

Asset Management Strategy

Strengthening Malta's Position as an
Asset Management Jurisdiction

Discussion Paper

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Letter to CEOs in the Asset Management Industry



Joseph Gavin
Chief Executive Officer

Dear Chief Executive Officer,

As my first public act in my role as CEO, I am delighted to publish the MFSA Asset Management Strategy for 2022.

Over the years, Malta has established itself as an EU jurisdiction of choice for asset managers and investment funds. However, we note that the sector has undergone many challenges in recent times and has been losing ground to other EU jurisdictions.

This strategy is part of our overall dialogue with stakeholders in the sector, including industry and consumer representatives, and we intend it to be a living process inviting your feedback to ensure a vibrant sector that is well supervised by the MFSA.

Our strategy sets out a range of regulatory initiatives, including improvements in our internal processes as well as proposed revisions to the framework for asset managers and investment funds in Malta, seeking to improve the attractiveness of Malta as a preferred jurisdiction.

We welcome your feedback and assure you of our high commitment to effective regulation of the sector.

Kind regards,

A handwritten signature in blue ink that reads "Joseph Gavin". The signature is written in a cursive, flowing style.

Joseph M. Gavin

Table of Abbreviations

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Alternative Investment Fund Managers Directive
AIFMR	Alternative Investment Fund Manager Regulation
AML/CFT	Anti-Money Laundering/ Combating the Financing of Terrorism
CIS	Collective Investment Scheme
ESG	Environmental, Social, Governance
DAO	Decentralised Autonomous Organisations
DLT	Distributed Ledger Technology
EU/ EEA	European Union/ European Economic Area
FinTech	Financial Technology
ISA	Investment Services Act, Chapter 370, Laws of Malta
LP	Limited Partnership
ManCo	Management Company
MBR	Malta Business Registry
MFSA	Malta Financial Services Authority
MoU	Memorandum of Understanding
NAIF	Notified Alternative Investment Fund
NAV	Net Asset Value
PIF	Professional Investor Fund
PQ	Personal Questionnaire
RegTech	Regulatory Technology
SCMS	Supervisory Cycle Management System
SMS	Securities and Markets Supervision
UCITS	Undertakings for Collective Investment in Transferable Securities

1 Introduction

The attractiveness of Malta as a reputable financial services domicile which has succeeded in attracting financial services business to the jurisdiction over the past decade, has been driven by various critical pull factors. These factors have largely helped the jurisdiction to develop an industry which is represented by international asset servicing operators in Malta, reaching out to both local and overseas clients.

Such pull factors notably include: the macroeconomic stability of the country; having a diversified finance centre and a comprehensive legal and regulatory framework, catering for various legal structures; and a comprehensive framework for regulated investment funds. Furthermore, as a jurisdiction, an extensive network of double tax treaty arrangements is in place, the business community is supported by a skilled work force, professional service providers and a diverse ecosystem, all of which make it ideal for both start-ups and established international entities.

That said, the local asset management industry has been not escaped unscathed from the impact of increased regulatory scrutiny, rapidly shifting environment and market turmoil, all of which have affected the growth of this sector in Malta. Asset managers are undoubtedly feeling the pressure of change while operating costs also keep increasing. At the same time, the sector is facing substantial regulatory and increased compliance requirements that operators need to abide with and might also be impacted by the upcoming Alternative Investment Fund Managers Directive (AIFMD) review.

In light of such an unprecedented event like the current pandemic, retail and professional investor demands are also changing, pushing asset managers to re-dimension and re-think the way that they are currently operating, including in terms of asset allocation. Against this backdrop, technological innovation and the need to invest in infrastructure tools have come into sharp focus and increasingly becoming an important competitive element for market operators, from both an operational processes and investment perspective.

One of the primary aims of the Asset Management Strategy is to ensure the continued stability and soundness of the sector through effective regulation, and facilitating business by means of streamlined, pragmatic and dynamic policy-making. In this respect, the Strategy focuses on revisiting certain existing regulatory frameworks with the aim of making the regime more pragmatic and accessible. The Strategy also focuses on the development of potentially new regulatory frameworks, as well as on initiatives that are directed towards the enhancement of MFSA authorisation and supervisory processes.

Furthermore, the Strategy also encapsulates a more holistic approach to asset management, ensuring a stronger business relationship with existing fund managers, as well as greater industry and regulatory outreach and collaboration with local key

stakeholders and institutions. This is aimed at ensuring a coordinated approach in enabling the further growth of this industry.

This Discussion Paper consists of four additional Sections as follows:

- **Chapter 2** provides an overview of the asset management industry in Malta, including an outline of the applicable regulatory framework, providing a background for the Strategy being presented by the MFSA through this document.
- **Chapter 3** explains the Asset Management Strategy, providing an outline of proposals forming part of the Strategy, by:
 - (i) providing a status update and visibility on the MFSA's current initiatives that are linked to the Strategy; and
 - (ii) setting out the regulatory and supervisory asset management initiatives that the MFSA is proposing as part of this Discussion Paper.
- **Chapter 4** seeks feedback from stakeholders as a conclusion to the Discussion Paper.

It is emphasised that the Proposals put forward in this Discussion Paper are not binding and are subject to further internal assessment and analysis to be undertaken by the Authority, following receipt of the representations received. It is important that persons involved in the consultation bear these considerations in mind.

2 The Asset Management Industry in Malta

2.1 An Overview¹

The financial services industry is considered to be a major contributor to the sustainable growth of the Maltese economy, accounting in 2020, for around 7% of it and around 5% of the total workforce in Malta². This industry features a diverse financial services portfolio, which – besides the traditional space – has also opened its doors to FinTech entrepreneurs.

Within the financial services sector as a whole, a key role is played by the asset management industry, composed of both funds that are invested through Maltese regulated investment vehicles and those managed by asset management firms. Over the past decade, Malta has proved particularly attractive to fund platforms, managers and administrators, who are able to service local or international funds from Malta, as well as to wealth managers, high-net-worth individuals and family offices, which benefit from the country's wide range of investment vehicles.

Most of the client base of the local asset managers and investment funds are typically professional investors made up of a combination of – largely – non-resident pension funds, financial institutions, insurance companies and, to a lesser extent, funds of funds, family offices and high-net-worth individuals.

Over the past two to three years, a number of economic, market, increased regulatory requirements and jurisdiction related issues have, however, impinged on both the continued operations of a number of existing funds and managers domiciled in Malta, as well as on the further growth of additional fund vehicles and asset managers. The development and growth of AIFs and UCITS funds in Malta has also been impacted to a certain extent by the lack of a European depositary passport, which continues to present challenges for operators establishing such types of funds in Malta.

On the fund managers side, in terms of size, as at December 2020, the estimated aggregate Asset under Management (AuM) managed by approximately 70 local asset managers (including local and overseas based collective investment vehicles and discretionary portfolio management) amounted to an estimate of €23 billion.

From a local funds' perspective, the aggregate NAV of Malta-domiciled funds experienced a decline of almost €2.2 billion over the period December 2019 to December 2020. Such decline has been the result of various factors, including the performance of the underlying markets which were negatively impacted by the global recession. As a consequence, funds

¹ Source: MFSA - The CIS statistics outlined in this section are available from <https://www.mfsa.mt/wp-content/uploads/2021/10/Collective-Investment-Schemes-licensed-by-Malta-Financial-Services-Authority-A-semi-annual-analysis-2021.pdf>

² Source: Ministry for Finance and Financial Services, Economic Policy Department - Economic Survey, October 2020: https://finance.gov.mt/en/the-budget/documents/the_budget_2021/economic_survey_2020_with_cover.pdf

experienced negative revaluation adjustments together with redemption flows, which substantially outperformed new subscriptions. However, such downturn has been partially counterbalanced in the first half of 2021, where the aggregate NAV of Malta-domiciled funds reached €17.7 billion by June 2021, registering an increase of 23.4% from the end of 2020. Of such aggregate NAV, AIFs made up 65.4%, followed by PIFs and UCITS funds at 18.8% and 15.8%, respectively.

In terms of the number of funds registered in Malta, as at 30 June 2021, these stood at 518, a decline of 1.3% compared to end 2020. The total number of funds comprises 116 AIFs, 282 PIFs, 110 UCITS, five Retail Non-UCITS, five Recognised Private CISs and 78 NAIFs.

With respect to the asset allocation of Malta-based funds, the majority of all fund categories has a diversified strategy, representing 43.8%. 31% of the aggregate NAV is represented by equity funds, then followed by 10.3% of bond funds.

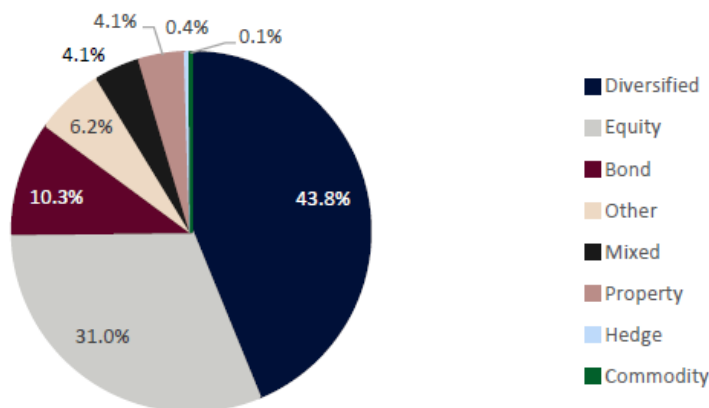


Figure 1: NAV by Asset Allocation (June 2021). Source: MFSA

As at June 2021, self-managed funds accounted for 36.5% of the total number of local funds, while among the third-party managed funds, the great majority relies on a local manager:

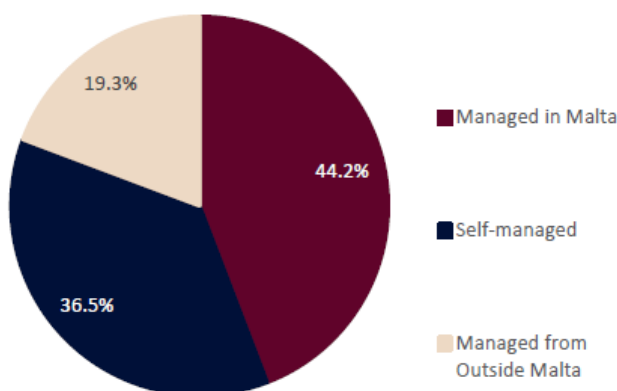


Figure 2: Management of locally based funds (June 2021). Source: MFSA.

2.2 Current Regulatory Framework of Fund Managers and Collective Investment Schemes

The following section covers the authorisation classifications of regulated fund managers and fund structures that are available within the Maltese regulatory framework, providing some general information with respect to the main features of each regime.

2.2.1 Fund Managers

Fund managers authorised in Malta require an **Investment Services Licence** and may opt for any of the following authorisation classifications:

- *De Minimis* AIFM;
- *De Minimis* AIFM and MiFID Investment Firm (requiring a MiFID licence);
- Alternative Investment Fund Manager;
- UCITS Management Company;
- UCITS Management Company and *De Minimis* AIFM; or
- Dual Authorisation Fund Managers (UCITS Management Company and AIFM).

2.2.1.1 AIFMs and *De Minimis* AIFMs

When the AIFMD was transposed to the Maltese legislative and regulatory framework in 2013, Malta had opted to regulate *De Minimis* AIFMs with a stricter regime than what is prescribed in the AIFMD³.

Therefore, *De Minimis* AIFMs are currently subject to regulation, authorisation and supervision by the MFSA, and both AIFMs and *De Minimis* AIFMs require a licence by the MFSA to operate as fund managers. The main distinction between the two types of authorisations, besides the maximum amount AuM that the entity is allowed to control, is the level of regulation and the intensity of supervision by the MFSA.

De Minimis AIFMs are exempted from complying with most of the AIFMD requirements, with the obligation of managing assets which collectively do not exceed:

- €100 million for leveraged AIFs; or
- €500 million for unleveraged AIFs with no redemption rights exercisable within the first five years⁴.

³ MFSA Consultation on the Rulebook applicable to *de minimis* licence holders, 22.03.13 < <https://www.mfsa.mt/publication/consultation-on-the-rulebook-applicable-to-de-minimis-licence-holders-2/>

⁴ In terms of Art. 3 of the AIFMD, an AIFM qualifies as a *de minimis* AIFM when:

- a. either directly or indirectly, through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manage portfolios of AIFs whose assets under management, including any assets acquired through use of leverage, in total do not exceed a threshold of €100 million; or

On the other hand, full-scope AIFMs are subject to all the requirements emanating from the AIFMD and can be licensed to provide Portfolio and Risk Management, together with non-core and ancillary activities, such as Discretionary Portfolio Management, Administration duties, Marketing, Reception and Transmission of Orders, Investment Advice and Activities related to the assets of the Alternative Investment Funds.

Only full-scope AIFMs are eligible for passporting rights, allowing them to manage and market AIFs in other EU/EEA jurisdictions in terms of the AIFMD passport.

On the other hand, *De Minimis* AIFMs are allowed to apply for a MIFID firm authorisation (which would not be allowed for full AIFMs) and also for a UCITS Management Company authorisation.

2.2.1.2 UCITS Management Companies

UCITS Management Companies (ManCo) are licensed to provide management of UCITS funds, which consist in the following functions:

- Investment management;
- Marketing; *and*
- Administration services.

Together with the above, UCITS ManCos are also allowed to provide discretionary portfolio management services and non-core activities (investment advice and safekeeping, and administration), and – similarly to full-scope AIFMs – can benefit from being able to passport any of their services in terms of the UCITS Directive in other EU/EEA countries.

A fund manager can also opt for dual authorisation as a full-scope AIFM and a UCITS Management Company, being therefore able to manage both AIFs and UCITS funds throughout the EU, which can then benefit from the passporting regime granted by the two Directives.

2.2.2 Funds

With respect to the fund toolbox envisaged by the Maltese regulatory framework, promoters have available a wide range of fund vehicles, which can be categorised with respect to their target investors. A brief description of each regime is included hereunder.

b. *either directly or indirectly, through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manage portfolios of AIFs whose assets under management in total do not exceed a threshold of €500 million when the portfolios of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF.*

2.2.2.1 Non-Retail Fund Structures

	Professional investors Funds (PIFs)	Alternative Investment Funds (AIFs)	Notified AIFs (NAIFs)
Regulatory Status	Subject to a licence	Subject to a licence	Subject to a notification – the fund will be set up within 10 working days after such notification
Fund Manager	Can be third-party managed or self-managed. When self-managed, they are categorised as <i>De Minimis</i> AIFMs.	Can be third-party managed or self-managed. When self-managed, they need to comply with all the provisions of the AIFMD concerning AIFMs.	Can only be third-party managed
Investment restrictions	None When 'investing in loans', specific requirements need to be fulfilled.	Only when targeting Retail Investors. When 'investing in loans', specific requirements need to be fulfilled.	Cannot engage in 'loan origination' and have to comply with prescriptive requirements when undertaking the activity of 'loan acquisition'. No other investment restrictions are envisaged.
Appointment of Service Providers	Fund Administrator and adequate safe-keeping arrangements.	Depositary and Fund Administrator.	Depositary and Fund Administrator.

Passporting Rights	Not granted (only under National Private Placement Regime - "NPPR")	AIFMD passporting rights (to Professional Investors) & NPPR	AIFMD passporting rights (to Professional Investors) & NPPR
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2.2.2.2 Retail Fund Structures

	Retail AIFs	UCITS
Structure	Can be both closed-ended and open-ended	Cannot be closed-ended
Fund Manager	Can be third-party managed or self-managed. When self-managed, they need to comply with all the provisions of the AIFMD concerning AIFMs.	Can be third-party managed or self-managed. When self-managed, they need to comply with all the provisions of the UCITS Directive concerning UCITS ManCo.
Investment restrictions	Restrictions apply with respect to investments in unlisted assets, exposures to a single body, investments in other CISs, exposures to FDIs.	Restrictions apply with respect to the permissible investment instruments and exposure to them.
Borrowing & Leverage restrictions	Borrowing is permitted up to maximum 10% of the fund's assets, leverage through FDIs is not permitted.	Borrowing is permitted only in certain circumstances and shall not exceed 10% of the fund's assets (15% in exceptional cases). Leverage through FDIs is subject to restrictions.
Appointment of Service Providers	Depositary and Fund Administrator	Depositary and Fund Administrator
Passporting Rights	Granted under the NPPR	UCITS passporting rights

Alongside the above-mentioned fund regimes, the Maltese fund framework also includes the **Recognised Private Collective Investment Schemes**.

This type of fund vehicle is private in nature and purpose, and the marketing of such funds to the public is therefore prohibited. Private CISs do not require a licence in order to conduct their activities, but a formal recognition is issued by the MFSA.

The main features of this fund framework are briefly summarised, as follows:

- The total number of participants is limited to 15 persons, one of which can also be a body corporate subject to certain conditions being satisfied;
- the participants must be close friends or relatives of the promoters, and all of them are subject to the MFSA fitness and properness assessment;
- the scheme must not qualify as a Professional Investor Fund;
- there are no specific requirements insofar as the investment strategy of the Private CIS is concerned, nor with respect to the appointment of service providers or officials of the Scheme; *and*
- in view that Private Schemes are not licensed but recognised, the special income tax rules applicable to other types of collective investment schemes do not apply and, as such, such type of fund structures are not eligible for the exemption from tax applicable in respect of the income of an investment fund.

2.3 The MFSA's Approach to the Authorisation and Supervision of Asset Managers and Funds

The MFSA is responsible for the regulation, monitoring and supervision of firms in the financial services sector in Malta. The aim of these responsibilities is ultimately that of safeguarding the integrity of markets and to maintain stability within the financial sector for the benefit and protection of consumers of financial services.

The entire regulatory and supervisory action carried out by the Authority revolves around the above objective, and, therefore, the MFSA places considerable focus on the suitability, experience and track record of applicants and all other parties involved, fostering a healthy regulatory environment which promotes competition and choice, innovation and trust in the Maltese financial services sector.

In practice, this translates into a regulatory framework which:

- requires all fund managers and funds to obtain authorisation, be it a licence, notification or recognition, based on specific requirements emanating from the various regulatory frameworks;

- is proportionate and risk-based: the extent of the requirements and scrutiny at authorisation and intensity level at supervision stage is greatly dependent on the nature and scope of the business activities of the entity, and the overall risk profile;
- comprehensive, giving access to different investment services typologies; and
- flexible and attentive to the industry's needs: financial services constantly evolve at a rapid pace and the Regulator has a duty to try and keep abreast with market developments in order to assist firms in embracing technology, overcoming the challenges it presents and taking advantage of the opportunities made possible through it. The MFSA strives to ensure that its regulatory and supervisory approach keeps pace with such technological progress, while adapting to embrace such technological shifts to better suit the needs of the financial services industry.

The MFSA's Securities and Markets function is responsible for, *inter alia*, the authorisation, oversight and prudential supervision of asset managers and CISs.

The MFSA ensures proper supervision of fund managers through onsite and offsite supervisory engagements. As outlined in a recent [Publication](#) issued by the MFSA, as part of the onsite engagements of asset managers, the MFSA *inter alia* focuses on the fund manager's (i) alignment of business model and strategy with the licence/permissible activities; (ii) profitability and regulatory capital buffers; (iii) adequacy of internal governance and organisational structure arrangements; (iv) investment management processes; and (v) risk management practices.

Furthermore, with regards to offsite supervision, the Authority carries out such work primarily through the review of returns, annual reports and audited financial statements submitted by fund managers and engagements on an *ad hoc* basis in relation to specific issues which may arise from time to time. This information, together with other data requested on an *ad hoc* basis, is then considered by the Authority in drawing up risk metrics and ratings for all fund managers, which are used as a basis for determining the intensity of supervision required for the respective entity.

As part of the supervision process of CISs, the MFSA ensures that these are in compliance with the provisions emanating from the various applicable rules and regulations relevant to the type of fund structure. The offsite and onsite supervisory work carried out may focus, *inter alia*, on the alignment of the underlying portfolio of assets with the investment strategy and restrictions contemplated by the relevant rules and offering documentation; the NAV trends and performance as well as the adequacy of internal governance arrangements and control functions.

2.3.1 Supervisory Engagement with Fund Managers and CISs

The Asset Management Strategy workstream does not only entail enhanced MFSA processes to ensure greater efficiency, or the review and/or development of frameworks. It also entails supervisory efforts in this area in ensuring a closer engagement with authorised fund managers and CISs in order for such entities to be able to achieve even higher standards of compliance with the regulatory frameworks, as part of the supervision process.

The use of thematic reviews and related circulars and guidance issued by the Authority from time to time is one way of how the MFSA communicates the expected standards and provide required guidance. As outlined in the [MFSA Supervision Priorities 2021](#), the Securities and Markets function has carried out a thematic review on liquidity risk management practices of AIFMs and UCITS Management Companies. Common findings identified as well as best practices to be adopted have been subsequently communicated to the industry, together with other general findings from onsite supervision.

Furthermore, during 2020, the Authority also carried out supervisory interactions covering *inter alia* the areas of governance, risk, compliance, as well as the internal controls employed by authorised entities in order to mitigate AML/CFT risk. In particular, in view of the COVID-19 developments, the SMS function also carried out reviews on the functionality of the business continuity arrangements employed and disaster recovery plans implemented by authorised entities.

Within the asset management and funds sphere, during 2021, the Authority built on the work carried out in 2020 and continued conducting thematic supervisory interactions on outsourcing of key functions. In addition, supervisory work was also conducted within the context of ESMA's Common Supervisory Approach on the adequacy of the fees and costs charged by funds in terms of the investment strategy of the fund, as well as compared to industry benchmarks, including performance and management fees.

Follow-up work is also being conducted on liquidity management of UCITS funds. Moreover, emphasis is also being placed on the operations of the existing depositaries of local CISs and additional procedures will be introduced to improve the cross-border collaboration of the MFSA with other National Competent Authorities, in particular for fund managers making use of the management passport.

Further to the above and on a more general cross-sectoral note, the Authority is increasingly placing greater supervisory focus on the timely submissions of regulatory returns by authorised entities. In this respect, the MFSA is also currently assessing the possibility of introducing stricter supervisory actions for delayed submissions.

Besides being a regulatory requirement, the greater push for ensuring timely submissions of returns is largely also in view of the overall strategic focus being placed by the Authority in ensuring accurate and timely regulatory data quality. Such data is considered as being a critical enabler for robust supervision, as well as for the monitoring of risks to markets and investors, and timely supervisory interventions.

2.3.2 Strengthening Governance and Compliance Standards

As shown by the [cross-sectoral analysis](#) published by the MFSA in November 2019, the promotion of a healthy and resilient financial sector must not disregard the importance of good governance and high compliance standards, which are in fact key priorities that the MFSA intends to keep fostering. Furthermore, as communicated in the [MFSA Strategic Plan 2019-2021](#), the Authority is committed to ensuring that the highest standards of governance, risk management, culture and conduct are applied within the financial services market, contributing towards enhanced accountability, market trust and transparency.

With regards to the asset management sector, weak governance and compliance issues are regularly raised by the Authority during onsite inspections held by SMS with authorised entities. MFSA circulars on the findings of the MFSA's inspections have also consistently highlighted related weaknesses, including the standards expected by the MFSA in this regard.

In line with the Authority's strategic priority of strengthening the overall governance, conduct and culture within the financial services sector, the MFSA embarked on a project aimed at strengthening the overall corporate governance standards of authorised entities. To this end, in February 2020, the [Stakeholder Consultation on Revisiting the Corporate Governance framework](#) was issued, proposing a comprehensive, principle-based and cross-sectoral Corporate Governance code. The Consultation Paper included a number of proposals covering a broad range of governance aspects, including:

- enhancing the effectiveness of the Board of Directors;
- revisiting the responsibilities of licence holders' functionaries and officials;
- strengthening engagement with stakeholders, shareholders, institutional investors, and employees; and
- several provisions with respect to different aspects of corporate governance including *inter alia* committees, corporate culture, ethics framework, AML and CFT, and risk management.

This project, which will not merely address asset management but will be undertaken on a cross-sectoral basis, continued this year with the issue of the [Feedback Statement to the Consultation Document](#). This will be followed by the publication of a consolidated MFSA Corporate Governance Code.

Further to this, additional policy work is planned in order to strengthen as needed the governance provisions emanating from the various MFSA Rulebooks, drafting of sectoral Codes and/or Guidance Notes. This workstream aims to have a major impact in instilling good corporate governance, to drive behavioural change and to raise standards overall.

3 The Asset Management Strategy

3.1 Introduction

The formulation of this Strategy required a thorough understanding of the different stakeholders' perspectives of the various issues being encountered, as well as other feedback on innovative proposals that could potentially be developed and implemented by the MFSA.

With this in mind, over the past year, the Authority sought direct engagement with senior executive stakeholders from the industry, with the aim of:

- **Understanding the critical issues encountered by practitioners:**
 - i. when dealing with the Regulator;
 - ii. issues encountered relating to the current regulatory frameworks including in terms of accessibility;
 - iii. practical issues when doing business in Malta;
 - iv. issues encountered in relation to the marketing of funds and of this sector in general in other jurisdictions and related barriers to entry; and

- **Exploring new strategic initiatives:** both from a regulatory and policy development perspective that may be adopted by the MFSA. The Authority also sought to understand what was being done or planned by way of initiatives undertaken in collaboration between key stakeholders involved in promoting Malta to the wider international asset management and financial community in order to obtain any leads that might influence its policy-thinking, from a broader regulatory and strategic perspective.

Stakeholders providing feedback included representatives of the industry, mainly consultancy firms, fund managers and funds, FinanceMalta, as well as selected individual stakeholders having involvements with local funds and fund managers and/or a good knowledge of the dynamics of this sector in Malta.

Further to the analysis of the critical issues presented to the MFSA as part of this engagement, as well as a statistical analysis carried out with regards to a degree of attrition in the growth of locally-domiciled asset managers and funds alike, this has substantiated further the need for the MFSA to put strategic focus on this sector. Policy work by the Authority on this area commenced in 2020 and is ongoing.

The above resulted in the development of an overarching Strategy focusing on initiatives addressing the criticalities that this sector is facing and to the identification of possible measures to be taken in order to address them. Furthermore, also forming part of the

Strategy, focus is being placed on strategic initiatives aimed at fostering long-term sustainable growth in this sector. While a number of policy initiatives have already been launched, this workstream should be further boosted by feedback obtained following the publication of this Consultation Document.

It is to be noted that the content of Pillar I of the Strategy is linked to an MFSA cross-sectoral exercise (i.e. not just focusing on fund managers and funds). Accordingly, this exercise, which is being undertaken as a separate standalone, critical project by the MFSA, is designed and expected to impact the overall processes across the sectors.

3.2 The Four Strategic Pillars

The proposed initiatives forming part of the Asset Management Strategy are being classified into four main Strategic Pillars:

Pillar I – MFSA Supervisory Lifecycle Processes

Pillar II – Revisiting Current Fund Manager and CIS Regulatory Frameworks

Pillar III – Innovation through Regulation

Pillar IV – Regulatory Outreach and Collaboration efforts with Industry Stakeholders and Internationally

The following sections provide an overview of the initiatives forming part of the Strategy, which includes a combination of proposed initiatives that have been either already implemented or are currently in the process of being implemented, or else which being proposed as part of this Discussion Paper.

3.3 Pillar I - MFSA Supervisory Lifecycle | Processes

Pillar I deals with initiatives relating to the restructuring and enhancements of the MFSA's Supervisory Lifecycle processes.

As part of the MFSA's industry engagement in the context of the fund management and the funds sectors, several issues have been raised that relate specifically to the MFSA internal processes (including authorisation and supervision-related matters) and how efficiency can be improved in this respect.

The Authority has considered such aspect and the feedback received in the context of all sectors falling within the remit of the MFSA, not just for the asset management industry. As part of the ongoing efforts to enhance the supervisory and regulatory approach, the Authority has embarked on an MFSA-wide project to re-evaluate and where necessary, re-engineer, the Supervisory Lifecycle and its underlying processes, with the aim of ensuring longer-term efficiencies and effectiveness, as well as consistency across all sectors.

At this stage, the MFSA is focusing on its Authorisations (including due diligence) and all application forms have been revised with the aim of ensuring consistency, to the extent possible, between the different sectors. In this regard, the extent of information required when filing an application, together with the relevant documentation to be submitted, have also been reassessed accordingly and on the 30 June 2021, [the MFSA communicated to the industry](#) the implementation of a revised authorisation process, together with the launch of a new dedicated authorisation webpage, and revised forms and templates required throughout the entire Authorisation process.

In structuring the new application forms, the Authority also took care to ensure that there is a clear demarcation between the information required at authorisation stage and that required at supervision stage and – in particular – consistency in the information being asked for by the Regulator in respect of similar types of applications and in handling applications.

In this respect, complementing the MFSA's Authorisation Process, the Authority concurrently published the [Authorisations Process - Service Charter](#) (Charter). The aim of the Charter is to communicate to applicants seeking authorisation what it is expected of them and to set out the MFSA's commitment in return. The Charter is meant to be a starting point when an applicant is considering applying for authorisation by providing high-level guidance, setting out the main changes and enhancements affecting the processing of applications that will be implemented by the Authority as well as its expectations in terms of regulatory standards. The Charter also includes timeframes that applicants should expect in relation to certain types of applications.

Further to the above, while a scoring system is already in place and used by Supervisory functions, the Authority is in the process of developing a formal **risk-based ranking framework** for all authorised entities, which will differentiate and, to a certain extent, also standardise the supervisory approach. This is expected to have a positive impact in terms of consistency and transparency matters on the authorisation process of both funds and fund managers, which assessment and risk-scoring will consider, *inter alia*, matters such as:

- the nature of the services being provided by the applicant, and whether it entails the holding or controlling of clients' money or assets;
- the type of target clients of the applicant, and whether these are retail or professional; and
- the extent of use of external regulated service providers, such as sub-investment managers or investment advisors.

Such developments are then expected to result in a more consistent supervisory process, by providing MFSA with better tools to assess the inherent risk of authorised entities and to prioritise its resources accordingly, as well as to compare and analyse entities bearing similar risk-scores while also looking at sector-specific supervisory matters which may arise thanks to a more focused and informed supervisory process.

It is to be noted that with regards to the area of fund management and funds, in order to improve process efficiency and in line with the increased onus and responsibility being placed on the governing body of the entity to ensure compliance with the relevant requirements, over the past year, the Authority has also implemented a number of changes in relation to certain documents that were previously required to be both submitted and approved by the MFSA.⁵

⁵ For example; i) No MFSA approval for changes to Terms of Reference of any internal Committees of an authorised entity ii) No MFSA approval for new Committees other than a Notification and Entity Assessment Letter of Proposed Members iii) Changes to Risk Management Policy – Not subject to MFSA approval - just Notification iv) KIIDs not subject to prior MFSA review (just provision of copy & changes)

3.4 Pillar II - Revisiting Current Fund Manager and Fund Regulatory Frameworks

Pillar II addresses initiatives targeting fund managers and funds, aimed at either enhancing or restructuring existing frameworks in order to make such frameworks more pragmatic and accessible to the industry.

It should be noted that as part of the overarching Asset Management Strategy being published in this document, the Authority has already implemented certain initiatives, and is close to implementing others. An overview of these proposals is detailed below.

Upon receipt of industry's feedback, and when taking into consideration the potential implementation of the proposals as detailed in this document, stakeholders are reminded that the MFSA will act, at all times, in accordance with its [Risk Appetite Statement](#) to achieve its strategic goals and objectives in pursuit of its remit as the single regulator of financial services in Malta.

Besides such initiatives, the Authority is also exploring the possibility of other proposals that are believed to be of potential benefit for the industry and is hereby inviting industry feedback in this respect.

3.4.1 Proposal 1 - Revisiting of the MFSA Loan Fund Framework (Implemented)

In April 2014, the MFSA published a new set of Investment Services Rules (Loan Fund Rules) applicable to funds "investing through loans", i.e. which directly originate loans (loan origination); and/or acquire portfolios of existing loans (loan participation).

After taking stock of the progress of the MFSA Loan Fund Rules framework over the years, also having regard to market developments and industry feedback on the matter, on 10 November 2020, the MFSA published [Revised Loan Fund Rules Framework](#). The intention was that of making the framework more accessible, while retaining a regulatory framework which is prescriptive and sound enough to address the risks that such vehicles may pose.

Besides undertaking an assessment of the current applicable requirements of the MFSA Loan Fund regime, attention was given by the Authority to the relevant EU regulatory developments and, in particular, the focus being placed on the area of non-bank financing by the European Commission, within the wider context of the Capital Markets Union. The revised Loan Fund Rules:

- reflect the direction taken at ESMA level with respect to loan origination;

- relax or remove a number of the current applicable rules which have been deemed too stringent or too restrictive;
- incorporate in the Rulebook the FAQ document which was published in 2015 and which clarifies a number of matters with respect to the Rules;
- remove the current Standard Licence Conditions applicable to AIFs investing through loans and that are merely replicating the requirements applicable for AIFMs in terms of the AIFMD; and
- provide a more accessible framework for *De Minimis* AIFMs, which according to the previous framework had to abide by the same requirements as full scope AIFMs.

Q1a	What is your view with respect to the revisions made to the MFSA Loan Fund framework?
Q1b	Do you believe it merits further improvements in order to enhance its accessibility while not compromising its regulatory soundness?

3.4.2 Proposal 2 - Revisiting of the Notified AIF Regime (Implemented)

Another initiative in relation to which the Authority has received substantial feedback relates to the proposal relating to revisions to the MFSA Notified AIF Regime.

Back in 2016, the MFSA launched a new fund structure for Alternative Investment Funds (AIFs) – [the Notified AIF \(NAIF\) regime](#). The intention was to offer fund managers a straightforward and quick process for establishing AIFs in Malta: AIFs falling within this regime are subject to a process of notification to the Authority which commits to process and register the NAIF in 10 working days, with no formal authorisation required and no ongoing supervision being carried out on these funds.

The full-scope AIFM establishing and managing the NAIF is required to take full responsibility with respect to the fund, which in turn is subject to the relevant provisions emanating from the AIFM Directive.

The take-up for this fund framework to date has been relatively positive and, since inception, NAIFs notifications experienced a steady increase. However, since the regime was issued, while positive feedback has been received with regards the relatively short timeframe needed to set up a NAIF in Malta, feedback was also received with respect to a number of aspects relating to this type of fund structure, notably with regard to the investment restrictions currently applicable to the regime, which limit the NAIF investments to certain asset classes only.

Accordingly, after due consideration, it was determined that the NAIF framework could be enhanced further, while also strengthening the supervisory focus on AIFMs managing NAIFs, making sure that the fund manager is in compliance with the relevant Rules. In this respect, the Investment Services Act (List of Notified AIF) Regulations, 2016 [was officially amended](#) to *inter alia* reflect the revised framework (as well as amending certain provisions that required updating) and on 24 June 2021 **the revised Notified AIF regulatory framework has been communicated to the industry**, together with the publication of a [standalone NAIF Rulebook](#).

The re-assessment of the NAIF Regime has focused on:

- broadening the scope of permissible instruments that such funds are allowed to invest in, as well as amending certain other minor provisions that require updating;
- addressing certain other restrictions that are currently in place with respect to NAIFs;
- creating a consolidated Rulebook detailing all the Investment Services Rules applicable to the NAIF regime in order to address a current regulatory gap in the framework, while also addressing the need to update certain provisions.

Q2

Is there any suggestions and/or feedback with respect to the revised NAIF Framework which you would like to provide?

3.4.3 Proposal 3 - Fitness and Properness of Committee Members Appointed by Authorised Entities (Implemented)

As part of the efforts that are being made by the MFSA to streamline and enhance the efficiency of the authorisation process, and promote good corporate governance practices across the financial services industry, the Authority is increasingly putting more onus on the important role of the governing body of authorised entities, when appointing key members with the entity. Within this context, the Authority has reassessed the current approval process of persons being proposed to hold Committee positions with certain authorised entities.

The Authority is of the view that the [due diligence process](#) which certain officials within regulated entities are subject to shall be increasingly focused on ensuring the fitness and properness of (i) those positions which can *effectively* influence the direction of an entity or (ii) those roles which in light of the nature of their role, occupy certain positions of trust within the entity; while increasingly putting more onus on the Board of the entity when it comes to ensuring the fitness and properness of less influential officers.

In [July 2020](#), the MFSA issued its revised position in relation to the submission of the PQ and related fitness and properness assessment carried out by the Authority in respect of Committee members, and Valuation Officers of MiFID Firms, Fund Managers and self-managed Collective Investment Schemes.

Accordingly, committee members and valuation officers have been excluded from the definition of “senior management”⁶ provided in the MFSA Rules and officials being proposed to hold such positions will no longer be vetted by the Authority. Authorised entities are still expected, however, to undertake internal due diligence upon engagement, and ongoing due diligence checks of any committee members and valuation officers. The Circular further sets out that the requirement of submitting a PQ Form remains valid in a number of scenarios.

Q3

Do you have any suggestions and/ or feedback with respect to the change in regulatory approval of Committee Members within CISs and ISLHs which you would like to provide?

3.4.4 Proposal 4 - Revisiting the Recognised Private CISs Framework

As detailed in Section 2.2 of this document, the Maltese regulatory framework currently envisages the possibility of setting up a recognised investment vehicle: the [Recognised Private CIS](#).

Under this framework, Recognised Private CISs are exempt from the need to obtain a CIS licence by virtue of their nature, which shall be “private in nature and purpose”. This translates in a requirement to limit the total number of the participants to the fund to 15 persons, which shall be “close friends or relatives of the promoters”.

Recognised Private CISs are subject to a recognition process, which revolves around ascertaining the fitness and properness status of all the participants to the CIS, while no other prescriptive requirements are imposed with respect the structure, appointment of officials or service providers, or investment strategy. In terms of the current framework, Recognised Private CIS are treated as falling outside the scope of the AIFM Directive, in terms of Recital 7.

However, under the current framework, Recognised Private CISs would necessarily always fall outside the scope of the AIF definition, in light of the fact that Article 4(1)(a)(i) of the

⁶ The MFSA Rules define **senior management** as “those natural persons who exercise executive functions within the Licence Holder and who are responsible, and accountable to the Management Body, for the day-to-day management of the Licence Holder”.

AIFMD provides that: “(...) *Investment undertakings, such as family office vehicles which invest the private wealth of investors **without raising external capital**, should not be considered to be AIFs in accordance with this Directive*”.

[The ESMA Guidelines on key concepts of the AIFMD](#) elaborate further on the concept of raising capital mentioned above, providing that “*when capital is invested in an undertaking by a member of a **pre-existing group**⁷, for the investment of whose private wealth the undertaking has been exclusively established, this is not likely to be within the scope of raising capital*”.

Consequently, allowing ‘close friends’ of the promoter as part of the investors to the Recognised Private CIS (which as per the definition above, would not be part of a ‘pre-existing group’) may result in these funds falling within the scope of the AIFMD.

Accordingly, it is being proposed that the current definition of a Recognised Private CIS is therefore revised and aligned with that of a ‘pre-existing group’ set out in the ESMA Guidelines.

Furthermore, on a broader scale and further to preliminary industry feedback received with regards to this framework, the MFSA is also considering the possibility of undertaking a wider restructuring of the Recognised Private CIS framework, in order to make it a possible structure for the management of private wealth.

The following are the main key features that are being considered as part of the revised structure for this framework:

- this CIS would continue to be granted a “Recognition” by the MFSA;
- this CIS will be made available only to a pre-defined / selected type of investors and would still not be eligible for passporting;
- Recognised Private CISs i) would still be required to fall within the CIS definition, ii) be private in nature and purpose and precluded from undertaking a commercial activity, and iii) still subject to certain authorisation checks and a degree of supervision;
- requirement to appoint at least one resident director (for corporate vehicles);
- allowed to engage an external asset manager and/or be self-managed;
- allowed to engage brokers and/or custodians based outside Malta in relation to the safekeeping of assets that can be held in a securities account and required to retain proper records in relation to other assets;

⁷ The pre-existing group is clearly defined by the Guidelines as “**a group of family members**, irrespective of the type of legal structure that may be put in place by them to invest in an undertaking and provided that the sole ultimate beneficiaries of such legal structure are family members, where the existence of the group pre-dates the establishment of the undertaking. This shall not prevent family members’ joining the group after the undertaking has been established. For the purpose of this definition, ‘family members’ means the spouse of an individual, the person who is living with an individual in a committed intimate relationship, in a joint household and on a stable and continuous basis, the relatives in direct line, the siblings, uncles, aunts, first cousins and the dependants of an individual”.

- requirement to engage a Maltese Fund Administrator that is recognised by the MFSA in terms of the ISA;
- Recognised Private CISs would start being subject persons⁸ for AML/CFT purposes and therefore be required to appoint an MLRO;
- be subject to regulatory reporting and drawing up of audited accounts on an annual basis;
- be required to draw up an information memorandum for investors (contents would be prescribed by the MFSA);
- governing body would be subject to fit and proper assessment by MFSA;
- bringing the taxation treatment of this fund in line with the local tax framework applicable to the rest of the regulated CIS frameworks.

Q4a

Do you see scope and added benefit for a revision of the Recognised Private CIS framework and why?

Q4b

If yes, what are your views on the proposed features of the revised framework, and do you have any suggested amendments in this respect?

3.4.5 Proposal 5 - A Restructured Limited Partnerships Legal Framework for CISs

A key consideration for any applicant establishing a fund in Malta is the type of corporate structure for the vehicle used to structure the CIS. The Maltese legislative framework permits the setting up of structures in the form of Limited Partnerships ('LPs').

While the basic provisions regulating the LP have remained the same over the years, specific provisions regulating the establishment of CISs as LPs were added to the Companies Act by means of Act IV of 2003. These provisions are contained in Article 66A and the Tenth Schedule to the Act (the Schedule), which modify and adapt the basic provisions related to the LPs to specifically cater for CISs.

As the LP structure became more popular at the time with fund managers, further amendments to the Schedule were brought in by Act XX of 2013 and Legal Notice 478 of 2014 to optimise the use of the LP as a fund vehicle. Among the most important features of the Maltese LP that were introduced is the option to have the investment scheme's capital divided or not divided into shares. This enhances the transparency of the structure thereby increasing its flexibility. Other key changes have substituted the requirement to register the Partnership Deed by the submission of a simple registration form and clarified

⁸ The Prevention of Money Laundering and Funding of Terrorism Regulations defines 'subject persons' as "any legal or natural person carrying out either relevant financial business or relevant activity".

the instances in which the LP is required to submit accounts, further simplifying the compliance framework for LPs.

These features did not alter the basic nature of the LP which, unlike the General Partnership, can continue to contract in its own right with limited liability where limited partners are concerned. Moreover, since limited partners are essentially passive members, the LP structure is particularly suitable for CISs since it is the general partner who is responsible for the management of the partnership. A LP may consist of one or more general partners and one or more limited partners and be registered with fixed or variable share capital, as a multi-class LP or a multi-fund LP.

The LP has a number of practical uses in ordinary business and in a financial services context. A number of CISs, particularly alternative investment funds, have been established in Malta as LPs. LPs operating as CISs require a licence or other form of recognition from the MFSA in terms of the ISA.

Following a surge in the investors' search for yield, the need for diversification and long-term investments, the past few years have seen incredible growth in alternative investments and less liquid assets, including private equity. Furthermore, the demand for the use of LPs also increased in view of the initiatives taken by the European Commission with regards to the harmonised rules for venture capital funds and long-term investment funds, where LP structures could be considered as a more adequate structure for such strategies.

Although in practice an LP structure would be the typical structure of choice when it comes to private equity investment strategies, the most popular legal form for local investment vehicles over the years has remained corporate variable capital funds (SICAV).

With the aim of increasing Malta's attractiveness for private equity funds and having in place a more bespoke corporate regulatory framework and structuring solution for limited partnerships, the MFSA is proposing that this framework is revisited.

Work in this respect could, *inter alia* entail:

- enhancing the contents of the Schedule to offer a competitive legal framework for CISs established as limited partnerships, so as to be able to leverage appropriately this increased interest in alternative investments. In this respect, the MFSA intends to conduct a thorough analysis with respect to the features that such a legal framework should have in order to enhance its attractiveness and to position it as a commercially-viable vehicle for investment funds, particularly for illiquid assets. Aspects of such frameworks that are being considered include the possibility of having limited partnership structures without separate legal personality; and

- effecting changes and enhancements to the MFSA’s CIS Rulebooks and related requirements relating to the establishment of CISs structured as LPs.

Q5a	Do you see scope for the enhancement of the LP legal framework?
Q5b	Do you have any recommendations with respect to the specific features that the framework for funds established as limited partnerships should include?
Q5c	Do you see scope for Malta, as a jurisdiction, to explore the possibility to complement the existing MFSA’s regulated and lightly-regulated investment toolbox with a structure that – albeit it would take the form of a CIS – would be in the form of an unregulated fund structure (falling outside the authorisation and supervision of the MFSA, but subject to certain registration requirements)?
Q5d	If yes, which type of corporate legal form do you consider would be best suited for such a structure?

3.4.6 Proposal 6 - Defined Proportionality Guidelines

The regulatory framework applicable to AIFMs and UCITS ManCos and self-managed CISs, envisages a number of scenarios in which certain requirements are eligible for a derogation by the MFSA in terms of the proportionality principle. These derogations (or exemptions) relate to the requirements emanating from the AIFM and UCITS Directives of having (i) a functionally and hierarchically independent risk management function; (ii) an independent internal audit function; and (iii) a remuneration committee and a prescriptive pay-out process.

Each request for derogation is assessed on its own merits by the Authority depending on the scale, nature, size and complexity of the authorised entity. Once granted by the MFSA, such derogations would also need to be properly assessed and monitored by the authorised entity, submitting also periodic confirmations to the MFSA with regards to the adequacy of the respective derogation, including the basis on which such an assessment would have been made.

To date, no defined proportionality guidelines have been issued by the Authority with respect to the aforementioned derogations in relation to these requirements. Supervisory experience and industry feedback have shown that the absence of such guidelines may lead to a degree of inconsistency in the treatment of the granting of these derogations by the Authority. In addition, requests have been made from time to time for more transparency

with the industry by the Regulator on what the relevant parameters (both qualitative and quantitative criteria) are when derogations are granted.

In aiming to address this issue and ensure both consistency and transparency in the treatment of these derogations throughout the whole authorisation and supervisory process, the MFSA is proposing the issue of Guidelines for the application of the proportionality principle⁹. Such Guidelines would set out parameters applicable to AIFMs and UCITS ManCos that the Authority would take into consideration when assessing whether an applicant/authorised entity should be granted a similar derogation.

The parameters that would be used for the purpose of assessing any derogation requests, would take into account considerations, such as the following:

- nature, scale, size and complexity of the proposed operational model of an entity;
- target market of the entity, in particular whether it will be targeting retail versus professional clients;
- marketing strategy of the entity;
- organisational structure and governance setup (including independence of the Board, presence/ passporting rights in other jurisdictions)
- proposed services to be provided by the entity (both core and ancillary); and
- financial position.

While such Proportionality Guidelines would not substitute the MFSA’s required assessment in this respect, it is expected that such Guidelines would enable greater efficiency in the processing of these derogations and as specified above, lead to more consistency in the treatment of such requests, as well as providing entities with clarity with respect to the internal assessment carried out by the MFSA when applying the proportionality principle and the granting of these derogations.

Q6a	Do you agree and see benefits associated with the proposal of having defined Proportionality Guidelines for AIFMs and UCITS ManCos in the context of risk vs portfolio management and also the internal audit function?
Q6b	If yes, are there suggestions with regards to specific criteria that you would deem the Authority should consider in the drafting of these Guidelines?

⁹ While for the purpose of the Asset Management Strategy, focus is being placed on fund managers and CISs, the Authority may consider adopting similar Guidelines also to MiFID firms.

3.4.7 Proposal 7 - Revisiting the Investment Committee Requirement for Fund Managers and Self-Managed CISs

In terms of the applicable Standard Licence Conditions emanating from the Investment Services Rules for Investment Service Providers and Investment Services Rules for CISs, local Fund Managers and self-managed CISs involved in the activity of portfolio management¹⁰ are required to have an in-house Investment Committee.

The establishment of an Investment Committee for fund managers and self-managed CISs is a homegrown requirement required by the local regulatory framework. Generally, the Committee needs to be made up of at least three voting members. Members of the Board are allowed to be part of it and its proceedings would be governed by Terms of Reference.

In terms of the applicable MFSA Rulebooks, the role of the Investment Committee include:

- monitoring and reviewing the investment policy of the mandates under management;
- establishing and reviewing guidelines for investments;
- issuing rules for stock selection;
- setting up the portfolio structure and asset allocation;
- making recommendations to the governing body of the CISs under management; and
- undertaking the day-to-day portfolio management of the mandates under management, unless such responsibility is delegated to one or more Portfolio Manager(s) which in turn can be a regulated entity or an individual(s).

Supervisory experience has shown that the prescriptive regulatory requirement to have a mandatory Investment Committee is, at times, for some entities being counterintuitive resulting in a 'tick-the-box' exercise and in increased costs, with no real value being added to the portfolio management function. This is in particular the case for entities where the set up of a Committee would not be adequate in view of the type of mandates being managed, as well as the overall organisational structure of the entity.

As mentioned earlier on, the Authority is increasingly putting more onus on the governing body of authorised entities, who are effectively responsible for directing, managing the operations of the entity and ensuring that the internal controls are in place. The Authority is of the view that placing an even greater emphasis on the calibre of the governing body being appointed in relation to the entity (including the overall collective composition, competence, and experience of the governing body) may mitigate the absence of an Investment

¹⁰ For the purposes of this Proposal, the term 'portfolio management' is used to refer to both collective portfolio management of CISs and for fund managers, also (individual) discretionary portfolio management as a MiFID activity.

Committee. Such aspect is also aligned with the overall strategic focus that the Authority is putting on the governing structures of authorised entities.

As also indicated earlier on under Proposal 4, in terms of the Circular dated 3 July 2020, Investment Committee members are no longer subject to the MFSA fitness and propriety assessment (unless the Committee is collectively responsible for the carrying out of the activity, as further explained in the aforementioned Circular). Such responsibility is now that of the authorised entity, which must in turn carry out such due diligence, both upon appointment and on ongoing basis.

With the aim of allowing sufficient flexibility in terms of the internal structure of firms in relation to the undertaking of portfolio management activities while remaining fully in line with the respective regulatory requirements, the Authority is now taking this a step further and is accordingly proposing that the regulatory requirement of having an Investment Committee is optional.

Applicants applying for a fund manager authorisation or an internally-managed CIS would still be expected to disclose in full, *inter alia*, the way the portfolio management activity will be undertaken once the authorisation is granted to the firm, explaining the dual control and business continuity arrangements that it would have in place, including an outline of the mitigating arrangements to ensure proper monitoring and oversight on the portfolio management activity. In addition, applicants would also be required to satisfy the MFSA local presence requirements applicable to such firms, at all times.

Q7a	What is your view on the proposal of making the Investment Committee optional?
Q7b	If you do not agree with the introduction of this proposal, explain the reasons why, including what are the risks that you envisage relating to the removal of this requirement.
Q7c	If you agree with this proposal, what safeguards do you deem would be necessary and in place in order to mitigate the absence of an Investment Committee setup.

3.5 Pillar III – Innovation through Regulation

Pillar III addresses initiatives targeted at proposing new regulatory frameworks that further facilitate the carrying out of asset management activity. This Pillar also includes increased collaboration with the industry to both facilitate and help in the scaling up of FinTech across this industry. The need for this collaboration has become more pronounced with the COVID-19 pandemic that has accelerated the pace of digital transformation, as well as the adoption of sustainability principles.

Respondents are to note that the MFSA still needs to undertake a full analysis of this proposal, including an assessment of the relevant risks and potential benefits arising from having a Notified PIF and a Registered *De Minimis* AIFM framework vis-à-vis also the Authority's risk appetite. At this stage, as a first step, the MFSA is inviting the industry to provide it with feedback on the possible introduction of such framework in order to be able to better assess the demand to have similar structures in place, related risks foreseen, together with alternative options relating to existing structures.

Respondents are to accordingly note that the proposed features of the Proposals as detailed below (including the Proposal itself altogether), do not imply that it will be adopted in the same way that they are being presented in this Paper.

3.5.1 Proposal 8 – Registered *De Minimis* AIFM

In terms of the current regulatory framework applicable for Investment Services Providers and CISs, *De Minimis* AIFMs are required to apply for an Investment Services Licence or a CIS licence (if self-managed) in terms of the ISA. Such entities are exempted from most of the requirements emanating from the AIFMD as they fall within the *De Minimis* threshold stipulated in Article 3 of the AIFM Directive.

As explained in Section 2.2 above, the Maltese regulatory framework contains licence conditions setting out, *inter alia*:

- the manager's capital requirements to be satisfied at the outset, of at least €125,000;
- governance and operational requirements;
- the ongoing requirements in terms of the licence conditions as set out in the respective MFSA Rulebooks covering fund managers and self-managed CISs.

In terms of the AIFM Directive, notwithstanding the possibility for Member States to adopt stricter rules, the AIFMD envisages limited conditions for small AIFMs to operate, and in particular *De Minimis* AIFM shall be¹¹:

- subject to registration with the competent authorities of their home Member State;
- required to identify themselves and the AIFs that they manage to the competent authorities of their home Member State at the time of registration;
- required to provide information on the investment strategies of the AIFs that they manage to the competent authorities of their home Member State at the time of registration;
- required to regularly provide the competent authorities of their home Member State with information on the main instruments in which they are trading and on the principal exposures and most important concentrations of the AIFs that they manage in order to enable the competent authorities to monitor systemic risk effectively; and
- notify the competent authorities of their home Member State in the event that they no longer meet the €100 million/€500 million *De Minimis* thresholds as applicable.

The MFSA is in this respect also inviting the industry's feedback in relation to a proposal put forward by a number of industry stakeholders to have a registered *De Minimis* AIFM framework, which is exempted from the requirement to hold an investment services licence, and subject to registration with the MFSA (in line with the AIFMD requirements applicable for *De Minimis* managers).

As a result, a *De Minimis* AIFM would be able to opt either to be registered with the MFSA, or alternatively, obtain a full licence¹². Should a *De Minimis* AIFM choose to be set up as a registered AIFM, its registration process would be largely limited to the criteria as set out in the AIFM Directive. Furthermore, such entities would also be subject to limited requirements, including, as a minimum:

- required to satisfy the MFSA that they have sufficient substance in Malta;
- remain a subject person for AML/KYC purposes, and hence be required to appoint an MLRO;
- be subject to a minimum amount of capital requirements.

The registration process would be processed by the MFSA within a stipulated period of time and would entail a lighter due diligence process, when compared to applicants applying for a full licence.

¹¹ Paragraph 3, Article 3, AIFMD.

¹² It is to be noted that in the first instance, however, registered *de minimis* AIFMs would not be allowed to manage any of the fund structures currently envisaged by the Maltese regulatory framework for collective investment schemes, which only permits licensed fund managers to manage such structures.

Q8a	Do you see scope for a registered <i>De Minimis</i> AIFM framework?
Q8b	If yes, why?
Q8c	What are your observations on the general features of the framework, and do you have alternative or additional recommendations in this respect?
Q8d	Do you consider that the current MFSA licensed <i>De Minimis</i> framework may be alternatively enhanced further, instead of having an additional framework such as the proposed registered <i>De Minimis</i> AIFM?
Q8e	If yes, in what way?

3.5.2 Proposal 9 – Notified Professional Investor Fund

Under the current MFSA regime, Professional Investor Funds are required to apply for a Collective Investment Scheme licence in terms of the ISA, which entails a number of requirements to be satisfied both at the outset and on an ongoing basis. Licensed PIFs may only be (a) managed by a European *De Minimis* AIFM; (b) managed by a non-EU full AIFM, (c) self-managed, and targeted to Qualifying Investors.

In order to achieve a better time-to-market for applicants and have another fund structure complementing the existing fund frameworks, the possibility of having a Notified PIF framework is being considered. The MFSA is accordingly inviting the wider industry's feedback in relation to such proposal put forward by a number of industry stakeholders, as further detailed below.

Similarly like a licensed PIF, the Notified PIF regime would not fall within the scope of the AIFMD and would only be available to Qualifying Investors. The Notified PIF would conceptually have the below features/need to satisfy the following requirements:

- Notified PIF would only be allowed to be managed by (i) an authorised EU-based *De Minimis* AIFM or (ii) an authorised non-EU AIFM. The MFSA would make available a list of EU jurisdictions and non-EU jurisdictions, which authorise and regulate *De Minimis* AIFMs in a manner which is of a similar standard to that applied to licensed *De Minimis* AIFMs in Malta;
- Notified PIFs would not be allowed to be structured as self-managed PIFs.
- Notified PIFs would be required to engage a Fund Administrator and brokers and/or custodians based and regulated in or outside of Malta in a reputable jurisdiction, in relation to the safekeeping of assets;

- the governing body would need to undertake and make available to the MFSA the due diligence undertaken on the service providers of the fund (Guidance would be provided);
- Notified PIF would qualify as a subject person for AML/KYC purposes. In this regard, the manager of the Notified PIF would be required to appoint an MLRO with respect to the fund, which may be (i) the MLRO of the manager; or (ii) the MLRO of the administrator, provided that such administrator is a Recognised Fund Administrator in Malta, or is authorised in an EU Member State, or in a reputable jurisdiction;
- Notified PIFs would be subject to submit audited accounts annually;
- Notified PIFs would be required to draw up an Offering Memorandum for investors (in line with a prescribed regulatory template).

The PIF notification process would be processed by the MFSA within a stipulated period of time and would entail a lighter due diligence process on the governing body of the fund, when compared to applicants applying for a full PIF licence.

Q9a	Do you see scope for a Notified PIF framework to complement the local available CIS frameworks?
Q9b	If yes, why?
Q9c	What are your observations on the general features of the framework, and do you have alternative or additional recommendations in this respect?
Q8d	Do you consider that the current MFSA licensed PIF framework may be alternatively enhanced further, instead of having an additional framework such as the proposed Notified PIF?
Q8e	If yes, in what way?

3.5.3 FinTech and Sustainable Finance - Shifting from Alternative to Mainstream

3.5.3.1 Financial Technology

Digitalisation has become increasingly important in financial services, with the COVID-19 outbreak certainly accelerating this process and highlighting the importance of digital financial services, as opposed to the analog ones. Customers are consistently pushing for such digital shifts and are rewarding those market players who invested in digital transformation for the provision of their services.

Furthermore, the role of technology and innovation is increasingly important, if one takes into account the shift in demographics which is currently taking place, with populations in emerging markets reaching ever-growing levels of wealth requiring asset management services. These services are now being made available through the use of technology, while stimulating uptake by offering lower cost structures, modularity and easier access with better user experience. This evolution, while giving rise to many opportunities in this industry, also requires market players to adapt their business models, applications, processes, or products to embrace innovation, technology-enabled or otherwise, while catering for a very diverse set of customers, needs and market features.

This is where FinTech solutions come into play, by empowering industry participants to offer more customised products, as well as leveraging access to efficient digital platform ecosystems, enabling clients to manage their investments, while gaining novel benefits from new value chains entitled through innovation.

Seeking to gain a competitive advantage and accelerate growth in new emerging markets, the asset management industry leverages on use of innovation to capture these objectives. In fact, the investment management industry has been largely affected by the disruptive impact of technology: many investors already make use of automated trading facilities in order to execute investment decisions through computer algorithms, while Big Data and Machine Learning allow the analysis of large volumes of data (from various sources) to be integrated, with a high degree of sophistication, into the decision-making process of asset managers, *inter alia*, helping to identify and predict trends and developments in the markets, and improving the portfolio and risk management processes and quantification.

The emergence of DLT and Blockchain is yet another meaningful development in the industry, offering a new and secure way to record, store and track financial assets and hence potentially bring automation and more efficiency into the post-trade and compliance processes. These technologies also enable more innovative business models and projects, *inter alia* making use of DAOs – ushering the use of blockchain and smart contracts for the purpose of establishing investment vehicles.

Conscious of the impact brought about by the interrelationship between finance and technology, the MFSA has focused its efforts on supporting this revolution, aiming – through its [FinTech Strategy](#) – at creating the right conditions for the establishment of a robust and sustainable FinTech sector both for start-ups and industry incumbents.

To further support the development of sustainable innovation in financial services, the MFSA launched on 22 July, 2020, its [FinTech Regulatory Sandbox](#) (Sandbox), one of the key objectives under Pillar 1 of the MFSA FinTech Strategy, which aims to foster sustainable technology-enabled financial innovation through legal certainty and knowledge sharing, by providing for a regulatory environment, where FinTech operators may test their innovation for a specified period of time within the financial services sectors, under certain prescribed conditions.

With innovation in mind, the MFSA is looking to explore how different innovative business models within the asset management sector are interacting with existing financial services frameworks in place, to identify any potential gaps and address them.

The MFSA thus encourages practitioners within the asset management sphere to make use of this regulatory tool to put forward their innovations in an environment that ensures regulatory certainty, and promotes knowledge sharing and collaboration.

Moreover, to emphasise the developments in use of innovative technologies in the markets, the European Commission has launched the [Digital Finance Package](#) (Package) along with the communication on the new Retail Payments Strategy. Supporting the European Union’s ambition for recovery through digital transformation, the Package will be implemented in the coming years and will shape the financial landscape of tomorrow by providing the consumer with greater access to digital financial services through the reduction of barriers and fragmentation at a European level while safeguarding the proper functioning of the financial services market.

Considering the benefits that FinTech can bring into the local financial services industry, the everchanging consumer needs that need to be addressed (e.g. mobile applications), and the global and EU-wide advance to become more digital and foster sustainable innovation – the MFSA encourages financial services operators, start ups, SMEs and incumbents alike in the asset management sphere to integrate these technologies or make use and develop these solutions within their business models by leveraging regulatory infrastructures and initiatives made available in this regard, thus contributing to an enriched, diverse and more competitive local market.

By supporting the development of local FinTech innovators and bringing new firms and their solutions to Malta – thus allowing them to access the local financial sector and market their solutions across the EU – the MFSA intends to foster a favourable environment in which networking and concentration of innovation and creativity generated by participants, together with the efficiency gains derived from it allow the financial sector to innovate, and develop new products and services sustainably.

Q9a	Have you observed any specific innovative business models, in context of FinTech, that the MFSA should take note of (e.g. complex platforms with multiple stakeholders)?
Q9b	If yes, kindly provide examples and relevance in terms of the asset management sector.
Q10a	If you are a licensed asset manager in Malta, are you currently in the process of, or otherwise planning to deploy digital transformation solutions and related innovative technologies, as part of your business?

Q11b	If yes, please elaborate on the specific solutions being deployed, or otherwise considered to be deployed [e.g. advanced analytical tools (such as artificial intelligence), DLT applications, automated trading, RegTech solutions etc.]?
Q12a	Are you aware of any regulatory barriers or implementation impediments in implementing digital initiatives within the asset manager’s business models [e.g. legislation hampering such implementation and development of innovative technologies, budget resources constraints, cybersecurity concerns etc.]?
Q12b	If yes, kindly elaborate and provide recommendations on how such barriers or impediments may be addressed/ facilitated.
Q13a	Taking into consideration the existing MFSA initiatives and/or policy for facilitating technology enabled financial innovation, do you think that something more specific should be done with respect to asset management?
Q13b	If yes, kindly elaborate on your proposal.

3.5.3.2 Sustainable Finance

Besides technology and innovation, there is another important factor that over the past years has increasingly come to the fore, and which will continue to shape business models in the asset management industry, climate risk and **the financing of the sustainable economy**.

On one hand, climate change is posing a tangible threat to the financial sector as a whole, which has to endure the contractions in the economy following the increasingly frequent extreme weather events. On the other, investors themselves across the globe are becoming more appreciative of ESG factors and are demanding higher ethical standards from their investment providers.

The move towards ‘sustainable finance’ – i.e. the integration of ESG criteria into financial services, and the support of a sustainable economic growth – has been embraced also at institutional level, with regulators introducing new rules that aim to (i) harmonise the way market participants take into account ESG factors in their business decisions; (ii) enhance market transparency and investor protection by addressing the risk of ‘greenwashing’; and (iii) contribute to the achievement of a sustainable economy by creating even more momentum towards this goal.

To this end, at EU level the European Commission has achieved significant progress under its Action Plan on Sustainable Finance, with the implementation of substantial regulatory changes through the action plan's first legislative package covering the area of disclosure, low carbon benchmark and taxonomy which details have been described in a [Circular](#) issued by the MFSA on 11 August 2020.

It is expected that authorised entities which are not already doing so, will increasingly give importance to ESG matters as part of their agenda, incorporating them in their decision-making process, going forward. Over the past year and in particular during the toughest months of the COVID-19 pandemic and the related recession, ESG-focused funds and companies performed comparatively well especially when looking at the performance of standard companies. This proves that moving towards sustainability is not only a matter of compliance with new legislation or of merely adapting to investors' needs: it is also a way of strengthening and giving resiliency to the business.

Consistent with their fiduciary duties, institutional investors, including asset managers and asset owners, cannot ignore the relevance of climate risk as one of the biggest threats of our times¹³, and therefore shall have no option but to incorporate ESG-specific issues into their investment analysis, strategies and overall governance, and take into account material ESG disclosures of the entities in which they invest.

It is with the ultimate aim of encouraging firms not only to look at ESG from a product perspective – e.g. by creating investment vehicles with a 'green' investment strategy – but to eventually incorporate ESG across all portfolios and companies' core values, that the MFSA intends to facilitate this shift by keeping the asset management industry informed with respect to the legislative changes being implemented and by assessing the impact of such legislative measures on the local market, seeking feedback from the industry as necessary.

As communicated in the MFSA Strategic Update 2021, on a wider cross-sectoral note, besides increasing our strategic focus on this area, particularly on the assessment of the potential impact and transmission of climate-related risk in the financial sector, the MFSA intends to conduct further preparatory work with a view to adopting a more holistic and strategic approach to sustainable finance in the national context. To this end, and with a view to be in a position to further harness the wider benefits of sustainable finance and the enhanced competitiveness of our sector in the field, the MFSA shall be consulting with stakeholders, including experts in the field, and publishing a discussion paper during 2021. As part of this workstream, the Authority also intends to hold information and discussion sessions, and generally enhance awareness and deeper understanding among the various market players and investors.

¹³ According to the World Economic Forum Global Risk Report 2020, climate-related issues dominate the top long-term risks by likelihood.

Based on our preparatory work conducted to date, we plan to steer our focus towards the development of a supporting framework to facilitate: (i) the greening of finance, (ii) financing green investments and (iii) the creation of a sustainable finance node in Malta.

In line with the above objective, the MFSA is willing to consider other initiatives which, together with the new EU legislative frameworks, will further enhance Malta's promotion of sustainable finance and a greener and more responsible financial services industry overall.

Such initiatives may take different forms, such as:

- the development of regulatory initiatives which facilitate the setting up of ESG funds (including MFSA Guidelines) and/or of designated venues where such products can be traded, potentially also by exploring synergies with the MFSA FinTech Strategy;
- an increased regulatory effort towards specific investor education with respect to the topics of sustainable investing;
- Supporting the introduction of specific incentives which complement or promote climate-related financial services – for example, incentives applicable to investments in products with a sustainable investment objective (dark green products), as identified by Article 9 of the Regulation on sustainability-related disclosures in the financial services sector (SFDR).

While, as specified above, the MFSA intends to also consult with the industry on a wider cross-sectoral scale at a later date, the Authority is meanwhile inviting industry feedback on the following:

Q14a	Do you think that the MFSA should adopt similar initiatives to encourage sustainable investing, in addition to those linked to the implementation of the relevant EU legislation?
Q14b	If yes, what initiative(s) from a regulatory perspective and in the context of the asset management sphere, would you consider as beneficial?

3.6 Pillar IV – Regulatory Outreach and Collaboration Efforts with Industry Stakeholders and Internationally

Pillar IV addresses the MFSA’s collaboration and outreach efforts at a national level with key stakeholders for positioning Malta as an asset management jurisdiction. This Pillar also entails the continued active participation of the MFSA in the wider European framework to effectively influence and contribute on policy work development impacting industry players operating in this sector. Furthermore, as part of this Pillar, there is also greater focus on the regulatory dialogue element with other jurisdictions, aimed at, inter alia, facilitating the conduct of international business by local market operators, particularly in non-EU jurisdictions.

The MFSA is cognisant that in order to effectively deliver on our mandate as an Authority, working closely and liaising with industry key stakeholders is of paramount importance to ensure a meaningful outcome for all the parties involved.

The Authority hence believes that effectively implementing the Pillars identified in the Asset Management Strategy also requires collaboration among various industry partners. Efforts to stimulate further growth within this sector, accordingly, require regulatory outreach together with strong collaboration efforts with such stakeholders, both at a national level and also on an international scale.

As mentioned at the outset of this Discussion Paper, over the past months, the MFSA has engaged with selected industry stakeholders in respect of the asset management and funds sector in particular, which have provided and continue to provide on a regular basis, valid contribution and recommendations aimed at further growth of this industry.

Currently, the nature and form of the engagement held with stakeholders in relation to issues concerning this sector, is informal. As part of this Strategy, the MFSA has identified that there is an opportunity to enhance its engagement with stakeholders in a more structured manner and also in broadening the stakeholders it engages with from this sector.

The proposed approach seeks to accordingly consolidate the existing form of stakeholder engagement and augment this further, both in terms of composition and scope, in order to also include other types of regulated firms (besides asset managers and funds) falling within the Securities sector.

3.6.1 Securities Stakeholders Consultation Group

As part of this Strategy, the MFSA is hence proposing that existing stakeholder engagement is augmented through a Stakeholder Consultation Group that is representative of the MFSA, regulated firms, industry representative groups and associations, Government and other State agencies.

This Group would hence be expected to bring key financial sector stakeholders together in a single forum approaching the sector-related issues and growth from different angles and perspectives.

Furthermore, this engagement would be formalised via **Terms of Reference** governing the Stakeholder Consultation Group, which would mainly be responsible for:

- i. identifying the issues that may potentially both impede and stimulate the sustainable growth of the Securities sector in Malta;
- ii. sharing information and arriving at a unified industry, regulatory and strategic vision for the benefit of the industry and the jurisdiction and sustain its competitiveness;
- iii. communicating and discussing supervisory and regulatory priorities, changes in regulation on the horizon and other matters that are of interest to and may impact the industry;
- iv. discussing new initiatives/innovation, by exchanging views on new potential proposals to complement the existing regulatory frameworks/ type of structures, new regulations (including interpretation issues arising from existing applicable regulations), feedback to consultations from EU fora, impact of regulation matters, as well as supervision and other pertinent information;
- v. addressing weaknesses, risks and vulnerabilities, bureaucracy, duplication and other concerns that are arising from or potentially impacting the Securities sector;
- vi. undertaking actions that would enhance Malta`s attraction as a solid, reputable and efficient jurisdiction for local and international operators.

Q15a	What are your views regarding the MFSA proposal to enhance and formalise the current industry stakeholder engagement in order to discuss strategic issues relating to the sector as outlined above?
Q15b	Are there any suggestions you would like to make regarding the establishment of such a Stakeholder Consultation Group?
Q15c	Are there any other formal or informal mechanisms that you think the MFSA should consider in order to ensure the views of the industry stakeholders are better captured and contribute to the Authority`s strategic focuses?

3.6.2 Regulatory Engagement at European Fora

Besides engaging with local industry stakeholders, as a competent authority, the MFSA is also heavily engaged in the wider European framework. The MFSA considers this to be a crucial part of our mandate and deems as critical participation and effective contribution at European fora in shaping policy outcomes affecting the industry.

Within the Securities markets sphere, the MFSA is active in attending and contributing at the various European fora, notably the ESMA Investment Management Standing Committee (IMSC), whose mandate is the work on issues relating to collective investment management, covering both harmonised and non-harmonised investment funds as well as to develop technical standards, preparing advice for the EC, or developing guidelines and recommendations relating to UCITS and AIFMD.

Notably, besides contributing at IMSC level and related European fora, the MFSA recently participated in the EC Public Consultation on the review of the AIFMD. Among the feedback and views provided on various aspects on the AIFMD regulatory framework, the Authority has also strongly voiced its concerns and sound arguments with regards to the issue of lack of a depositary passport, including via direct engagement with the EC, as well as during IMSC meetings.

MFSA expressed the view that it considers that the lack of depositary passporting for CISs remains a critical concern to the fund industry for countries and has put forward arguments regarding risks emanating from the absence of a depositary passport for the industry, including the benefits associated with the introduction of such passport.

In its contribution, MFSA stated *inter alia* that it considers that the introduction of a depositary passport would have a substantial benefit for the overall EU funds industry, as well as being in line with the spirit of the Capital Markets Union, which is undertaking a drive to strengthen European's competitiveness. Discussions on the depositary passport front (or a related alternative long-term solution) are still ongoing at EU level.

Furthermore, the MFSA has also set out that it considers it critical that a balance is maintained between the need to harmonise regulatory and supervisory frameworks, having regard to country-specific dynamics and proportionality criteria. In particular, it has expressed views on the proposed amendments to the delegation rules emanating from the AIFMD/AIFMR highlighting the potential disruptions and practical industry implications that may arise if certain changes in the delegation framework as proposed in the Consultation were to be implemented.

3.6.3 Regulatory Engagement with Other Competent Authorities

Besides the above, the MFSA also considers that close international cooperation between Regulators is also crucial as it drives collaboration on common challenges, potentially making it easier for entities to operate across global borders.

Besides having a number of MoUs in place with various jurisdictions (both on a bilateral basis and by being a member of multilateral MoUs covering *inter alia* the Securities sector), ongoing direct liaison with other competent authorities are deemed important to assist in reducing barriers to market entry while encouraging a more harmonised approach and strengthening links between the regulators.

Furthermore, strong international links provide jurisdictions with the ability to collaborate on common challenges or issues which can contribute positively to the development of emerging trends. Such links enable regulators to have visibility with regards to ongoing regulatory and relevant economic or commercial developments in overseas markets.

Q16a	In doing business in other jurisdictions, are there any barriers to entry/difficulties encountered, that you believe can be addressed through increased regulatory dialogue and closer collaboration with certain jurisdictions (including, in particular, non-EU jurisdictions)?
Q16b	If yes, what are the nature of the related barriers to entry/difficulties encountered?
Q16c	Are there any particular jurisdictions where you would like to see closer collaboration by the Authority, that may potentially facilitate accessing overseas markets?

4 Conclusion

The MFSA is seeking feedback from stakeholders prior to proceeding with detailed proposals on the implementation of the initiatives presented in this document.

The Authority is also inviting participants to contribute on other proposals not covered in this Discussion Paper that may contribute to the further growth of the asset management industry.

The consultation is open to the public until **17 December 2021**. Industry participants and interested parties are invited to send their responses via email to AssetManagementStrategy@mfsa.mt.

Following this consultation process, the Authority will review feedback received from stakeholders on the various proposals and subsequently proceed to issue a feedback statement and continue working on the implementation of the asset management initiatives accordingly.

In line with the Authority's Vision to enhance stakeholder engagement, draft versions of any proposed major amendments or MFSA Rules will be issued for public consultation.

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