The proposed depositary reforms under the AIFM Directive and their impact on Malta's attractiveness as a growing onshore fund domicile

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1. Introduction

It is widely recognised that offshore fund managers are becoming increasingly interested in using onshore European Union (EU) domiciles for their fund structures. This is generally attributed to the fact that retail and institutional investors are, in times of financial and economic turmoil, becoming more prudent and cautious as well as to the fact that previously unregulated investment entities with EU investors are bound to fall within the parameters of the Alternative Investment Fund Managers Directive (the Directive).[1]

The Directive, in fact, seeks to satisfy investors' and fund managers' demands by offering a European regulatory framework that provides comfort, security, robustness and transparency.[2]

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1 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.

2 For a general overview about Directive 2011/61/EU, see A. Luciano, *La direttiva sui gestori di fondi di investimento alternativi,* Contratto e Impresa / Europa, 2011, p. 604, and E. Guffanti, *La direttiva sui fondi alternativi: prime considerazioni,* Società, 10, 2011, p. 1181.

In the run up to the implementation of the Directive and, of course, upon the Directive coming into force in 2013, Malta will discover whether the Directive will boost Malta's chances of benefitting from funds looking to re-domicile (from jurisdictions such as the Cayman Islands or the British Virgin Islands) towards onshore jurisdictions and what impact the Directive will have on Malta's competitive edge as an attractive onshore jurisdiction.

One of the most significant – and equally controversial – measures undertaken by the Directive is depository reform. This article analyses the salient features of the depository reform proposed in the Directive (with particular attention to the European Securities and Markets Authority (ESMA)[3] consultation document issued in July 2012) and the repercussions the reform may have on Malta's growing hedge fund industry.

2. The Directive's proposed depository reform

The Directive seeks to establish a new pan-European legal and regulatory framework for the authorisation and operation of managers of private equity, hedge, real estate and other non-UCITS funds.

The AIFMD requires that all alternative investments funds (AIF or fund) appoint a depositary in addition to the alternative investments fund manager (AIFM or manager).[4]

This is a significant change; while certain jurisdictions[5] required that AIF are required to appoint a custodian to hold the assets of the

3 ESMA is an independent EU Authority that contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection.

4 For an alanisys of the role of the depositary in the context of the Directive 2011/61/EU, see A. Luciano, *La direttiva sui gestori di fondi di investimento alternativi,* Contratto e Impresa / Europa, 2011, p. 623 and E. Guffanti, *La direttiva sui fondi alternativi: prime considerazioni*, Società, 10, 2011, p. 1187. For a general point of view about the depositary bank under the Italian jurisdiction, see L. Enriques, *La banca depositaria*, in *La disciplina delle gestioni patrimoniali*, (a cura di) Assogestioni, p. 172; Assogestioni (a cura di), *Regolamento Banca d'Italia 20 settembre 1999*. Condizioni per l'assunzione dell'incarico di banca depositaria e modalità di sub-deposito dei beni dell'OICR, 1999.

5 One such jurisdiction is Italy. In Malta's case, only professional investor funds promoted to "experienced investors" require the appointment of a custodian. In the case of a professional investor fund promoted to "qualifying investors", although the Malta Financial Services Authority (MFSA) recommends and would ordinarily expect the appointment of a custodian, there is no obligation to appoint one.

fund[6], it has not been the norm in the entire EU. Moreover, under the Directive the depositary is not simply appointed to hold assets and provide custody services, but is also responsible for a range of additional functions including:

(a) ensuring proper monitoring of cash flows, particularly in relation to receipt of payments from investors, but also in relation to transactions undertaken;
(b) verifying ownership of assets (even those not held by it);
(c) ensuring issue and redemption of interests, and valuation of interests, is carried out in accordance with the fund rules;
(d) ensuring consideration for assets is remitted in the usual time frame; and
(e) following the manager's instructions, but also monitoring them in order to refuse to follow instructions which are in breach of law or the fund rules.

Clearly, therefore, the depositary will become a full scale functionary of the fund. The Directive has imposed on depositaries onerous responsibilities to act in the best interests of funds and investors in much the same way as are generally required, and expected, of managers. It is to be noted that there must be a single depositary for each fund rather than splitting the functions.

Rules to be issued in terms of the Directive will prescribe the contents of the depositary agreement and although, after much debate, depositaries are permitted to delegate some of their custody activities (not other functions), there are detailed requirements on the way in which such delegation can be carried out and to whom. Unless these conditions are met in full, the depositary will retain near-strict liability. Conditions generally include objective justification for delegation and

6 As for example in Italy, see M. Lubrano, *Commento all'art. 38*, in G.F. Campobasso (a cura di), *Testo Unico della Finanza,* Commentario, 2002, I, p. 336; A. Colavolpe, *Brevi note sulle condizioni per l'assunzione dell'incarico di banca depositaria di fondi comuni di investimento,* Rivista di diritto privato, 2005, p. 615; A. Colavolpe, *Ruolo e funzioni della banca depositaria dei fondi pensione negoziale e dei fondi pensione aperti,* Previdenza e assistenza pubblica e privata, vol. 4, 2004, p. 1021; M. Bessone, *Fondi pensione aperti. Le imprese auorizzate alla attività, 'Il responsabile del fondo', la banca 'depositaria'*, Diritto della banca e del mercato finanziario, vol. 4, 2001, p. 407; R. Russo, *Banche e fondi di investimento: le funzioni della banca depositaria*, Rivista italiana di ragioneria e di economia aziendale, vol. 1/2, 1984, p. 19.

due care in the choice of delegate, prudential regulation, minimum capital, external audit, appropriate expertise and resources, segregation, compliance with Directive obligations and liability standards, conflicts management, restrictions on reuse of assets and on-going monitoring and review. This is possibly the most controversial single aspect of the proposed reforms.

A distinction is made in the Directive between: (a) financial instruments (a term which is widely defined under the Markets in Financial Instruments Directive (MiFID)[7] which "can be held in custody"; and "other" fund assets.

The former must be held in custody by the depositary or its permitted delegate and the depositary will be fully liable for their loss except in the event of *force majeure* or in the limited circumstances where it has been allowed to transfer this liability to its delegate (in which case the delegate must have direct liability to the fund, manager or the investors).

In relation to "other" fund assets, the Directive imposes an obligation on the depositary to verify ownership to which obligations, like other duties of the depositary, "due skill care and diligence" apply. ESMA has proposed that financial instruments should be included in the scope of the depositary's custody function when they are: (i) transferable securities, money market instruments or units of collective investment undertakings (as defined under MiFID); (ii) not provided as collateral (title transfer collateral agreements or security financial collateral agreement); (iii) registered or held in an account directly or indirectly in the name of the depositary; or (iv) capable of being physically delivered to the depositary. All financial instruments that do not comply with this definition should be considered as "other assets".

The Directive further imposes segregation, control and record keeping obligations similar to those imposed on MiFID investment firms in relation to holdings of cash and assets. In relation to cash it is far from clear how these provisions relate to the normal status of bank accounts held with the depositary itself.

There are restrictions on who can act as depositary. Most specifically, the manager may not act as depositary, although it appears

[7] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC

that a member of its group may do so. A prime broker could be appointed as depositary but only if it has 'functionally and hierarchically separated depositary functions from its tasks as prime broker and potential conflicts of interest are properly identified, managed, monitored and disclosed'[8] to the investors of the fund.

The depositary must be established in the home state of the fund or, in the case of a non-EU fund and subject to certain restrictions, in the third country where the fund is established or the home state of the manager, or the member state of reference of the manager. This, as we shall see further on, may have important consequences on Malta as a hedge fund domicile.

Depositaries must generally be EU authorised banks or investment firms, or similarly authorised and capitalised institutions under prudential regulation and constant supervision.[9] For certain closed ended funds whose core investment policy is to invest in companies so as to obtain control of them, or not to invest in assets that can be held in custody, the Directive allows the appointment of entities which carry out depositary functions as part of their professional or business activities in respect of which they are subject to appropriate professional registration or other regulation and can furnish appropriate financial and professional guarantees. It is hoped that this extension will apply to most private equity and real estate funds.

On July 13, 2011, ESMA published a consultation paper which contains proposed Level 2 measures relating to depositaries[10]. The extent of a depositary's liability, and the circumstances in which it can be relieved of that liability, are central to the degree of cost and burden which will in practice be generated by the Directive's requirements on depositaries. Other key practical issues relate to the precise scope of a depositary's oversight responsibilities and, in particular, whether a depositary would have any pre-transaction clearance powers.

ESMA's advice regarding the depositary can be summarised as set out hereunder.

Article 21(2) of the Directive requires the appointment of a depositary to 'be evidenced by written contract'. In this respect, ESMA

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[8] Directive, art 21(4)(b)

[9] Directive, art 21(3)

10 About, ESMA consultation paper see also A. Luciano, *La direttiva sui gestori di fondi di investimento alternativi*, Contratto e Impresa / Europa, 2011, p. 626

is not proposing to publish a "model agreement"; of course, it is not possible to draft a model agreement or template that would be applicable and neutral to the wide range of situations that may exist under the Directive in terms of legal structures, investment strategies, and the various ownership rights in the different jurisdictions. Instead, The Directive requires the contract to 'inter alia, regulate the flow of information deemed necessary to allow the depositary to perform its functions for the AIF for which it has been appointed as depositary'.[11] ESMA has gone a step further and has indicated the types of issues that should be covered in such an agreement. By way of example, the agreement pursuant to which the depositary is appointed must: (i) include provisions on the depositary's liability and the condition under which it may transfer its liability to a sub custodian; (ii) cater for the possibility of re-using the assets with which it has been entrusted; or (iii) include a description of the types of asset it will have to safe keep; furthermore, the agreement should (iv) require the depositary to be in informed of all cash accounts opened at third parties in the name of the AIF or of the AIFM (acting on behalf of the AIF); and (v) clarify the procedures to be followed in the event that the depositary needs to launch an escalation procedure.

ESMA is consulting on two alternative manners in which the type of assets is identified in order to determine whether such assets are subject to the custody requirement. Such a determination has an important impact on the depositary because, if an asset is considered to be subject to the custody requirement, the depositary shall be subject to "near strict liability" in relation to those assets.[12] ESMA, however, has excluded outright: (a) all securities that are directly registered with the issuer itself or its agents in the name of the fund, and (b) derivative instruments. It is important to note, however, that neither option is free from uncertainty.

As mentioned earlier, the depositary is responsible for a wide range of matters, including ensuring that the fund's assets are appropriately protected and overseeing the fund's activities to ensure compliance with the fund rules. ESMA's advice extends such an oversight obligation, possibly in a more extensive sense than what was originally envisaged in the text of the Directive.

Pursuant to article 21(12), of the Directive, the depositary is subject to "near strict liability", which means that on loss of assets held

[11] Directive, art 21(2)

12 See below about the "near strict liability"

by it on custody, the depositary is obliged to return identical financial instruments or the corresponding amount to the AIF, without undue delay, even if the instruments were held by a sub-custodian. However, the depositary shall not be liable if it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. Equally, where the assets are sub-held, the depositary may be able to contract out of this liability if it has complied with all prescribed obligations in the Directive and there is an 'objective reason' for the delegation. An objective reason exists if the depositary can demonstrate that:

1. it had no other option but to delegate its custody duties to a third party (e.g. as a result of legal constraints); or
2. the AIFM considers that it is in the best interest of the AIF and its investors for the depositary to discharge its liability and has notified the depositary of that assessment in writing).

In the case of "other losses", liability only flows if there is a "negligent or intentional" failure on the part of the depositary to comply with its obligations under the Directive.

Financial instruments should be considered 'lost' if one of the following conditions is met:

(a) a stated right of ownership of the AIF is uncovered to be unfounded because it either ceases to exist or never existed;
(b) the AIF has been permanently deprived of its right of ownership over the financial instruments;
(c) the AIF is permanently unable to directly or indirectly dispose of the financial instruments.

Where an AIF is permanently deprived of its right of ownership in respect of a particular instrument, but this instrument is substituted by or converted into another financial instrument or instruments, for example in situations where shares are cancelled and replaced by the issue of new shares in a company reorganisation, this is not considered to be an example of the loss of financial instruments held in custody.

In case of a fraud whereby the financial instruments have never existed or have never been attributed to the AIF (e.g. as a result of a falsified evidence of title, accounting fraud etc.), all the above mentioned conditions should be deemed to be met.

With respect to a depositary's cash management obligations, ESMA had, in its first consultation paper in 2010, set out two options. The first option, proposing that the depositary acts as a central hub for cash movement, has been removed from its latest advice. This, because ESMA has acknowledged that the depositary is not expected to interfere with an AIF's distribution channel. Depositaries should, however, ensure that cash accounts have been opened with properly authorised entities.

The depositary's supervision, cash management monitoring and oversight responsibilities are generally limited to post-transaction review. Yet, ESMA's consultation paper proposes that the depositary may be entitled to introduce a pre-transaction clearance process in certain circumstances – such as, where the fund invests in less liquid assets or initiates transactions infrequently. ESMA also refers to possibility that the depositary requires the reversal of certain transactions found to be in breach of the fund's investment restrictions and leverage limits. Certainly, each of these proposed powers seem to go beyond what is considered to be necessary under the Directive.

As noted above the depositary shall be subject to near-strict custody liability to return assets held in custody unless they are lost by reason of an external event beyond the reasonable control of the depositary, the consequences of which would have been unavoidable despite all reasonable efforts. ESMA provides some further clarity on the extent of this liability by defining the meaning of 'loss', an 'external event', 'beyond reasonable control' and 'reasonable efforts' to avoid. These proposed definitions are fairly demanding. But when it comes to identifying "objective reasons" for a depositary contractually discharging its liability/responsibilities by transfer to a sub-custodian ESMA's requirements are not very onerous, largely because there are so many other protective provisions and limitations on any such discharge. In other terms, a depository, with a view to latest ESMA's position, will have both (i) full depository's duty in relation to the holding of securities, (ii) custodian's duty in relation to safekeeping of securities and (iii) a number of agent's duties in relation to pre and post-transaction checks.

Furthermore, in its final report, ESMA has confirmed the criteria, indicated in its second consultation paper, for assessing whether the prudential regulation and supervision applicable to a depositary established in a third country with respect to its depositary duties, like capital requirements, eligibility criteria and operating conditions, are

to the same effect as the provisions laid down in European law. The second ESMA consultation paper appears to work on the assumption that any such depositary will be a bank rather than addressing the wider class of persons permitted to act as depositaries in the circumstances described above. In particular, a third country authority should be deemed to be independent if it fulfils the criteria set out in Part II (the Regulator) of the IOSCO Objectives and Principles for Securities Regulation[13] and relevant Methodology,[14] and the Basel Committee Core Principles[15] and the relevant methodology. This does not mean that the assessed authority needs to be member of IOSCO or of the Basel Committee. Instead these criteria will be used as a rule of thumb. The third country competent authority should have power to obtain information and to enforce the relevant requirements under the domestic legislation in the third country.

3. The AIFMD and its impact on the Malta domicile

The Maltese current regulatory framework imposes the requirement to entrust a fund's assets to a custodian for safekeeping only in the case of retail collective investment schemes and professional investor schemes targeting "experienced investors", that is more affluent and sophisticated retail investors with a minimum investment level of just ten thousand euro (€10,000). In such cases, in addition to safekeeping, the custodian must monitor the extent to which the investment manager is compliant with the investment and borrowing restrictions of the fund.

Professional investor funds promoted to "qualifying investors" and "extraordinary investors" are not obliged to appoint a custodian (or a prime broker), although the MFSA recommends, and would ordinarily expect, such an appointment. In fact, in practice, most professional investor funds do appoint a custodian. In this case, the

[13] IOSCO, Objectives and Principles for Securities Regulation (May 2003) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>

[14] IOSCO, Methodology For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation (September 2011) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdf>

[15] Basle Committee on Banking Supervision, Basle Core Principles for Effective Banking Supervision (September 1997) <http://www.bis.org/publ/bcbs30a.pdf>

custodian or prime broker is not required to assume a monitoring function in respect of the activities of the investment manager.

In terms of the Investment Services Rules for Professional Investor Funds[16] issued under the Investment Services Act (Cap. 370, Laws of Malta) (the "Rules"), a professional investor fund may appoint a custodian (or prime broker) established outside of Malta, provided the necessary conditions set out in the Rules are satisfied – generally referred to as 'approved jurisdictions'. This currently gives Malta a certain level of flexibility. As a consequence of this flexibility, there has been exponential growth in the number of hedge funds operating from Malta over the recent years.

The Directive drastically changes this position. The Directive imposes restrictions on the location of the depository and requires an AIF established in Malta, with an AIFM authorised under the Directive, to appoint a custodian established in Malta.

However, it is important to note that, when implementing the Directive, Malta is expected to make use of the transitional provision under the Directive that will allow AIFs established in Malta to appoint a credit institution situated in another member state until 22 July 2017.

The Maltese custody industry is a small one.[17] As at October 2012, the MFSA had licensed two main global custodians (HSBC p.l.c. and Deutsche Bank (Malta) Ltd.) and three smaller custodians concentrating on the smaller end of the scale (Sparkasse p.l.c., a subsidiary of Erste Bank, the Austrian financial institution), Custom House (part of the TMF group) and Mediterranean Bank (owned by Anacap, a US private equity house). JP Morgan is present in Malta through Bank of Valletta p.l.c. which acts in partnership as sub-custodian.[18]

In fact, such a factor has often been considered as one of the reasons why Malta is less popular with the establishment of UCITS in

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[16] MFSA, Investment Services Rules for Professional Investor Funds (issued 17 July, 2007 and last updated 1st December, 2009) <http://mfsa.com.mt/Files/LegislationRegulation/regulation/securities/collectiveInvestmentSchemes/Rules%20for%20PIF/001%20ISR%20-%20PIF%20Introduction%20-%201st%20December%202009.pdf>

17 For a report about the Italian market of the depositary banks, see F. Cesarini, R. Oberti, R. Hamaui, *Il mercato italiano dei servizi di banca depositaria*, Banca impresa società, vol. 3, 2002, p. 367

[18] M Lindsay, *Lack of choice of custodian slows Malta's progress as a European fund jurisdiction* (Hedge Fund Review) (20 Dec 2011) <http://www.hedgefundsreview.com/hedge-funds-review/feature/2133742/lack-choice-custodian-slows-malta-s-progress-european-fund-jurisdiction>

Malta than it is with the establishment of professional investor funds. The presence of more internationally recognised custodians in Malta is a critical factor in Malta's offering.

Attracting custodians to Malta is the 'next major challenge in the investment services space'[19] for the Maltese financial services sector. Malta has, justifiably, concentrated on developing other local services when it first began developing its fund sector. The MFSA is now actively encouraging more custodians to set up in the jurisdiction.

Malta must also promote itself as an attractive jurisdiction for custody services; certainly, the factors that contribute to Malta's attractiveness as a fund jurisdiction equally apply to the establishment custodians in Malta. The jurisdiction's flexible yet robust investment services regulatory framework, its sound infrastructure and the presence of reputable service providers make Malta a jurisdiction of choice for the attainment of a Category 4 investment services licence, that is, the licence required for custodians to be able to offer such services in Malta. The industry expects an increase in the presence of internationally recognised custodians as the volume of custodial business increases.

The Maltese regulatory framework has, in recent years, addressed deficiencies in the treatment of assets under custody in terms of our civil law. The Investment Services Act (Control Of Assets) Regulations (Legal Notice 240 of 1998, as amended) (the Regulations), aligns the position of the custodian to that of trustee, even if a trust relationship is not formally created. The Regulations ensure the segregation of the assets of a fund from the assets of its custodian which, in turn, protect the fund's assets from the custodian's creditors in the event of the custodian's insolvency. Part 4 of the Regulations (dealing with custody of assets of collective investment schemes) also regulate the functions and duties of the custodian, the delegation of functions to a sub-custodian, the independence of the custodian from the management of the AIF, as well as fiscal aspects where the delivery of the assets to the custodian will not be deemed to constitute a 'chargeable transfer' in terms of the Duty on Documents and Transfers Act (Cap. 364, Laws of Malta) and the Income Tax Act (Cap. 123, Laws of Malta).

In terms of the Regulations, a custodian (or sub-custodian) is liable for 'any loss or prejudice suffered by the manager, the scheme or

[19] Ganado, M. 'Custodial operations in Malta: Current opportunities' Journal of Securities Operations & Custody Volume 3 Number 3 (20 September 2010)

the holders of units or participants in the scheme due to the custodian's fraud, wilful default or negligence including the unjustifiable failure to perform in whole or in part the custodian's obligations' arising under the Regulations, the terms and conditions of the custody agreement, the deed or other instrument establishing or regulating the AIF or the conditions of the AIF's licence.[20] The custodian however will not be liable for any 'loss or prejudice suffered by the scheme or the holders of units or participants in the scheme as a result of the acts or omissions of the manager except where and to the extent that the custodian has failed to perform its functions and duties'.[21] The level of depositary liability introduced by the Directive goes beyond the current position at law and places additional pressure on the custodian's relationship with the other service providers to the fund. Custodians would need to work closely with other service providers; custodians will expect such service providers, especially administrators, to provide their services at excellent professional standards. This enforces the argument that Malta must continue to attract high quality and internationally recognised service providers to further improve the country's offering.

Another consequence on Malta's attractiveness to AIFs is the increase in costs relating to the engagement of the depositary. Hedge funds operating in Malta frequently attribute their decision to move their fund structures onshore to Malta to its relatively low cost for the establishment and maintenance of fund structures, especially smaller start-up funds.

The Directive, in particular the introduction of depositary's loss of assets liability, will certainly lead to an increase in a range of costs. The depositary function, and the imposition of substantial obligations has led to an unnecessary and costly duplication of many of the functions of the manager that, in the context of funds targeting professional investors only, seems difficult to justify. The proposed reforms will create a contingent risk since they would be required to additional capital against potential loss. The new monitoring and reporting obligations are an additional burden. Also, the legal and hierarchical separation between prime brokers and depositaries will add a further level of complexity to custody service charges and requiring new tri-party contracts to be drawn up. In all likelihood,

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[20] Investment Services Act (Control Of Assets) Regulations, Reg. 19(1)

[21] Investment Services Act (Control Of Assets) Regulations, Reg. 19(2)

depositaries will pass most of these costs on to the AIFMs including a premium to reflect their additional liability.[22]

It remains to be seen whether this will affect Malta's competitive edge over other established – and more costly – jurisdictions. Alternatively, as the costs for depositary services rise, managers may become more conscious and seek to establish their fund structures in Malta.

In this respect, also due to the fact that pursuant to the implementation of the Directive, investment funds domiciled in Malta should benefit from the pan-European passport offered to professional investor funds.[23] Malta's cost-competitiveness and flexibility should appeal to managers looking for a viable and attractive alternative to other EU fund domiciles such as Ireland and Luxembourg.

It is likely that the Directive will inspire a number of re-domiciliations from offshore jurisdictions to Malta. In fact, experience shows that a number of fund platforms have done so over the past few years. The Maltese legislative framework for re-domiciliations, the Continuation of Companies Regulations (Legal Notice 344 of 2002, as amended), has been in existence since 2002 and has proved to be an extremely beneficial tool. Maltese law provides a relatively straight forward process and permits re-domiciliation of legal entities from all EU, EEA and OECD member states as well as a number of offshore fund jurisdictions such as the British Virgin Islands, The Cayman Islands, and The Channel Islands.

4. Concluding Remarks

As fund managers re-evaluate their domiciliation options, one can safely remark that the Directive will present itself as an opportunity to the Maltese jurisdiction.

The popularity of offshore fund destinations is waning in recent years as investors are favouring onshore environments for their investments.

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[22] Ernst & Young, *View point: AIFMD: Get ready for European depositary reform* (March 2012) p. 2

23 About the European passport, see E. Guffanti, *La direttiva sui fondi alternativi: prime considerazioni*, Società, 10, 2011, p. 1192

Malta's unique success factor, in being a stable jurisdiction with a firm but flexible regulatory regime, a relatively low general cost, an efficient fiscal regime as well as an approachable and business-oriented MFSA, serves to attract offshore fund managers as well as custodians seeking to establish a presence in Malta to tap into the growth witnessed by the jurisdiction. Moreover, as an EU Member State, Malta offers the perfect stepping stone into Europe through which AIFMs may passport their services and funds to the rest of the EU.

One should also keep in mind Malta's proximity to the Middle East and North Africa, in respect of which region Malta could act as a centre for Shariah-compliant funds.

The Directive will therefore present itself more as an opportunity rather than a threat to the Maltese jurisdiction – at least until 2017 when Malta's opt-out from the local depositary requirement expires. Until then, however, Malta should focus on attracting and increasing the presence of custodians in order to fully take advantage of the opportunities presented by the Directive and to enforce its competitive position vis-à-vis other European fund jurisdictions.