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Investment Funds

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GTG Advocates includes investment funds, investment services, insurance and captives, financial institutions, credit institutions and pension schemes among its primary practice areas within the financial services sector. Dr Ian Gauci is the partner in charge of the financial services and FinTech team, which is composed of eight individuals at the following levels: two partners, one senior associate, three junior associates and two trainees. Other practice areas that relate to the investment funds sector in which GTG Advocates is highly active are competition law, corporate and commercial law, capital markets, blockchain and virtual currencies, litigation and ADR, and consumer law. The firm's offices are located in Valletta.

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1. Fund Formation

1.1 Formation of Investment Funds

The investment funds and asset management industry is one of Malta's main growth areas as a finance centre.

As at the end of 2017, over 670 funds (including sub-funds) were registered in Malta. Of these, more than 60% were Professional Investor Funds (PIFs), with the remaining being largely Undertakings for Collective Investment Schemes in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs) and a small number of Retail Non-UCITS and Notified AIFs.

The net asset value of Malta domiciled funds at the end of this period was calculated at EUR10.8 billion.

Traditionally, Malta has held a reputation as a jurisdiction for smaller financial services companies. However, over the years it has emerged as a jurisdiction of choice for bringing new funds to the market.

1.2 Raising Capital from Investors

Although no specific statistics are available, owing to the size of the Maltese population and bearing in mind the number of funds registered in Malta, it can be said that the majority of investors raising capital through the investment funds set-up in Malta are international clients.

1.3 Common Process for Setting Up Investment Funds

Depending on the type of legal structure chosen to set up the investment fund in Malta, different procedures and documents are required at set-up stage. One must also determine whether the investment fund will be a single legal entity or be set up as a multi-fund structure.

UCITS
The UCITS regime in Malta is based on the EU's UCITS Directive.

UCITS established in Malta must be authorised and licensed by the Malta Financial Services Authority (MFSA) to operate. The approval process for setting up a UCITS can be divided into three phases.

Preparatory phase
During this phase a detailed proposal is submitted and discussed with the MFSA on the proposed activities and terms of the fund to be licensed. The promoters subsequently submit the draft application documents to be reviewed by the MFSA, including an assessment on the fitness and properness of the applicant. The application documents to be submitted include:

(a) an application form;
(b) an application fee;
(c) a near final draft prospectus including relevant offering supplements of the UCITS;
(d) a near final draft of the memorandum and articles of association/partnership deed/trust deed/fund rules (as applicable);
(e) a resolution from the board of directors/general partners/management company;
(f) the Personal Questionnaire filled in by the UBOs and relevant officers of the AIF together with all supporting documentation and declarations; and
(g) draft investment management agreement, depositary agreement and administration agreement.

If the UCITS is internally managed, the following additional documents must be submitted:

(a) information including the Personal Questionnaire and supporting documentation and declarations of the individuals responsible for the portfolio management function and risk management function;
(b) a near final investment committee terms of reference;
(c) confirmations from the portfolio managers and investment committee;
(d) portfolio delegation agreement and/or risk management delegation agreement (if applicable); and
(e) a near final risk management policy.

Pre-licensing phase
When all the review points raised by the MFSA at the preparatory phase have been resolved, the MFSA will issue an approval 'in principle' for a licence. At this stage, the promoters are required to finalise any outstanding matters and submit signed final application documents.

Post-licensing/Pre-commencement of business phase
If the MFSA determines that the applicant must meet any post-licensing requirements, these must be satisfied prior to commencement of business.

AIF
The AIF regime in Malta is based on the Alternative Investment Fund Managers Directive (AIFMD), duly transposed under the Maltese Investment Services Act.

An AIF established in Malta must be authorised and licensed by the MFSA to operate. The approval process for setting up a new AIF can be divided into three phases:

Preparatory phase
During this phase a detailed proposal is submitted and discussed with the MFSA on the proposed activities and terms of the fund to be licensed. The promoters subsequently submit the draft application documents to be reviewed by the MFSA, including an assessment on the fitness and properness of the applicant. The application documents to be submitted include:

(a) an application form;
(b) an application fee;
(c) a near final draft of the offering document or marketing document;
(d) a near final draft of the memorandum and articles of association/partnership deed/trust deed/fund rules (as applicable);
(e) a resolution from the board of directors/general partners/management company; and
(f) the Personal Questionnaire filled in by the UBOs and relevant officers of the AIF together with all supporting documentation and declarations.

If the AIF is internally managed, the following additional documents must be submitted:

(a) information including the Personal Questionnaire and supporting documentation and declarations on the investment committee members;
(b) investment committee terms of reference;
(c) confirmations from the portfolio manager and investment committee;
(d) portfolio and risk delegation agreements (as applicable);
(e) a risk management policy document;
(f) a business plan; and
(g) a copy of the cover note to the insurance policy if the AIF intends to cover potential professional liability risks by way of professional indemnity insurance.

Pre-licensing phase
When all the review points raised by the MFSA at the preparatory phase have been resolved, the MFSA will issue an

approval 'in principle' for a licence. At this stage, the promoters are required to finalise any outstanding matters and submit signed final application documents.

Post-licensing/Pre-commencement of business phase
if the MFSA determines that the applicant must meet any post-licensing requirements, these must be satisfied prior to commencement of business.

PIF
The PIFs regime in Malta is aimed towards those investors that qualify as professional in nature. Because they are not intended for the general public, PIFs are deemed to have a flexible regulatory regime.

A PIF established in Malta must be authorised and licensed by the MFSA to operate. The approval process for setting up a new PIF can be divided into three phases:

Preparatory phase
During this phase a detailed proposal is submitted and discussed with the MFSA on the proposed activities and terms of the fund to be licensed. The promoters subsequently submit the draft application documents to be reviewed by the MFSA, including an assessment on the fitness and properness of the applicant. The application documents to be submitted include:

(a) an application form;
(b) an application fee;
(c) a near final draft offering document or marketing document;
(d) a near final draft of the memorandum and articles of association/partnership deed/trust deed/fund rules (as applicable);
(e) a resolution from the board of directors/general partners/management company; and
(f) the Personal Questionnaire filled in by the UBOs and relevant officers of the PIF together with all supporting documentation and declarations.

Where the PIF is internally managed or self-managed, the following additional documents must be submitted:

(a) information including the Personal Questionnaire and supporting documentation and declarations of the individuals responsible for the asset management function of the PIF;
(b) investment committee terms of reference;
(c) confirmations from the portfolio manager and investment committee; and
(d) a portfolio delegation agreement (if applicable).

Pre-licensing phase
when all the review points raised by the MFSA at the preparatory phase have been resolved, the MFSA will issue an

approval 'in principle' for a licence. At this stage, the promoters are required to finalise any outstanding matters and submit signed final application documents.

Post-licensing/Pre-commencement of business phase
if the MFSA determines that the applicant must meet any post-licensing requirements, these must be satisfied prior to commencement of business.

The Notified AIFs regime allows fund promoters to launch their investment vehicle in only ten working days. The NAIF is not subject to the three different licensing phases of the investment funds but it is still subject to a notification process. Thus, the AIFM must first submit a written request for the AIF, and its sub-funds (if any), to be included in the list of Notified AIFs. This may only be done if the governing body of the AIF has approved a resolution certifying that the Prospectus of the AIF satisfies the minimum criteria prescribed by the MFSA. The AIFM then submits the duly completed notification together with the accompanying documents within 30 calendar days from the date of the resolution and prior to the effective date of the prospectus. The MFSA then has ten working days from the date of filing to include the AIF in the List of Notified AIFs.

1.4 Regulation of Fund Structures
The management company passport under the UCITS IV Directive (Directive 2009/65/EC) ended the requirement that the investment fund management company needs to be established in the same country in which the UCITS is established. A Malta-based UCITS can thus be managed by a foreign management company or vice versa. This change, together with the adoption of the AIFMD has presented Malta as a particularly attractive jurisdiction for fund management and fund administration as well.

Indeed, as at June 2017, 30.2% of licensed funds in Malta were managed outside of Malta, while 29.9% were managed in Malta. The rest were self-managed.

On the other hand, as at the same date, 86.2% of funds were administered in Malta.

1.5 Limited Liability
Depending on the legal form and structure adopted in setting up an investment fund, investors may benefit from limited liability. Where a fund is set up as an Investment Company with Variable Share Capital (SICAV) or an Investment Company with Fixed Share Capital (INVCO) the company would be set up as a private or a public limited liability company. On the other hand where the fund is set up as a partnership en commandite or a limited partnership, the partnership would have its obligations guaranteed by the unlimited and joint and several liability of one or more partners (termed as general partners) and by the liability, limited to the amount, if any, unpaid on their contribution, of one or more partners

(termed as limited partners). As a general rule, at least one of the general partners in limited partnerships must be either an individual or a body corporate which has its obligations guaranteed by the unlimited and joint and several liability of one or more of its members. In the case of limited partnership funds, however, this does not apply and the general partner may be a limited liability company.

Although less popular in Malta, investment funds may also be set up in the form of a Unit Trust or a Common Contractual Fund. These types of structures do not have separate legal personality. Nevertheless, the Investment Services Act (Contractual Funds) Regulations contemplate the limitation of liability of unit-holders to their agreed contribution.

1.6 Common Tax Regimes

Maltese tax law contemplates a special tax regime applicable to investment funds. These specific rules create a number of opportunities for tax mitigation.

Maltese Income Tax law distinguishes between two different types of investment funds: prescribed funds and non-prescribed funds. Non-prescribed funds offer more fiscally advantageous benefits than prescribed funds.

Investment funds in Malta are also subject to specific tax accounting rules. In particular, unlike most companies, investment funds do not allocate profits to the foreign income account. Furthermore, profits resulting from dividends distributed out of the foreign income account of another company are allocated to the investment fund's Maltese taxed account.

1.7 Investment Sponsors

Although no official figures have been issued by the relevant authorities, it can be said that, particularly in view of Malta's prominence as a financial centre, the majority of those seeking to establish investment funds in Malta are not themselves based in Malta. Similarly, most of the investment itself by these funds is not done in Malta.

The Maltese investment funds regime is also particularly attractive to set up Shariah-Compliant Funds, having specific guidelines for these types of funds.

1.8 Disclosure Requirements

In the case of a Maltese UCITS, it is required to draw up a prospectus which must be approved by the MFSA, a Key Investor Information Document (KIID) including information on the essential characteristics of the UCITS, annual reports (for each financial year) and half-yearly reports. Where a Malta UCITS markets its units in a host member state, it must provide the information or documents to investors in the host member state, according to its laws and regulations. Any changes to the prospectus need to be pre-approved by the MFSA while keeping investors informed of any material changes thereto.

In the case of AIFs, these must issue an offering document which must have sufficient information to enable investors to make an informed decision, particularly taking into consideration the risks related thereto. The MFSA has also outlined specific information that needs to be made available to investors, whether in the offering document or through a separate information sheet. Furthermore, investors must periodically be kept updated on:

- the percentage of the AIF's assets which are subject to special arrangements arising from their illiquid nature;
- any new liquidity management arrangements;
- the current risk profile and risk management systems employed to manage those risks; and
- if the AIF employs leverage, they must be informed of any change to the maximum level of leverage permitted as well as any re-hypothecation rights or any guarantee granted under the leveraging arrangement and the total amount of leverage that it employs.

Similarly, PIFs must also provide investors with an offering document which must provide sufficient information to enable a potential qualifying investor to make an informed investment decision and, in particular, to assess the risks attached thereto. The offering document should include information such as the fund's investment strategy, objectives and details of how any changes may be implemented, the main legal implications of the investment contracts and valuation procedures.

NAIFs must submit a prospectus for approval to the MFSA in order to be added to the list of Notified AIFs. Specific information must also be disclosed to investors in line with the AIFMD.

1.9 Legal Forms

Investment funds can take various legal forms depending on the objectives of the fund.

Open-ended investment companies (SICAV's)

The main objective of the SICAV is the collective investment of its funds in securities or other movable and immovable property with the aim of spreading risk and giving unit-holders the benefits of the results of fund management. The SICAV may be constituted as a multi-fund company and even as Incorporated Cell Companies.

Closed-ended investment companies (INVCOs)

The main purpose of the INVCO is very similar to that of the SICAV. However, the INVCO cannot hold more than 15% of its investment in companies that do not qualify as INVCOs. The company may not distribute its capital profits and may not retain more than 15% of its income from secu-

rities. Similar to the SICAV, the INVCO can also operate as an umbrella fund.

Limited partnerships
Similar to the SICAV and INVCO, the limited partnership structure also offers separate legal personality. The partnership's obligations are guaranteed by the unlimited and joint and several liability of its general partner(s), and the liability of the limited partners, which is, however, limited to the amount still unpaid of their contribution. A limited partnership may also be set up as a multi-fund or a multi-class structure.

Unit trusts
this is an investment fund that is constituted by a trust deed. This structure allows investors to participate as beneficiaries under the trust in any profits or income that may arise from the acquisition, holding, management or disposal of any property under the trust. The Unit Trust structure does not benefit from separate legal personality; as such it does not have the capacity to enter into contracts and it cannot itself be sued. Instead, it is the manager and/or the trustee who may be sued in relation to the management, compliance and custody functions of the trust.

Common contractual fund
this is an investment fund under which the unit-holders participate and share in the property of the fund as evidenced by units issued by the manager. A contractual deed may be constituted through a public deed or a private writing and it may be set up as either an open-ended or a closed-ended scheme. However, the common contractual fund does not have a legal personality and its property is represented by freely transferable units. In these cases, the liability of the unit-holders is limited to the amount agreed to be contributed by each unit-holder to subscribe for units in the scheme.

The SICAV structure is one of the more popular formats used to set up an investment fund in Malta. It is commonly used to set up a UCITS but remains the vehicle of choice for other fund types. INVCOs and limited partnerships can also be similarly used. Unit trusts are mainly used for retail funds as they allow for the sale of separate units, while contractual funds can also be used to set up private investment funds.

1.10 Regulatory Status
Investment funds in Malta are categorised as retail and non-retail funds. Retail investment funds are aimed at retail investors and generally take into consideration the need for added investor protection required for retail investors. These primarily comprise UCITS and retail AIFs. Non-retail investment funds on the other hand are aimed at professional investors, and thus exclude retail investors. These in turn comprise PIFs, non-retail AIFs and NAIFs.

One can also consider the concept of private funds which are neither retail nor non-retail in nature. In this case, the investment fund is required to be private in nature, having not more than 15 individuals, and it must not qualify as a PIF.

1.11 Legal, Regulatory or Tax Legislative Changes
In 2018, the MFSA introduced supplementary conditions applicable to PIFs investing in virtual currencies. The aim of these additional rules was to provide a robust regulatory framework to ensure investor protection, market integrity and financial soundness with regards to investment funds that invest in virtual currencies.

Following the coming into force of the Virtual Financial Assets Act in Malta which regulates a particular class of virtual currencies classified as Virtual Financial Assets (VFAs) under the Act, these supplementary conditions are expected to be amended so as to refer to PIFs that invest in VFAs rather than virtual currencies. The term 'virtual currencies' remains undefined under Maltese law.

Furthermore, the MFSA has discussed the prospect of extending the possibility for investment funds to invest in VFAs to AIFs as well, although to date no adoption documentation has been issued by the authority in this regard.

2. Fund Investment

2.1 Types of Investors
Maltese investors generally tend to be retail investors.

2.2 Legal, Regulatory and Investment Structures
The traditional Maltese investor is typically risk-averse, opting to invest in low to medium-risk investment funds, more typically, UCITS. This, however, has not had a major impact on the type of investment funds set up in Malta. Indeed, the majority of investment funds set up are PIFs. These are commonly used for hedge fund structures and their underlying assets can range from transferable securities, private equity, immovable property and infrastructure, to more complicated asset classes including debt-financing and derivatives. Through amendments adopted in 2018, PIFs are the only type of Malta-based fund that can invest in virtual currencies that qualify as VFAs under the relevant Maltese legislation.

2.3 Restrictions on Investors
Investment funds in Malta are not all suitable for all types of investors and this difference is primarily categorised by having retail and non-retail investment funds. The investment funds themselves may be subject to restrictions on the permissible investment instruments, including specific requirements on diversification and borrowing. From an investor point of view, while there are no restrictions for UCITS, AIFs (non-retail) may only target professional investors, similar

to PIFs and NAIFs. In order to be classified as a qualifying investor to invest in PIF's, one must:

- invest a minimum of EUR100,000, or its currency equivalent;
- declare in writing to the manager and the investment fund that he is aware of and accepts the risks associated with the proposed investment; and
- satisfy at least one of the following:
  - (e) be a body corporate with net assets in excess of EUR750,000 or the currency equivalent;
    - (i) be an unincorporated body of persons with net assets in excess of EUR750,000, or the currency equivalent;
    - (ii) be a trust where the net value of the trust's assets is in excess of EUR750,000, or the currency equivalent;
    - (iii) be an individual whose net worth or joint net worth with that of a person's spouse exceeds EUR750,000, or the currency equivalent; or
  - (f) be a senior employee or a director of a service provider to the PIF.
  - (g) The MFSA has also deemed that, due to the risk borne by certain types of investment funds, these should be limited to professional investors. These include investment funds authorised to invest through loans, real estate investment funds and funds investing in virtual currencies.

2.4 Marketing Restrictions

Investment funds may be marketed to certain classes of investors depending on the fund category under which they fall. Thus, retail funds such as UCITS and retail AIFs may be marketed to any type of investor. AIFs, PIFs and NAIFs on the other hand may only be marketed to professional investors and/or qualifying investors as applicable. In view of their limited nature, private investment funds are not generally marketed since their total number of participants is limited to 15 persons.

3. Regulatory Environment

3.1 Regulatory Regime

A distinction needs to be drawn between UCITS Managers and AIF Managers. In both cases, these need to be licensed by the MFSA under Maltese law.

The UCITS Manager may be licensed to conduct different activities including investment management and administration, management of portfolios of investments, investment advice and safekeeping and administration of units. The AIFM's functions include portfolio management and risk management in relation to the AIF being managed as well as activities related to the assets of the AIF, primarily services necessary to meet the fiduciary duties of the AIFM, facilities management, real estate administration activities, advice to undertakings on capital structure, industrial strategy and related matters.

The fund manager is expected to comply with specific conduct of business rules and being effectively directed and managed by at least two individuals to satisfy the dual control principle. It must also have an investment committee with a minimum of three members, a portfolio manager (this function may be outsourced by the AIFM), a risk manager (this function may also be outsourced by the AIFM), a money laundering reporting officer, a compliance officer and an auditor.

3.2 Territorial Reach of Regulators

Following the implementation of the UCITS IV Directive and the adoption of the AIFMD, fund managers registered in another jurisdiction can more easily provide services to a fund domiciled in Malta. The management company passport under the UCITS IV Directive ended the requirement that the management company needs to be established in the same country in which the UCITS is established. The AIFMD has also facilitated the process whereby a European AIFM may manage a Maltese AIF directly in Malta. Both of these types of fund managers are required to undergo the Notification Procedure with the MFSA and obtain the authority's approval prior to commencing activities in Malta.

3.3 Regulatory Approval

If an investment fund is marketing or promoting its units in Malta, whether directly or through intermediaries, this would be deemed to be "carrying on an activity in Malta" in terms of the Investment Services Act and would thus require a licence prior to marketing or promoting these units in Malta.

Where a PIF is established outside Malta, it would require a licence to obtain a listing on a Maltese regulated market or if it undertakes any licensable activity, such as managing itself in or from Malta.

3.4 Authorisation of Marketing Activities

The marketing of units in an investment fund qualifying as a UCITS or an AIF is primarily regulated by the relevant EU Directives. These benefit from the European passporting regime available to licensees. Investment funds that do not benefit from this passporting regime are required to hold a Collective Investment Scheme Licence in Malta prior to actively marketing their units in Malta, whether directly or through intermediaries. The marketing of PIFs does not benefit from the same passporting regime and is subject to the Maltese National Private Placement Regime.

The UCITS Directive provides a harmonised passporting regime whereby a UCITS authorised in any EU member

state (the home member state) may be marketed to investors in another member state (the host member state) following notification to the host member state's competent authority. European UCITS schemes wishing to actively market or promote their units in Malta are exempt from the requirement to hold a Collective Investment Scheme Licence in Malta, provided that they follow the necessary notification procedure. If a UCITS is sold exclusively on a one-to-one basis to Maltese residents by licence holders or companies passporting into Malta, the investment fund is not deemed to be marketing its units in Malta and is thus not required to follow the notification procedure. Likewise, when an investor in Malta requests and is provided with information (including marketing material) on a European UCITS Scheme, no marketing is deemed to take place in Malta and thus no notification needs to be submitted.

The AIFM Directive defines "marketing" as the "direct or indirect offering or placement at the initiative of the AIFM or on behalf of the AIFM of units or shares of an AIF it manages to or with investors domiciled or with a registered office in the EU". Thus, "reverse solicitation" or "passive marketing" does not constitute "marketing" within this definition. Similar to the UCITS regime, EU-domiciled AIF's benefit from the EU passporting mechanism under the Directive. EU-authorised AIFMs thus have a passport to freely market EU-domiciled AIFs to professional investors. The AIFM must thus submit a notification to the competent authority in the home member state, which in turn may transmit this form to any other EU member state where the units of the AIF will be marketed. Once the authorisation has been granted in one member state, there is no need for the AIFM to seek further authorisation in other member states. A similar notification process is required when marketing third-country AIFs to professional investors.

Where any AIFM wishes to market AIFs to retail investors in Malta, it must obtain prior authorisation from the MFSA. The MFSA may impose stricter requirements on a case-by-case basis.

3.5 Investor-Protection Rules

Apart from the general restrictions borne from the difference between retail and non-retail investment funds, the MFSA has also categorised certain fund types as high risk, and thus not being suitable for retail investors. Thus, in the case of investment funds authorised to invest through loans, real estate investment funds and funds investing in virtual currencies, these may only be marketed to professional investors. In the former two cases, these may be set up either as PIFs or as AIFs targeting qualifying investors. An investment fund investing in virtual currencies may only be set up as a PIF.

3.6 Approach of the Regulator

The MFSA, Malta's financial regulator, has specific timeframes for the approval of licence applications for financial services, including for investment funds. The incorporation of an entity in Malta can be done within a matter of days. The authority takes a diligent, risk-based approach to each licence application and applicants are invited to discuss their licence application with the authority in the pre-application stage and on an ongoing basis during the application process, should the need arise. The MFSA is well known for having an open-door policy and this has helped ensure it can provide the necessary guidance to operators seeking to be regulated under the Maltese regime and thus leading to Malta's growth as a financial services centre.

The authority is approachable and offers face-to-face meetings with international companies seeking to operate from Malta. This type of level of access is generally rare to find in other finance centres. The MFSA establishes constructive working relationships with companies investing in Malta, which helps ensure a smoother start up and full compliance with all regulatory standards.

4. Fund Finance

4.1 Access to Fund Finance

The local regulator has established specific rules applicable to investment funds (including their sub-funds) that are established to carry out investments through loans.

More specifically, these are investment funds which, as a significant part of their investment objective or strategy, aim to, directly or indirectly through SPVs, (i) grant or issue loans to borrowers as lender of record (Loan Origination) or (ii) acquire one or more loans or portfolios of loans under arrangements where the Fund (or its SPV) becomes the new lender of record (Acquiring Loans).

The term 'Loan Origination' consists in the granting or issuing of a loan or credit as lender or co-lender to a third party as borrower. Trade finance, including forfaiting, is deemed to constitute a lending activity, while an investment fund is considered to fall outside the scope of Rules if its exposure to a borrower is exclusively as co-lender in a loan syndicate where the lead arranger and lender is a credit institution or other financial institution that is authorised and regulated to undertake lending activity.

On the other hand, the term 'Acquiring Loans' is interpreted as the acquisition (whether by novation or assignment) of one or more loans or portfolios of loans (whether from an originator or on the secondary markets) which gives rise to a direct legal relationship between the investment fund as the lender and the borrower(s).

The Rules are designed to apply to funds whose investment objective or strategies include direct lending or the acquisition and subsequent management of loans or portfolios of loans, as a means of generating an investment return or gain for the fund and its investors. The term 'lending' is not deemed to include investing in or acquiring transferable securities nor efficient portfolio management or treasury management techniques.

The MFSA Rules also allow investment funds to borrow funds, subject to certain restrictions applicable particularly to UCITS, non-UCITS and retail AIFs.

4.2 Borrowing Restrictions/Requirements

The MFSA has devised uniform rules for the establishment and marketing of investment funds established with the aim to invest through loans. The fund must be structured as a closed-ended fund, with a duration that is sufficient to cover the life cycle of the loans granted. Fund managers thus structure these types of funds either as PIFs or AIFs. The investment fund is not allowed to short-sell any securities. There are also certain restrictions in terms of the amount of each investment type. Thus, the fund may invest up to 30% of its assets in liquid securities and may not invest more than 10% of its capital in a single undertaking. No more than 10% of its capital may be invested in units or shares in another loan fund, provided that the fund abides by the same investment restrictions. The fund may also not acquire more than 25% of the units or shares of a single loan fund.

The investment fund may borrow cash provided that this borrowing fulfils specific conditions. It must:

- consist of short-term borrowing to bridge drawdown commitment dates or serve the purpose of acquiring units or shares in the fund's investments in terms of the fund's offering documents;
- represent not more than 30% of the capital of the investment fund;
- be contracted in the same currency as the assets to be acquired with the borrowed cash;
- not hinder the realisation of any asset held in the portfolio of the fund; and
- not encumber the assets held in the portfolio of the investment fund.

It is also important to note that the use of leverage and the re-use of collateral by the investment fund are not permitted.

These types of investment funds are to be marketed exclusively to professional investors and/or investors who, on request, elect to be treated as professional clients and who commit to investing a minimum of EUR100,000.

Furthermore, a number of borrowing restrictions apply to UCITS funds, non-UCITS funds and retail AIFs. When a UCITS is structured as an investment company it cannot borrow funds. However, it can acquire foreign currency through a 'back-to-back' loan. The MFSA provides a derogation whereby a UCITS can borrow if this is (i) on a temporary basis and represents for an investment company, no more than 10% of its assets or for a common fund, no more than 10% of the value of the fund; or (ii) to enable the acquisition of immovable property that is essential for the direct pursuit of its business and represents, in the case of an investment company, no more than 10% of its assets.

In these cases, the fund cannot borrow more than 15% of its asset value.

A non-UCITS investment fund can only borrow up to a maximum of 10% of either its assets, when set up as an investment company or limited partnership; or the value of the fund, when set up as a unit trust or common contractual fund.

In these cases, the borrowing can only be made on a temporary basis and the fund's overall risk exposure must not exceed 110% of its assets under any circumstances. In addition, the fund can acquire foreign currency by means of a 'back-to-back' loan. Foreign currency obtained in this manner is not classified as borrowing, provided the offsetting deposit both is denominated in the base currency of the fund and equals or exceeds the value of the foreign currency loan outstanding.

Retail AIFs can borrow up to a maximum of 10% of their assets, when set up as an investment company or limited partnership, or 10% of their value, when set up as a unit trust or common contractual fund.

The borrowing must be on a temporary basis and must be such that the AIF's overall risk exposure does not exceed 110% of its assets under any circumstances. Furthermore, the AIF can obtain foreign currency through a 'back-to-back' loan and this will not be classified as borrowing, provided the offsetting deposit both is denominated in the base currency of the AIF and equals or exceeds the value of the foreign currency loan outstanding.

4.3 Securing Finance

The majority of investment funds targeting Maltese investment are generally funded directly by the investors themselves. Investment funds may also make use of an overdraft facility on the cash account for liquidity purposes.

4.4 Common Issues in Relation to Fund Finance

Investment funds seeking funding may at times face requests for excessive collateral.

5. Tax Environment

5.1 Tax Framework

Maltese income tax law distinguishes between two different types of investment funds: prescribed funds and non-prescribed funds. Non-prescribed funds offer more fiscally advantageous benefits than prescribed funds.

An investment fund is deemed to be a prescribed fund where it is a fund of a Malta-based scheme that has declared that the value of the assets situated in Malta allocated to that fund is at least 85% of the value of the total assets so allocated and in the case of a fund that has been granted a collective investment scheme licence, the value of the assets situated in Malta that will be allocated to that fund for its operations is expected to be at least 85% of the value of the total assets that will be so allocated.

Thus, a prescribed fund is deemed to be an investment fund that invests wholly or mainly in assets situated in Malta. Investment funds that do not fall within these criteria may apply to be classified as a non-prescribed fund. Indeed, the relevant tax rules provide that a fund in an overseas-based scheme is to be treated as a non-prescribed fund.

Non-prescribed funds benefit from an exemption from tax on the income other than income from immovable property situated in Malta and investment income as defined under the Maltese Income Tax Act. The term 'investment income' under the Act refers to income that falls to be accounted for by that investment fund as profits of a prescribed fund and that is not paid by another investment fund. Since non-prescribed funds, by their definition, do not principally hold immovable property situated in Malta and Maltese investment income, the income of a non-prescribed fund can generally be said to be wholly or mainly exempt from tax in Malta. In this case, this exempt income is allocated to the untaxed account of the non-prescribed fund. Thus, in practice, distributions are taxed at the withholding tax rate of 15% only when made to recipients, resident individuals or a non-resident person (including a non-resident company) that is owned and controlled by, directly or indirectly, or who acts on behalf of, an individual who is ordinarily resident and domiciled in Malta. Other distributions are not taxed.

On the other hand, most of the income of a prescribed fund is not so exempt. By default, a prescribed fund is taxed at the rate of 35%. However, other rates of tax may apply depending on the investment fund's income streams. When a payor of investment income (as defined above) pays investment income to an investment fund, a 15% tax rate applies on interest payable by a person licensed as a banking institution under the Maltese Banking Act, while a tax rate of 10% applies to any other investment income. Furthermore, when investment income (as defined) consisting in interest is paid to an investment fund, it is treated as investment income, only to the extent that it falls to be accounted for by that investment fund as profits of a prescribed fund and it is not paid by another investment fund. In the case of prescribed funds, profits are not allocated to the Foreign Income Account. Normal distribution rules would apply to distributions from other accounts.

Where an investment fund is not established as a company, it is still treated as a company for certain purposes. When an investment fund, which is not set up as a company, distributes profits to non-tax-exempt Maltese resident investors, tax is withheld as though the investment fund was constituted as a company. In this case, tax is deducted from every distribution of profits which would have been allocated to the untaxed account if the investment fund were constituted as a company.

An investment fund does not have the right to elect to be paid investment income without a deduction of tax being made. Furthermore, no refund may be made to an investment fund in respect of tax withheld in accordance with the investment income provisions from investment income paid to that fund. No refund may also be made in respect of tax which a company has deducted or is entitled to deduct from any dividend paid to an investment fund.

5.2 Tax Treaty Network

To date Malta has double taxation treaties (in force) with over 70 countries. Most of the double tax treaties were drafted on the basis of the Organisation for Economic Co-operation and Development model. Double tax relief may be claimed by taxpayers – who satisfy certain conditions – on income which occurs outside of Malta, but which was included in one's taxable income. Compensation for the foreign tax incurred will be given to taxpayers in the form of credit effected against the tax chargeable in Malta on the gross chargeable income. This is subject to the condition that this credit does not exceed the total tax liability in Malta on the foreign source income. In Malta, a licensed investment fund may choose between two fiscal regimes.

A licensed investment fund has the option to not be subject to income tax in Malta; however, they cannot benefit from Malta's numerous double tax treaties. Where investment income is derived from prescribed funds, this regime is not applicable. The applicable tax to the income originating from these funds is a withholding tax. There is, however, a tax exemption to capital gains derived through the fund. On the other hand, the investment fund may choose to be liable vis-a-vis income and make use of Malta's double tax treaties. One may say that the latter regime is better suited for investment funds which undertake international investment since they may avail themselves of treaty relief, along with other means for tax amelioration.

5.3 FATCA and CRS Regimes

The US has concluded intergovernmental agreements (IGAs) with numerous jurisdictions, apart from issuing the FATCA regulations. The IGA was signed between Malta and the USA in December 2013 based on the Model 1 reciprocal version. By virtue of the IGA, financial institutions established both in Malta and in the USA must submit the requisite information to the pertinent tax authority. This authority would then share the submitted information with the tax authority in the other jurisdiction.

As one of the 'early adopters' under the Common Reporting Standard (CRS), Malta has been reporting to other countries, which also duly comply.

5.4 Tax Structuring Preferences of Investors

The tax impact borne by an investor primarily depends on the type of distribution, that is, whether this is by way of dividends or capital.

Where the dividends being distributed by the fund have already been subject to final withholding tax, no further tax is levied. In any other case, it is important to take note of the provisions under the relevant double taxation agreement Malta may have with the respective country. Under the Maltese regime, no withholding tax is payable on dividends to non-resident individuals.

No tax on capital gains is charged for the sale of units in an investment fund by non-residents. Furthermore, no tax on capital gains is charged on the sale of shares or units by Maltese residents, provided that these shares or units are listed on the Malta Stock Exchange.

Where distributions are made by a non-prescribed fund, they are taxed at 15% withholding tax when made to recipients, resident individuals or a non-resident person (including a non-resident company) that is owned and controlled by, directly or indirectly, or who acts on behalf of, an individual who is ordinarily resident and domiciled in Malta.

In the case of Maltese residents, any capital gains arising from the redemption, liquidation, or cancellation of units in a non-prescribed fund by Maltese shareholders may attract 15% final withholding tax.

Non-Malta resident unit-holders on the other hand are exempt from tax on gains or profits arising from the disposal of units in both prescribed and non-prescribed funds. This exemption applies on the basis that the unit-holder is not a Maltese resident for tax purposes and provided that the non-resident is not owned and controlled by, directly or indirectly, nor acts on behalf of an individual/s ordinarily resident and domiciled in Malta.

6. Miscellaneous

6.1 Asset Management Industry Bodies

The Malta Funds Industry Association (MFIA) was established in 2003, originally to represent the common interests of fund managers. Following an increased interest by international fund promoters to domicile their funds in Malta, subsequent to Malta's accession to the EU, the MFIA also extended its remit to cover the interests of fund administrators. The MFIA aims to act as a channel of communication and present its members' views to the Maltese government and the MFSA on legislative, regulatory and fiscal matters which impact the business and professional interests of its members.

The Institute of Financial Services Practitioners (IFSP) on the other hand has been recognised as the body representing financial services practitioners in Malta. The IFSP thus keeps itself fully updated on developments in financial services regulation and is regularly consulted by the competent authorities on important issues. It aims to promote the continued development of the financial services industry in Malta, develop professional standards for the industry as a whole and foster, advance and protect the professional and business interests of its members.

6.2 Preference for Courts or Arbitration

Fund documents regulated by the laws of Malta are generally subject to the jurisdiction of the Maltese courts.

6.3 Level of Litigation/Arbitration

There do not appear to be many legal judgments in the field of investment fund management and investment funds. However, one particular judgment of note was Global Capital Funds Advisors Ltd v MFSA. Global Capital Funds Advisors Ltd (the appellant) where a company was offering investment services in relation to its MFSA licence. It was involved in a number of investment funds licensed by the MFSA and took up the obligation to "pay any performance fees due." Although this activity was duly authorised by the MFSA, the authority later published a document relating to an amendment in the licence conditions. This affected licensing vis-a-vis investment funds and thus also affected the appellant.

Apart from the appellant's claim that these amendments would alter the calculation of performance fees, there was also the claim that the appellant would ultimately incur unjustified losses. The appellant also contended that it experienced a breach of its vested rights. On the other hand, the MFSA contended that the appellant did not possess the requisite locus standi or judicial interest for an appeal before the Financial Services Tribunal. Furthermore, given that it was not unusual for there to be a change to ministerial regulations, the matter of vested rights was debatable.

The Tribunal held that not every licensed person which concluded an agreement with a SICAV has a right of appeal against the MFSA. The Maltese Investment Services Act holds that only licence holders, managers, trustees or custodians of an investment fund, or their equivalent, have a right of appeal before the Tribunal on matters relating to licence variations. The Tribunal held that the appellant simply acted as an investment adviser of the relevant SICAV company. This activity could not be viewed as falling within the pertinent legal definition. The reason why the MFSA also informed the appellant of the mentioned amendments was because it wanted to obtain a broad scope of feedback, not because it acknowledged the appellant's locus standi.

Moreover, it was concluded that the Tribunal did not have competence in matters where the Investment Services Act allows the Minister of Finance to bring about regulations, since the amendments were effectively carried out in this form. To conclude, the circulated document simply constituted an update vis-a-vis the status of the proposed fee amendments. The Tribunal agreed with the pleas brought forward by the MFSA in its final decision.

6.4 Periodic Reporting Requirements

Investment funds are required to report financial data to the MFSA at regular intervals.

UCITS must submit audited annual reports for each financial year as well as half-yearly reports. These must be published and submitted to the MFSA within four months and two months respectively of the end of the period concerned.

AIFs on the other hand are to produce an annual report, including audited financial statements, which is to be provided to investors on request and to be made available to the MFSA within six months of the end of the fund's accounting period. The annual report must also be accompanied by a report from the Custodian confirming whether the AIF has been managed in accordance with the limitations imposed on the investment and borrowing powers of the AIF by the Constitutional Document and by the MFSA; and in accordance with its Constitutional Document and its licence conditions.

PIFs are also required to produce an annual report including audited financial statements, which should be published and submitted to the MFSA within six months of the end of the accounting period. However, they are not required to produce a half-yearly report. Should these PIFs opt to produce one, this should be published and submitted to the MFSA within two months of the end of the accounting period.

Investment funds are also required to report statistical information to the Central Bank of Malta on a security-by-security basis for debt and equity securities. The reporting periods primarily depend on the types of investments of the fund. The data may then be published by the Central Bank.

6.5 Powers of Attorney

Where a person holds a power of attorney by which he can control an investor's assets, he is deemed to be controlling clients' money. A fund manager requires a Category 2 licence under the Maltese Investment Services Act to provide services in or from Malta. The Category 2 licence covers licence holders authorised to provide any investment service and to hold or control clients' money or customers' assets, but not to operate a multilateral trading facility or deal for their own account or underwrite or place instruments on a firm commitment basis. Thus, the fund management licence category in itself empowers licensees to control clients' money, including by way of receiving a power of attorney from the investor.

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