

Malta as a Hedge Fund Domicile - Its Evolution and Continued Growth

Background

Malta's investment services legislation was enacted back in 1994 as part of the jurisdiction's initiative to bolster its legal and regulatory framework in anticipation of its application for EU membership. Indeed the island's accession to the European Union in May, 2004 proved to be the primary catalyst for the exponential growth of its financial services industry, thrusting the jurisdiction onto the world map by coupling an 'onshore' robust and comprehensive regulatory and legislative framework which inspires confidence with a Europe-wide 'passporting' system and effectively crystallising Malta's role as a European hub for financial services.

That Malta's fund industry would not have enjoyed the growth experienced to date but for its regulator is unanimous among practitioners and industry players alike. The Malta Financial Services Authority (MFSA) is the single regulator for financial services in Malta tasked, *inter alia*, with regulating banks, insurance and investment services and has gained a Europe-wide reputation for flexibility and pragmatism tempered with diligence and meticulous attention to detail, preferring quality over quantity and promoting investor protection to safeguard Malta's position as a jurisdiction of repute.

Regulatory Framework

The most attractive, and by far the most popular, aspect of the Maltese hedge fund framework broadly comprises (i) the Professional Investor Fund (PIF) regime which offers three different fund typologies, based on the participating investors' wealth and experience, with the regulatory regime being relaxed proportionally to the minimum entry threshold required from each individual investor; and (ii) an Alternative Investment Fund (AIF) regime allowing Fund Managers to launch AIFs under the AIFM Directive.

The Maltese regulatory framework also provides for the following types of investment funds:

- Retail Non-UCITS Schemes - comprising retail funds which may be marketed solely to Malta-based investors.
- Retail UCITS Schemes - UCITS-compliant funds may avail themselves of a larger market for the sale of their units by way of retail distribution which is enhanced by the 'passporting' of the fund's units into any EEA or EU member state without the requirement of licensing in each such member state. Funds which are established as UCITS schemes, are subject to the various regulations transposing Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (the "UCITS Directive").
- Private Collective Investment Schemes - in order to operate as such these are required to be 'recognised' by the MFSA, as opposed to being licensed like the other forms of schemes. In order to be recognised as 'Private' a collective investment scheme must satisfy certain conditions including, *inter alia*, that the total number of participants is limited to fifteen persons who are close friends or relatives of the promoter/s.

The most common legal form for a collective investment scheme in Malta is the SICAV (multi class or single class open ended investment company), established in terms of the Companies Act (Investment Companies with Variable Share Capital) Regulations, due particularly to the structural and operational flexibility afforded by such vehicles. Whilst a SICAV can be formed as a private or a public company, it is typical for promoters to establish a public limited liability company from the outset in order that its units may be offered to an unlimited number of investors, which would otherwise be limited to 50 in the case of a private company.

The local legislative framework also accommodates “umbrella” type structures, whereby the assets and liabilities of each sub-fund are treated as a patrimony separate from the assets and liabilities of each other sub-fund of such company, thereby effectively containing and segregating the risks associated with each investment made by a class of shares within that respective class.

Self-managed AIFs which have assets under management in excess of €100 million, or €500 million if the AIF is unleveraged, will be required to operate within the heightened regulatory strictures of the various regulations transposing Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 as amended from time to time (the “AIFM Directive”) into Maltese law. Operators not exceeding the said prescribed thresholds qualify as ‘*de minimis*’ AIFMs.

Post-AIFMD- an opportunity seized

Whilst full AIFMD compliance could certainly benefit larger operators, start-ups and ‘smaller’ funds may indeed be overwhelmed by the regulatory load inherent in AIFMD compliance. Consistent with its forward-looking and pragmatic approach to regulation, the MFSA has maintained the popular PIF framework alongside the new AIF regime and, in so doing, has potentially created niche market which it is well-positioned to service.

Accordingly, whilst many EU jurisdictions have seemingly been left reeling by the regulatory overhaul that is the AIFM Directive, Malta has coupled its transposition into the local legislative framework (specifically that of the AIFMD *de minimis* provisions) with the retention of the light-touch, more flexible PIF regime and, effectively, has guaranteed the survival of the ‘start-up’ fund, which has come to be synonymous with pre-AIFMD Malta. A PIF is fundamentally an AIF which escapes the necessity of full AIFMD compliance when structured as a self-managed fund satisfying the said *de minimis* thresholds (or externally managed by a *de minimis* AIFM).

As such, Malta offers operators enhanced flexibility when deciding on how to tailor and structure their business. Whilst PIFs will not enjoy the EU passporting entitlements granted by the AIFM Directive, they may still be marketed in accordance with EU Member States’ national private placement regimes.

Moreover, the appropriate mechanisms are in place to facilitate the change from *de minimis* status to full AIFMD compliance once the operators feel that the expense and resource inherent in AIFMD compliance can be justified by the fund’s growth.

Way forward- outlook is bright

Despite the turbulence that has plagued global markets over the course of the past years, Malta's fund industry has managed to secure consistent growth, not least due to the continued pragmatic but prudent style of regulation with which the jurisdiction has become synonymous.

Malta was named as the 'most favoured domicile in Europe' by the prestigious *Hedge Funds Review* in its recent Service Provider Rankings released in November 2013 and, moreover, continues to register year-on-year growth with combined net assets of Maltese funds as at the end of June 2013 totalling €8.95billion.

What is certain, in the light of the unremitting waves of regulatory reform which the industry has had to endure in recent years, and indeed continues to endure, is that proper preparation and careful selection of professional advisors will be paramount for operators to correctly implement a structure which suits their requirements and to deliver a robust and reliable compliance programme, duly tailored to the appropriate regulatory regime.

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