Malta Funds Industry Association

NEWSLETTER Q4 2011

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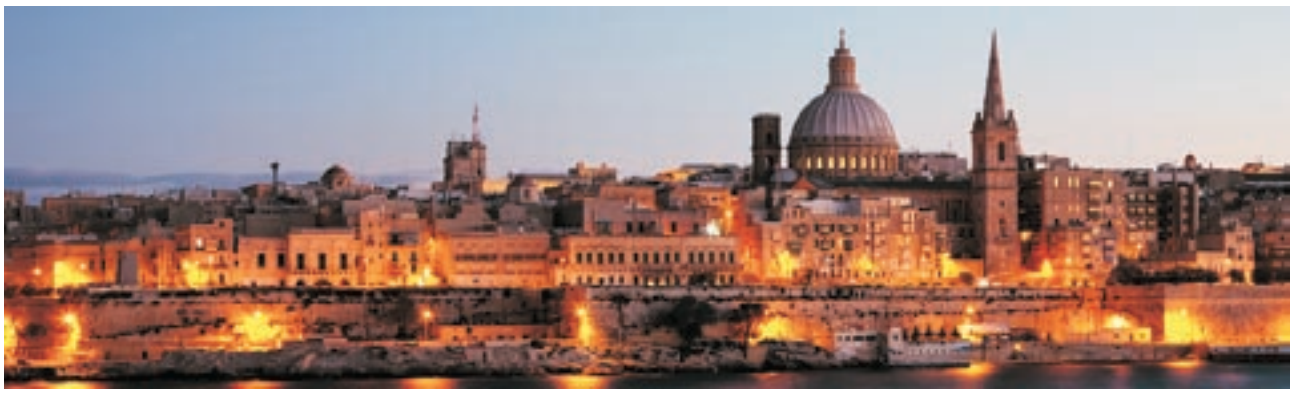
CAMILLERI DEMARCO & ZAHRA ADVOCATES
ERREMME BUSINESS ADVISORS Accountants, Business and Management Consultants
SPARKASSE Bank Malta plc
VALLETTA FUND MANAGEMENT
VALLETTA FUND SERVICES



Malta's Fund Industry - from strength to strength

KENNETH FARRUGIA
CHAIRMAN
MALTA FUNDS INDUSTRY ASSOCIATION

When one looks back at the results achieved by the funds industry over the course of 2011, it is clearly evident that Malta is being seen as a highly suitable jurisdiction domicile for the setting up of both UCITS and hedge funds particularly for start up funds. The growth and development of the industry is clearly evidenced by the increasing number of funds that are being domiciled in Malta, or redomiciled to Malta from other jurisdictions. Equally important is the growth that Malta is the development of the operational infrastructure as is evidenced by the number of investment services licences, which have increased to 111 as at the 30th September as well as the 24 recognised fund administrators that are now operating from Malta. The statistics issued by the MFSA as at the end of September 2011 clearly show that the number of schemes authorised over this period have increased to 142 from 108 registered in December 2010 - a 31% growth in just nine months.

Equally, the number of funds authorised by the MFSA have increased from 410 in December 2010 to 533 - a 30% increase in nine months. This double digit growth has likewise been experienced in the number of fund administrators which have increased to 24, from 18 in December 2010 - a 33% increase.

It is interesting to note that this growth is being experienced despite the challenging economic environment which normally tends to dampen growth prospects. Nonetheless, the challenge going forward is to maintain these growth trends which in turn require that the critical success factors that have contributed to the growth of the industry be maintained and improved upon.

Islamic Funds in Malta

REUBEN BUTTIGIEG
MANAGING DIRECTOR
ERREMME BUSINESS ADVISORS

The publication of the Guidance Note on Islamic Funds by the Malta Financial Services Authority was a positive step towards the introduction of Islamic Funds in Malta. The aforementioned note on its own is certainly not enough in order to attract the necessary interest in Malta. To the contrary, if taken in isolation the said note may be a deterrent for Islamic Funds as may in itself show a certain lack of expertise.

Organisations wishing to attract Islamic Funds to Malta need to present a holistic package and point out the advantages of Malta for Islamic Funds to be registered in Malta. One of the considerations is certainly our tax advantageous system which many are still unaware of. The tax structure analysis needs to go beyond the simple prescribed and non prescribed funds analysis. Also, the combination of various Legal instruments that render many Islamic Finance Transactions possible is very often overlooked by many promoting Islamic finance in Malta. Many are under the impression that through Malta, Islamic Finance Transactions cannot happen whilst in reality through the use of legal instruments such as the Trusts and Trustees Act structured in combination with other Special Purpose Companies most transactions can be achieved in an even more efficient way than in other countries such as Luxembourg (leader in Islamic Funds).

The development and analysis of these structures is however, not a simple exercise. Regrettably certain assertions made by Maltese organisations were factually not correct which led to certain Islamic Finance Institutions be wary of Malta. The presentation of certain organisations as Shariah Experts did not do Malta any good as it was evident that this was not the case. Shariah, Sunnah, Fatwas and their interpretation is not a simple thing and must not be interpreted at face value. Maltese organisations having interest in attracting such funds should ensure to start building a certain knowledge that may answer basic questions on Shariah Law within a Maltese context. Alternatively, one may seek strategic alliance that allows the firms access to such information.

An understanding on what Luxembourg and Ireland are doing in this context would also assist Maltese organisations to put to light the advantages of Malta. Luxembourg certainly has taken Islamic Finance on a national strategic level evidenced by the Foreign Policy they have adopted. The Industry in Malta may achieve the same effect by creating a National Task Force to build a common strategy to attract this lucrative potential market as evidenced by many studies, particularly now in view of the changes occurring all over the Mediterranean. There exists a niche for Malta in Islamic Finance Industry, a niche which Luxembourg firms recognise that they could never compete with Malta on. The critical success factor is a national strategy for the market and the educational element that comes with it.

Challenges facing Custody Service Providers Present and Future

PAUL MIFSUD
MANAGING DIRECTOR
SPARKASSE BANK MALTA P.L.C.

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 any shadow of doubt, the major challenge facing custodians (and other fund providers for that matter) is and will be the implementation of new legislation into real work flows and risk monitoring realities. 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 AIFMD, UCITS IV/V, FATCA and Dodd Frank in the US. In fact, one of the main challenges possibly facing custodians over the next year is the interpretation and implementation of the said directives. As can be witnessed from recent replies to ESMA's consultation paper on possible implementing measures of the Alternative Investment Fund Manager Directive, 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, on-line trading venues, TA's and sub-custodians. 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 massive challenge and will inevitably lead to hybrid solutions of 'prime-custody' between these service providers.

Subsequently, the challenge facing custodians in a similar scenario 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. Furthermore, similar agreements and work arrangements will have to be highlighted and clearly manifested in all supplementary prospectuses potentially presenting yet further challenges and costs in themselves. There are obviously several other challenges facing custodians 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. The success of a custodian is currently dependent upon their willingness to adapt and change procedure to cater for the new realities and deal with complex relationships between them and their sub-custodians. This involves the ability to cost-effectively construct a network of service providers and seamless work flows between them. Inevitably, custodians will be resorting to further investment in risk management, IT and human recourses development.

Hedge fund governance: the need for quality directors

DAVID ZAHRA
PARTNER
CAMILLERI DE MARCO & ZAHRA ADVOCATES

As Malta increasingly becomes a domicile of choice for hedge funds and their managers, a natural question arises: can hedge funds source enough capable and experienced individuals to keep up with the demand for independent directors on their boards of directors? This challenge is typical in all financial services centres, particularly in those of our size. A limited pool of human resources may lead to individuals sitting on a large number of boards at the same time. A recent Financial Times investigation on the Cayman Islands identified one "jumbo director" sitting on more than 560 boards!

Internationally, investors are calling for transparency in the number of directorships hedge fund directors hold. These calls have increased following a number of recent court judgements, in particular the Grand Court of the Cayman Islands judgement in August 2011 which found the directors of Weavering Macro Fixed Income Fund guilty of wilful default in the discharge of their duties and which ordered them to pay significant damages to the fund's liquidators in compensation for the losses it suffered. The two directors on the Weavering fund were directly related to the fund's manager, consistently signed documents without making any enquiry whatsoever, signed sham investment management agreements and advisory agreements without either reading them or knowing that the agreements would never be acted upon and even produced false board minutes. Moreover, the directors completely relied on their legal advisers with no analysis of the advice they received.

The Weavering judgement highlights the necessity, and the importance, of appointing independent directors with the required expertise to carry out their duties professionally by complying with strict codes of conduct, making the necessary enquiries, applying their minds to the matters in issue and diligently supervising the fund's performance. Individuals accepting directorships should make sure that they have sufficient time and enough logistical support to properly discharge their fiduciary duties. Malta has taken note of the current debate and developments in competing jurisdictions.

Experience has shown that service providers in Malta refer as directors, individuals who are adequately qualified and who have the appropriate expertise and experience. Moreover, the MFSA (as reported by Hedge Funds Review) is seeking to introduce a system whereby directors are assigned weighted points according to the responsibilities they assume on boards, rather than limiting its focus on the number of directorships they may hold. An overall maximum point limit would be imposed and, accordingly, restrictions would be proportionate to the responsibilites and commitment assumed by each individual.

Malta's current status as a jurisdiction of choice for hedge funds and fund managers can also be attributed to the manner in which Maltese directors on funds discharge their duties. As Malta seeks to consolidate its attractiveness, the MFSA's efforts to put the oversight of the corporate governance side of funds and fund managers as its top priority for 2012 are an important step in the right direction.

David Zahra is partner at Camilleri de Marco & Zahra Advocates (www.cdz.com.mt). He has specialised in financial services at King's College, University of London and has extensive experience in the field. He has advised a number of Maltese funds on corporate governance issues.

Key Investor Information Document - KIID

ANATOLI GRECH
HEAD STRATEGY & REGULATORY AFFAIRS
VALLETTA FUND MANAGEMENT LIMITED

The UCITS IV Directive which came into force on 1 July 2011, introduced a number of changes to the UCITS regime with the objective of strengthening the UCITS market and making the operation and distribution of UCITS funds more time and cost efficient.

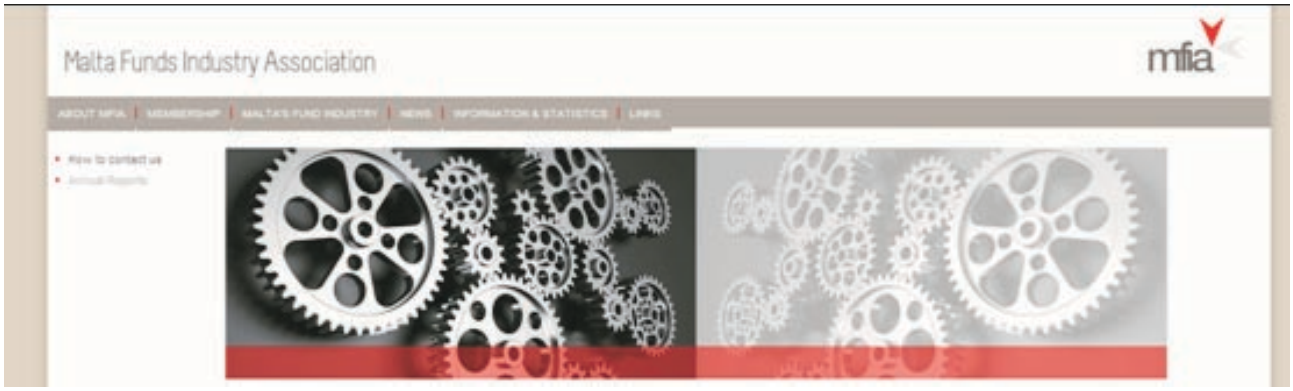
One major component of the UCITS IV Directive is the Key Investor Information Document, widely referred to through its acronym KIID. The KIID which has an implementation deadline for existing funds of 1 July 2012 was introduced as a replacement to the Simplified Prospectus which is largely viewed as having failed to meet the objective of providing clear, simple investment information to investors, an objective which the KIID seeks to address.

To this end, the KIID has been intentionally designed to be a short document, not exceeding two pages in length, the form and content of which is highly prescribed by the European Securities and Markets Authority. Each KIID must include set text together with financial data such as a synthetic risk/reward indicator (SRRI) based on a volatility formula and past performance bar charts and be written in the local language of each country in which a fund is sold.

Each KIID must be updated at least annually, within 35 business days of year-end, to include refreshed performance data to the end of the previous calendar year. Interim updates may be triggered throughout the year based on a number of potential events such as SRRI update if there is a change to the indicator value, any variation to the entry & exit charges, on-going charges and conditional charges and any updates to a fund's name, investment objective or benchmark.
Each Manager and Distributor will be impacted differently based on the fund range/s involved. The number of funds, the number of share classes and the distribution in multiple languages create scale challenges that require an automated solution. A large number of Managers and Distributors have opted to outsource the production and maintanence of the KIID to specialised firms which have the required regulatory and technical knowledge, translation capabilities and the IT infrastructure necessary to produce and monitor the content of the KIIDs.

The requirement to produce KIIDs has the potential to be the most expensive consequence of the new UCITS regime, both in terms of financial, human and IT resources, and ultimately, in view that the KIID is a regulatory requirement, these costs may possibly be borne entirely by the end-investor. It has been stated that in no other project so much effort has been placed in producing so few words.

The introduction of the KIID is widely acknowldeged as an ambitious and complex project, however, nonetheless, a major milestone which promotes harmonisation and comparability of investor information. Adequate investor disclosures surely provides an important contribution to the efficient functioning of the UCITS market, however, only time will tell whether the KIID will provide the perceived benefits which the Commission is seeking.



News

MFIA launches new website

The Malta Funds Industry Association (MFIA) has just launched a newly designed and revamped web-site, www.mfia.org.mt, making it more attractive and easier to navigate thereby improving its functionality.

The new web-site hosts useful statistical and other useful information on the funds industry in Malta and details on the Association's members. The MFIA also publishes an interesting quarterly newsletter which includes a number of specialist articles by local professionals covering various legal, regulatory, operational and business aspects of the fund industry.

Membership, which is possible across two levels, can be attained by sending in the application form which can be downloaded directly from the Association's web-site.

Update on the Markets in Financial Instruments Directive

The Markets in Financial Instruments Directive ('MiFID') is one of the cornerstones of European financial regulation. The Directive establishes a regulatory framework for the provision of investment ser-vices by investment firms and credit institutions and for the operation of trading platforms in the form of regulated markets, multilateral trading facilities and systematic internalisers. The MiFID has three main objectives: the establishment of an internal market for investment firms and trading platforms; investor protection; and the transparency of European financial markets.

With the aim of addressing a number of regulatory concerns which came to light as a result of the financial crisis and in view of identified failures in the regulatory framework applicable to investment firms and trading platforms, on 20th October 2011 the European Commission issued a proposal for the revision of the MiFID. The proposal amending the MiFID, is divided into two: [i] a proposed EU Directive ('MiFID II') that partly recasts the MiFID; and [ii] a proposed EU Regulation ('MiFIR') which will replace part of the MiFID. The proposed split of the MiFID level I into a proposed Directive and a Regulation reflects the De Larosière agenda of creating a single rule book in certain areas, whilst allowing national specificities in other.

A number of changes to MiFID are being proposed with the aim of strengthening the investor protection requirements in the Directive. Other changes have the purpose of widening the European regulatory framework to capture new and emerging forms of trading platforms and to ensure that European financial markets become more efficient and transparent. The MiFID is also being amended to fulfil the G20 commitment of requiring OTC derivatives to be traded on exchange.

The European proposals are currently being debated at the level of the Council of the European Union and are also being considered by the European Parliament. A copy of the proposals may be retrieved from the European Commission's web-page.

For any queries on MiFID II, please contact Mr Christopher P. Buttigieg, Deputy Director, Securities and Markets Supervision Unit at MFSA on cbuttigieg@mfsa.com.mt or tel: 25485229.

Source: Malta Financial services Authority

IOSCO publishes principles on suspension of CIS redemptions

On the 19th January 2012, the International Organization of Securities Commissions ('IOSCO') published its final report on principles regarding the suspension of redemptions for open-ended collective investment schemes.

The principles reflect a common level of approach with regards to suspension of redemptions and provide standards against which both regulators and the industry can assess the quality of industry practices concerning suspensions of redemptions.

A copy of the IOSCO principles is available on the web-site.

Most of the principles reflect current regulatory and industry practice in Malta. However, the MFSA encourages the local industry to consider and where relevant, strengthen their internal procedures with a view to implement fully the IOSCO principles.

For any queries on the IOSCO principles, please contact MFSA officials Mr Christopher P. Buttigieg, Deputy Director - SMSU on cbuttigieg@mfsa.com.mt or Mr Jonathan Sammut, Manager - SMSU (jsammut@mfsa.com.mt).

Source: Malta Financial Services Authority

Guidelines by ESMA on Exchange Traded Funds and other UCITS issues

On 30th January 2012, ESMA issued a consultation document entitled "ESMA's Guidelines on ETFs and other UCITS issues" [ESMA/2012/43]. The consultation paper set out ESMA's proposals for guidelines on UCITS ETFs, index-tracking UCITS, efficient portfolio management techniques, total return swaps and strategy indices for UCITS.

This consultation document follows a Discussion Paper which ESMA had issued on the same matter way back in July 2011 and for which responses were encouraged by 22nd September 2011.

In drafting this proposal, ESMA took stock of all the feedback it received following the July 2011 discussion paper which by large generally acknowledged that the issues identified by ESMA should not only target UCITS ETFs but all UCITS that engage in the relevant activity or pursue the same type of investment policy.

For this reason, ESMA decided to widen the scope of its proposals and go beyond ETFs to cover such areas as the use of total return swaps by any UCITS. In this consultation document ESMA is also seeking responses on the requirements for securities lending and collateral management.

The consultation period runs till 30th March 2012 and the document can be downloaded from ESMA's web-site.

Source: Malta Financial Services Authority

• Operations Centre, 80 Mill Street, Qormi QRM 3101 - Malta.
• Telephone: 356 23805100
• Facsimile: 356 23805190

www.mfia.org.mt