At the forefront of global investment trends

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Malta is gaining momentum. The recent Global Financial Centers Index named it as one of the top three financial centres likely to increase in importance over the next two to three years, while the World Economic Forums Global Competitiveness Index 2009-2010 ranked Malta 13 out of 133 countries for its financial market sophistication.

Only outsiders are surprised. The island has made a concerted collective effort to grow its financial services sector over a number of years. Chris Bond, head of global banking and markets at HSBC in Malta, says: "The government set a target last year for financial services to grow from 12% of total GDP to 25% by 2015 and it is well on target."

The cause has been helped by the fact that Malta did not experience a banking meltdown like many of its European Union neighbours. "Banks are well regulated, there were no bail-outs and no liquidity problems," Bond says.

The rock on which Malta's growing reputation is built is the Malta Financial Services Authority, under whose guidance the number of professional investor funds (essentially hedge funds) has grown to over 400, an increase of 44% since 2007, according to the University of Malta. Indeed, according to HSBC, the fund sector in Malta grew by 30% in 2008, 22% in 2009 and 26% in the first quarter of this year alone, despite national GDP only rising slightly over theseÊperiods.

New fund launches are a major driver of this growth. Nick Mahy, managing director of Praxis Fund Services, says: "Start-up managers are looking for a European jurisdiction that is cost-effective given the constraints on smaller funds. Some of the other jurisdictions have grown so large they have taken their eye off the ball."

But there are headwinds for Malta too, as Mahy points out: "Malta is a relatively new jurisdiction while the herd has headed offshore for years and the lawyers walk a well-trodden route. But Malta is gaining momentum as promoters look for more future-proof solutions."

Malta’s accession to the European Union in 2004 and its adoption of the euro in 2008 has solidified the country’s status – it was not always so well perceived. Joseph Saliba, a partner at Mamo TCV Advocates, says: “In 1988 Malta decided to promote itself as an offshore jurisdiction and only underwent an overhaul in 1994 to change to onshore. It took time and effort to rebrand and was considered offshore for quite some time afterwards. It took some years to get Malta off some grey and black lists and it only really fully achieved this with EU membership.”

Legislation was revamped and, to the two types of PIFs, targeting “experienced” and “qualifying” investors, the MFSA in July 2007 added a new category suitable for “extraordinary” investors, for which the minimum investment threshold was EUR 750,000 – compared with the EUR 10,000 and EUR 75,000 levels for experienced and qualifying investors. Importantly for the island’s growth, professional investor funds investing outside Malta -and their clients – are exempt from Maltese capital gains and income taxes, meaning non-residents are not liable to pay income tax in Malta while benefiting from one of the world’s most extensive double-tax treaty networks with more than 50 countries.

The attractive regime was devised – and continues to be refined – by a co-operative effort by the government, the regulator and the industry. Tonio Fenech, Minister of Finance, Economy and Investment, says: “Regimes become flexible when there is openness and transparency. There has not been any lowering of standards, however, and the engagement of the regulator with the promoters creates meaningful discussion and the adaptation of the regime to the requirements of promoters.”

Industry participants are appreciative of the flexibility provided by the government and regulator. As Simon Tortell, founder of Simon Tortell & Associates, says: “The regulator is always willing to discuss what are and what are not eligible investments for Ucits and the oversight of risk management in Ucits funds. Also issues such as whether a fund is closed or open-ended, which is not always obvious.”

The recognition of side-pockets and provisions for drawdowns on investors’ committed funds – with the possibility for investors to subscribe units at a pre-agreed price which constitutes a discount to the current net asset value – are two recent examples of changes to the financial services laws by a regulator with its finger on the pulse.

The flexibility of the regime is also demonstrated in the form that funds can take: while the SICAV is the most popular legal form in Malta, the legal framework allows any of the other forms commonly used in the global funds industry, including limited partnership and unit trust structures. The regulator is also piloting a consultation process to enable the creation of contractual mutual funds (fonds commun de placement), which are popular in France and other European jurisdictions. In addition, the regime allows for the creation of increasingly in-demand Islamic funds without the reconfiguration of existing rules.

There is flexibility regarding the appointment and choice of service providers. In many cases, no external service providers have to be appointed, as long as the fund has resources and arrangements to protect the interests of investors. While it is standard practice to appoint a custodian, in some cases it is acceptable to adopt alternative adequate safe-keeping arrangements. This is convenient for property funds and, to a lesser extent, for private equity funds. Furthermore, Malta is not protectionist since professional investor funds can appoint service providers not established on the island provided they are regulated in a recognised jurisdiction.

Saliba says: “We distinguish ourselves from Ireland and Luxembourg in this respect. But many funds actually choose local administrators because the costs are low and they can provide added value services linked to the local market.”

Although government and regulator are strong partners in the growth story, it is the industry itself that is the main driver of fund flows to Maltese shores, as Fenech recognises: “The promotion of Malta as a finance centre is in the hands of FinanceMalta, a public-private partnership. But ultimately it is the practitioners themselves – particularly law firms – who carry out the networking.”

This networking has enabled the island’s service providers to stay at the forefront of global investment trends.

Mamo TCV, for one, has a highly diversified fund portfolio, ranging from plain vanilla private equity and long-only funds to more exotic fund structures employing complex management strategies and techniques. It is involved in the setting up and licensing of property funds (residential, industrial and sectoral, such as hotels and retirement homes), master-feeder and fund of funds structures, special situations funds, multi-strategy funds, renewable energy funds, as well as funds investing in unusual asset classes, such as medical debt, vintage watches and vintage cars.

To service such an array of instruments and structures requires experience and expertise. Malta has gained a reputation for a well-developed infrastructure and services industry and a skilled professional labour force at a competitive operating cost. This makes it possible for even small fund promoters with low levels of seed capital to realise projects.

Dermot Butler, chairman of Custom House, which relocated its headquarters from Dublin to Malta this year, says: “In times of plenty, the Channel islands, Ireland and the Caribbean find it hard to get staff. They need people to relocate but it can cost £10,000 to import someone – that’s a lot to add to the first year’s salary. Malta has a high education level and a population of about 400,000 so has plenty of capacity.”

He points out that Chicago is cheaper than Dublin and Singapore is cheaper than Chicago, while Malta is similar to Singapore in terms of cost.

Custom House is not the only service provider to move to the island in recent times. Praxis set up in Malta in October 2008, viewing it not just as a low-cost place of business, but as one that would expand fast and increase opportunities for revenues too. “Cost was a driver, but not the key driver,” says Mahy. “We thought Malta would expand as a jurisdiction in its own right and that tipped the balance for us. Added benefits are it has highly numerate graduates who know IFRS well and the proximity to our other offices so staff could relocate or be seconded.”

So will Malta’s many attractions and advantages give it a platform to challenge its more illustrious rivals in the Caribbean and Europe?

Custom House believes the island is in the early stages of take-off and is poised to take market share from the established EU jurisdictions. “Apart from the fund industry, there are lots of call centres in Malta now, just as there were in Ireland 10-20 years ago before they moved on to India. This is how new jurisdictions develop,” says Butler.

Some point out that the island is not trying to replicate and compete with Caribbean counterparts. “I don’t like the term ‘new Caymans’ as applied to Malta,” says Tortell. “Caymans is unregulated. Even before Malta’s entry to the EU we had a fully regulated market.”

If Malta does succeed in growing exponentially, as Dublin once did, some market participants worry that quality would suffer and margins would be eroded. However, Mahy believes such concerns are misplaced: “Costs would rise, but expertise would too. You need far less people to do the job now than in the past.”

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