



Annual Report

2007

Contents

| | Page |
|---|------|
| Malta Association of Fund Managers and Administrators | 3 |
| Malta's Funds Industry | |
| -Business Developments | 4 |
| -Regulatory Developments | 5 |
| MAFMA Committee Meetings | 8 |
| Going Forward in 2008 | 9 |

Malta Association of Fund Managers and Administrators (MAFMA)

MAFMA was originally set up on 22 September 2003 by two of its current members, HSBC Fund Management (Malta) Limited and Valletta Fund Management Limited. At that time, MAFMA was known as the Malta Investment Management Association and, initially, it represented the common interests of fund managers.

Following Malta's accession to the European Union on 1 May 2004, the industry witnessed an increased interest by international fund promoters to domicile their funds in Malta. This was without doubt driven by a number of success factors which amongst others, include the presence of a comprehensive legal and regulatory framework, cost competitiveness and a professional business environment. As a result of these developments, MAFMA broadened its remit to represent the interest of fund administrators, following the action taken by the main market players at that time to set up specialist fund administration operations and with a clear distinction from fund management business.

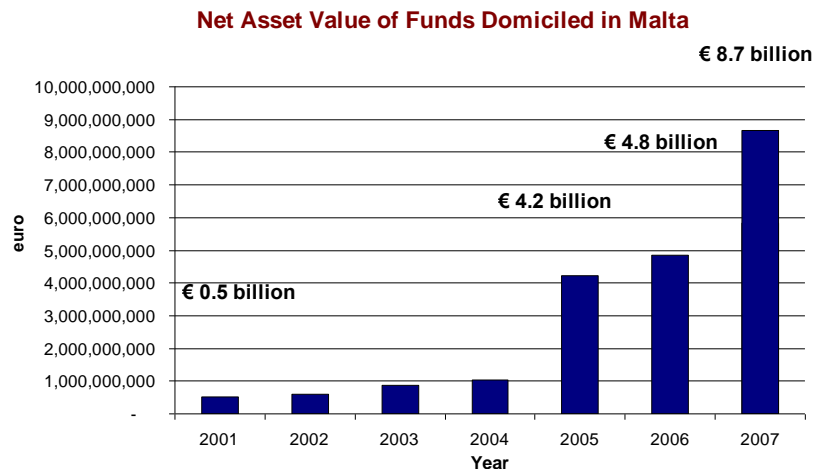
MAFMA primary objective is to act as a channel of communication and to make representations to the Maltese Government and the Malta Financial Services Authority on legislative, regulatory and fiscal matters amongst others which, directly or indirectly, have an effect on the business and/or professional interests of its members.

MAFMA is also represented on the Financial Services Consultative Council and we are pleased to report that the Council's Chairman is Mr Kenneth Farrugia, who is also the Chairman of MAFMA. MAFMA is also represented on the Board of Governors of FinanceMalta, a Foundation which was set up between the Industry and Government of Malta. In the conduct of its activities, MAFMA works very closely with the Malta Bankers Association especially in those area where the interests of the members of both Associations converge.

Malta's Funds Industry

Business Developments - Record Growth Registered in 2007

The Funds industry recorded significant growth in the year under review. Assets of Funds registered in Malta increased from €4.9bn as at 31 December 2006 to reach €8.7bn as at the end of 31 December 2007.



During the year under review, both the domestic and international markets experienced significant volatility which had a corresponding negative impact on the bond funds, notably those denominated in Maltese Lira. As Malta joined ERM II, local bond yields started to mirror movements in their euro counterparts and the Maltese bond market was no longer insulated from developments taking place outside our shores. As the Central Bank of Malta, in its role as market maker, constantly revised its bid prices in Malta Government paper in line with developments in the euro denominated bond market, significant outflows from bond funds as Maltese cautious investors showed a marked preference to term deposit accounts when faced with turbulent bond market conditions. This situation has since improved as bond markets have somewhat stabilised.

Equity Funds, both domestic and foreign, have retained their ground or lost marginally notwithstanding the immensely volatile market conditions which were driven by the US sub-prime mortgage crisis as well as concerns of recession in the world's major economies.

On the property front, the two main market players saw aggregate inflows of about €35m as this alternative asset class which became increasingly popular with Maltese investors who traditionally have been very keen in investing in bricks and mortar, whether directly or indirectly. During the year Absolute Return Funds were also introduced in Malta which further widened the gamut of investment opportunities made available by the members of the Association.

The major growth area in the period under review remains undoubtedly that recorded in Professional Investor Funds which has also been a strong contributor in attracting international fund business to Malta. Whilst data concerning the growth of Professional Investor Funds by Net Asset Value is not

available, we estimate the growth in these type of funds during 2007 to be in the region of €2.4bn. This growth is indeed a very encouraging one and we augur that this positive growth momentum is sustained.

Funds Authorised in 2007

As stated earlier on in this report, 2007 was a very active year for the Malta Financial Services Authority. In fact the Regulator has issued a total of 117 Collective Investment Scheme licences (including sub-funds) of which:-

51 were Professional Investor Funds;
18 were UCITS Funds;
2 were Non UCITS Funds; and
46 were foreign based retail funds.

Members of the Association launched the following funds in 2007:-

- Maltese Money Market Fund
- Diversified Multi Manager Income Fund

During this year, Valletta Fund Management Limited has converted its seven sub-funds from a retail locally based Non UCITS Scheme to a retail locally based UCITS Scheme.

Regulatory Developments – A Challenging Year

MiFID

The main regulatory development that has impacted the funds industry in the period under review was undoubtedly the implementation of the Markets in Financial Instruments Directive (MiFID 2004/39/EC). Notwithstanding that this Directive has been the subject of much debate and displeasure in international industry circles, the implementation of this Directive in Malta was done in a very efficient and timely manner.

This Directive covers various aspects of financial services including suitability and appropriateness, conflicts of interests, best execution, amongst others. It involved not only fund managers, administrators and custodians but also banks and other investment firms.

As part of the transposition of MiFID, five new Legal Notices were issued in 2007. One of these Legal Notices exempted certain service providers from the provisions of the Act, and the other stipulating the fees payable to the Authority by ISA licensed and recognised entities.

On 1 November 2007 the Investment Services Guidelines were replaced by four new Rule books¹:-

¹ Source: Malta Financial Services Authority Annual Report 2007

- a) **Investment Services Rules for Investment Services Providers:** These Rules transpose Pillar one of the CRD and parts of MiFID, and apply to all investment licence holders including fund managers and custodians of collective investment schemes. Being Rules which provide for the transposition of MiFID, these also contain standard licence conditions which regulate the activity of multilateral trading facilities ('MTFs') and Systematic Internalisers which are alternative forms of trading venues provided for by MiFID. As at the end of the year no operators had yet been licensed to provide such trading facilities.
- b) **Investment Services Rules for Professional Investor Funds (PIFs):** These Rules apply to Collective Investment Schemes which qualify as professional investor funds and which were licensed after 17 July 2007. All PIFs licensed before that date must come in line with the requirements of these Rules by the 17 July 2008.

Among other things, the Professional Investor Fund Rule Book incorporates the new class of Professional Investor Fund (PIF) for "extraordinary investors" launched earlier in the year. The new framework targets private equity and family offices and is subject to a lighter regulatory regime than that applicable to PIFs for "experienced" and "qualifying" investors.

- c) **Investment Services Rules for Recognised Persons and Retail Collective Investment Schemes:** These Rules regulate the activity of recognised fund administrators, recognised private schemes and existing retail collective investment schemes, including both retail UCITS and Non-UCITS schemes licensed before 1st November 2007. The standard licence conditions relative to retail collective investment schemes will remain applicable until 23 July 2008, by which date existing schemes will need to comply with (d) below.
- d) **Investment Services Rules for Retail Collective Investment Schemes:** These Rules apply to all retail collective investment schemes [both UCITS and NON-UCITS] licensed on or after the 1 November 2007 and will become applicable to all such Schemes after the 23 July 2008. By means of these rules, all the provisions of the UCITS directive, the Commission's UCITS implementing measures and the applicable third level CESR UCITS guidelines and recommendations have been implemented.

The new Investment Services Rules for Retail Collective Investment Schemes which have fully transposed the Directive, provide a better understanding as to the nature of "Permissible Investment Instruments" that UCITS may invest in. The Rules now also allow the use of investment instruments linked to Hedge Fund Indices provided these qualify as "financial indices" under the Directive and that the index methodology provides for the selection and the re-balancing of components on the basis of pre-determined rules and objective criteria. In this regard the Rules also take into account the Guidelines published by CESR to assist regulators and market participants in the interpretation of the Directive.

Under the new Rules the assessment of the global/total exposure relating to Financial Derivative Instruments within a UCITS Scheme, and its leverage may be assessed on the basis of an Advanced Risk-Measurement Approach such as VaR as proposed by Commission Recommendation 27/4/04. Non-sophisticated UCITS may alternatively make use of the Commitment Approach.

Euro conversion

Although, strictly speaking, not a “regulatory development”, the adoption of the Euro in Malta on 1 January 2008 was another “mandatory” project undertaken by our members in 2007.

Most (if not all) of MAFMA members have set up project groups – or sub groups of their parent bodies, with a view to implementing euro in a seamless manner.

Our members and their parent holding companies (as applicable) have contributed in no small way in the achievement of this important milestone in Malta’s financial services history and it is also to their credit that the implementation of euro has been a widely acknowledge success.

MAFMA Committee Meetings

During the period under review, the following matters were attended to during MAFMA's Committee Meetings

- significant work has been undertaken on the organisation of a training program on fund administration;
- the development of a MAFMA website;
- discussion on the merits and demerits of the adoption of different fund valuation methodologies in relation to domestic capital market instruments;
- achievement of a consensus view on the Value Added Tax treatment of different aspects of fund administration services;
- a drive to recruit new members to the Association;
- representations to the Minister of Finance on the implementation of the Investment Registration Scheme;
- representations to the authorities on the green paper pertaining to the revision of the EU Saving Tax Directive;
- discussions on particular aspects of the PIF Sourcebook issued by Malta Financial Services Authority; and
- comprehensive recommendations raised on the impact of EU proposals on the harmonisation of VAT rules.

Going Forward in 2008

The ink has barely dried on the transposition of the MiFID Directive and Implementation Measures on 1 November 2007 by the Malta Financial Services Authority, when we have now to start looking at the revision of the UCITS Directive which is currently being discussed at EU level. Despite the challenges that this brings with it, this is what makes the Funds Industry a dynamic one. The current revision of the UCITS Directive includes:-

- simplification of notification procedures for UCITS III Funds;
- making the simplified prospectus even simpler and with more concise and understandable information to investors;
- measures at facilitating cross-border fund mergers; and
- the creation of an effective Management Company passport which allow Managers to manage funds in other member state.

The proposed revisions will further facilitate the reduction of bureaucracy and complexity in the current UCITS Directive and will result in more funds being passported to Malta and these being actively promoted/marketed in the Maltese islands. Maltese Fund Managers can therefore be expected to bite some colder winds of competition as we are likely to see more aggressive marketing of overseas funds in Malta. On the other side of the equation those members who have adopted the UCITS passport can now undertake cross-border marketing without significant regulatory interference in overseas EU member states and this could possibly be an opportunity to exploit further.

Moving away from the regulatory issues – on the business front, we are likely to see the further development of other types of investment products such as structured notes. With equity markets showing signs of nearing the end of years long bull-run, some of our members are providing investors with an exposure to equity and alternative asset class with the capital of the investor remaining “protected”. We have seen products which include potential yearly income and these have gone done well with the Maltese investor. Clearly these type of investments should continue to remain popular in the months ahead.

On the fund administration front, we should continue to see a sustained growth in the number of funds seeking Malta as their fund domicile. The challenge remains for the fund administration mandates to be administered in Malta driven by the presence in the calibre of human talent and technological innovation are a must if we are to move forward in the area. We are, however, encouraged by the reference to our country in the Financial Times of 7 April 2008 as “..... Malta is seen as a domicile for the future”.