

## INVESTMENT SERVICES RULES

### STANDARD LICENCE CONDITIONS APPLICABLE TO COLLECTIVE INVESTMENT SCHEMES AUTHORISED TO INVEST THROUGH LOANS

#### APPLICABILITY OF THESE INVESTMENT SERVICES RULES TO COLLECTIVE INVESTMENT SCHEMES

Collective Investment Schemes that are established to carry out investments through loans, whether licensed as Alternative Investment Funds or Professional Investor Funds, shall, in addition to any laws, regulations or Standard Licence Conditions applicable thereto, **also** comply with the Standard Licence Conditions prescribed in this Rule Book.

In the case of conflict between these Rules and the Standard Licence Conditions prescribed in the Investment Services Rules for Alternative Investment Funds/ Investment Services Rules for Professional Investor Funds as the case may be, the Rules prescribed in this Rulebook shall prevail.

For the purposes of these Investment Services Rules, the use of the terms “invest through loans” shall be understood as constituting:

- [i] the direct origination of loans by the Scheme; or
- [ii] the acquisition by the Scheme of a portfolio of loans or a direct interest in loans which gives rise to a direct legal relationship between the Scheme as lender and the borrower.

#### 1. GENERAL REQUIREMENTS

1.01 The following Standard Licence Conditions lay down uniform rules for the establishment and marketing of a Collective Investment Scheme established to invest through loans in terms of the Investment Services Act (the ‘Act’), hereinafter referred to as ‘the Scheme’.

1.02 The Scheme may issue loans solely and exclusively to unlisted companies and SMEs as defined in the Commission Recommendation of 6 May 2013 concerning the definition of micro, small and medium-sized enterprises:

Provided that any entity receiving a loan shall be prohibited from transferring such loan to a third party;

Provided further that financial undertakings shall not be eligible to receive financing from these Schemes:

For the purpose of these Rules, the term ‘financial undertakings’ means any of the following:

- a. a credit institution as defined in point (1) of Article 4(1) of Regulation (EU) 575/2013 of the European Parliament and of the Council;
- b. an investment firm as defined in point (1) of Article 4(1) of Directive 2004/39/EC;
- c. an insurance undertaking as defined in point (1) of Article 13 of Directive 2009/138/EC of the European Parliament and of the Council;
- d. a financial holding company as defined in point (20) of Article 4(1) of Regulation (EU) 575/2013 of the European Parliament and of the Council; and
- e. a mixed-activity holding company as defined in point (22) of Article 4(1) of Regulation (EU) 575/2013 of the European Parliament and of the Council.

Provided further that households and individuals shall not be eligible to receive any financing from these Schemes.

1.03 The Scheme shall be structured as a closed-ended fund:

Provided that for the purpose of these Investment Services Rules, the terms ‘closed-ended fund’ shall be understood as referring to a collective investment scheme:

- (a) which does not raise capital through the continuous sale of units or shares;
- (b) has a fixed duration;
- (c) the units of which can only be redeemed at the end of the duration of the Scheme save as otherwise permitted by these Rules.

1.04 Where the Scheme is licenced under an umbrella structure, the funds in the structure shall be strictly licenced as loan funds.

1.05 The duration of the Scheme shall be sufficient to cover the life-cycle of the loans granted by the Scheme as well as the investment objectives thereof.

1.06 The Scheme shall commence its investment activities within 12 months of the date of issue of its Licence. If, for any reason, the Scheme is not in a position to comply with this condition, it shall notify the MFSA in writing setting out the reason(s) for such a delay indicating the proposed date of commencement of business. On the basis of the information provided and the circumstances of the case, the MFSA may decide to suspend or cancel the Licence in accordance with the relevant provisions of the Act.

1.07 The Scheme shall co-operate in an open and honest manner with the MFSA and inform it promptly of any relevant information. The Scheme shall provide the MFSA

with such information and returns as the MFSA requires to monitor compliance with the conditions referred to in the Act and any rules and regulations issued thereunder.

1.08 Where a Standard Licence Condition demands that the Scheme notifies the MFSA of an event, such notification shall be made to the MFSA formally, in a durable medium. The request to notify the MFSA of an event shall not be satisfied merely by the fact that the information which ought to be notified to the MFSA is included in a standard regulatory return.

1.09 The Scheme shall notify the MFSA in writing of:

- a. a change in the Scheme's name or business name (if different) at least one month in advance of the change being made;
- b. a change of address, at least one month in advance of the change being made;
- c. any material changes to the conditions for initial authorisation, in particular material changes to the information provided during the application process, at least one month in advance of the change being made;
- d. the departure of a member of the governing body or Senior Manager, Portfolio Manager, Compliance Officer, MLRO, Risk Manager and any official engaged in the provision of investment management, risk management and valuation activities (as applicable) whose role does not require MFSA approval, within fourteen days of the departure.

In case of MFSA-approved roles, the Scheme shall also request the individual holding such position to confirm to MFSA that their departure had no regulatory implications or to provide relevant details as appropriate. A copy of such request shall be provided to MFSA together with the Scheme's notification of departure.

- e. the appointment of Committee members who are not in charge of the day-to-day investment management of the assets of the Scheme (i.e. those persons who are not subject to the MFSA approval as per the criteria set out in 1.10(c) below), and of any official engaged in the provision of risk management and valuation activities (as applicable) whose role does not require MFSA approval. Such notification should be submitted by the Scheme upon engagement of the official, and shall be accompanied by a declaration confirming that:
  - i. The Licence Holder has carried out a due diligence assessment on the appointed individual and is satisfied that he/ she complies with the standards of fitness and properness required by the MFSA, and that the Licence Holder shall notify the MFSA should such individual cease to comply with the mentioned standards;
  - ii. the due diligence exercise undertaken has been fully documented, held at the registered office, and is available upon request by the

- MFSA; and
- iii. the due diligence exercise carried out will be updated at periodical intervals as applicable and the updates will be documented and will be made available upon request by the MFSA.
  - f. any proposed material change to its business (whether that business constitutes licensable activity under the Act or not), at least one month before the change is to take effect (where a new or amended Investment Services Licence is required, the new business shall not begin until the new Investment Services Licence has been granted or the amendment has been approved);
  - g. a decision to make a material claim on any insurance policy held in relation to the Scheme's business, as soon as the decision is taken;
  - h. any actual or intended legal proceedings of a material nature by or against the Scheme, immediately after the decision has been taken or on becoming aware of the matter;
  - i. the fact, where applicable, that it has not provided any investment activity for the preceding six months, setting out the reasons for such inactivity and providing a business plan for future activity.
  - j. any other material information concerning the Scheme, its business or its officials in Malta or abroad, immediately upon becoming aware of the matter.

1.10 The Scheme shall obtain the written consent of the MFSA before:

- a. taking any steps to cease its operations;
- b. agreeing to sell or merge the whole or any part of its undertaking;
- c. making an application to a Regulator abroad to undertake any form of licensable activity outside Malta;
- d. the appointment of a Director or Senior Manager, Compliance Officer, MLRO, Portfolio Manager and Risk Manager, at least 21 business days in advance. The request for consent shall be accompanied by a Personal Questionnaire ('PQ') duly completed by the person proposed.

For the purposes of the above, 'Portfolio Manager(s)' should be interpreted as the person(s) in charge of the day-to-day investment management of the Scheme, whether the person is also a member of the Investment Committee or otherwise.

Provided that, when the Investment Committee is to be considered as being collectively responsible for the day-to-day investment management of the assets of the Scheme, all its members would be required to submit a Personal Questionnaire.

For the purposes of points (d) and (e) of this Rule, ‘Senior Manager’ should be interpreted as the person occupying the most senior role following that of director so that, in the case where there are various management grades, it is the most senior manager who will require the MFSA’s authorisation.

- e. the change in the responsibilities of a Director or Senior Manager at least twenty-one business days in advance. The request for consent of the change in responsibilities of a Director or Senior Manager shall be accompanied by a PQ unless the individual concerned had, within the previous five years, submitted a PQ to the MFSA in connection with another role occupied by such individual with the same Scheme, in which case it shall be accompanied by a confirmation by the Director or Senior Manager as to whether the information included in the PQ previously submitted is still current, and indicating any changes or updates thereto:

Provided that a change in the responsibilities of a Director or Senior Manager should only be notified to the MFSA when such a change is material, including where a change has occurred in the status or seniority of the person concerned (whether upwards or downwards).

- 1.11 The Scheme shall co-operate fully with any inspection or other enquiry carried out by or on behalf of the MFSA and inform it promptly of any relevant information. The Scheme shall provide the MFSA with such information as the MFSA may require.
- 1.12 The Scheme shall pay promptly all amounts due to the MFSA. The Supervision Fee shall be payable by the Scheme on the day the Licence is first issued and thereafter annually on the anniversary of the date of issue of the Licence.
- 1.13 The Scheme shall notify the MFSA of any breach of the Licence Conditions or of any of the provisions of the Offering Document or Constitutional Documents of the Scheme as soon as the Scheme becomes aware of the breach.
- 1.14 The Scheme shall submit to the MFSA copies of the Scheme’s annual audited financial statements.
- 1.15 The Scheme shall disclose the identity of the regulated entity and its regulator or regulators in all correspondence, advertisements and other documents. Wording similar to the following shall be used: “Licenced by the MFSA as an Alternative Investment Fund/[or] Professional Investor Fund available to specified professional investors.”
- 1.16 The MFSA shall not be liable in damages for anything done or omitted to be done unless the act or omission is shown to have been done or omitted to be done in bad faith.
- 1.17 The MFSA has the right, from time to time and following advance notification to the Scheme, to vary or revoke any Licence Condition or to impose new conditions.

- 1.18 The Scheme shall not be required to make public the issue and redemption prices of its Units or Shares. However, these must be made available to unit-holders upon request.
- 1.19 If the dealings in the Units or Shares are suspended, the Scheme – or the fund manager or the Administrator on its behalf – shall inform the MFSA forthwith stating the reason for this suspension.
- 1.20 The Scheme shall keep such accounting and other records as are necessary to enable it to comply with these conditions and to demonstrate that compliance has been achieved. Accounting records shall be retained for a minimum period of ten years. During the first two years, they shall be kept in a place from which they can be produced within two working days of their being requested. After the first two years, they shall be kept in a place from which they can be produced within five working days of their being requested.
- 1.21 In the event of a winding up, the Scheme must give the MFSA at least two weeks' notice of the intention to wind up. The prior approval of the MFSA shall be obtained with regards to the approach to be adopted for the winding up. If requested to do so by the MFSA, the Scheme shall do all in its power either to delay the winding up or to proceed with it in accordance with the conditions imposed by the MFSA.
- 1.22 Any changes to the financial year-end of the Scheme shall be notified to the MFSA and disclosed in the Offering Document.

## 2. SERVICE PROVIDERS

201 A Scheme may appoint the service providers it deems necessary. It is required to appoint a fund manager (unless self-managed), a custodian, an auditor, an external valuer (where applicable), a Compliance Officer and a Money Laundering Reporting Officer.

202 The MFSA shall be satisfied on a continuing basis of the fitness and properness of any service provider appointed by the Scheme.

203 The Scheme, together with the service providers appointed, shall comply with all laws, to which they may be subject, whether enacted in Malta or at an EU level.

### • The Fund Manager

204 The Scheme may appoint a single third party fund manager with responsibility for portfolio management and risk management of the Scheme and other permitted services.

The fund manager may be:

- a. a *de minimis* fund manager licenced in terms of the Act;
- b. a fund manager duly authorised in terms of the Alternative Investment Fund Managers Directive (the 'AIFMD') and licenced in terms of the Act;
- c. a *de minimis* fund manager authorised/registered in another Member State;
- d. a fund manager authorised/licenced in a Recognised Jurisdiction.

In all instances, the fund manager shall comply with the Standard Licence Conditions prescribed in this Rulebook together with the applicable sections of the Investment Services Rules for Investment Services Providers, the Standard Licence Conditions prescribed in the Investment Services Rules for Professional Investor Funds/ Investment Services Rules for Alternative Investment Funds as the case may be:

Provided that the Directors of the Scheme shall monitor the compliance by the fund manager with all the obligations for which it is responsible in terms of these Rules.

205 Where the Scheme does not appoint an external fund manager but opts for a self-managed structure, it shall be subject to all the Standard Licence Conditions prescribed in Section 8 of this Rulebook as well as the relevant sections of the Investment Services Rules for Professional Investor Funds or the Investment Services Rules for Alternative Investment Funds applicable to Self-Managed Collective Investment Schemes, as may be the case.

206 The fund manager may have an established place of business in Malta, be licenced/ authorised in a recognised jurisdiction or be a European fund manager subject to compliance with SLC 2.10:

Provided that, where the fund manager is established in Malta, it shall be in possession of a Category 2 Investment Services Licence as a *de minimis* fund manager or a Category 2 Investment Services Licence as an alternative investment fund manager (an 'AIFM') and in both instances authorised by the MFSA as a fund manager in terms of the Act.

207 The fund manager shall have sufficient financial resources and liquidity at its disposal to enable it to conduct its business. It shall also possess such organisation, systems, experience and expertise deemed necessary by the MFSA for it to provide management services to funds authorised to invest through loans.

208 The fund manager shall also possess the required skills and expertise to ensure that any lending decisions are made with due consideration. During the application process, the fund manager will have to demonstrate to the Authority that it has proven experience in the area of granting of loans including credit assessment, credit provisioning monitoring and control of exposures as outlined in the sections hereunder.

209 The Scheme shall be required to satisfy the MFSA that the proposed fund manager meets the above requirements on a continuing basis. It shall also notify the MFSA with regards to any material changes concerning the appointment of the fund manager.

2.10 Where the Scheme is licensed as an alternative investment fund ('AIF'), it may appoint a European AIFM in accordance with the Investment Services Act (Alternative Investment Fund Manager Passport) Regulations. A European AIFM may seek to establish a branch in Malta or provide services pursuant to Regulations 6 and 7 of the said Regulations:

In all instances, the European AIFM shall comply with the Standard Licence Conditions prescribed in this Rulebook together with the Standard Licence Conditions prescribed in the Investment Services Rules for Professional Investor Funds/ Investment Services Rules for Alternative Investment Funds as the case may be:

Provided that the Directors of the Scheme shall monitor the compliance by the fund manager with all the obligations for which it is responsible in terms of these Rules.

2.11 The appointment and/or replacement of the fund manager, the terms of the appointment and the contents of the agreement to which the appointment is subject shall be agreed with the MFSA. The MFSA shall have the right to require the replacement of the fund manager.

- **Fund Administrator**

- 2.12 The Scheme or the fund manager may appoint an Administrator. Where a fund administrator is not appointed, the fund manager shall be responsible for the administration function.
- 2.13 Where the proposed fund administrator is established in Malta, it shall be in possession of a Fund Administration Recognition Certificate issued in terms of Article 9A of the Investment Services Act.
- 2.14 The fund administrator shall have the business organisations, systems, experience and expertise deemed necessary by the MFSA for it to act as a Fund Administrator. The MFSA shall be satisfied that the proposed Fund Administrator meets the above requirements.

- **Custodian**

- 2.15 A single custodian shall be appointed for each Scheme.
- 2.16 The custodian shall be the holder of a Category 4a Investment Services Licence issued by the Authority or a Credit Institution having its registered office in the EU and authorised in accordance with Directive 2013/36/EU:

Provided that a custodian licensed in terms of the Act shall further comply with Sections 1, 2 and 4 of Part BIV of the Investment Services Rules for Investment Services Providers as far as applicable.

- 2.17 In the case of schemes which have no redemption rights exercisable during the period of 5 years from the date of the initial investments and which in accordance with their core investment policy, generally do not invest in assets that must be held in custody in accordance with their core investment policy, or generally invest in issuers or non-listed companies in order to potentially acquire control over such companies, the fund manager may appoint either a Category 4a Licence Holder or a Category 4b Licence Holder to provide custody services.
- 2.18 The appointment of the custodian shall be evidenced by a written contract. This contract shall *inter alia* regulate the flow of information deemed necessary to allow the custodian to perform its functions for the Scheme.
- 2.19 The custodian shall be separate and independent from the fund manager and shall act independently and solely in the interests of the Unit- or Shareholders. Any facts, relationships, arrangements or circumstances which may at any stage bring that independence into question shall be declared to the MFSA as soon as the Scheme becomes aware of any such matter.

2.20 The written consent of the MFSA shall be obtained before the appointment or replacement of any party to act in the capacity of custodian to the Scheme. The MFSA reserves the right to object to the proposed replacement or appointment and to require such additional information it considers appropriate.

- **Compliance Officer**

2.21 Responsibility for the Scheme's compliance with its licence conditions rests with the following:

- a. The Board of Directors - in the case of a Scheme set up as an investment company;
- b. The General Partner(s) - in the case of a Scheme set up as a limited partnership;
- c. The fund manager - in the case of a Scheme set up as a unit trust or a common contractual fund:

Provided that nothing in the foregoing shall exclude any responsibility on the part of the fund manager for any obligations in terms of Part BIII of the Investment Services Rules for Investment Services Providers.

2.22 In order to enable the compliance functions to be properly carried out, the Scheme shall establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the Scheme to comply with its obligations under the Act, the Regulations issued thereunder and these Rules, as well as with its obligations under other applicable legislation, in particular the Prevention of Money Laundering Act, 1994 and the Prevention of Financial Markets Abuse Act, 2005 and the Regulations issued thereunder, as well as to detect any associated risks. The Scheme shall put in place adequate measures and procedures designed to minimize such risk and to enable the MFSA to exercise its powers effectively.

2.23 In order to enable the compliance function to discharge its responsibilities properly, the Scheme shall ensure that a Compliance Officer is appointed to assume responsibility for the compliance function and for any reporting as to compliance required by these Rules.

2.24 DELETED

2.25 The Scheme shall notify the MFSA of the resignation or removal of its Compliance Officer upon becoming aware of the proposed resignation or removal. The Scheme shall also request the Compliance Officer to confirm to the MFSA that his departure had no regulatory implications or to provide relevant details, as appropriate. A copy of such request shall be provided to the MFSA together with the Scheme's notification of resignation or removal.

- 2.26 The Scheme shall request its Compliance Officer to prepare a Compliance Report at least on a six monthly basis, which in the case of a Scheme taking the form of:
- a. an investment company, should be presented to the fund manager and Board of Directors; or
  - b. a limited partnership, should be presented to the fund manager and General Partner; or
  - c. a unit trust or a common contractual fund should be presented to the fund manager and the Trustee.
- 2.27 The Compliance Report should indicate any:
- a. breaches to the Investment and Borrowing Restrictions;
  - b. complaints from Unit- or Shareholders in the Scheme and the manner in which these have been handled;
  - c. material valuation errors (higher than 0.5% of NAV) and the manner in which these have been handled; and
  - d. material compliance issues during the period covered by the Compliance Report.
- 2.28 The Compliance Report should also include a confirmation that all local requirements as regards prevention of money laundering have been satisfied. This confirmation should be obtained from the Scheme's Money Laundering Reporting Officer.
- 2.29 A copy of the Compliance Report should be held in Malta at the registered office of the Scheme and made available to the MFSA during compliance visits.

- **Money Laundering Reporting Officer**

- 2.30 The Scheme shall at all times have a Money Laundering Reporting Officer.
- 2.31 DELETED.
- 2.32 The Scheme shall notify the MFSA of the resignation or removal of its Money Laundering Reporting Officer upon becoming aware of the proposed resignation or removal. The Scheme shall also request the Money Laundering Reporting Officer to confirm to the MFSA that his departure had no regulatory implications or to provide relevant details, as appropriate. A copy of such request shall be provided to the MFSA together with the Scheme's notification of resignation or removal.

- **Auditor**

- 2.33 The Scheme shall appoint an auditor approved by the MFSA. The Auditor shall be a person empowered to audit accounts in terms of Directive 2006/43/EC of the

European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts.

- 2.34 The MFSA's consent shall be sought prior to the appointment or replacement of an auditor. Furthermore, the Scheme shall replace its auditor if requested to do so by the MFSA.
- 2.35 The Scheme shall make available to its auditor the information and explanations he/she needs to discharge his/her responsibilities as an auditor and in order to meet the MFSA's requirements.
- 2.36 The Scheme shall not appoint any of the following individuals as auditor, nor appoint an audit firm as auditor where the individual directly responsible for the audit is:
- a. a director, partner, qualifying shareholder, officer, representative or employee of the Scheme;
  - b. a partner of, or in the employment of, any person described in (a) above;
  - c. a spouse, parent, step-parent, child, step-child or other close relative of any person described in (a) above;
  - d. a person who is not otherwise independent of the Scheme; or
  - e. a person disqualified by the MFSA from acting as an auditor of a Scheme.

For this purpose, an auditor shall not be regarded as an officer or an employee of the Scheme solely by reason of being an auditor of that Scheme.

- 2.37 The Scheme shall obtain from its auditor a signed letter of engagement defining clearly the extent of the auditor's responsibilities and the terms of his appointment. The Scheme shall confirm in writing to its auditor its agreement to the terms in the letter of engagement.
- 2.38 The letter of engagement shall include terms requiring the auditor:
- a. to provide such information or verification to the MFSA as the MFSA may request;
  - b. to vacate his/her office if he/she becomes disqualified to act as auditor for any reason;
  - c. if he/she resigns, or is removed or not reappointed, to advise the MFSA of that fact and of the reasons for his/her ceasing to hold office. The auditor shall also be required to advise the MFSA if there are matters he/she considers should be brought to the attention of the MFSA;
  - d. in accordance with article 18 of the Act, to report immediately to the MFSA any fact or decision of which he becomes aware in his capacity as auditor of the Scheme which:
    - i. is likely to lead to a serious qualification or refusal of his/her audit report on the accounts of the Scheme;

- ii. constitutes or is likely to constitute a material breach of the legal and regulatory requirements applicable to the Scheme in or under the Act;
- iii. gravely impairs the ability of the Scheme to continue as a going concern; or
- iv. relates to any other matter which has been prescribed.

2.39 If at any time the Scheme fails to have an auditor in office for a period exceeding four weeks, the MFSA shall be entitled to appoint a person to fill the vacancy, the fees and charges so incurred being payable by the Scheme.

2.40 In respect of each annual accounting period, the Scheme shall require its auditor to prepare its management letter in accordance with the International Standards on Auditing.

- **Valuation**

2.41 The valuation function shall be performed by:

- a. An external valuer, being a legal or natural person independent from the Scheme, from the fund manager and from any other persons with close links to the Scheme or the fund manager; or
- b. The fund manager, provided that the valuation task is functionally independent from the portfolio management and the credit granting function and provided that other measures have been taken to ensure that conflicts of interest are mitigated and that undue influence upon employees is prevented.

### 3. INVESTMENT OBJECTIVES, POLICIES AND RESTRICTIONS

- 3.01 The Scheme shall be subject to the investment objectives and policies outlined in its Offering Document as well as the restrictions prescribed in SLC 1.02 of these Rules. The fund manager shall take all reasonable steps to comply with the investment policies and restrictions of the Scheme.
- 3.02 The Scheme, or the fund manager on behalf of the Scheme, shall notify any material changes to the investment policies and restrictions of the Scheme to investors in advance of such change.

#### Investment Restrictions

- 3.03 The Scheme shall not be allowed to short-sell any securities.
- 3.04 The Scheme may invest up to 30% of its assets in liquid securities:  
Provided that the stock of liquid securities shall be available at any time to meet the liquidity requirements of the Scheme.
- 3.05 The Scheme may invest not more than 10% of its capital in a single undertaking:  
Provided that the same restriction shall apply in the case where the Scheme is purchasing a portfolio of loans.
- 3.06 The Scheme may invest not more than 10% of its capital in units or shares in another loan fund provided that this fund operates within the same investment restrictions applicable under these Rules:  
Provided that the aggregate value of the units or shares of loan funds in the portfolio of the Scheme shall not exceed 20% of the value of its capital.
- 3.07 The Scheme may acquire not more than 25% of the units or shares of a single loan fund.
- 3.08 The Scheme may borrow cash provided that such borrowing fulfils all of the following conditions:
- a. it is short-term borrowing to bridge drawdown commitment dates or it serves the purpose of acquiring units or shares in the Scheme's investments in terms of the Scheme's offering documents; and
  - b. it represents not more than 30% of the capital of the Scheme;
  - c. it is contracted in the same currency as the assets to be acquired with the borrowed cash;

- d. it does not hinder the realisation of any asset held in the portfolio of the Scheme; and
- e. it does not encumber the assets held in the portfolio of the Scheme.

309 The use of leverage and the reuse of collateral by the Scheme are not permitted.

### **Target Investors**

3.10 Schemes established in terms of these Rules shall be marketed exclusively to the following types of professional investors:

- a) investors which are considered to be professional clients in accordance with Section I of Annex II to Directive 2014/65/EU;
- b) investors which, on request, elect to be treated as professional clients in accordance with Section II of Annex II to Directive 2014/65/EU.

### **Eligible Investors and Minimum Entry Levels**

3.11 Subject to the marketing restrictions prescribed in SLC 3.10 and subject to compliance with the SLCs prescribed in this Rulebook, Schemes (including sub-funds) established under these Rules may only be established as:

- (a) Alternative Investment Funds established in accordance with the applicable Investment Services Rules subject to a minimum investment of EUR 100,000;
- (b) Professional Investor Funds for Qualifying Investors established in accordance with the applicable Investment Services Rules subject to a minimum investment of EUR 100,000;
- (c) Professional Investor funds for Extraordinary Investors established in accordance with the applicable Investment Services Rules:

Provided that such Schemes may not be set up as Retail Collective Investment Schemes or as Professional Investor Funds/ Alternative Investment Funds to be sold or marketed to Experienced Investors.

### **Distributions of Income**

3.12 The Scheme may effect any distributions of income to its investors.

3.13 The distribution policy that the Scheme intends to adopt will be stated in its Constitutional Document and/or Offering Document.

### **Cross Sub-Fund Investments**

3.14 Subject to the application of SLCs 3.03 to 3.09 of these Rules, a sub-fund of a scheme may invest in units of one or more sub-funds within the same scheme,

subject to this being permitted in the Constitutional Documents and the Offering Memorandum of the said Scheme and subject also to the following:

- a. the investment company elects, in its memorandum of association, to have the assets and liabilities of each sub-fund comprised in that company treated as a patrimony separate from the assets and liabilities of each other sub-fund of such company in terms of Regulation 9 of the Companies Act (Investment Companies with Variable Share Capital) Regulations;
- b. the sub-fund is allowed to invest up to 25% of its assets into any sub-fund or sub-funds within the same scheme;
- c. the target sub-fund/s may not themselves invest in the sub-fund which is to invest in the target sub-fund/s;
- d. in order to avoid duplication of fees, where the manager of the sub-fund and the manager of the target sub-fund is the same or (in the case of different managers) where one manager is an affiliate of the other, only one set of management fees (excluding performance fees), subscription and/or redemption fees applies between the sub-fund and the target sub-fund, provided that this restriction shall apply only in respect of and to the extent (up to the portion) of the investment of the sub-fund in the target sub-fund;
- e. for the purposes of ensuring compliance with any applicable capital requirements, cross-investments will be counted once; and
- f. any voting rights acquired by the sub-fund from the acquisition of the units in the target sub-fund shall be disapplied as appropriate.

### Side Letters

- 3.15 Side letters to be entered into by the Scheme must be circulated prior to issue and approved by the following persons:
- a. The fund manager and the Board of Directors - where the Scheme is set up as an investment company;
  - b. The fund manager and the General Partner(s) - where the Scheme is set up as a limited partnership;
  - c. The fund manager of the Scheme - where the Scheme is set up as a unit trust or a common contractual fund.
- 3.16 The Scheme shall disclose in the Constitutional Document and/or Offering Document the fact that side letters detailing preferential treatment of certain investors may be issued.

- 3.17 Side letters issued by the Scheme should be retained in Malta at the registered office of the Scheme and should be available for inspection by the MFSA during compliance visits.

## **Control of Exposures**

- 3.18 For each scheme managed, the fund manager shall implement sound administrative and accounting procedures together with adequate internal control mechanisms for the purpose of identifying and recording all large exposures and subsequent changes thereto and for the purpose of monitoring such exposures in the light of the Scheme's own exposure policies.
- 3.19 For each scheme managed, the fund manager shall monitor and control large exposures as appropriate and within established limits.
- 3.20 The fund manager shall measure the scheme's exposure to each client and this measurement shall reflect and control the maximum loss to be incurred by the Scheme should the customer or a particular group of customers fail.

## **Additional Licence Conditions applicable to Schemes engaged in foreign currency lending**

- 3.21 The Scheme shall, in as far as these may be applicable to any foreign currency lending which it may carry out, abide by the high level principles on foreign currency lending as outlined in MFSA Rule 1 of 2012 on foreign currency lending, which is modelled on the Recommendation of the European Systemic Risk Board on lending in foreign currencies (ESRB/2011/1).
- 3.22 Foreign currency lending means lending in any currency other than the legal tender of the country in which the borrower is domiciled. This includes situations where the Euro is the foreign currency due to the borrower's domicile being outside the euro zone.
- 3.23 When the Scheme has engaged in any form of foreign currency lending during the period under review, it shall submit a confirmation to this effect together with its annual report. Any foreign currency lending activity shall be indicated as a percentage of the scheme's total NAV. A Scheme which has not carried out any foreign currency lending during the period under review is required to submit a 'nil' return.

## 4. CREDIT RISK POLICY

- 4.01 The fund manager is expected to establish and implement a credit risk strategy and related policies in proportion with the scope and sophistication of the Scheme's activities.
- 4.02 The credit policy shall establish the framework for lending and guide the credit-granting activities of the Scheme. It shall include a risk appetite statement and shall address items such as target markets, portfolio mix, structuring of credit limits, processing and reporting.
- 4.03 The credit policy shall also reflect the risk tolerance and the level of profitability which the fund manager expects the Scheme to achieve for incurring various credit risks. It shall also cover the activities of the Scheme in which credit exposure is a significant risk.
- 4.04 The credit policy of the Scheme shall also establish targets for portfolio mix as well as set exposure limits on single counterparties and groups of connected counterparties, particular industries or economic sectors and specific products.
- 4.05 The fund manager shall submit the credit risk strategy and any significant credit risk policies which it proposes to implement for approval from the Governing Body/Supervisory Body of the Scheme.
- 4.06 The Governing Body/ Supervisory Body shall approve and periodically review such strategy and policies at least on an annual basis to ensure its continued appropriateness to changing circumstances and economic conditions.
- 4.07 The Governing Body shall approve the Scheme's strategy for the selection of risks and maximising profits and returns. The Governing Board shall periodically review, at least on an annual basis:
- a. the Scheme's financial results, on the basis of which, it shall determine whether the strategy requires revising; and
  - b. whether, within the credit risk strategy or within a statement of credit policy, it approves of the Scheme's overall credit granting criteria.
- 4.08 The fund manager shall implement a strategy with which the Scheme will organise its credit-granting functions. Such strategy shall include independent review of the credit-granting and the management thereof, the overall portfolio, a thorough understanding of the relevant borrower or counterparty, as well as the purpose and structure of the credit and its source of payment.

- 4.09 The Scheme's credit risk strategies shall make provision for continuity in approach, the cyclical aspect of the economy and the resulting shifts in the composition and quality of the overall credit portfolio.
- 4.10 The fund manager shall communicate effectively the Scheme's credit risk strategy and policies to all the relevant personnel who shall be held accountable for compliance therewith.
- 4.11 The fund manager shall ensure that the credit portfolio is adequately diversified given the Scheme's target markets and overall credit strategy.
- 4.12 Apart from the standard credit risk, the fund manager shall also take into consideration other relevant risk such as country/sovereign risk and transfer risk.
- 4.13 In pursuance of the above Standard Licence Condition, the fund manager must have adequate policies and procedures to identify, measure, monitor and control country and transfer risk in its lending and investment activities incorporating any potential default of foreign private sector counterparties arising from country-specific economic factors, the enforceability of loan agreements and the timing and ability to realise collateral held by way of security for repayment of loans.

### **Criteria for a sound credit-granting process**

- 4.14 The fund manager shall ensure that the Scheme has sufficient information on borrowers and counterparties to enable it to make a comprehensive assessment of their risk profile.
- 4.15 The fund manager must avoid conflicts of interest which can or may potentially influence the credit-granting monitoring processes.
- 4.16 In instances where actual or potential conflicts of interest are deemed to exist within the Scheme managed, the fund manager shall establish and implement internal confidentiality arrangements to ensure that there is no hindrance in obtaining the relevant information from the borrower.
- 4.17 The fund manager shall apply strict and efficient KYC policies to borrowers or counterparties to be confident that the Scheme is dealing with entities of sound repute and creditworthiness.
- 4.18 The fund manager shall also establish and implement procedures for aggregating and monitoring the fund's exposures to individual clients across business activities.
- 4.19 For each fund managed, the fund manager shall also make provision for appropriate pricing of credit as well as the overall profitability of the account relationship to assess the return of adequate compensation for the risks incurred.

- 4.20 The fund manager shall establish and implement policies for the treatment of identified and expected losses and the valuation of these losses.

### **Acquisition of an existing portfolio of loans**

- 4.21 In the case where a Scheme purchases an existing portfolio of loans from a credit institution, the fund manager shall ensure that the credit institution had carried out the required due diligence and credit risk analysis at origination stage. Prior to taking over the existing portfolio of loans, the Scheme shall carry out its own independent credit risk analysis of the underlying assets of the portfolio and review the terms of the take-over contract and shall ensure that these conform to the conditions and terms of disclosure in the Scheme's offering documents:

Provided that where a Scheme acquires an existing portfolio of loans the conditions and obligations contained in these Rules shall *mutatis mutandis* apply in the same manner with respect to the assets so acquired as they would apply to any loan originated by the Scheme.

### **Establishing credit limits and approving new credits**

- 4.22 The fund manager shall establish exposure limits on single counterparties and groups of connected counterparties, or of each underlying facility if an existing portfolio of loans is taken over. This shall be done in all areas of activities of the Scheme that involve credit risk. The fund manager shall normally establish these limits based on the internal risk rating assigned to the borrower or counterparty.
- 4.23 The fund manager shall also consider limits for particular industries or economic sectors and specific products.
- 4.24 The fund manager shall establish and implement policies regarding the information and documentation needed to approve new credits, renew existing credits and/or change the terms and conditions of previously approved credits.
- 4.25 The fund manager shall ensure that the amount of credit granted shall be suitably monitored.

### **Establishing a credit administration function**

- 4.26 The fund manager shall establish a credit administration function in relation to the scheme under management:

Provided that the fund manager shall ensure that the credit administration function is functionally independent from the portfolio management and the credit-granting function.

- 4.27 The credit files relating to each loan shall include all the information necessary to ascertain the current financial condition of the borrower or counterparty as well as sufficient information to track the decisions made and the history of the credit.
- 4.28 The fund manager shall develop and implement comprehensive procedures and information systems to monitor the conditions and quality of individual credits and single obligors across the scheme's various portfolios thus being able to assign internal risk ratings to the credit.
- 4.29 The procedures referred to above should be able to lead to the identification and reporting of potential problem credits and other transactions to ensure that they are subject to more frequent monitoring as well as possible corrective action, revaluation and/or provisioning.
- 4.30 The fund manager shall monitor on an ongoing basis the underlying collateral and guarantees to be able to reassess the value of the collateral, call for additional security as may be required, make the necessary changes to contractual arrangements as well as maintain adequate reserves and make provision for credit losses.

### **Credit Provisioning Policy**

- 4.31 The fund manager shall implement a robust credit provisioning policy which shall form part of the scheme's overall Credit Risk Policy.
- 4.32 The credit provisioning policy should as a minimum include appropriate credit risk assessment processes and effective internal controls to enable the fund manager to consistently determine provisions in accordance with the scheme's stated policies and procedures in accordance with IFRS.
- 4.33 The fund manager shall regularly review and revise its key management judgements, assumptions and estimates in its Credit Provisioning Framework. The disclosures should include key inputs and parameters used in the scheme's provisioning models and an explanation of significant changes in the inputs used from the preceding year.
- 4.34 The scheme's Credit Provisioning Policy shall incorporate but shall not be limited to:
- a. Procedures and internal controls, namely the fund manager's role in implementing the Credit Risk Policy and the Credit Provisioning Policy; a description of the procedures and internal controls which the fund manager employs in determining impairment provisions; and a description of the independent credit review process indicating who is responsible for performing the review and how often it takes place.

- b. Credit risk management, namely a description of the methodology for assessing credit risk and a description of the credit risk management system including disclosures of policies and procedures on: (a) credit risk classification systems and internal loan grading systems; (b) collateral and guarantees; (c) periodic review of exposures and collateral; (d) internal credit quality reviews; (e) monitoring overdue credits; (f) limiting and controlling exposures; and (g) forbearance measures and the process for granting them.
- c. Measuring impairment: the fund manager shall document information in the fund's Credit Risk Policy which relates to the methodology for assessing exposures for objective evidence of loan impairment and measuring impairment on a specific basis and on a collective basis and should also be able to provide a description of the observable data that is used in the determination of impairment triggers and the method of segmenting portfolios for collective evaluation, along with the types of exposures in each portfolio.
- d. Actual loss review, namely the frequency with which actual losses in the preceding period are compared to historical experience for each portfolio and the frequency with which actual losses are compared to the impairment provisions held against such losses and are taken into account in the Scheme's Net Asset Valuations.

## 5. LIQUIDITY MANAGEMENT

5.01 The fund manager shall employ an appropriate liquidity management system and adopt procedures which enable the monitoring of liquidity risk of the scheme and ensure that the liquidity profile of the investments of the Scheme complies with its underlying obligations.

5.02 The liquidity management system referred to in SLC 5.01 shall ensure that the fund manager maintains a level of liquidity appropriate to the scheme's underlying obligations. This should be based on an assessment of the relative liquidity of the scheme's assets in the market, taking account of the time required for liquidation and the price or value at which those assets can be liquidated and their sensitivity to other market risks or factors.

5.03 The fund manager shall ensure that the scheme maintains a minimum liquid-asset proportion.

5.04 The fund manager shall monitor the liquidity profile of the scheme's portfolio of assets, having regard to the marginal contribution of individual assets which may have a material impact on liquidity and the material liabilities and commitments, contingent or otherwise, which the scheme may have in relation to its underlying obligations:

For these purposes, the fund manager shall take into account the profile of the scheme's investor base, including the type of investors, the relative size of investments and the redemptions terms to which these investments are subject.

5.05 Where the Scheme invests in other collective investment undertakings, the fund manager shall monitor the approach adopted by the managers of the other collective investment undertakings to the management of liquidity, including through conducting periodic reviews to monitor changes to the redemption provisions of the underlying collective investment undertakings in which the scheme invests.

5.06 The obligation referred to in SCL 5.05 shall not apply where the other collective investment undertakings in which the scheme invests are actively traded on a regulated market within the meaning of Article 4(1) point 14 of Directive 2004/39/EC or an equivalent third country market.

5.07 The fund manager shall implement and maintain liquidity measurement arrangements and procedures to assess the quantitative and qualitative risks of positions and of intended investments which have a material impact on the liquidity profile of the portfolio of the scheme's assets to enable their effects on the overall liquidity profile to be appropriately measured.

- 5.08 The fund manager shall monitor the maturity structure of the scheme's receivables and payables as well as its assets and liabilities taking into account the type, scope and risks of the scheme's activities.
- 5.09 The fund manager is expected to keep the scheme in a state of continuous liquidity by:
- a. holding sufficient available liquefiable assets, subject to the qualification that marketable assets vary in quality in terms of the prices at which they are capable of being sold;
  - b. securing an appropriately matching future profile of cash flows from maturing assets, subject to the qualification that in practice there may be shortfalls if the borrowers are unable to pay; and
  - c. maintaining the minimum liquid-assets requirements specified hereunder.
- 5.10 The procedures employed shall ensure that the fund manager has the appropriate knowledge and understanding of the liquidity of the assets in which the scheme has invested or intends to invest including, where applicable, the trading volume and sensitivity of prices and, as the case may be, of spreads of individual assets in normal and exceptional liquidity conditions.
- 5.11 The fund manager is expected to apply a policy of prudent mix of the different forms of liquidity specified in SLC 5.09 appropriate to the circumstances of the scheme. Such policy must be sustained at all times.
- In this context, the term 'prudent mix' shall be understood as referring to a mix which offers security of access to liquidity without undue exposure to sudden rising costs from liquefying assets or bidding for loans.
- 5.12 The fund manager shall consider and put into effect tools and arrangements (including special arrangements) necessary to manage the liquidity risk of the scheme.
- 5.13 The fund manager shall identify the types of circumstances where the tools and arrangements specified in SLC 5.11 may be used in both normal and exceptional circumstances, taking into account the fair treatment of all the scheme's investors.
- 5.14 The fund manager may use the tools and arrangements specified in SLC 5.12 only in the circumstances identified in SLC 5.13 and if appropriate disclosures have been made.
- 5.15 The fund manager shall apply a variable NAV to the scheme.

- 5.16 The fund manager shall document the liquidity management policies and procedures, review them on at least an annual basis and update them for any changes or new arrangements.
- 5.17 Notwithstanding, that the scheme shall be structured as a closed-ended fund, the fund manager may, on a yearly basis, opt to redeem and cancel any shares on a non-preferred basis in the case where the fund has excess liquidity and when this is in the best interests of the unit-holders:

Provided that such redemption or cancellation shall take place in accordance with the Constitutional Documents and the Offering Memorandum of the Scheme;

Provided further that, where the fund manager intends allowing redemptions in accordance with the above, prior to proceeding with the redemption, the fund manager shall require the Auditor to confirm to the Authority that the relevant redemption requests can be met.

### **Liquidity management limits and stress tests**

- 5.18 The fund manager shall, where appropriate when considering the nature, scale and complexity of the scheme managed, implement and maintain adequate limits for the liquidity or illiquidity of the scheme consistent with its underlying obligations and redemption policy in accordance with the requirements prescribed hereunder in SLCs 6.24 to 6.27 in relation to quantitative and qualitative risk limits.
- 5.19 The fund manager shall monitor compliance with those limits and where the limits are exceeded or likely to be exceeded, it shall determine the required course of action.
- 5.20 In determining appropriate action in relation to SLC 5.19, the fund manager shall consider the adequacy of the liquidity management policies and procedures, the appropriateness of the liquidity profile of the scheme's assets and the effect of atypical levels of redemption requests.
- 5.21 The fund manager shall regularly conduct stress tests, under both normal and exceptional liquidity conditions, which enable it to assess the liquidity risk of the scheme accordingly.
- 5.22 The stress tests shall:
- a. be conducted on the basis of reliable and up-to-date information in quantitative terms or, where this is not appropriate, in qualitative terms;
  - b. where appropriate, simulate a shortage of liquidity of the assets in the scheme and atypical redemption requests;

- c. cover market risks and any resulting impact including on margin calls, collateral requirements or credit lines;
  - d. account for valuation sensitivities under stressed conditions; and
  - e. be conducted at least once a year and at a frequency which is appropriate to the nature of the scheme when taking into account the investment strategy, liquidity profile, type of investor and redemption policy of the scheme.
- 5.23 The fund manager shall act in the best interest of investors in relation to the outcome of any stress tests.
- 5.24 The fund manager shall include appropriate escalation measures in the liquidity management system and procedures to address anticipated or actual liquidity shortages or other distressed situations of the scheme.
- 5.25 The fund manager shall ensure that the investment strategy, the liquidity profile and the redemption policy of the scheme are consistent and that investors have the ability to redeem their investments in a manner consistent with the fair treatment of all the scheme's investors and in accordance with the scheme's redemption policy and its obligations.
- 5.26 In assessing the alignment of the investment strategy, liquidity profile and redemption policy of the scheme, the fund manager shall also have regard to the impact that redemptions may have on the underlying prices or spreads of the individual assets of the scheme.

### **Liquidity Maturity Ladder**

- 5.27 The fund manager shall keep a liquidity maturity ladder so as to assess the liquidity of the scheme's total business.
- 5.28 The liquidity maturity ladder shall be based on a cash flow approach normally taking assets and liabilities in all currencies together.
- 5.29 The assets and liabilities are inserted in a 'maturity ladder' with net positions in each time period being accumulated.
- 5.30 In the first maturity bands the ladder will compare cash and assets capable of generating cash immediately with demand and quasi-demand liabilities.
- 5.31 Marketable assets are placed at the start of the maturity ladder rather than according to the maturity date. Account should be taken of limitations on their marketability and their susceptibility to price fluctuations.
- 5.32 Commitments are recognised by being included as liabilities or as agreed in specific cases.

5.33 The measurement derived from the liquidity maturity ladder should incorporate the following elements:

- a. Assets: These are measured by reference to their maturity unless they are marketable or repayable on demand or are known to be of doubtful value. In the case of lending repayable on demand, the Authority may allow the fund manager to treat some proportion of the total as generating an immediate cash flow or to treat it as repayable in instalments over a period.

The treatment of marketable assets takes account of the extent to which they can be sold for cash quickly or used as security for borrowing, incurring little or no cost penalty, and of any credit or investment risks which may make their potential value less predictable. The market for the asset should be sufficiently deep to ensure a stable demand for it.

Assets known to be of doubtful value should normally be excluded from the measurement.

- b. Liabilities: All types of amounts owed are included according to earliest maturity.

Known firm commitments to make funds available on a particular date are included in the appropriate time band at their full value.

Commitments which are not due to be met on a particular date are unlikely to have to be met in full and cannot be treated precisely.

5.34 It is at the discretion of the fund manager to reach a determination as to how far into the future it is appropriate to measure liquidity profiles. Such determination should be made on the basis of the circumstances of the particular Scheme.

5.35 The fund manager shall submit a notification on a quarterly basis to the Authority on the liquidity structure of the scheme.

## 6. RISK MANAGEMENT

- 601 The fund manager shall functionally and hierarchically separate the functions of risk management from the operating units of the Scheme as well as from the function of portfolio management.
- 602 The functional and hierarchical separation of the functions of risk management in accordance with SLC 6.01 shall be reviewed by the MFSA in accordance with the principle of proportionality on the understanding that the fund manager shall, in any event, be able to demonstrate that specific safeguards against conflicts of interest allow for the independent performance of risk management activities and that the risk management process satisfies the requirements of this section and is constantly effective.
- 603 The risk management function shall be considered as functionally and hierarchically separated from the operating units, including the portfolio management function, only where all the following conditions are satisfied:
- a. Persons engaged in the performance of the risk management function are not supervised by those responsible for the performance of the operating units, including the portfolio management function of the fund manager;
  - b. Persons engaged in the performance of the risk management function are not engaged in the performance of activities within the operating units, including the portfolio management function;
  - c. Persons engaged in the performance of the risk management function are compensated in accordance with the achievement of objectives linked to that function and independently of the performance of the operating units, including the portfolio management function; and
  - d. The remuneration of senior officers in the risk management function is directly overseen by the remuneration committee where such a committee has been established.
- 604 The functional and hierarchical separation of the risk management function in accordance with SLC 6.03 shall be ensured throughout the whole hierarchical structure of the fund manager, up to its governing body. It shall be reviewed by the governing body and, where it exists, the supervisory function of the fund manager.
- 605 The MFSA shall review the way in which the fund manager has applied SLCs 6.03 and 6.04 on the basis of the criteria prescribed in SLCs 6.01 and 6.02.

- 606 The safeguards against conflicts of interest referred to in SLC 6.02 shall ensure at least that:
- a. Decisions taken by the risk management function are based on reliable data, which are subject to an appropriate degree of control by the risk management function;
  - b. The remuneration of those engaged in the performance of the risk management function reflects the achievement of the objectives linked to the risk management function, independently of the performance of the business areas in which they are engaged;
  - c. The risk management function is subject to an appropriate independent review to ensure that decisions are being arrived at independently;
  - d. The risk management function is represented in the governing body or the supervisory function, if applicable, with at least equal authority to that of the portfolio management function; and
  - e. Any conflicting duties are properly segregated.
- 607 Where proportionate, taking into account the nature, scale and complexity of the fund manager, the safeguards referred to in SLC 6.06 shall also ensure that:
- a. The performance of the risk management function is reviewed regularly by the internal audit function or, if the latter has not been established, by an external party appointed by the governing body; and
  - b. Where a risk committee has been established, it is appropriately resourced and non-independent members do not have undue influence over the performance of the risk management function.
- 608 The governing body of the fund manager and, where it exists, the supervisory function shall establish the safeguards against conflicts of interest prescribed in SLCs 6.06 and 6.07. They shall regularly review their effectiveness and take timely remedial action to address any deficiencies.
- 609 The fund manager shall implement adequate risk management systems in order to identify, measure, manage and monitor appropriately all risks relevant to the scheme's investment strategy and to which the scheme is or may be exposed. Furthermore, the permanent risk management function shall:
- a. Ensure that the risk profile of the scheme disclosed to investors is consistent with the risk limits that have been set in this section;

- b. Monitor compliance with the risk limits set in accordance with this section and notify the fund manager's governing body and, where it exists, the fund manager's supervisory function in a timely manner when it considers the scheme's risk profile inconsistent with these limits or sees a material risk that the risk profile will become inconsistent with these limits;
  - c. Provide the following regular updates to the fund manager's governing body and, where it exists, the fund manager's supervisory function at a frequency which is in accordance with the nature, scale and complexity of the scheme or the fund manager's activities:
    - i. The consistency between and compliance with the risk limits prescribed hereunder and the risk profile of the scheme as disclosed to investors; and
    - ii. The adequacy and effectiveness of the risk management process, indicating in particular whether appropriate remedial measures have been or will be taken in the event of any actual or anticipated deficiencies.
  - d. Provide regular updates to the senior management outlining the current level of risk incurred by the scheme and any actual or foreseeable breaches of any risk limits prescribed hereunder, so as to ensure that prompt and appropriate action can be taken.
- 6.10 The risk management function shall have the necessary authority and access to all relevant information necessary to fulfil the tasks prescribed in SLC 6.09.
- 6.11 The fund manager shall review the risk management system with appropriate frequency at least once a year and adapt it whenever necessary.
- 6.12 The fund manager shall establish, implement and maintain an adequate and documented risk management policy which identifies all the relevant risks to which the scheme may be exposed.
- 6.13 The risk management policy shall comprise such procedures as are necessary to enable the fund manager to assess the exposure of the Scheme under management to market-, liquidity- and counterparty risks as well as the exposure of the scheme to all other relevant risks that may prove material for the fund, including operational risks.
- 6.14 The fund manager shall address at least the following elements in the risk management policy:
- a. the techniques, tools and arrangements that enable it to comply with the risk management and risk measurement obligations as prescribed in SLCs 6.27 to 6.29;

- b. the techniques, tools and arrangements that enable liquidity risk of the scheme to be assessed and monitored under normal and exceptional liquidity conditions including through the use of regularly conducted stress tests in accordance with SLCs 5.18 to 5.23;
  - c. the allocation of responsibilities within the fund manager pertaining to risk management;
  - d. the risk limits set in accordance with SLCs 6.24 to 6.27 and a justification of how these are aligned with the risk profile of the scheme disclosed to investors; and
  - e. the terms, contents, frequency and addresses of reporting by the permanent risk management function.
- 6.15 The risk management policy referred to in SLCs 6.06 to 6.08 shall include a description of the safeguards against conflicts of interest, in particular:
- a. The nature of the potential conflicts of interest;
  - b. The remedial measures put in place;
  - c. The reasons why these measures should be reasonably expected to result in independent performance of the risk management function; and
  - d. The manner in which the fund manager expects to ensure that the safeguards are consistently effective.
- 6.16 The risk management policy referred to in SLC 6.12 shall be appropriate to the nature, scale and complexity of the business of the fund manager and of the scheme.
- Provided that a copy of the risk management policy shall be held at the registered office of the Scheme and shall be made available to MFSA officials in the course of Compliance Visits.
- 6.17 The fund manager shall at least:
- a. Implement an appropriate, documented and regularly updated due diligence process when investing on behalf of the scheme and shall ensure that this is in accordance with the investment strategy, the objectives and the risk profile of the scheme;
  - b. Ensure that the risks associated with each investment position of the scheme and the overall effect on the scheme's portfolio can be properly identified, measured, managed and monitored on an ongoing basis, including through the use of appropriate stress-testing procedures;

- c. Ensure that the risk profile of the scheme corresponds to the size, portfolio structure and investment strategies and objectives of the scheme as laid down in the scheme's instruments of incorporation, prospectus and offering documents.
- 6.18 The fund manager shall assess, monitor and periodically, (at least once a year) review:
- a. The adequacy and effectiveness of the risk management policy and of the arrangements, processes and techniques for risk measurement and management;
  - b. The degree of compliance by the fund manager with the risk management policy and with the arrangements, processes and techniques for risk measurement and management;
  - c. The adequacy and effectiveness of measures taken to address any deficiencies in the performance of the risk management process;
  - d. The performance of the risk management function;
  - e. The adequacy and effectiveness of measures aiming to ensure the functional and hierarchical separation of the risk management function as prescribed hereunder.
- 6.19 The frequency of the periodic review referred to in SLC 6.18 shall be decided by the senior management in accordance with the principle of proportionality given the nature, scale and complexity of the fund manager's business and the scheme it manages.
- 6.20 In addition to the periodic review referred to in SLC 6.18, the risk management systems shall be reviewed where:
- a. Material changes are made to the risk management policies and procedures and to the arrangements, processes and techniques in relation to risk management and measurement;
  - b. Internal or external events indicate that an additional review is required;
  - c. Material changes are made to the investment strategy and objectives of the scheme managed.
- 6.21 The fund manager shall update the risk management systems on the basis of the outcome of the review referred to in SLCs 6.18 to 6.20.

- 6.22 The fund manager shall notify the MFSA of any material changes to the risk management policy and of the arrangements, processes and techniques referred to in risk management and measurement as referred to in SLCs 6.28 to 6.30.
- 6.23 The fund manager shall establish and implement quantitative or qualitative risk limits, or both, for the scheme managed, taking into account all relevant risks.
- 6.24 Where only qualitative limits are set, the fund manager shall be able to justify this approach to the MFSA.
- 6.25 The qualitative and quantitative risk limits for the scheme shall at least cover the following risks:
- a. Market risks;
  - b. Credit risks;
  - c. Liquidity risks;
  - d. Counterparty risks; and
  - e. Operational risks.
- 6.26 When setting risk limits, the fund manager shall take into account the strategies and assets employed in respect of the scheme managed as well as the national rules applicable thereto. The risk limits shall be aligned with the risk profile of the scheme as disclosed to investors.
- 6.27 The fund manager shall adopt adequate and effective arrangements, processes and techniques in order to:
- a. Identify, measure, manage and monitor at any time the risks which the scheme is or might be exposed to;
  - b. Ensure compliance with the limits set in accordance with SLCs 6.23 to 6.26.
- 6.28 The arrangements, processes and techniques referred to in SLC 6.28 shall be proportionate to the nature, scale and complexity of the business of the fund manager and the funds managed and shall be consistent with the scheme's risk profile as disclosed to investors.
- 6.29 For the purposes of SLC 6.28, the fund manager shall take the following actions for the scheme managed:
- a. Put in place such risk measurement arrangements, processes and techniques as are necessary to ensure that the risks of positions taken and their contribution to the overall risk profile are accurately measured on the basis of sound and reliable data and that the risk measurement arrangements, processes and techniques are adequately documented;

- b. Conduct periodic back-tests in order to review the validity of risk measurement arrangements which include model-based forecasts and estimates;
- c. Conduct periodic appropriate stress tests and scenario analysis to address risks arising from potential changes in market conditions that might adversely impact the scheme;
- d. Ensure that the current level of risk complies with the risk limits prescribed in SLCs 6.23 to 6.26;
- e. Establish, implement and maintain adequate procedures that, in the event of actual or anticipated breaches of the risk limits of the scheme, result in timely remedial actions in the best interests of investors; and
- f. Ensure that there are appropriate liquidity management systems and procedures for the scheme in line with the requirements prescribed for liquidity management.

## 7. DISCLOSURE TO INVESTORS

7.01 The Scheme shall make available to investors, in accordance with the Constitutional Documents and/or Offering Document and prior to their investment in the Scheme, the following information and any material changes thereto:

- a. A description of the investment strategy and the objectives of the Scheme, information on where any master fund is established and where the underlying funds are established if the Scheme is a fund of funds, a description of the types of assets in which the Scheme may invest, the techniques it may employ and all associated risks, and any applicable investment restrictions;
- b. A description of the procedures by which the Scheme may change its investment strategy or investment policy, or both;
- c. A description of the main legal implications of the contractual relationship entered into for the purpose of investment, including information on jurisdiction, on the applicable law and on the existence or not of any legal instruments providing for the recognition and enforcement of judgements in the territory where the Scheme is established;
- d. The identity of the Scheme's custodian, auditor and any other service providers and a description of their duties and the investors' rights;
- e. A description of how the Scheme is complying with the requirements of providing a professional liability cover where this is applicable;
- f. A description of any delegation of the management function by the fund manager and of any safe-keeping function delegated by the custodian, the identification of the delegate and any conflicts of interest that may arise from such delegations;
- g. A description of the Scheme's valuation procedure and of the pricing methodology for valuing assets, including the methods used in valuing hard-to-value assets;
- h. A description of the Scheme's credit risk policy including the Scheme's credit provisioning policy and the risk appetite statement;
- i. A description of the risks to which the Scheme may be exposed from its concentrations;
- j. A description of the Scheme's liquidity risk management, including the redemption rights both in normal and in exceptional circumstances, and the existing redemption arrangements with investors;

- k. A description of all fees, charges and expenses and of the maximum amounts thereof which are directly or indirectly borne by investors;
  - l. A description of how the Scheme ensures a fair treatment of investors and, whenever an investor obtains preferential treatment, a description of that preferential treatment, the type of investors who obtain such preferential treatment and, where relevant, their legal or economic links with the Scheme;
  - m. The latest annual report which the fund manager must submit in relation to the Scheme;
  - n. The procedure and conditions for the issue and sale of units or shares;
  - o. The latest net asset value of the Scheme or the latest market price of the unit or share of the Scheme;
  - p. Where available, the historical performance of the Scheme;
  - q. The identity of the prime broker and a description of any material arrangements of the Scheme with its prime brokers and the way the conflicts of interest in relation thereto are managed; and the provision in the contract with the custodian on the possibility of transfer and reuse of the Scheme's assets, as well as information about any transfer of liability to the prime broker that may exist;
  - r. A description of how and when the following information will be disclosed:
    - i. The percentage of the Scheme's assets which are subject to special arrangements arising from their illiquid nature;
    - ii. Any new arrangements for managing the liquidity of the Scheme; and
    - iii. The current risk profile of the Scheme and the risk management systems employed to manage those risks.
- 7.02 The Scheme shall inform the investors before they invest therein of any arrangement made by the custodian to contractually discharge itself of liability.
- 7.03 The Scheme shall also inform investors without delay of any changes with respect to custodian liability.

704 The Scheme shall be marketed only to professional investors as prescribed in SLC 3.10 of these Rules and the following statements must be placed in a prominent position in the Offering Document and printed in a font whose pitch is at least 12:

- “[name of the FUND] is licensed by the Malta Financial Services Authority (“MFSA”) as an Alternative Investment Fund/ Professional Investor Fund which is marketed only to specified professional investors.
- “This Alternative Investor Fund/Professional Investor Fund is a Non–Retail Scheme. Therefore, the protection normally arising as a result of the imposition of the MFSA’s investment and borrowing restrictions and other requirements applicable to retail schemes do not apply.”
- “The MFSA has made no assessment or value judgment on the soundness of the fund or on the accuracy or completeness of statements made or opinions expressed with regard to it.”

## 8. SUPPLEMENTARY LICENCE CONDITIONS APPLICABLE TO SELF-MANAGED SCHEMES

### NOTE:

#### IN ADDITION TO THE FOREGOING:

- SELF-MANAGED COLLECTIVE INVESTMENT SCHEMES WHICH QUALIFY AS DE MINIMIS SELF-MANAGED SCHEMES SHALL ALSO COMPLY WITH THE APPLICABLE SLCs PRESCRIBED IN THE INVESTMENT SERVICES RULES FOR PROFESSIONAL INVESTOR FUNDS
- SELF-MANAGED COLLECTIVE INVESTMENT SCHEMES WHICH ARE ESTABLISHED AS ALTERNATIVE INVESTMENT FUNDS SHALL ENSURE COMPLIANCE WITH SECTION 8 OF THE INVESTMENT SERVICES RULES FOR ALTERNATIVE INVESTMENT FUNDS APPLICABLE FOR SELF-MANAGED AIFs.

#### SELF-MANAGED SCHEMES SHALL MOREOVER BE SUBJECT TO THE SUPPLEMENTARY LICENCE CONDITIONS ESTABLISHED IN THIS SECTION.

- 801 The Scheme shall be operated in or from Malta, as agreed with the MFSA.
- 802 The Scheme shall have sufficient financial resources at its disposal to enable it to conduct its business effectively, to meet its liabilities and to be prepared to cope with the risks to which it is exposed.
- 803 The initial paid-up share capital for the Scheme should not be less than EUR 300,000 and the NAV of the Scheme is expected to exceed this amount on an ongoing basis.
- 804 The Scheme shall notify the MFSA as soon as its NAV falls below EUR 300,000.
- 805 The Scheme shall organise and control its affairs in a responsible manner and shall have adequate operational, administrative and financial procedures and controls to ensure compliance with all regulatory requirements and shall provide the MFSA with all the information it may require from time to time.
- 806 The management of the assets of the Scheme is to be the responsibility of the Board of Directors, at least one of whom must be resident in Malta. The Board of Directors of the Scheme shall establish an in-house Investment Committee made up of at least three members, whose composition may include Board members. The Terms of Reference of this Investment Committee – which regulate the proceedings of the Investment Committee – and any changes thereto, is subject to a notification to the MFSA. The majority of Investment Committee meetings – the required frequency of which should depend on the nature of the Scheme’s investment policy, but which should be at least quarterly – are to be physically held in Malta.

Investment Committee meetings are deemed to be physically held in Malta if the minimum number of members that form a quorum necessary for a meeting are physically present in Malta.

- 8.07 Minutes of Investment Committee meetings should be available in Malta for review during the MFSA's compliance visits. The role of the Investment Committee is to:
- a. monitor and review the investment policy of the Scheme;
  - b. establish and review guidelines for investments by the Scheme;
  - c. issue rules for stock selection;
  - d. set up the portfolio structure and asset allocation; and
  - e. make recommendations to the Board of Directors of the Scheme.
- 8.08 Where the Scheme has not appointed an Investment Committee, the functions mentioned under SLC 8.07 shall be undertaken by the Directors of the Scheme and any reference to the Investment Committee in these Rules and any other applicable laws and regulations shall be construed as a reference to the Board of Directors of the Scheme.
- 8.09 Where the Scheme is self-managed, the obligations which would usually be incumbent on the fund manager, shall be carried out by the Scheme.
- 8.10 The Investment Committee may delegate the day-to-day investment management of the assets of the Scheme to one or more officials of the Scheme (referred to as "the Portfolio Manager/s"). Such officials will effect the day-to-day transactions of the Scheme within the investment guidelines set by the Investment Committee and in accordance with the investment objectives, policy and restrictions described in the Scheme's Offering Document/ Marketing Document.
- 8.11 The Scheme shall obtain the written consent of the MFSA before the appointment or replacement of a Portfolio Manager. For the purposes of the above and 8.12 and 8.13 below, 'Portfolio Manager(s)' should be interpreted as the person(s) in charge of the day-to-day investment management of the scheme, whether he/she is also a member of the Investment Committee or otherwise. Provided that, when the Investment Committee is to be considered as being collectively responsible for the day-to-day investment management of the assets of the Scheme, all its members would require the prior approval of the MFSA
- The MFSA reserves the right to object to the proposed replacement or appointment and to require such additional information it considers appropriate. The MFSA shall be entitled to be satisfied, on a continuing basis, of the fitness and properness, including competence, of the Portfolio Manager/s.
- 8.12 Where the prior approval of the Authority is required, the request for approval shall be submitted to the Authority together with a Personal Questionnaire duly completed by the person(s) proposed.
- 8.13 The Scheme shall notify the MFSA in writing:

i of the departure of a Portfolio Manager within 14 days of the departure. The

Scheme shall also request the Portfolio Manager to confirm that his/her departure has no regulatory implications or otherwise provide any relevant details, as appropriate. A copy of such request shall be provided to MFSA;

- ii. of the appointment of Investment Committee members which are not in charge of the day-to-day investment management of the assets of the Scheme (i.e. do not fall under the definition of ‘Portfolio Manager(s)’ of 8.11 above), and of any official engaged in the provision of risk management and valuation activities whose role does not require MFSA approval. Such notification should be submitted by the Scheme upon engagement of the official, and shall be accompanied by a declaration confirming that:
  - a. The Licence Holder has carried out a due diligence assessment on the appointed individual and is satisfied that he/ she complies with the standards of fitness and properness required by the MFSA, and that the Licence Holder shall notify the MFSA should such individual cease to comply with the mentioned standards;
  - b. the due diligence exercise undertaken has been fully documented, held at the registered office, and is available upon request by the MFSA; and
  - c. the due diligence exercise carried out will be updated at periodical intervals as applicable and the updates will be documented and will be made available upon request by the MFSA.
- iii. of the departure of Investment Committee members which are not in charge of the day-to-day investment management of the assets of the Scheme (i.e. do not fall under the definition of ‘Portfolio Manager(s)’ of 8.11 above), and of any official engaged in the provision of risk management and valuation activities whose role does not require MFSA approval, within 14 days of the departure.

8.14 The Scheme shall have adequate arrangements, in agreement with and subject to the approval of the MFSA, to ensure adequate monitoring of the activities of the Portfolio Manager/s and the Investment Committee.

8.15 The Scheme shall on a continuing basis ensure that it has sufficient management resources to effectively conduct its business.

### **Dealing by Officials of the Scheme**

8.16 Where the Scheme allows its officials to deal for their own account, it is responsible for ensuring that such a practice does not lead to abuse. The standards and procedures to be adopted should include the following:

- i. The Scheme must take appropriate steps to ensure that officials act in conformity with the statutory requirements concerning insider dealing and market abuse.
- ii. The Scheme must take reasonable steps to ensure that its officials do not initiate personal transactions which might impair their ability to manage the Scheme’s assets objectively and effectively or which might create a conflict between their

own interest and that of the Scheme.

- iii. Internal mechanisms should be established to prompt the Compliance Officer's intervention if and when, in respect of any staff member, abnormal behaviour or patterns concerning investment transactions are observed.

8.17 All transactions undertaken by officials on their own account should be at "arm's length". However, this does not preclude discounts being allowed to officials.

### **Reporting Requirements**

8.18 The Scheme shall notify the MFSA immediately if it is itself notified that its auditor intends to qualify the audit report.

### **Documents and Records**

8.19 The Scheme shall comply with any reporting requirements which the MFSA may prescribe in relation to the obligations prescribed in these Rules.

8.20 The Scheme or the Administrator shall keep such accounting and other records, in particular regarding the whole process of the investment management function and the monitoring thereof, as are necessary to enable it to comply with the licence conditions and to demonstrate that compliance has been achieved. Records are to be retained in Malta and made available for the MFSA's review as the need arises. Records shall be retained for a minimum period of ten years. During the first two years they shall be kept in a place from which they can be produced within two working days of their being requested. After the first two years they shall be kept in a place from which they can be produced within five working days of their being requested.