survey carried out by AGN International, a prestigious international association of accountants of which our firm is the sole Maltese representative, Malta was placed first in all EU members' states for tax advantages offered to non-resident investors.

Ciantar Associates comprises auditors, accountants, tax advisers and management consultants. The firm also provides fiduciary and trustee services through other associate companies. It specialises in providing these services to foreign investors, and company incorporations comprise a significant portion of its business.