

FEEDBACK STATEMENT FURTHER TO INDUSTRY RESPONSES TO MFSA CONSULTATION DOCUMENT DATED 3RD DECEMBER 2012 ON THE PROPOSED TRANSPOSITION OF CERTAIN REQUIREMENTS OF THE ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE

1. INTRODUCTION

On 3rd December 2012, the MFSA issued a consultation document regarding the proposed transposition of certain requirements of the Alternative Investment Fund Managers Directive [‘AIFMD’].

The documents which were circulated to the financial services industry for comments were the following:

- [a] Part BIII of the Investment Services Rules for Investment Services Providers applicable to Alternative Investment Fund Managers;
- [b] Part BIV of the Investment Services Rules for Investment Services Providers applicable to Custodians of Collective Investment Schemes;
- [c] Appendix 12 – Remuneration Policy
- [d] Appendix 13 – Transparency Requirements
- [e] Part CIII – Rules for European AIFMs providing services in Malta
- [f] Part CIV - Rules for Third Country AIFMs providing services in Malta

The deadline for the submission of comments with respect to the Consultation document was 11th January 2013. The Authority received comments from eight members of Malta’s financial services industry.

The Authority has assessed all the feedback received and after careful consideration has incorporated most of the drafting suggestions which were proposed by the industry.

The Authority also took cognisance of the wide array of issues which were raised by the industry in response to this consultation exercise. The majority of the questions made were of a generic nature. On the other hand specific questions on interpretation were made with regards to Articles 3, 6, 8, 12, 15, 19, 20, 21, 22, 25 and 26 AIFMD. The Authority’s position has been determined after a careful and thorough consideration of the submissions received.

2. ISSUES RAISED DURING THE CONSULTATION EXERCISE

Reported hereunder are all the issues raised by the industry together with the Authority’s comments.

2.1. GENERAL COMMENTS

Q1) *The AIFMD aims to regulate all investment fund managers whose regular business is the management of one or more AIFs. Since AIFs are defined as being those CISs which are not UCITS, would this imply that the PIF regime currently in place will be replaced wholesale by AIFs? Clarification is being sought as to whether or not the categories of CISs which can be licenced in Malta following implementation of AIFMD will be two namely (1) UCITS Schemes and (2) AIFs (which shall encompass PIFs and Retail Non-UCITS.*

A1) No, the PIF Regime will be retained alongside the AIF Regime which will be regulated by the AIF Rulebook. In particular *de minimis* fund managers and third country managers will be able to establish a collective investment scheme in terms of the Investment Services Act and regulated by the Investment Services Rules for Professional Investor Funds. The categories of CISs which will continue to be licenced in Malta will be:

- i. UCITS Schemes
- ii. Non-UCITS Retail Schemes
- iii. Professional Investor Funds; and
- iv. Alternative Investment Funds.

Q2) *SLC 1.01 of Part BII of the Investment Services Rules for Investment Services Providers¹ is diametrically opposed to the provisions of the AIFMD.*

A2) SLC 1.01 of Part BII of the ISP Rulebook transposes Article 6(2) of the UCITS Directive². Reference should be made to SLC 1.03 of Part BIII of the ISP Rulebook which provides that “*the Licence Holder shall not engage in activities other than those prescribed hereunder and the additional management of UCITS subject to authorisation in terms of the Act and in terms of Part BII of the Investment Services Rules for Investment Services Providers.*”. Both SLCs complement each other and are not diametrically opposed.

Q3) *In view of the fact that all licence holders ‘licenced’ following 22nd July 2013 will need to be AIFMD compliant as from the date of licencing and thus would not be able to avail of transitory phase if licenced after such date but before 22 July 2014, can the Authority confirm whether it will be imposing a cut-off date within which complete applications must be received in order to obtain a licence prior to 22 July 2013?*

A3) Any cut-off dates will be indicated in the Self-Assessment Questionnaires which shall be issued by the Authority shortly.

Q4) *Clarity should be provided whether any current PIF managers that do not fall below the threshold need to restructure the PIF into either a self-managed structure or appoint an AIFM.*

A4) Current PIF managers which exceed the thresholds prescribed in Article 3 AIFMD must become AIFMD Compliant by completing the relevant self-assessment questionnaire which will be issued shortly by the Authority and consequently comply with all the obligations prescribed by the AIFMD concerning AIFMs. PIF managers which do not exceed the Article 3 thresholds will be subject to the Standard Licence Conditions applicable to de minimis fund managers prescribed in Part BIII of the ISP Rulebook.

Q5) *The Authority is requested to indicate whether during the authorisation process it will actually require two individuals as a minimum or whether it will insist on there being more than two individuals to effectively manage the business in certain cases.*

A5) The Authority notes that as a practice of corporate governance it usually recommends that more than two individuals effectively manage the business to avoid situations where following the resignation of one director, the entity is left with one director actually running the business. Furthermore, the appointment of three persons to manage the business ensures that a quorum is always achieved and that the directors do not get to a stalemate situation. This is usually a recommendation and in certain instances, licenced entities opt not to take it up or to add on the third director in due course. On the other hand, given that the Directive emphasises the importance of the ‘dual control’ principle, the Authority deemed appropriate to reflect this principle in the Rules.

¹ hereinafter referred to as the ‘ISP Rulebook’

² Article 6(2) UCITS provides as follows: “No management company shall engage in activities other than the management of UCITS authorised under this Directive, with the exception of the additional management of other collective investment undertakings which are not covered by this Directive and for which the management company is subject to prudential supervision but the units of which cannot be marketed in other Member States under this Directive.”

- Q6)** *A query was raised with regards to the interplay of SLC 1.10 [Part BIII ISP Rulebook] which provides that the AIFM must commence its business within twelve months of the date of issue of the licence, and SLC 1.17(m) [Part BIII] which binds the AIFM to notify the Authority where it has not provided any Investment Service for the preceding six months. An amendment was also called for SLC 1.17(m).*
- A6)** SLC 1.17(m) does not require amending primarily because the reporting obligation stemming therefrom is not applied during the first year of business given the leeway granted to the AIFM to commence business within the first twelve months from the date of issue of the licence.
- Q7)** *A request was made to also exempt any person who is being proposed to be appointed by a Licence Holder from submitting a PQ to the MFSA in the event such person has, within the previous three years from the proposed appointment, submitted a PQ to the MFSA in connection with some role with another Licence Holder.*
- A7)** The Authority disagrees with this proposal primarily because the PQ must be endorsed by the new Licence Holder and in a case where the exemption is extended as is being proposed, there would be no endorsement whatsoever. Moreover, the approach which is currently being adopted by the Authority in the case of a new appointment with another Licence Holder is the following:
- where the PQ is less than 5 years old, the Authority requires updating to the information provided in the PQ;
 - where the PQ is more than 5 years old, the Authority requires submission of a new PQ.

2.2. ARTICLE 3 – EXEMPTIONS

- Q8)** *The Authority is requested to confirm whether it will require a de minimis AIFM to be regularly checking the status of such other companies and be regularly updated of any take-on of new AIFs by regulated entities.*
- A8)** The Authority refers to Article 3 of the Commission Delegated Regulation (EU) No. 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision³ which deals with the ongoing monitoring of assets under management.
- In this regard, Article 3 provides that AIFMs shall establish, implement and apply procedures to monitor on an on-going basis the total value of assets under management. Monitoring shall reflect an up-to-date overview of the assets under management and shall include the observation of subscription and redemption activity or, where applicable, capital draw-downs, capital distributions and the value of the assets invested in for each AIF. The proximity of the total value of assets under management to the threshold set in Article 3(2) AIFMD and the anticipated subscription and redemption activity shall be taken into account in order to assess the need for more frequent calculations of the total value of assets under management. Article 4 of the Regulation further deals with occasional breaches of the threshold.
- Q9)** *The Authority is requested to clarify the exact remit of the phrase “assets under management” when used in SLC 6.04 of Part BIII of the ISP Rulebook. Reference is also made to SLC 5.02(b) of Part BII of the said Rules applicable to UCITS Management Companies.*

³ hereinafter referred to as ‘the Regulation’

- A9) The Authority notes that the additional detail provided in SLC 5.02(b) of Part BII transposed a provision of the UCITS Directive. In the case of AIFMs, reference should be made to Article 2 of the Regulation which deals with calculation of the total value of assets under management. Article 2 is meant to supplement Article 3(2) AIFMD and it provides an indication as to how the AIFM can calculate the assets under management.
- Q10) *A suggestion was made to revise SLC 6.03 of Part BIII of the ISP Rulebook to include more detail on the restriction of capitalising non-tangible assets.*
- A10) The Authority refers to Appendix I to Part B of the ISP Rulebook which deals with the Financial Resources Requirements and Guidance on the Compilation of the Financial Return. This Appendix is meant to supplement the section in Part BIII dealing with the AIFM's financial resources requirements.
- Q11) *A clarification was requested on the applicability or otherwise of Section 73 of the Companies Act to start-ups.*
- A11) The Authority notes that the applicability or otherwise of Article 73 of the Companies Act depends on the particular circumstances of the case and on the type of assets which at the end would make up the capital of the start-up.

2.3. ARTICLE 6 - CONDITIONS FOR TAKING UP ACTIVITIES AS AN AIFM

- Q12) *A Category 2 Licence Holder, may if so licenced, concurrently provide investment management services to collective investment schemes and to non-collective investment schemes. Article 6(4)(a) AIFMD also provides that "an external AIFM shall not be prevented from also providing the service of management of portfolios of investment with mandates given by investors on a discretionary, client-by-client basis.*
- A12) Reference should be made to SLC 1.09 of Part BIII of the Investment Services Rules for Investment Services Providers which refers to the provisions of the MiFID Directive which are applicable where the AIFM provides the so called "MiFID Services".

2.4. ARTICLE 8 – CONDITIONS FOR GRANTING AUTHORISATION

- Q13) *The Authority is requested to clarify how it will handle the scenario envisaged in Article 8(4) AIFMD namely that of restricting the scope of the authorisation in particular as regards the investment strategies of AIFs which the AIFM is allowed to manage. For example, will the MFSA allow an AIFM or self-managed AIF to manage an AIF in a PE, even if the Investment Committee of the AIFM does not have individuals with experience in PE, as long as it can rely on the advice of an external expert in PE. Or will the MFSA insist on such expertise to be available within the AIFM/IC?*
- A13) The AIFM must prove that it has sufficient knowledge and experience through its Investment Committee Members to handle the investment strategy of the various AIFs managed by it. However this does not preclude the AIFM from having external experts to compliment that of the Members.
- Q14) *Query concerning the third subparagraph of Article 8(5) AIFMD and the possibility that the Authority consider allowing for a shorter period of time as it deems appropriate.*

⁴ "AIFMs may start managing AIFs with investment strategies described in the application in accordance with point (a) of Article 7(3) in their home Member State as soon as the authorisation is granted but not earlier than 1 month after having submitted any missing information referred to in point (e) of Article 7(2) and points (c), (d) and (e) of Article 7(3)."

- A14) The third subparagraph of Article 8(5) AIFMD is transposed in SLC 1.13 of Part BIII of the ISP Rulebook. When considering Schedule A to Part A of the ISP Rulebook, it transpires that all these issues would have been dealt with at licencing stage upon submission of a complete application and therefore the one month delay might never be applied.

2.5. ARTICLE 12 – GENERAL PRINCIPLES

- Q15) *The Authority is requested to clarify whether participation in the Investor Compensation Scheme prescribed in Article 12(2)(b) AIFMD will also apply to self-managed funds.*

- A15) Article 12(2) AIFMD refers to “each AIFM the authorisation of which also covers the discretionary portfolio management services referred to in point (a) of Article 6(4)....” Article 6(4) AIFMD refers exclusively to external AIFMs, to the exclusion of self-managed AIFs. Therefore, the Investor Compensation Scheme will not apply to self-managed AIFs.

- Q16) *The Authority is requested to clarify whether participation in the Investor Compensation Scheme will also apply to AIFMs providing the activities listed under Article 6(4) AIFMD.*

- A16) The Authority confirms that participation in the Investor Compensation Scheme is triggered when the AIFM proposes to provide the additional activities listed in Article 6(4) AIFMD.

2.6. ARTICLE 15 – RISK MANAGEMENT

- Q17) *The Authority is requested to clarify whether in application of the principle of proportionality as prescribed in the second subparagraph of Article 15(1) AIFMD, certain AIFMs would be able to request a derogation from the requirement of an independent risk management function.*

- A17) The Authority refers to Section 3 of the Regulation which is intended to supplement Article 15 AIFMD. The Articles included within Section 3 refer to the application of the principle of proportionality by the Authority but no reference is made to the possibility of requesting a derogation from the requirements prescribed in Article 15 of the Directive. Therefore, whilst applying the principle of proportionality, the Authority does not envisage any circumstances that might justify a complete derogation from these obligations.

2.7. ARTICLE 19 – VALUATION FUNCTION

- Q18) *What do the terms “mandatory professional registration” for external valuers mean?*

- A18) The Authority already expects a CIS to appoint an independent valuer for the purposes of valuing unlisted securities or any other assets which are not dealt in a regulated market and/or where prices are not readily available. Such valuer would already need to satisfy the following criteria which would also need to be detailed in the Offering Memorandum:

- [I] The valuer needs to be a person independent from the Scheme, its officials or any service providers to the scheme;
- [II] The valuer needs to be of good standing with recognised and relevant qualifications and an authorised member of a Recognised Professional Body (e.g. EVCA for PEs) in the jurisdiction of the assets; and
- [III] The valuer shall be appointed by the Directors (ideally in consultation with and approval of the Auditors).

The Authority will apply the same standards in the case of appointment of external valuers pursuant to Article 19 AIFMD.

Q19) *The Authority is requested to clarify the instances when it would allow the valuation procedures and/or valuations to be verified by an auditor rather than an independent external valuer.*

A19) Both can be acceptable depending on the resources at hand and the nature of the assets. However the AIFM is ultimately responsible for the proper valuation of all assets and remains fully liable to the AIFs and its investors.

2.8. ARTICLE 20 – DELEGATION

Q20) *Clarification was requested whether the Authority will allow a delegate to be a non-FINMA licenced Swiss manager since it is an SRO/BOVV member.*

A20) The Authority will allow a delegate to be an SRO/BOVV member due to the fact that such entities fall under FINMA’s supervision and subsequently FINMA would be able to gather the necessary information in relation to the entity to ensure an efficient exchange of information under the appropriate cooperation agreements.

Q21) *A question was raised as to whether the AIFM would still be liable to the AIF irrespective of sub-delegation for investment management and risk management.*

A21) The Authority confirms that the liability of the AIFM remains unchanged notwithstanding any delegation arrangements which the AIFM may have concluded with regards to the investment management and risk management. Article 20(3) is clear in stating that the liability of the AIFM towards the AIF and its investors shall not be affected by the fact that the AIFM has delegated functions to a third party.

2.9. ARTICLE 21 – DEPOSITARY

Q22) *The Authority is requested to clarify whether Article 21(8)(a) AIFMD dealing with financial instruments that can be held in custody applies to Financial Derivative Instruments.*

A22) The Authority notes that financial derivative instruments are not deemed to be instruments that can be held in custody but ‘other assets’ which are usually held by the counterparty and are only subject to record-keeping.

Q23) *The Authority is requested to clarify whether with regards to Article 21(8)(b) AIFMD dealing with other assets, it is enough for the Custodian to rely on the documentation provided by the AIF/AIFM.*

A23) The Authority notes that Article 21(8)(b) AIFMD lists the custodian’s obligations with regards to other assets which consist in:

- i. Verification of the ownership of the AIF/AIFM acting on behalf of the AIF of such assets;
- ii. Keeping of a record of those assets for which it is satisfied that the AIF or AIFM acting on behalf of the AIF holds the ownership of such assets;
- iii. The custodian’s assessment shall be based on information or documents provided by the AIF/ AIFM acting on behalf of the AIF and where available, external evidence;
- iv. The custodian shall keep its records up-to-date.

Therefore Article 21(8)(b) further confirms that it shall suffice for the Custodian to rely on the documentation provided by the AIF/ AIFM acting on behalf of the AIF. Reference should also be made to Article 90 of the Regulation which deals with safekeeping duties regarding ownership verification and record keeping and further enhances the obligations of the AIFM.

Q24) *The Authority is requested to clarify whether the measures specified in Article 21(8)(b) are sufficient due to the increased liability on the Custodian for the “loss” of an asset. It is suggested that the Custodian should additionally enter into a tripartite agreement with the AIF/AIFM and Prime Broker which specifies the ownership and the manner in which such assets will be held as well as effectively transferring the liability for loss of such instruments from the Custodian to the Prime Broker.*

A24) The Authority refers to the answer provided for Q.14 and further refers to Article 91 of the Regulation which deals with safekeeping duties regarding ownership verification and record keeping which deals with the reporting obligations for Prime Brokers. Tripartite agreements could be a solution; however any development in the area of data sharing will need to be rigorously controlled to ensure that integrity and segregation are maintained. A robust and efficient flow of information must be in place whilst at the same time maintaining appropriate Chinese walls to ensure there is the necessary degree of independence. Therefore particularly when an entity provides a plurality of services or has in place direct systems for sharing information to reduce duplication of work, it must be very careful to ensure that through this process, compliance with the legal provisions is still and ensured.

Q25) *The Authority is requested to provide clarification on the record keeping requirements in particular where FDI's are concerned.*

A25) The Authority notes that record keeping is not prescribed for FDIs. Presumably a reconciliation procedure could be accepted for the Custodian to ensure that all records are up to date.

Q26) *The Authority is requested to clarify whether the Custodian is obliged to replicate on its own systems all Financial Derivative transactions effected by the AIF or would it suffice if the Custodian were just to reconcile the positions as provided by the Prime Broker and confirm figures with the AIF.*

A26) The Authority notes that record keeping is not prescribed for FDIs. Presumably a reconciliation procedure could be accepted for the Custodian to ensure that all records are up to date.

Q27) *The Authority is requested to clarify whether with regards to Article 21(9)(b) it shall suffice for the Custodian to rely on the valuation provided by the external valuer appointed by the AIF or whether the Custodian is obliged to appoint a separate valuer for the SPV.*

A27) The Authority refers to Article 94 of the Regulation further supplements Article 21(9)(b). Article 94 provides for the duties of the custodian regarding the valuation of shares/units and states that in order to comply with Article 21(9)(b), the custodian shall:

- a. verify on an on-going basis that appropriate and consistent procedures are established and applied for the valuation of the assets of the AIF in compliance with Article 19 of AIFMD and its implementing measures and with the AIF rules and instruments of incorporation; and
- b. ensure that the valuation policies and procedures are effectively implemented and periodically reviewed.

Article 94(2) provides that the custodian's procedures shall be conducted at a frequency consistent with the frequency of the AIF's valuation policy as defined in Article 19 AIFMD.

Where the custodian considers that the calculation of the value of the shares or units of the AIF has not been performed in compliance with applicable law or the AIF rules or with Article 19 AIFMD, it shall notify the AIFM and, as the case may be, or the AIF and ensure that timely remedial action is taken in the best interest of the investors in the AIF. Where an external valuer has been appointed, a custodian shall check that the external valuer's appointment is in accordance with Article 19 AIFMD and its implementing measures.

Q28) *It is common practice for the manager to provide the Board of the AIF with information on the PB contracts but the AIF contracts with the prime broker not the Manager. The contractual arrangement and the responsibility for the Prime Broker are with the fund and the Board not with the Manager.*

A28) The Authority refers to Article 20 of the Regulation which deals with due diligence in the selection and appointment of counterparties and prime brokers.

In particular, Article 20(1) provides that when selecting and appointing counterparties and prime brokers, AIFMs shall exercise due skill, care and diligence before entering into an agreement and on an ongoing basis thereafter taking into account the full range and quality of their services. Article 20(4) provides that the list of selected prime brokers shall be approved by the AIFM's senior management. In exceptional cases prime brokers not included in the list may be appointed provided that they fulfil the requirements laid down in Article 20(2) and subject to approval by senior management. The AIFM shall be able to demonstrate the reasons for such a choice and the due diligence that it exercised in selecting and monitoring the prime brokers which had not been listed.

In view of the above, the Authority would like to precise that it is not a question of the Authority trying to change market practice, rather these provisions stem from EU Directives and Regulations, the latter being directly applicable.

2.10. ARTICLE 22 – ANNUAL REPORT

Q29) *The Authority is requested to clarify whether the obligation to compile an annual report and to provide disclosure is also applicable to non-EU AIF Investors.*

A29) The Authority notes that Article 22(1) AIFMD which provides that “an AIFM shall for each of the EU AIFs it manages and for each of the AIFs it markets in the Union make available an annual report...” Similarly Article 23 provides that “AIFMs shall for of the EU AIFs that they manage and for each of the AIFs that they market in the Union make available to AIF investors.....”. Therefore this obligation focusses more on the country of registration of the AIF and the Member State or EEA State where the marketing/management is taking place rather than the nationality of the investors.

2.11. ARTICLE 25 – USE OF INFORMATION BY COMPETENT AUTHORITIES, SUPERVISORY COOPERATION AND LIMITS TO LEVERAGE

Q30) *The Authority was requested to clarify whether it will apply the requirements prescribed in Article 25(3) AIFMD to AIFs which are already licenced prior to the coming into force of the AIFMD.*

A30) The Authority notes that once a fund manager upgrades its licence to an AIFM Licence, the Authority expects that the funds managed by the said fund manager to be all AIFMD compliant funds. Therefore the fund manager would be expected not only to upgrade its processes but to bring the funds in line with the requirements prescribed in the Directive.

2.12. ARTICLE 26 – SCOPE - OBLIGATIONS FOR AIFMS MANAGING AIFs WHICH ACQUIRE CONTROL OF NON-LISTED COMPANIES AND ISSUERS

Q31) *The Authority is requested to clarify whether the requirement to report positions in non-listed investment made by the AIF applies to non-EU AIFs.*

A31) The Authority notes that throughout SLCs 9.01 to 9.22 in the same way as in the Directive, the term ‘AIF’ is used without qualifying whether this is an EU or non-EU AIFs or both. Reference is made to Recital 13 of the Directive which provides that “subject to the exceptions and restrictions provided for, this Directive should be applicable to all EU AIFMs managing EU AIFs or non-EU AIFs....” Therefore, unless expressly stated, the relevant articles of the Directive apply to all AIFs whether EU or non-EU AIFs.

Q32) *The Authority was requested to clarify whether Article 26(7) AIFMD has been actually transposed.*

A32) The Authority notes that Article 26(7) provides the MFSA with the option to apply stricter rules with respect to the acquisition of holdings in issuers and non-listed companies in Malta. In this case, the Authority has decided not apply stricter rules.

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