

Investment Services Rules Alternative Investment Funds

**Part B: Standard Licence Conditions
Applicable to Collective Investment Schemes
Authorised to Invest Through Loans**

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REVISIONS LOG

VERSION	DATE ISSUED	DETAILS
1.00	10 November 2020	Circular on the Restructuring of the MFSA Loan Funds Regime
2.00	30 April 2026	See: Various Amendments to the Investment Services Rulebooks for the Purposes of Directive 2024/927(EU)

Applicability of these Standard Licence Conditions

Collective Investment Schemes (the 'Scheme' or 'Schemes') that are established to carry out investments through loans, ('Lending Fund') whether licensed as (a) Alternative Investment Funds or (b) Professional Investor Funds in terms of the Investment Services Act (the 'Act'), shall, in addition to any laws, regulations or standard licence conditions applicable thereto, also comply with these standard licence conditions.

For the purposes of these standard licence conditions, the use of the terms "invest through loans" shall be understood as constituting:

- a. the direct origination of loans by the Scheme ('Loan Origination'); and/or
- b. the acquisition by the Scheme of one or more loans which gives rise to a direct legal relationship between the Scheme as lender and the borrower ('Loan Acquisition'); and/or
- c. factoring, with or without recourse, and/or forfaiting ('Receivables Financing').

(Loan Origination, Loan Acquisition and Receivables Financing are hereinafter collectively referred to as 'Lending').

These standard licence conditions apply in respect of Schemes whose investment objective or strategies include any form of Lending.

Loan Origination is to be construed as consisting in the granting or issuing of a loan as lender or co-lender to a third party as borrower.

Loan Acquisition is to be construed as the acquisition (whether by novation or assignment) of one or more loans or portfolios of loans (whether from an originator or on the secondary markets) which gives rise to a direct legal relationship between on the one hand the Scheme as lender and on the other hand the borrower or borrowers. Arrangements entered into on an arm's length basis where the Scheme may have economic exposure to loans but has no direct legal relationship with underlying borrower/s (such as notes, participating notes, swaps, sub-participation arrangements or similar instruments or arrangements) are not considered as Loan Acquisition.

Factoring is the outright purchase of the invoices of a company. By buying the invoice, the factor may either assume the risk of default (without recourse factoring) or retain the right to obtain reimbursement from the vendor (with recourse factoring). A Scheme that engages in factoring with or without recourse is deemed to be investing through loans for the purposes of these Rules. Forfaiting is considered to be an extension of credit. The short-term nature of this lending however mitigates the liquidity risk, but forfaiting is still considered to be investing through loans for the purposes of these Rules.

Where a Scheme's:

- a. investment objective and strategy is not primarily concerned with Loan Origination and/or Loan Acquisition and/or Receivables Financing; and
- b. Offering Documentation contains an express investment restriction that prohibits the Scheme, at the time of investment, from investing, either directly or indirectly through special purpose vehicles, more than 20% of its net asset value in:
 - (i) loans, whether through Loan Origination and/or Loan Acquisition; and/or
 - (ii) receivables or other payables through Receivables Financing,

such Scheme shall not qualify as a Lending Fund and not be subject to these standard licence conditions.

For the avoidance of doubt, the following activities shall not be deemed as Lending and hence these standard licence conditions shall not be applicable to Schemes which:

- a. Invest in or acquire transferable securities (as defined under the Investment Services Act) including debt securities issued by a securitisation vehicle (that does not qualify as a Special Purpose Vehicle, as defined below);
- b. Employ techniques of efficient portfolio management or treasury management, such as securities lending, repo and reverse repo activities;
- c. Invest in venture capital or private equity and which have specific investment objectives and strategies that only engage in lending as an ancillary activity in furtherance of their investment strategy. These Schemes may grant shareholder loans or undertake other private equity financing techniques without being subject to these Rules;
- d. Provide loan/s to any Special Purpose Vehicle/s (as defined below) in which it or any of its Sub-Fund/s is invested; and
- e. Engage in syndicated loans, if its exposure to a borrower is exclusively as co-lender in a loan syndicate where the lead arranger and lender is a credit

institution or other financial institution that is authorised and regulated to undertake lending activity.

For the purposes of the above, Schemes which invest in a master fund or through a Special Purpose Vehicle are subject to a look through approach.

A Special Purpose Vehicle is a company or other legal entity set up by the Scheme as part of its investment strategy for the purpose of achieving its investment objectives; and owned or controlled via majority shareholding of the voting shares either directly or indirectly by the Scheme.

This Rulebook shall cease to apply as of 15th April 2029. However, loan-originating funds established before this date, with a redemption date after 16th April 2029, shall remain subject to this Rulebook until their redemption.

Applicability of the Financial Institutions Act to Lending Funds

The Financial Institutions Act regulates the carrying on of business of a financial institution (which includes regularly or habitually lending) in or from Malta. Under Article 3(6) of the Financial Institutions Act:

“Where a person is already licensed under the Banking Act or the Investment Services Act to carry out an activity listed in the First Schedule, such person shall not require a licence for such activity under this Act.”

For the purposes of this Article where a Scheme qualifies as a Lending Fund, the Scheme is, through the issuance of a collective investment scheme licence under the Investment Services Act, deemed licensed to carry out the activity of Lending under the Investment Services Act, without the requirement to obtain a license under the Financial Institutions Act.

1. General Requirements

1.01 The following standard licence conditions lay down uniform rules for the establishment and marketing of a Collective Investment Scheme established to invest through loans in terms of the Investment Services Act.

1.02 Where the Scheme is self-managed, any references to “management company” and/or “fund manager” and/or “manager” in the following licence conditions shall be construed as being a direct reference to the Scheme and, accordingly,

any obligations incumbent upon the management company shall mutatis mutandis apply to the Scheme.

1.03 The Scheme shall not be able to originate loans to the following debtors:

Individuals;

Financial undertakings (as defined below);

Collective Investment Schemes;

The manager and related parties (e.g. depositary, general partner or delegates), including the Scheme's service providers.

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

- a) a credit institution as defined in point (1) of Article 4(1) of Regulation (EU) 575/2013 of the European Parliament and of the Council;
- b) an investment firm as defined in point (1) of Article 4(1) of Directive 2014/65/EU;
- c) an insurance undertaking as defined in point (1) of Article 13 of Directive 2009/138/EC of the European Parliament and of the Council;
- d) a financial holding company as defined in point (20) of Article 4(1) of Regulation (EU) 575/2013 of the European Parliament and of the Council; and
- e) a mixed-activity holding company as defined in point (22) of Article 4(1) of Regulation (EU) 575/2013 of the European Parliament and of the Council.

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

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

- a. Provided that for the purpose of these Investment Services Rules, the terms 'closed-ended fund' shall be understood as referring to a collective investment scheme:
 - a) which does not raise capital through the continuous sale of units or shares;
 - b) has a fixed duration;
 - c) the units of which can only be redeemed at the end of the duration of the Scheme, save as otherwise permitted by these Rules.

- b. Notwithstanding that the Scheme shall be structured as a closed-ended fund, the fund manager may, on a yearly basis, opt to redeem and cancel any shares on a nonpreferred basis in the case where the Scheme has excess liquidity and when this is in the best interests of the unit-holders.
 - c. Provided that such redemption or cancellation shall take place in accordance with the Constitutional Documents and the Offering Memorandum of the Scheme.
- 1.05 The duration of the Scheme shall be sufficient to cover the life-cycle of the loans granted by the Scheme as well as the investment objectives thereof.
- 1.06 The fund manager of the Scheme shall possess such organisation, systems, experience and expertise deemed necessary by the MFSA for it to provide management services to funds authorised to invest through loans.
- 1.07 The fund manager of the Scheme shall also possess the required skills and expertise to ensure that any lending decisions are made with due consideration. During the application process, the Scheme shall demonstrate to the Authority that the manager has proven experience in the area of granting of loans including credit assessment, credit provisioning monitoring and control of exposures.
- 1.08 The fund manager of the Scheme shall employ an appropriate liquidity management system and adopt procedures which enable the monitoring of liquidity risk of the Scheme and ensure that the liquidity profile of the investments of the Scheme complies with its underlying obligations.
- 1.09 The Scheme shall co-operate in an open and honest manner with the MFSA and inform it promptly of any relevant information. The Scheme shall provide the MFSA with such information and returns as the MFSA requires to monitor compliance with the conditions referred to in the Act and any rules and regulations issued thereunder.

Target Investors

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

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

Eligible Investors and Minimum Entry Levels

1.11 Subject to the marketing restrictions prescribed in SLC 1.10 and subject to compliance with the standard licence conditions prescribed in this Rulebook, Schemes (including sub-funds) established under these Rules may only be established as:

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

Provided that Alternative Investment Funds investing through loans may not be set up as Retail Collective Investment Schemes.

2. Investment Objectives, Policies and Restrictions

2.01 The Scheme shall be subject to the investment objectives and policies outlined in its Offering Memorandum as well as the restrictions prescribed in these Rules. The fund manager shall take all reasonable steps to comply with the investment objectives, policies and restrictions of the Scheme.

2.02 In achieving its investment objectives and policies, the Scheme shall ensure that the credit portfolio is sufficiently diversified.

Investment Restrictions

- 2.03 The Scheme shall not be allowed to short-sell any securities nor to reuse collateral.
- 2.04 The use of leverage (including borrowing) shall be allowed up to 200% of the net assets of the Scheme.

3. Risk Management

- 3.01 The fund manager of the Scheme shall functionally and hierarchically separate the functions of risk management from the operating units, as well as from the portfolio management function.

The requirement for a functional and hierarchical separation of the function of risk management in accordance with SLC 3.01 shall be reviewed by the MFSA in accordance with the principle of proportionality on the understanding that the manager shall, in any event, be able to demonstrate that specific safeguards against conflicts of interest allow for the independent performance of risk management activities and that the risk management process satisfies the requirements of this section and is constantly effective.

- 3.02 The risk management function of the management company shall be considered as functionally and hierarchically separated from the operating units, including the portfolio management function, only where all the following conditions are satisfied:

- i. Persons engaged in the performance of the risk management function are not supervised by those responsible for the performance of the operating units, including the portfolio management function of the fund manager;
- ii. Persons engaged in the performance of the risk management function are not engaged in the performance of activities within the operating units, including the portfolio management function;
- iii. Persons engaged in the performance of the risk management function are compensated in accordance with the achievement of objectives linked

to that function and independently of the performance of the operating units, including the portfolio management function; and

iv. The remuneration of senior officers in the risk management function is directly overseen by the remuneration committee, where such a committee has been established.

3.03 During the application process, the Scheme shall ensure and demonstrate to the Authority that the management company has in place an adequate and documented risk management policy ('Risk Management Policy') which measures, manages and monitors the risks which the Scheme is or is likely to be exposed to.

3.04 The Risk Management Policy shall set out the risk measurement arrangements, processes and techniques as are reasonable to ensure that the risks of positions taken and their contribution to the overall risk profile of the Scheme are measured on the basis of reasonably selected data and that the risk measurement arrangements, processes and techniques are adequately documented. In this respect, the management company shall:

i. conduct periodic back-tests in order to review the validity of risk measurement arrangements;

ii. conduct periodic stress tests and scenario analysis to address risks arising from potential changes in market conditions that might adversely impact the Scheme; and

iii. establish, implement and maintain adequate escalation procedures in the event of actual or anticipated breaches of the risk limits applicable to the Scheme.

3.05 During the application process, the Scheme shall ensure and demonstrate to the Authority that the management company's Risk Management Policy covers credit risk, as well liquidity risk.

3.06 The Risk Management Policy shall, as applicable, in respect of credit risk:

i. establish the framework for lending and guide the credit-granting activities of the Scheme;

- ii. reflect the risk tolerance which the management company or the Scheme (as applicable) have in relation to the various credit risks and early warning indicators in respect of individual credits and the overall portfolio of loans;
- iii. establish exposure limits on single counterparties and groups of connected counterparties;
- iv. take into consideration other relevant risk such as country/sovereign risk and transfer risk;
- v. specify the information that the management company should obtain on borrowers and counterparties, prior to onboarding them, to enable it to make an assessment of their risk profile;
- vi. cater for the aggregation and monitoring of the Scheme's exposures to individual counterparties across business activities;
- vii. set out the due diligence and credit risk analysis to be undertaken by the management company in the event that it proposes to acquire or renew existing credits and/or change the terms and conditions of previously approved credits;
- viii. consider eligible security that the Scheme may receive when granting a loan;
and
- ix. establish the process for monitoring the loans granted by the Scheme and related security.

3.07 The Risk Management Policy shall, in respect of liquidity risk:

- i. specify the manner in which the management company monitors the liquidity risk of the Scheme such that the liquidity profile of the portfolio of the Scheme is appropriate to its underlying obligations. For these purposes the Scheme's manager shall take into account the profile of the investor base of the Scheme, including the type of investors, the relative size of investments and the redemption terms set out in the Offering Documentation of the Scheme, where applicable; and
- ii. set out appropriate liquidity measurement arrangements and procedures to assess the quantitative and qualitative risks of positions and of intended investments which have a material impact on the liquidity profile of the Scheme's assets, to enable their effects on the overall liquidity profile of the Scheme to be appropriately measured, in normal and exceptional liquidity conditions. The

procedures employed shall ensure that the manager has the appropriate knowledge and understanding of the liquidity of the assets in which the Scheme has invested or intends to invest.

- 3.08 The Scheme shall ensure that the investment objectives and policies are consistent with the liquidity profile and the redemption policy of the Scheme.
- 3.09 The Scheme shall ensure that the management company establishes and implements quantitative or qualitative risk limits or both for the Scheme taking into account relevant risks, covering market risk, credit risk, liquidity risk, counterparty risk and operational risk.
- 3.10 The Risk Management Policy shall include a description of the safeguards against conflicts of interest, in particular:
- i. the nature of the potential conflicts of interest; and
 - ii. the remedial measures put in place.
- 3.11 The Scheme shall ensure that the management company reviews and updates as needed and at least, on an annual basis:
- i. the adequacy and effectiveness of the Risk Management Policy and of the arrangements, processes and techniques for risk measurement and management;
 - ii. the degree of compliance by the management company with the Risk Management Policy and with the arrangements, processes and techniques for risk measurement and management;
 - iii. the adequacy and effectiveness of measures taken to address any deficiencies in the performance of the risk management process;
 - iv. the performance of the risk management function; and
 - v. the adequacy and effectiveness of measures aiming to ensure the functional and hierarchical separation of the risk management function.
- 3.12 The Management Company shall report to the Scheme in respect of the portfolio and risk management functions at such frequencies, as may be determined by the Scheme but in any event at least, on a quarterly basis.

4. Valuation

4.01 The valuation function shall be performed by:

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

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