MFSA

MALTA FINANCIAL SERVICES AUTHORITY

MFSA LAUNCHES INVESTMENT SERVICES RULES FOR LOAN FUNDS

INTRODUCTION

The MFSA has in recent months received a number of enquiries relating to the licensing and regulation of loan funds under the Investment Services Act. The approval and licensing of loan funds is regulated by the Act which provides for the licensing and regulation of Collective Investment Schemes investing in any type of assets, subject to any conditions as the MFSA may impose.

Due to the particular nature of the risks involved, collective investment schemes investing through loans would be open to specified professional investors.

Moreover, conscious of the particular risks associated with these types of funds, the MFSA is today publishing a set of Investment Services Rules with the "Standard Licence Conditions applicable to Collective Investment Schemes authorised to invest through Loans". These Rules apply specifically to loan funds in addition to any laws, regulations or standard licence conditions that are already applicable to Alternative Investment Funds or Professional Investor Funds.

In preparing these Rules, the MFSA has taken as a basis the provisions of the AIFMD as transposed into Maltese law in the first half of 2013. The Authority has also taken into consideration the various studies and policy recommendations on the regulation of shadow banking published by the Financial Stability Board and other standard setting bodies in recent months.

The Rules also draw on the relevant MFSA Banking Rules in order to address the specific areas of risk in a manner that ensures consistency with the Banking Act while retaining the inherent characteristics of collective investment schemes established under the Investment Services Act.

The Authority will continue to monitor developments related to the regulation of shadow banking both at European and international level and does not exclude any updating of these Rules should circumstances so merit.

SALIENT FEATURES

The following are the salient features of this new regime:

[I] General Requirements

Fund Managers will be able to establish loan funds either as Professional Investor Funds or as Alternative Investment Funds depending on whether the fund manager is licensed as a *de minimis* manager or as a fully licensed AIFM in terms of the Investment Services Act. The Scheme, which will be structured as an unleveraged closed-ended scheme, will be able to invest through loans solely and exclusively to unlisted companies and SMEs. Financial institutions as defined in the Rules will not be eligible to receive financing from these Schemes.

[II] Target Investors

The units of these collective investment schemes may only be sold to professional investors as defined in Section I to Annex II to the Markets in Financial Services Directive ("MiFID") or alternatively to investors who, on request, elect to be treated as professional clients as per Section II to Annex II to the MiFID <u>and</u> commit to investing a minimum of EUR 100,000.

[III] Service Providers

A Scheme is required to appoint a fund manager, a custodian, an auditor, a compliance officer and a money laundering reporting officer.

In particular, the fund manager shall have sufficient financial resources and liquidity at its disposal to enable it to conduct its business, and such organisation, systems, experience and expertise deemed necessary by the Authority for it to provide management services to these funds. The fund manager shall also possess the required skills and expertise to ensure that any lending decisions are made with due consideration and will also have proven experience in the area of granting of loans including credit assessment, credit provisioning monitoring and control of exposures as outlined in the Rules.

The Rules also provide for the appointment of a custodian, either as a Category 4a or Category 4b Investment Services Licence Holder. A Category 4a Investment Services Licence Holder is eligible to act as custodian to all categories of collective investment schemes. On the other hand a Category 4b Investment Services Licence Holder can act as custodian of schemes which:

(a) have no redemption rights exercisable during the period of 5 years from the date of the initial investments; and

(b) in accordance with their core investment policy, generally do not invest in assets that must be held in custody; or

(c) generally invest in issuers or non-listed companies in order to potentially acquire control over such companies.

[IV] **Investment Restrictions**

The Rulebook also provides that the fund manager shall comply with the investment objectives, policies and restrictions of the scheme as outlined in the Offering Document, particularly with regards to eligible investments, the risk profile of the fund and other terms of the offer and contains provisions against large exposures.

The use of leverage and short selling techniques and the reuse of collateral by the Scheme are not permitted.

[V] **Credit Risk**

The Rules require the fund manager to establish and implement a credit risk strategy and related policies in proportion with the scope and sophistication of the Scheme's activities. The credit policy will establish the framework for lending and guide the credit granting activities of the Scheme. It shall include a risk appetite statement and shall address items such as target markets, portfolio mix, structuring of credit limits, processing and reporting. The fund manager is bound to submit for approval by its governing body, the Scheme's strategy for the selection of risks and maximising the profits and returns.

[VI] **Liquidity Management Policy**

The fund manager shall employ an appropriate liquidity management system and adopt procedures which enable the monitoring of liquidity risk of the scheme and ensure that the liquidity profile of the scheme complies with its underlying obligations. Whilst this feature is already provided for in the provisions of the AIFMD, the new Rulebook seeks to further build on this requirement using concepts normally applied in the banking sector. Notwithstanding that the scheme shall be structured as a closed-ended scheme, the fund manager may on a yearly basis opt to redeem and cancel any shares in accordance with the terms of the offer should the fund have excess liquidity. The Rules also make provision for the application of a variable NAV.

[VII] **Disclosure, Records and Reporting**

The Rules contain detailed disclosure obligations to investors with appropriate Standard Licence Conditions modelled on the disclosure provisions prescribed in the AIFMD. Managers are also required to keep detailed records on the credit risk and liquidity management processes of the fund, and to abide by the appropriate reporting obligations for regulatory purposes.

CONTACTS

The Rules are available for download from the MFSA website [Legislation/Regulation/Securities and Markets Supervision/Collective Investment Schemes/ Rules for Professional Investor Funds OR Rules for Alternative Investment Funds.]

Any queries or requests for clarifications in respect of the above should be addressed to Dr. Isabelle Agius. Regulatory Development Unit, Phone: 2548 5359 or by e-mail on iagius@mfsa.com.mt

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