Malta seals place among Europe's leading fund jurisdictions

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Over the past 15 years, the competition to attract cross-border fund business within the European Union and, more recently, to provide a domicile and specialist services to alternative investments, has been largely limited to Ireland and Luxembourg, countries that have successfully rebuilt their economies around financial services to become two of the EU's most prosperous countries

However, over the past five years the Mediterranean island of Malta has inexorably moved into contention as a centre for the European fund industry, armed with a well-calibrated array of fund legislation, a regulator that wins widespread praise for openness and flexibility, a well-educated workforce with steadily growing experience in the fund sector, and a cost base its northern European rivals simply cannot match.

Malta's culture and character has been formed its geographical location between Sicily and North Africa, and a tempestuous history that has encompassed rule by the Greeks, Phoenicians, Romans, Arabs, Normans, Spanish and French, as well as the Knights of Malta. Today it is an independent republic that gained independence from the UK in 1964 and became a full member of the European Union since May 2004, as well as one of the 15 member states to adopt the euro.

The country's historic heritage has helped to shape a legal system based on the continental European civil law system and the Napoleonic Code, although public and commercial law have been strongly influenced by the Anglo-Saxon model over the two centuries since Malta became part of the British Empire in 1814. The official language is Maltese, but English is the most commonly-used language in business, while Italian is spoken fluently by a significant proportion of the population.

Malta's geography has imbued the country with an outward-looking mentality and a history of trading and entrepreneurialism that has served it well in today's increasingly globalised economic environment. The World Economic Forum's 2008-09 Competitiveness Index ranks it 34th out of 134 countries for financial market sophistication and rates its banking system as the 10th soundest in the world.

The European Commission's latest Internal Market Scoreboard published in January emphasises how Malta has been quick to embrace the opportunities offered by the EU single market. It places Malta and Denmark in joint first position for the implementation of internal market directives, demonstrating both Malta's efficiency in transposing European rules into domestic law and the fact that its economy is one of the most integrated in the union. The country is also one of the top five EU performers in terms of foreign direct investment inflows as a proportion of gross domestic product.

This is the backdrop to Malta's development as a financial services hub, which dates back more than a decade but has noticeably gained traction since the country's accession to the EU gave it access to the single market for financial services. While the jurisdiction is home to a significant number of both Ucits and non-Ucits retail funds, the most significant growth over the past few years has been in Professional Investor Funds, the vehicle of choice for hedge funds and other types of alternative investments aimed at both institutional and sophisticated individual investors.

The number of funds domiciled in Malta is growing rapidly and now has reached around 500, including about 280 alternative funds. This compares with 230 PIFs with total assets of nearly EUR3.9bn registered with the Malta Financial Services Authority at the end of 2008, a tally itself up from 75 PIFs with EUR1.27bn in assets recorded at the end of September 2006.

PIFs were introduced in 2000 when the regulator issued the Guide to the Establishment of Professional Investor Funds; previously all funds established in Malta were governed by the rules covering retail collective investment schemes, which made them unattractive for vehicles aimed at sophisticated investors.

There are now three categories of PIF with differing minimum investment levels and investment and other rules, depending on the type of investors at which they are aimed. The Qualifying Investor Fund carries an investment minimum of EUR75,000 and is not subject to any restrictions on investment scope, borrowing or use of leverage; they do not require the appointment of a custodian or prime broker. Designed for private equity investment, Extraordinary Investor Funds have a minimum threshold of EUR750,000, offer customised disclosure requirements and benefit from a faster licensing process at the regulator.

Experienced Investor Funds currently entail a minimum investment of just EUR15,000, but require the appointment of a custodian and leverage cannot exceed 100 per cent of net asset value; in May the MFSA published proposals that include lowering the minimum investment level to EUR10,000. Promoters can also set up self-managed PIFs whose investment management is the responsibility of the board of directors and which must have a minimum capital of EUR125,000.

The growth of Malta's alternative funds market this year is no doubt down in part to increasing awareness of its merits in the global fund industry; unquestionably it has also benefited from the new level of often hostile scrutiny under which the hedge fund industry's traditional main offshore domiciles have been placed, notably during the G20 summit in London in April and by the EU in its draft Directive on Alternative Investment Fund Managers.

The G20 prompted the compilation by the Organisation for Economic Co-operation and Development of a report on the progress or otherwise of international financial centres towards compliance with the standards it has sponsored on tax transparency and exchange of information. Malta was one of a group of jurisdictions that benefited from being placed immediately on the OECD's 'white list' of countries and territories that had both embraced and substantially implemented the tax standards.

Meanwhile rival fund domiciles Luxembourg, Bermuda, the British Virgin Islands and Cayman Islands were initially put on a 'grey list' of jurisdictions that had not satisfactorily implemented the standards. Although all have subsequently signed sufficient tax information exchange agreements to be admitted to the white list, the OECD's initiative has reflected a wider concern, particularly among institutions, that the funds they invest in should ideally be domiciled and regulated in jurisdictions in good standing with the international community.

According to Andre Zerafa, a senior associate in the investment services and funds practice at law firm Ganado & Associates, the campaigns launched in recent years by organisations such as the OECD and the anti-money laundering Financial Action Task Force as well as the US government and the EU are making offshore centres less attractive and prompting increasing interest in the redomiciling of funds to Malta, as well as the possibility of gaining access to the EU single market if the funds can live with the restrictions imposed by the Ucits regime.

Says Zerafa: 'The Maltese financial services industry is presently going through a period of expansion and growth due to the growing interest of fund promoters and service providers in having onshore structures that are subject to a robust regulatory framework, supervised by an approachable regulator in a jurisdiction which is cost-effective and where professionals and regulators are able to rise to the complex regulatory, legal, governance, risk, accounting and operational challenges that have become synonymous with the financial services industry. Malta fits this bill.'

The proposed EU legislation is currently awaiting debate in the European Parliament and may see some changes to measures with which the alternative investment industry took vehement exception, but most experts believe that even if amended the directive will make it more attractive for fund promoters to base themselves and domicile their funds within Europe, and that in any case EU jurisdictions are already well placed to capitalise on the current uncertainty about the ability to market offshore funds to EU investors in the future.

'Probably the most important development on the horizon is the proposed EU Directive on

Alternative Investment Fund Managers and the impact that this is likely to have on the industry,' says Louis de Gabriele, chairman of the funds expert group at industry promotional body Finance Malta. 'The industry's concerns that this could lead to the migration of service providers within the industry toward EU jurisdictions are an new opportunity for Malta to consolidate its position as a domicile and servicing centre for alternative funds.'

De Gabriele argues that the EU proposals represent part of a global trend towards higher levels of regulation, and that the appeal of offshore centres precisely because they offered low or minimal levels of regulation is now largely a thing of the past. As a result, he says, funds are increasingly likely to migrate to regulated jurisdictions, and Malta's combination of EU membership with flexibility and a burgeoning reputation for financial services expertise leaves it well placed to capitalise.

Industry members are united in their praise for the approach taken by the MFSA that combines effective regulation with a common-sense approach to new initiatives and investment ideas. 'The Malta Financial Services Authority was set up in 2002 as a single regulator to consolidate the work previously carried out by several agencies,' says Michael Xuereb, director of the authority's strategic development unit. 'We seek to combine a high standard of regulation with an efficient response to industry needs.'

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