21st May, 2009

Consultation on proposed amendments to the Investment Services Rules applicable to Professional Investor Funds targeting Experienced Investors

1.0 Background

Following a review of the current requirements for Professional Investor Funds ("PIFs") targeting Experienced Investors, the Authority considers it appropriate to introduce certain investment restrictions in the Standard Licence Conditions applicable to these funds which – subject to the investor qualifying as 'experienced' – may be sold to persons who may not necessarily be high net worth investors and who are not required to satisfy a high minimum investment threshold. The objective of the proposed changes to the regulatory requirements for Experienced Investor PIFs, is that of ensuring a minimum level of risk diversification given that with the exception of the five hedge fund rule for funds of hedge funds, there are currently no prescriptive requirements relating to risk-spreading, with the consequent risk that such funds may be excessively exposed to a single issuer or counterparty.

The main purpose of this circular is to provide the industry with details of the proposed restrictions and the opportunity for interested parties to submit their views and comments in relation to the proposed changes.

2.0 Proposed Changes

2.1 The following are the new investment requirements which are being proposed for Experienced Investor PIFs to be incorporated in Part B.I of the Investment Services Rules for Professional Investor Funds:

a. The Manager or (in the case of a self-managed scheme), the Scheme, must take reasonable steps to ensure that the Scheme is managed according to the risk spreading principle. In particular, the Scheme shall be required to adhere to the diversification requirements set out below. In the case of a Scheme investing in alternative assets, the MFSA may impose tailored investment restrictions.

b. The Scheme may invest up to 20% of its net assets in securities issued by the same body and up to 30% of its assets in money market instruments issued by the same body provided that :

   (i) the 20%/ 30% limit set out in (b) above may be increased to a maximum of 100% in the case of securities and money market instruments issued or guaranteed by an OECD or EU/ EEA Member State, its local authorities or public international bodies of which one or more such States are members;

   (ii) the 20%/ 30% limit set out in (b) above may be increased to a maximum of 35% in the case of securities and money market instruments guaranteed by a credit institution authorised in the EEA or which is subject to equivalent prudential requirements;

   (iii) the 20% limit set out in (b) above may be increased up to a maximum of 30% in the case of transferable securities traded in or dealt on a regulated market which operates regularly, is recognised and is open to the public.

c. Scheme may invest up to a maximum of 30% of its net assets in deposits held with a single body.

d. The Scheme is not subject to any investment restrictions with respect to investments in a single collective investment scheme provided that the underlying scheme is a UCITS or other open ended collective investment scheme subject to risk spreading requirements which are at least comparable to those applicable to the Scheme itself.

e. The Scheme may invest up to a maximum of 30% of its net assets in any single collective investment scheme which does not satisfy the conditions indicated in (d) above.

f. Where the Scheme is a fund of hedge funds it shall invest in at least five hedge funds.

g. Where the Scheme enters into OTC derivative transactions, it shall ensure that its exposure to a single counterparty is limited to 20% of its net assets.

h. The Scheme shall limit its aggregate maximum exposure (through securities, money market instrument, deposits and OTC derivatives transactions) to a single issuer/ counterparty to 40% of its net assets.

Conditions for PIFs investing directly or indirectly in immovable property

i. The Scheme may invest up to a maximum of 25% of its net assets directly or indirectly (through an SPV) in any one single immovable property. Subject to the Scheme being operated according to the risk-spreading principle, it will not be required to comply with this restriction before three years from its launch. For the purposes of this restriction, a property whose economic viability is linked to another property, is not considered as a separate item of property for this purpose.

j. Where the Scheme invests solely in immoveable property (rather than also in property funds and/or other securities), it should be exposed to not less than 5 different properties.

k. The Scheme shall not invest more than 30% of its net assets in any single property fund.

2.2 It is also being proposed that the definition of Experienced Investor is expanded to include persons who fall under the definition of "professional investors" in terms of the Markets in Financial Instruments Directive (Directive 39/2004/EC). Such persons would automatically qualify as Experienced Investors without the need for any appropriateness test to be carried out by the intermediary selling units in the PIF.

2.3 The MFSA is also considering reducing the minimum investment threshold in an Experienced Investor PIF from the current Euro 15,000 to Euro 10,000. This should enable experienced investors to diversify their investment portfolios further by not requiring them to commit Euro 15,000 to any one PIF. Moreover, the proposed new investment restrictions should enhance risk diversification. The Authority would however like to stress to intermediaries selling Experienced Investor PIFs that they are expected to satisfy themselves that the investor has the necessary experience and knowledge in order to understand the risks involved in investing in the PIF and that the MFSA will be monitoring the extent to which the appropriateness tests, are properly performed by intermediaries selling Experienced Investor PIFs to investors who do not qualify as Professional clients in terms of the Investment Services Rules for Investment Services Providers which transpose MiFID.

3.0 Proposed Way Forward

Following the consultation period and once the proposed changes are finalised, it is currently intended that these are published and operative as from 1st October, 2009 or such later date as may be specified. Moreover, Experienced Investor PIFs licensed prior such cut-off date, will have the option to reduce their minimum investment limit to Euro 10,000 subject to compliance with the proposed new investment restrictions OR to continue to be subject to the current regulatory requirements.

4.0 Consultation Period and Contacts

Interested parties are requested to send their submissions in writing to the Director – Securities Unit, MFSA (or by email at su@mfsa.com.mt) by **not later than the 30th June, 2009.**

In case of difficulties, please contact Dr. Sarah Pulis on 25485232 or spulis@mfsa.com.mt or Mr. Robert Higgans on 25485230 or rhiggans@mfsa.com.mt.

Securities Unit – 21st May, 2009