

**Questionnaire concerning the implementation of the  
BASEL III guidelines and the regulatory framework  
for Managers of Alternative Investment Funds**

**Banking, Finance and Capital Markets Law Commission**

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**General Report**

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## **1. Introduction**

The topics of the questionnaire are the regulations with regard to Basel III as well as legal aspects with regard to Alternative Investment Funds. Basel III aims to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage. Provisions with regard to Alternative Investment Funds are supposed to increase protection of investors by increasing the regulations with regard to Managers of Alternative Investment Funds. Both topics are subject to recently emerged innovative but also intense regulation. The regulation in both fields was initiated by the financial crises and the principal aim of both of them is to prevent the systematic risks that compromise the financial market. Both regulations are highly controversial. According to proponents they are necessary to protect the financial system. Opponents on the other hand fear a regulatory overreach. Even though Basel III as well as AIFM are strongly affected by regulations of the EU/EEA, the questionnaire is designed to be answered for participants of all jurisdictions.

The questionnaire is intended to enable you as National Reporter to provide an overview on the key issues which arise in your jurisdiction in relation to the above mentioned topics. We have structured the questionnaire, based on broad open questions, in order for you to elaborate on the main topics as freely as possible and the questions should be seen more as guidance rather than specific questions that could be answered with a simple yes or no. That said, please focus on the practical aspects, rather than a theoretical analysis when completing the National Report.

Ideally, the National Reports should be no more than 10 pages and be formatted on a consistent basis. You will find the formatting guidelines attached to the E-Mail. Please ensure that these guidelines are observed.

Should the National Report be prepared by more than one National Reporter, please ensure that only one single document is provided. In such case, please also note that we will not coordinate the preparation of the Reports between the co reporters. You may do so on your own.

Looking forward to working together and we remain at your disposal whenever you have any questions or like to discuss.

All the best and looking forward to be seeing you in Prague

## **2. The implementation of the Basel III guidelines**

### **2.1 Is there a basic intend in you country to implement the Basel III guidelines?**

If yes: Why does your country intend to implement the Basel III guidelines?

The Basel III agreement was adopted into the EU legal framework by the European Union with the aim of strengthening the regulation of the banking sector. The agreement was adopted through a legislative package consisting of a Regulation (Capital Requirements Regulation) and a Directive (Capital Requirements Directive IV). Being a Member State of the European Union, the Regulation is directly applicable to Malta, while the Directive needs to be transposed into national law.

If not: What is the reason for not implementing the Basel II guidelines?

If not: What is planed instead? Are there any similar rules already in force in your country?

### **2.2 In which stage of the implementation of the Basel III guidelines is your country currently? When will the rules be enacted?**

The process of implementation by transposition has been initiated by subsidiary legislation and regulations. The Directive has been transposed in part by means of Subsidiary Legislation 204.06 under the Central Bank of Malta Act, namely, the Central Bank of Malta Act (Appointment of Designate Authority to Implement Macro-Prudential Instruments) Regulations.

Moreover, Articles 64(2), 65, 67, 68, 69, 71 and 72 of the Directive has been implemented through the regulations under the Investment Services Act, namely, the CRD (Administrative Penalties, Measures and Investigatory Powers) Regulations, 2014.

Furthermore, the Investment Services Act (Supervisory Review) Regulations of 2014 implemented, articles 3 (in part), 4(1), 6, 7, 50, 52, 53(2), 56, 57, 58(1), 58 (3), 59, 60, 61, 74(4), 75(1), 75(3), 77(2), 78(2), 78(3), 78(4), 78(5), 86(3), 91(6), 91(11), 97, 98, 99, 100 to 105 inclusive, 107, 110, 143, 144, 151, 157, and 159 of the CRD.

According to the European Union instruments, the aforementioned Directive and Regulation entered into force on 1<sup>st</sup> January 2014, while the newer provisions are expected to be phased-in between 2014 and 2019.

Transposition of the Directive has been taken on by the MFSA and the process will involve significant amendments to the Investment Services Act, the Banking Act and the Investment Services Rules for Investment Service Providers. Major transposition has also been made by the MFSA through amendments of Banking Rules, through the powers granted to it under Article 4(2) of the Banking Act.

**2.3 Is there a delay in the implementation of the Basel III guidelines? If yes, what is the main cause for it?**

Refer to reply above.

**2.4 Does the national implementation of the Basel III guidelines meet, exceed or undercut the stated minimum standards concerning the below mentioned issues?**

- a.) Capital requirements: Regulation 575/2013, which is directly applicable to Malta conforms with the minimum capital requirements set out in Basel III, setting the following thresholds which are consistent with those found in Basel III – Common Equity Tier 1 ratio of 4.5%; Tier 1 Capital ratio of 6%; Total Capital ratio of 8%.
- b.) Leverage Ratio: As Recital 18 of the Regulation states: ‘Until the harmonisation of liquidity requirements in 2015 and the harmonisation of a leverage ratio in 2018, Member States should be able to apply such measures as they consider appropriate, including measures to mitigate macroprudential or systemic risk in a specific Member State. Recital 94 goes on to assert that ‘A leverage ratio is a new regulatory and supervisory tool for the Union. In line with international agreements, it should be introduced first as an additional feature that can be applied on individual institutions at the discretion of supervisory authorities. Reporting obligations for institutions would allow appropriate review and calibration, with a view to migrating to a binding measure in 2018.’ Consistent with Basel III, the Regulation in article 429 defines the leverage ratio as the ‘capital measure’

and 'shall be expressed as a percentage'. Moreover, similar to Basel III, the capital measure is defined as the Tier 1 capital.

- c.) Counter cyclical capital buffer: the Basel III guidelines establish that the country cyclical capital buffer is to be set by each State and must range between 0% and 2.5%. The Directive in this regard states that each Member State shall designate a public authority to be responsible for the setting of this rate. In the Central Bank of Malta Act (Appointment of Designate Authority to implement Macro-Prudential Instruments) Regulations of 2014 the Central Bank of Malta is appointed as the Designate Authority to set this buffer. The Directive furthermore abides by the above percentages in relation to the counter cyclical capital buffer. While Malta's counter cyclical capital buffer rate is yet to be set by the Central Bank of Malta, the parameters set out in the Directive ensure that Malta's rate will comply with the requirements set out in Basel III.
- d.) Capital conservation buffer: the Directive abides by the percentage set out in Basel III in relation to the capital conservation buffer, that is 2.5% of the total risk exposure amount.

If your country does not implement one of the above mentioned Basel III standards, is there any alternative regulation?

## **2.5 How many systematically relevant financial institutions are located in your jurisdiction?**

Systematically relevant financial institutions are financial institutions, including banks and insurance companies whose failure might trigger a financial crisis.

The Central Bank of Malta in the Fifth Financial Stability Report of 2012 asserted that five banks in Malta qualify as being systematically relevant financial institutions. The Report termed these banks as being 'core domestic banks' and included in its list: APS Bank Limited, Banif Bank (Malta) plc, Bank of Valletta plc, HSBC Bank Malta plc, and Lombard Bank.

## **2.6 How does your country regulate the capital requirements for systematically relevant financial institutions?**

The existing capital regime under Maltese law consists of the following instruments:

- The Banking Act
- The Capital Requirements Rule (Banking Rule 04 of 2013)
- The Large Exposures of Credit Institutions Rule (Banking Rule 02 of 2008)
- Capital Adequacy of Capital Institutions (Banking Rule 08 of 2008)

Article 17 of the Banking Act states that:

- "(1) A credit institution, to the exclusion of an electronic money institution, shall:
- (a) maintain capital requirements to risk-weighted assets and notional risk-weighted assets as defined in and calculated according to the provisions of a Banking Rule;
  - (b) notify the ratio to the competent authority at such times and in such manner as shall be prescribed by a Banking Rule;
  - (c) notify the competent authority forthwith upon the ratio falling below the level required by paragraph (a) whereupon the competent authority shall require the credit institution, to the exclusion of an electronic money institution, to take necessary measures to restore the capital requirements to the required level within such period as the competent authority may determine."

In the Capital Requirements Rule (Banking Rule 04 of 2013) a minimum capital requirement is established at 8% (banking book trigger). The Rule goes on to establish that a higher minimum may be set by the authority, if required by the institution.

## **2.7 Do you think that many banks in your country will struggle to meet the requirements of Basel III? Why do you think so?**

Basel III aims to establish what is termed a 'single rule book', that is, a common set of banking rules for all banks, regardless of size and resources. With the implementation of the Capital Requirements Directive and the Capital Requirements Regulation, this single rule book approach is adopted in relation to all EU banks. Hence, smaller Maltese banks might struggle in order to reach the imposed capital requirements. While this may not necessarily be an issue for larger banks, these banks will also face additional problems such as the administrative burdens which the Directive imposes. Further struggles might also

be faced by smaller banks, such as the need to boost human resources and IT personnel, since they are put on a par with larger banks and will thus need to keep up in this area.

### **3. Regulatory Framework for Managers of Alternative Investment Funds**

#### **3.1 Is there any legislation in your jurisdiction concerning Managers of Alternative Investment Funds?**

Yes, Malta has enacted legislation in view of the transposition of the AIFMD as follows:

##### Primary Legislation

- Investment Services Act

##### Subsidiary Legislation

- Investment Services Act (Alternative Investment Fund Manager Passport) Regulations;
- Investment Services Act (Marketing of Alternative Investment Funds) Regulations;
- Investment Services Act (Alternative Investment Fund Manager Third Country) Regulations; and
- Investment Services Act (Alternative Investment Fund Managers) Regulations.

##### Investment Services Rules

- Investment Services Rules for Investment Services Providers
- Investment Services Rules for Alternative Investment Funds

#### **3.2 Is your jurisdiction member of the EU or the EEA and therefore legally obligated to implement the AIFM directive 2011/61/EU? If yes: Is the implementation of the AIFM directive 2011/61/EU already successfully completed?**

Yes, Malta is a member of the European Union and as such was bound to transpose the provisions of the AIFMD. Malta has successfully completed the transposition of the Directive well before the 22 July 2013 deadline.

**3.3 At which point in time was the legislation concerning AIFM enacted?**

The legislation concerning the AIFMD was transposed at different stages. The changes to the Investment Services Act and the Subsidiary Legislation were published during the first quarter of 2013. The Revised Investment Services Rules were officially launched on 27<sup>th</sup> June 2013.

**3.4 What is the name of the competent supervisory authority for Alternative Investment Funds in your country?**

The Malta Financial Services Authority is the competent supervisory authority.

**3.5 Which minimum-capital does an AIFM require in order to obtain a licence or authorization?**

The Authority applied the minimum capital requirements prescribed in the Directive for AIFMS.

**3.6 How long is the duration of authorisation process to obtain an AIFM-Licence?**

The MFSA shall inform an applicant for a licence to provide services as an AIFM in writing within three months of the submission of a complete application, whether or not authorisation has been granted. The MFSA may prolong this period for up to three additional months, where it considers necessary due to the specific circumstances of the case and after having notified the applicant accordingly. An application is deemed to be complete if the applicant has at least submitted the information referred to in the Checklist to the Application Form in Schedule A2 of the Rules to the satisfaction of the Authority.

**3.7 What are the key elements of the authorisation process?**

Article 6 of the Investment Services Act prohibits the MFSA from granting an Investment Services Licence unless it is satisfied that the Applicant is a fit and proper person to provide the relevant Investment Services and that the Applicant will comply with and observe the appropriate rules and regulations. When considering whether to grant or refuse an Investment Services Licence, the MFSA must take account of:

- a. the degree of protection to the investors;
- b. the protection of the reputation of Malta taking into account Malta's international commitments; and
- c. the promotion of competition and choice.



In all cases, the MFSA applies the standards relating to the “fit and proper” status of the Applicant, the track record of the Applicant (and those associated with it), and the nature of the business. The “fit and proper” test is one which an Applicant and a Licence Holder must satisfy on a continuing basis. Each case is assessed on the basis of the relevant circumstances. The onus of proving that it meets the required standards is on the Applicant and Licence Holder. It is not the task of the MFSA to prove that an Applicant is “fit and proper” either on licensing or thereafter. The MFSA’s approach is cumulative that is to say the Authority may conclude that a Licence Holder has failed the test on the basis of considering several situations, each of which on its own would not lead to that conclusion. When arriving at its decision as to whether a Licence Holder is “fit and proper” the MFSA will take account both of what is said and of what is not said (for example in respect of a Director’s criminal record). It should be noted that it is an offence to provide inaccurate, false or misleading information to the MFSA.

In general terms, there are three criteria which must be met, to satisfy the “fit and proper” test:

- a. **integrity:** Integrity involves the Licence Holder and its employees being of good repute and acting honestly and in a trustworthy fashion in relation to its clients and other parties.
- b. **competence:** Competence means that those people carrying on the business of the Licence Holder must be able to demonstrate an acceptable amount of knowledge, professional expertise and experience. The degree of competence required will depend upon the job being performed. The MFSA will take into account the qualifications, experience and skills of those involved. Sound and prudent management, adequate resources, and a scrupulous attitude towards clients are essential. The business should be well organised, it should have adequate controls, and it should maintain sufficient records to demonstrate these attributes. Individuals should have a sufficient understanding of the business, and of the Investment Services and Instruments (including the related markets) with which they are dealing; and
- c. **solvency:** Solvency means ensuring that proper financial control and management of liquidity and capital is applied. The business should have sufficient Financial Resources to meet not only the financial demands on the business but also the Financial Resources Requirement established by the MFSA.

**3.8 Is it mandatory for AIFM to have a local residence in your jurisdiction?**

Yes it is mandatory for AIFMs licenced in Malta to have a local residence in Malta.

**3.9 Does the legislation distinguish between different types of AIFM? What are the key differences between them?**

The Investment Services Rules for Investment Services Providers distinguish between *de minimis* AIFMs and AIFMs. The former consist in those managers of AIFs which do not exceed the thresholds stipulated in Article 3(2) AIFMD. In both instances, the Authority requires that these AIFMs be in possession of a Category 2 Investment Services Licence issued in terms of the Investment Services Act. By proposing a licencing regime to *de minimis* AIFMs, the Authority is striving to retain a degree of control on the activity of these fund managers to seek to ensure that only persons who are fit and proper are allowed to establish a financial activity and operate on an on-going basis in Malta. Furthermore, the Category 2 Licence in this case will allow the De Minimis AIFM to provide collective portfolio management to collective investment schemes which are AIFs.

**3.10 Are there any legislative restrictions regarding legal structures of AIFM?**

The AIFM must be a legal person.

**3.11 If you are a member of the EU or EEA, can AIFM in your country obtain an EEA/EU Passport which enables to distribute AIFs to professional investors?**

Yes, Malta has transposed Articles 31 to 33 of the Directive in the following regulations:

- Investment Services Act (Alternative Investment Fund Manager Passport) Regulations;
- Investment Services Act (Marketing of Alternative Investment Funds) Regulations.

**3.12 Do AIF themselves require to be licensed or authorised by a competent supervisory authority?**

Yes an AIF in itself must be licenced in terms of the Investment Services Act.

**3.13 How are AIFs categorized and what is the authorisation or licence requirement for each category?**

AIFs can be classified as AIFs which can be marketed to retail investors and AIFs which can be marketed to professional investors. In both instances a collective investment scheme licence issued in terms of the Investment Services Act is required, however in the case of AIFs which are marketed to retail investors, additional investment restrictions are imposed with a view to achieving investor protection.

**3.14 How long does the process of authorisation or licensing of AIFs take?**

The granting of a licence is dependent upon a variety of factors amongst which the submission of a complete application form and the carrying out of the fitness and properness tests. Nonetheless the process realistically takes between 4 - 6 months.

**3.15 Are there certain legal structures for AIFs? Please name them.**

In Malta an AIF can be established as an open or closed-ended investment company – in the form of a SICAV or INVCO, or a limited partnership or a unit trust. An AIF may also be set up as a SICAV Incorporated Cell Company (SICAV ICC) or an incorporated cell (IC) of a Recognised Incorporated Cell Company (RICC).

**3.16 What are the key differences with reference to the authorisation and marketing of AIFs that are distributed to retail investors and those only distributed to professional investors?**

In the case of AIFs which are distributed to retail investors, the Investment Services Rules for Investment Services Providers stipulate that the AIFM must be in possession of a specific authorisation to market to retail investors, granted to it for this purpose by the MFSA in terms of the applicable regulations issued in terms of the Investment Services Act.

**3.17 Are there any special requirements for leveraged AIFs?**

The Authority did not impose any additional requirements with regards to leverage used other than the disclosure requirements stipulated in Article 23 AIFMD. However the Authority reserves the right to question the leverage arrangements being made by the fund manager.

**3.18 Are there any special regulations with regard to private investors or semi-professional investors?**

Articles 36 and 42 AIFMD relating to the private placement regime have been transposed in the Investment Services Act (Alternative Investment Fund Manager) (Third Country) Regulations.