

*Proposal for a Legal Notice regarding
the establishment of contractual collective investment schemes*

Feedback Statement

*(including new Regulation 3A on the use of Special Purpose Vehicles by
Contractual Funds and Proposed Draft Rules)*

26th August 2010

Explanatory Note on this Consultation Procedure

The documents circulated by the MFSA for the purpose of consultation are in draft form and consist of proposals. Accordingly these proposals are not binding and are subject to changes and revisions following representations received not only from licence-holders and other involved parties. It is important that persons involved in the consultation bear these considerations in mind.

1.0 Background

- 1.1 On 27th July 2009 the Malta Financial Services Authority (“MFSA”) issued a circular attaching a set of regulations with the aim of setting out a proper workable framework for the establishment of Contractual Collective Investment Schemes.
- 1.2 The industry was requested to submit any comments in relation to the proposed Regulations by not later than 9th August 2009.
- 1.3 The MFSA received feedback from IFSP, the Association of Insurance Brokers, Mamo TCV Advocates and the Malta Funds Industry Association (the latest feedback having been received in September 2009).
- 1.4 This Feedback Statement outlines (in no particular order) the main issues raised during the consultation process and the MFSA’s views on these issues. It also presents – in Annex 1 – the proposed Regulations (with tracked changes for ease of reference) which the MFSA has updated following consideration of all feedback received.

- 1.5 Part 3 of the Feedback Statement also outlines the approach proposed to be taken by the MFSA in relation to the use of Special Purpose Vehicles by a contractual fund through the introduction of a new Regulation 14A.
- 1.6 The MFSA is open to consider any further comments which may be received in relation to the changes indicated in the attached proposed Regulations, within the timeframe indicated in the covering note to this Feedback Statement.
- 1.7 Subject to any further changes which the MFSA considers appropriate following consideration of any final feedback received in response to this Feedback Statement (paragraph above refers), it is envisaged that the final version of these Regulations will be forwarded for Ministerial approval with the intention of these becoming operative upon their publication.

2.0 Comments Received

2.1 Introduction of specific Regulations for the establishment of contractual funds

- 2.1.1 The introduction of specific Regulations regarding the establishment of contractual funds was welcomed in principle.

2.2 Legal Personality

- 2.2.1 Reference was made to the proposed Section 3(2) of the Regulations which states that “*A contractual fund shall not have legal personality and its property shall be represented by freely transferable units*”. Various comments were made in this regard as outlined below.
- 2.2.2 It was suggested that the Regulations are amended to allow the possibility of contractual funds to assume legal personality for the following reasons:
 - a. There exists no outright need for the abolition of separate legal personality, which effectively limits choice and flexibility
 - b. The fact that the fund would not have legal personality could mean that the fund’s creditors could focus on the Manager. Reference in this regard was made to the fact that whilst the Regulations clearly provide for the separate patrimony of sub-funds, they do not provide for separate patrimony of the Fund. It was argued that this could result in these types of arrangements being considered as

unattractive by Fund Managers since their liability would not be limited to loss or damage arising through their fault or negligence.

- 2.2.3 It was highlighted that one should consider the possibility, depending on the outcome of further consultation regarding taxation and regarding the Second Schedule of the Civil Code, of leaving it at the option of the promoters of the contractual funds whether to have the fund vested with legal personality or not.

With reference to the Second Schedule of the Civil Code, it was suggested that an assessment of the validity and applicability of the Regulations in the light of the Second Schedule of the Civil Code dealing with legal organisations, foundations and associations, the existence of any overlap or potential overlap between the two pieces of legislation and the need to disapply in whole and in part the provision of the Second Schedule to contractual funds should be carried out - particularly with respect to the issue of legal personality. This suggestion was made given that Foundations under the Second Schedule are in principle bound to be registered and acquire a legal personality upon such registration and Article 32A of the Schedule expressly provides for their possible use as a vehicle for collective investment.

It was commented that should a contractual fund have the characteristics of a foundation in terms of the Second Schedule (and it was opined that it can, particularly but not exclusively if one were to apply a separate patrimony status to a single contractual fund or a sub-fund of a multi contractual fund) then a contractual fund might be obliged to register in terms of such Schedule and acquire legal personality which would be in stark conflict with the provisions of the Regulations. This unless the Second Schedule (or relevant parts thereof) are expressly disapplied to contractual funds or if the contractual fund may be qualified as an Association, in which case registration (and thus the possibility to acquire legal personality) is optional.

- 2.2.4 In contrast, another respondent commented that the principle that a contractual fund does not have legal personality should be retained as this is in-keeping with the concept of contractual funds.

MFSA's Position

MFSA considers that Regulation 3(2) should be retained.

MFSA considers that a collective investment scheme established by contract is an unincorporated arrangement established by the parties to the contract. Accordingly

MFSA considers that Contractual Funds by their very nature cannot be attributed legal personality.

Moreover, alternative vehicles exist for the establishment of Collective Investment Schemes with legal personality under the Companies Act.

With reference to the comments regarding the separate patrimony and the liability of the Manager please refer to point 2.10.4 below.

In response to the comments received regarding the possible applicability of the Second Schedule of the Civil Code to contractual funds, the proposed Legal Notice has been amended to disapply the provisions of Title III of the Second Schedule to the Civil Code for contractual funds.

2.3 Civil Law Issues

- 2.3.1 Reference was made to the Civil Code provisions on co-ownership as not being appropriate and in-keeping with industry practice with respect to contractual funds. It was commented that despite proposed Regulation 20 (now re-numbered as Regulation 21), the manner in which the proposed Regulations will relate to the Civil Code remains unclear and it was suggested that an in-depth analysis of these matters is carried out to ensure clarity in this regard.

MFSA's Position

MFSA wishes to highlight that Regulation 20 (re-numbered 21) clearly states that the provisions of Title V of Part 1 of Book Second of the Civil Code shall not apply to property held in a contractual fund.

This Regulation was proposed following a review of the co-ownership provisions in this section of the Civil Code, as a result of which it was considered that these were not appropriate in the context of contractual funds.

Please refer also to point 2.5 below – Unit holders as Parties to the Contract and Co-Owners.

2.4 Definition of a Contractual Fund

- 2.4.1 The definition of a contractual fund in terms of Regulation 3 was considered as unduly restrictive since this refers solely to the establishment of contractual funds by means of an arrangement between a manager and a custodian. This approach:

- a. invariably assumes that a CIS is a business venture which is initiated by a fund manager. This excludes for example an arrangement in which a number of investors pool assets and select a manager to manage those assets in accordance with a deed of constitution which would have been drawn up by the investors themselves.
- b. assumes that the manager and custodian constitute an essential characteristic of the contractual fund set-up. While it was observed that this makes very much sense for the Manager (since a contractual fund has no Board of Directors or equivalent administrative body) – this is not necessarily the case for custodians. It was noted that for certain categories of collective investment schemes, the appointment of a custodian is not obligatory. In such cases the deed of constitution can be entered into solely by and between the manager and the unit-holders.

It was suggested that the Regulations should be expanded to accommodate other types of arrangements.

MFSA's Position

With reference to point (a), MFSA would like to refer to the definition of a 'collective investment scheme' in the Investment Services Act¹. This definition, inter alia, presupposes the existence of a promoter, which is ordinarily the Management Company, which raises capital by means of an offer of units for subscription, sale or exchange. In the absence of the appointment by the scheme of a third party Management Company, the scheme itself (where it has legal personality) could retain the investment management role. In any event it is considered that the role of the Management Company or the persons to be responsible for managing the scheme's assets is key to the establishment of a collective investment scheme is key. In the case of a contractual fund which does not itself have distinct legal personality, it is therefore considered vital for the Management Company to be a party to the contract establishing the fund.

Moreover, with reference to point (b), as an unincorporated arrangement, a contractual fund does not have an internal governing body (e.g. like a Board of Directors in a corporate entity) but is administered by an 'external entity'. This 'external entity' is suggested to be the Management Company, which is attributed the administration and management of the fund. However the Management Company is not the legal owner of the assets constituting the Fund – rather the unit-holders have a legal contractual claim on those assets. Accordingly, at least at this stage, it is considered important that a Custodian is also a party to the contractual arrangement to assume safekeeping of those assets constituting the fund.

In situations where collective investment schemes are not necessarily required to appoint a Custodian but may put in place alternative custodial arrangements, the collective investment scheme in question can be established in the form of a SICAV or INVCO or partnership.

2.5 Unit-holders as Parties to the Contract and Co-Owners

2.5.1 It was observed that the Regulations do not specifically contemplate the fact that the unit-holders would need to be a party to the agreement (e.g. by signing the subscription form) and their status as ‘co-owners’. In this regard, it was suggested that:

- a. the Regulations should also mention the unit-holders as parties to the contract establishing the fund, since the contract determines the contractual relationship between the Manager, the Custodian and the unit holders. It was further suggested that the Regulations could also provide that the unit holders are deemed to become parties and to have accepted to be bound by the deed, by the mere fact of subscribing to / acquiring the units.

MFSA’s Position

Further to our comments with regards to point 2.4(a) above, it is considered that at the outset there are no unit holders. Accordingly MFSA considers that unit-holders cannot be named a party to the deed at the time of the establishment of the fund. However the MFSA agrees with the latter suggestion that unit holders are deemed to become parties and to have accepted to be bound by the deed upon subscribing to the units in the fund. MFSA is proposing the introduction of Regulation 3(5) in this regard.

- b. It was further observed that the Regulations do not specifically state that unit holders are ‘co-owners’. In this regard it was commented that the fund is nothing more and nothing less than a collection / patrimony of assets which is co-owned by the unit-holders. It was commented that although the co-ownership provisions under the Civil Code have been dis-applied to the property of a contractual fund, it was assumed that this dis-application was not meant to rule out the co-ownership concept underlying a contractual fund but simply to dis-apply traditional civil law co-ownership rules and principles which are to a great extent clearly inappropriate to investment funds. Reference was made to the reference in the definition to participants who “*participate and share in the property*” of the fund which was being interpreted to refer to co-ownership. Accordingly it was suggested that the Regulations should clarify that the property making up the fund is co-owned by the unit holders (as an undivided collection).
- c. A question was raised as to whether the co-ownership of the fund’s property by the unit-holders is actually “undivided” since this is in effect divided into a number of

units which are then assigned to each unit holder in accordance with his subscription request thereof.

MFSA Position:

MFSA considers that given there is unitisation, each unit represents the unit-holder's entitlement to the fund's underlying assets. It is considered that the Regulation 3(1) of the proposed Regulations which provides that unit holders participate and share in the property of the collective investment scheme as evidenced by units issued by the manager is clear enough.

2.6 Domicile of the Fund

2.6.1 It was suggested that the Regulations should address the question of domicile of the Fund more clearly. In this regard reference was made to Article 4 of the Investment Services Act and the issue was raised as to how the question of whether activity is being conducted 'in or from Malta' is to be determined – particularly in a scenario where collective investment schemes are permitted to appoint service providers based outside of Malta. It was suggested that for contractual funds with no legal personality, the domicile of the Manager could be used as the determinant criterion of the Fund's domicile.

MFSA's Position

MFSA considers that the domicile of the Fund should be determined by the jurisdiction in terms of whose laws the contract is signed. MFSA is suggesting the introduction of new Regulation 3(7) in this regard.

2.7 Definition of "Management Company" or "Manager"

2.7.1 A suggestion was made that the definition of 'management company' or 'manager' should be clarified because the proposed wording is too restrictive since it implies that the manager must be responsible for both the management and the day-to-day administration of the property of the contractual fund, in a framework where fund management and fund administration can be carried out by different entities. It was suggested that the definition is amended to refer to the manager as being the person responsible for the management of the property of the contractual fund.

2.7.2 It was also suggested that:

- a. The PIF rule whereby in the absence of an external administrator the manager is responsible for the administration of the fund should be retained.

- b. The Regulations may also provide that the activity of the fund manager may also entail the provision of fund administration as an ancillary activity.
- c. In cases where the manager carries out both management and administration, the Regulations should provide that the fund manager need not hold a dual licence / authorisation.

MFSA's Position

MFSA clarifies that the reference to “management and day-to-day administration of the property of the contractual fund” in the definition of “Management Company” or “Manager” was intended to attribute responsibility for the overall operation of the contractual fund to the Manager – in order to cater for the fact that contractual funds do not have a legal personality and accordingly the overall operation thereof needs to be assumed by an external entity.

The reference to ‘day-to-day administration of the property of the contractual fund’ was not intended to be limited to the ‘day-to-day fund administration functions’ that require recognition in terms of the Investment Services Act, but rather to capture the wider ‘administrative’ responsibility of the Manager as the external governing body of the contractual fund.

It is further clarified that it was never intended that for a Malta-based Manager to act as Manager of a contractual fund, that entity would need to be licensed as a Fund Manager and also hold a fund administration recognition certificate in terms of the Investment Services Act. Rather the intention is that the current licensing and recognition frameworks in so far as fund management and fund administration will continue to apply i.e. a Management Company may either carry out the recognised fund administration functions itself (in which case it would require a fund administration certificate) or else it may appoint a third party fund administrator to provide the fund administration services for the contractual fund. However as a Manager of a contractual fund, that entity would still remain responsible for the overall administration / operation of the contractual fund – which responsibility cannot be delegated.

Further to the above, the MFSA is suggesting a slight amendment to the definition of “Management Company” or “Manager” by replacing the reference to “day-to-day administration of the property of the contractual fund” with “the proper administration and management of the contractual fund, the general supervision of the contractual fund’s affairs..”.

2.8 Application of General Rules and Regulations to Contractual Funds and their Service Providers (Regulation 14 – now renumbered as Regulation 15)

- 2.8.1 It was noted that Regulation 14 is drafted in a very wide sense and the generality thereof may in future give rise to problems of interpretation since it does not give any certainty regarding applicable rules (given the different rules which apply to the

various types of collective investment schemes). It was suggested that:

- a. this Regulation should refer to specific rules and regulations but also exemptions;
- b. the qualification at the beginning “Unless the context otherwise requires” should be extended to say “and unless otherwise provided in rules and regulations published by the competent authority or otherwise specifically applying to contractual funds” in order to take into account any further regulation through MFSA Rules that may be specifically applicable to contractual funds.

MFSA Position:

MFSA agrees that Regulation 14 (now renumbered as Regulation 15) is amended along the lines suggested in 2.8.1 (b) above.

In addition, MFSA would like to clarify that in terms of the Investment Services Act, the term ‘Regulations’ refers only to Legal Notices and that MFSA only issues Rules. Moreover, it is to be noted that Regulations (being equivalent to Legal Notices) capture also any exemptions that may be issued in the form of Legal Notices.

MFSA further clarifies that the standard Collective Investment Scheme Rules and Legal Notices applicable to Managers of Collective Investment Schemes would also be applicable to Managers of contractual funds. It is the legal form of the fund which is different not the services which are ordinarily offered by Fund Managers to collective investment schemes – with the exception in this scenario of the additional governing responsibility attributed to the Manager as the external governing body of the contractual fund, as specified in the proposed Legal Notice.

2.9 Limitation of Liability

- 2.9.1 Reference was made to Regulation 13 and the principle of limitation of liability of unit holders up to the amount of their agreed contribution. An observation was made that this principle should be applicable generally – however its inclusion in Regulation 13 which deals with multi-fund structures might be confusing as it might give the impression that it applies only in the case of multi fund schemes. Accordingly a suggestion was made that this principle is moved to the general provisions (for example Regulation 3).

MFSA Position:

MFSA agrees with the recommendation made and is proposing that the principle in question is moved to Regulation 3(6) from Regulation 13(5).

2.10 Ring Fencing, Separate Patrimony and Liabilities

2.10.1 It was noted that the Regulations do not include any general rules, applicable to multi fund and single fund structures alike, to ring fence the assets and liabilities of the fund from those of the manager, the custodian and the unit holders and their respective creditors or clients.

A detailed review of the draft Regulations was suggested with a view to:

- a. Assess the adequacy or otherwise of clearly providing for segregation of assets
- b. Assess the appropriateness of employing the concept of 'separate patrimony' generally to all contractual funds (be they multi or single fund structures)
- c. The need to set out the parameters of liability of each of the parties constituting the fund, the unit holders, the manager and the custodian.

A. Segregation of Assets

2.10.2 It was suggested that the Regulations should include clear segregation of assets requirements imposed in respect of the property of the Fund and on the Manager and on the Custodian. It was further commented that it may be assumed that the segregation of the fund assets from the assets of the manager and the custodian can be imposed through:

- The respective licence conditions and rules and regulations applicable to Managers and Custodians in terms of Rules on Safeguarding Clients' Assets in the MFSA Investment Services Rules for Investment Services Providers and the Investment Services Act (Control of Assets) Regulations, both of which speak of and impose segregation of assets to varying degrees.
- The above rules and Regulations invariably apply by virtue of the proposed Regulation 14.

However it was argued that such an assumption would be inappropriate and to a certain extent dangerous for the following reasons:

- Due to the fact that no rules have been yet proposed regarding the eligibility criteria for managers and custodians of contractual funds, which makes it difficult to determine in advance if and to what extent the above mentioned rules will apply to them.
- Depending on the type of contractual fund (particularly if it is a non-retail fund in the form of a PIF) these service providers might not be established in Malta (an argument supported by Regulation 16(e) and again the aforesaid local regulations may not apply to them (although they be subject to similar rules under the laws of their respective jurisdictions).
- The proposed Regulation 14 is too widely drafted

- In any case it would always be more sensible not to leave segregation of assets to be regulated exclusively by the rules and regulations specifically applicable to the service providers but to resound them and incorporate them again in the regulations applicable to the fund itself.

B. Separate Patrimony

2.10.3 It was commented that the concept of separate patrimony may provide the basis for adequately addressing the issues outlined regarding the segregation of assets. This has the advantage of ring fencing the assets and liabilities included in a defined patrimony without assigning separate legal personality to such patrimony.

2.10.4 Reference was made to Regulation 13 (renumbered to 14) which regards the separate patrimony of assets and liabilities solely of sub-funds within a multi-fund structure. It was suggested that the Regulation should be amended so as to clearly establish a separate patrimony for:

- (i) a single fund scheme
- (ii) the general scheme itself within a multi fund context [it was commented that it is quite strange for distinct sub-funds / compartments of a scheme to be assigned a separate patrimony status without the scheme itself (of which such compartments form an integral part) being first assigned them status of separate patrimony ring-fenced from the assets and liabilities of the manager, custodian and unit holders]

MFSA Position

MFSA would like to clarify a number of points:

- In so far as eligibility criteria for Managers and other service providers that may be appointed in relation to the contractual fund, the standard rules applicable to service providers for any other form of collective investment scheme shall apply, as would the ISA (Exemption) Regulations setting out the criteria for exempting overseas service providers to Malta based funds. As stated in point 2.8 above, it is the legal form of the fund which is different not the services which are ordinarily offered by service providers to collective investment schemes. Accordingly, in so far as Managers of contractual funds are concerned, these will need to be licensed under the Investment Services Act if based in Malta or adequately regulated in EU /EEA, or must satisfy the requirements of the relative exemption under the Exemption Regulations if a licence is not to be issued under the ISA in their regard. Overseas based Managers and Custodians would need to be subject to similar requirements in their respective jurisdictions – hence the reference in the Exemption Regulations to MFSA needing to be satisfied of the good standing and repute of these entities. In addition, overseas-based Custodians and Managers for retail funds need to be adequately regulated.

- *The assets of a contractual fund are not legally owned by the Manager responsible for the fund nor by the Custodian responsible for the safe-keeping of the assets of the fund despite the fact that the fund does not have legal personality. The unit-holders have a contractual claim on the fund's assets and the service providers will be holding the fund assets on behalf of the fund – similar to the case of a fund with legal personality. Accordingly the Service providers of a contractual fund will still be bound by the respective licence conditions and rules and regulations applicable to Managers and Custodians in terms of Rules on Safeguarding Clients' Assets in the MFSA Investment Services Rules for Investment Services Providers and the Investment Services Act (Control of Assets) Regulations.*

Notwithstanding the above, MFSA however agrees that for clarity purposes, the proposed Regulations should establish the principle that the property of a contractual fund and of each of its sub-funds, if any, shall constitute a separate patrimony and shall be separate and distinct from the property of its unit holders, its manager and of its custodian. A new Regulation 9(1) is being proposed in this regard.

Please refer also to comments below regarding Regulation 14.

C. Limitation of Liabilities

2.10.5 The following comments / suggestions were made in this regard:

- a. Whilst the contractual fund is said to have no legal personality, it was assumed that the underlying intention is or should be for the property constituting the fund not to be available to satisfy the claims of creditors of unit holders, the manager and the custodian, but should be available only to satisfy the obligations, expenses and liabilities of the fund itself (including in the case of a sub-fund or a multi fund structure, the liabilities of the scheme in general imposed upon it by deed of constitution) and this in the general interest and protection of investors / unit holders themselves;
- b. On the other hand, creditors of the fund whose debts arise from or in connection with the assets of the fund, or even in connection with the management or custody of such assets, should not have a right of recourse against the personal assets of the unit holders (except up to the property and assets of the fund co-owned by the said unit holders) or against the assets (own assets or those of other clients) of either the manager or the custodian, except as provided in (c) below. The limitation of the unit holders' liability is already provided for in the Regulations but the same does not apply in respect of the manager and the custodian and without express provision to this effect (coupled with the lack of legal personality of the fund) one could make an argument that the manager (as party to the deed of constitution and manager and representative – in terms of regulation 17 – of the property constituting the

fund) and (to a lesser extent) the custodian responsible for the debts of the fund

MFSA Position

Further to the above comments, MFSA is proposing the introduction of a new Regulation 9(2).

- c. Each of the manager and custodian should on the other hand be unlimitedly liable with its own property to the unit holders and other creditors for losses and damages arising through its own fault, negligence, improper performance or failure of performance of functions, violation of laws, regulations, deed of constitution and fund rules (which is one of the reasons why managers and custodians of contractual funds shall presumably be required by specific MFSA Rules to have adequate financial resources to meet their respective liabilities).

MFSA Position

MFSA would like to refer to the explanations provided above regarding the role of the Service Providers – including the Managers and the Custodian – of contractual funds.

Accordingly the Service providers of a contractual fund will still be bound by the respective licence conditions and rules and regulations applicable to Managers and Custodians in terms of Rules on Safeguarding Clients' Assets in the MFSA Investment Services Rules for Investment Services Providers and the Investment Services Act (Control of Assets) Regulations.

2.11 Multi Fund Structure – Regulation 13

- 2.11.1 Reference was made to the statement in Regulation 13(3) (renumbered 14(3))“*the other assets belonging to the multi-fund scheme*”. It was noted that in the context of a contractual fund having no legal personality, the reference to property belonging to the fund might be a misnomer since only legal persons have the capacity to own property. It was further suggested that one may then refer to the property forming part of such separate patrimony if the suggestion of separate patrimony is adopted.

MFSA Position

MFSA agrees with the suggestion made and is proposing an amendment to Regulation 14(3) in this regard.

2.11.2 It was suggested that the term “proceedings” as used in Regulation 13(3) (renumbered 14(3)), should be defined in a similar fashion to the definition given to the term as used in Regulation 9 of the Companies Act (Investment Companies with Variable Share Capital) regulations, 2006 (LN 241 of 2006 as amended). It was further suggested that “proceedings” in respect of contractual funds cannot be defined by reference to the winding up and insolvency provisions of the Companies Act but can be defined as including proceedings in respect of the dissolution and liquidation of the fund as per Regulation 20.

MFSA Position

MFSA agrees with the suggestion made and is proposing a definition of “proceedings” is included in Regulation 14(3).

2.12 Manager and Custodian

2.12.1 It was assumed that the MFSA will eventually publish eligibility criteria and other characteristics and requirements for the managers and custodians of contractual funds which will specifically relate to contractual funds. It was recommended that such rules should take into account the different types of collective investment schemes that can be set up under Maltese law.

MFSA Position

Please refer to the clarifications already provided above regarding the eligibility criteria for Managers and other service providers that may be appointed in relation to the contractual fund. Any new Rules specific to contractual funds and their service-providers which may be proposed in future will be issued for consultation with the industry

2.13 Regulation 16 – Duties of the Manager and the Custodian

2.13.1 The following comments were made with reference to Regulation 16 (renumbered 17) which sets out instances where duties of the Manager and the Custodian shall cease:

- a. The Regulations should include more detail of the duties of the Manager other the indirect reference thereof in the definition of Manager.
- b. The Regulations should include a definition of Custodian as well as more detail of the duties of the Custodians. In so far as the definition of Custodian, it was further suggested that such definition should be in

line with the respective definition in the Investment Services Act (Control of Assets) Regulations.

MFSA Position

MFSA agrees that the Regulations should include a definition of Custodian. Please refer to the revised definitions section in this regard. As stated above, the MFSA clarifies that the general duties of the Manager and the Custodian of contractual funds would not be different from those of a Manager and Custodian of a Collective Investment Scheme established in a legal form other than by contract.

- c. Whilst Regulation 16 (a) and (b) (re-numbered Regulation 17 (a) and (b)) - dealing with voluntary withdrawals of the manager and the custodian - cater for the intervening period until a replacement is appointed and approved, no similar provisions are included in the cases referred to under paragraphs (c) to (f) of Regulation 16. The only rule which would apply in such cases is that the fund would be dissolved if no replacement is effected within two months from the cessation of duties. It was suggested that this should be revisited and appropriate rules included in the interest of unit holders.

MFSA Position

MFSA agrees with the suggestions made and is proposing some amendments to Regulation 16 (now re-numbered Regulation 17) in this regard.

- d. It was suggested that the Regulations should specify who has the right to and the procedure to remove the management company and to replace the management company and the custodian. Regulation 16(b) refers to the custodian being removed by the Manager but they do not specify who can remove and replace the Manager. In this respect, it was suggested that the consideration is given to the granting of some powers or at least rights of consultation to the unit holders.

MFSA Position

MFSA is of the opinion that the procedure for the removal of the custodian and/or the manager should be included in the deed of constitution not in the Regulations. The deed of constitution would need to be approved by the MFSA.

2.14 Prospectus

- 2.14.1 The following comments were made with reference to Regulation 6 :

- a. The opening paragraph “Where a contractual fund is required to issue a prospectus...” implies that there may be instances that a prospectus may not be necessary.
- b. The regulations contain no definition of the term “Prospectus”. In this regard, it was commented that by default, in all probability the definition in the ISA would be applied which in turn refers to the respective definition in the Companies Act. In this regard it was observed that the Companies Act definition of Prospectus refers to any prospectus, notice, circular, advertisement or other invitation, offering to the public for subscription any shares (including units) or debentures of a company or other commercial partnership. An offer to the public is then specifically defined in the Companies Act by virtue of provisions which were essentially meant to transpose the Prospectus Directive (which applies to closed ended collective investment schemes but not to open ended ones). In this regard, clarification was requested as to whether Regulation 6 and the rules thereunder (including the publication of the Prospectus) was meant to apply only to:
 - Closed ended contractual funds
 - Contractual funds offered to the public
 - In circumstances where the Prospectus Directive would applyOr whether it should apply also to:
 - Open ended schemes and to PIFs (and whether “prospectus” should also be taken to include an offering memorandum / document of a PIF as mentioned in the MFSA Rules for PIFs)

It was suggested that a clear definition is included in the Regulations to clarify the above issues.

MFSA Position

MFSA considers collective investment schemes established by contract as equivalent to collective investment schemes established in any other legal form for the purposes of the Investment Services Act.

Accordingly MFSA is of the opinion that the definition of prospectus included in the Investment Services Act, which makes cross-reference to the Companies Act, is also applicable in relation to contractual funds. MFSA considers that there is no need to include a definition of prospectus in the Regulations. Please refer also to comments in relation to point 2.18.1 below.

MFSA would also like to clarify that the provisions of the Companies Act relating to Prospectuses do not apply solely to closed ended schemes.

2.15 Registered Certificates

2.15.1 Regulation 7 provides for the issue of registered certificates by the Manager. Various comments were received in this regard as follows:

- a. It was commented that the restriction to issue registered certificates is too rigid and restrictive. In this regard:
 - It was opined that it should be possible for the issuance of written confirmations of entry in the register of unit holders instead of certificates.
 - It was suggested that the issuance of dematerialised statements should be allowed. In this regard the following amendments to Regulation 7 were suggested:
 - “(1) The Management Company of a contractual fund shall issue registered certificates or alternatively written confirmation of entry in the registry of units....
 - (2) Certificates or written confirmations issued in accordance with sub-regulation (1) shall be...”

MFSA Position

Regulation 7 has been expanded to clarify this aspect further.

- b. Clarification was requested as to whether the reference in Regulation 7(2) stating that “Such signatures may be reproduced electronically” implies that certificates (or other evidence of ownership / registration) may be issued in electronic format. It was recommended that this possibility (including the issue of electronic signatures) should be considered in line with the relevant provisions of the Electronic Commerce Act (Chapter 426 of the Laws of Malta).

MFSA Position

MFSA considers that the wording in question should be deleted in order to avoid any confusion in this regard. MFSA is proposing that Regulation 7(2) is amended accordingly.

- c. One should also evaluate the possibility of a fund to issue bearer units as under Luxembourg Law.

MFSA Position

MFSA wishes to discourage the issuance of bearer units and does not consider it appropriate to provide for this possibility in the Regulations.

2.16 Taxation

- 2.16.1 A comment was made that appropriate consideration should be given to the tax consequences raised by a fund structure which has no legal personality. Various comments were made regarding the taxation of such vehicles.

MFSA Position

Under the draft Regulations a contractual fund shall be considered as collective investment scheme licensed under Article 2 of the Investment Services Act. A Special Purpose Vehicle ('SPV') established under a contractual fund shall also licensed as part of the Collective Investment Scheme licence which regulates the fund and shall be considered an integral part of the same collective investment scheme.

Further information on the use of SPVs by contractual funds may be found under Section 3 of this Feedback Statement.

2.17 Registration

- 2.17.1 Reference was made to Regulation 5(4). It was suggested that the proposed registration procedure for the deed of constitution of the Fund is further formalised by means of a register to be set up and kept by the MFSA itself.

MFSA Position

MFSA would like to make reference to the proposed Regulation 5(4). The intention in this regard is that a section dedicated to the constitutional deed of any contractual funds that may be established and recognised or licensed, is created on MFSA's website. The public can then access copies of such deeds of constitution. This section can also include a list in the form of a register, of all the constitutional deeds of the contractual funds established and recognised or licensed under the Investment Services Act.

2.18 Definitions

- 2.18.1 An observation was made that certain definitions such as 'unit', 'prospectus' etc are missing from the Regulations. On the assumption that the respective definitions in the ISA should apply, it was suggested that at the end of Regulation 2, a statement which provides that: "*Unless otherwise defined herein, the terms defined in the Act shall, when used herein, have the same meaning assigned to them under the Act*".

MFSA Position

MFSA agrees with the recommendation made and is proposing the insertion of new Regulation 2(2) cross referring to other definitions contained in the Investment Services Act.

2.19 Nature of the deed of constitution

2.19.1 A comment was made that it was not clear whether the deed of constitution refers to a public deed or to a private writing. It was suggested that a private writing ought to be sufficient in view of the proposed registration requirement of the deed itself. It was further suggested that this is specified clearly in the Regulations.

MFSA Position

A new sub-Regulation (3) has been introduced to Regulation 3 of the draft Regulations to clarify that a contractual fund may be constituted by a public deed or by private writing.

2.20 Decision-Making

2.20.1 Reference was made to the wording in Regulation 17 (renumbered 18), that the Manager of a contractual fund shall take decisions “*in consultation with the Custodian*”. It was observed that consultation is generally not meant to be binding. In this regard, it was further observed that technically, in instances where the Custodian does not agree with the Manager, the latter should be able to proceed with an action binding the unit holders albeit at significant reputation risk to himself. It was therefore suggested that in the instances where the Custodian does not agree with the Manager, reference is made to the Competent Authority.

MFSA Position

This Regulation has been clarified to provide that decisions affecting the rights of unit-holders shall be taken by the Manager of a contractual fund in agreement with the Custodian

Percentage of Unit-Holders to request a meeting

2.20.2 A suggestion was made that the percentage of unit holders who have the power to call a meeting should be covered in the contract of constitution over and above the issues based on which the unit holders have the right to ask the Management Company to convene a meeting.

MFSA Position:

MFSA is of the opinion that the procedure in this regard should be included in the deed of constitution not in the Regulations. The deed of constitution would need to be approved by the MFSA.

3.0 New article 3A relating to the use of Special Purpose Vehicles (SPVs) by Contractual Funds.

- 3.1 New provisions added on to the Draft Regulations provide that where the Manager of a contractual fund decides to effect all or any investments (except for ancillary cash) of the contractual fund exclusively through a company formed and incorporated in Malta whose object is solely that of acting as a special purpose vehicle to the contractual fund established pursuant to the ISA (Contractual Fund) Regulations (i.e. established for the principal purpose of holding and investing the investments made to the contractual fund), then the licence granted to the contractual fund in terms of article 4 of the ISA shall also cover the special purpose investment company (SPV) and the licence conditions applicable to the contractual fund will also include licence conditions applicable specifically to the special purpose investment company.
- 3.2 Regulation 3A makes specific provisions related to the setting up of SPVs by a contractual fund and the relationships and responsibilities of related persons.
- 3.3 Supplementary amendments to the original draft Legal Notice have also been incorporated in Regulation 2 and Regulation 4.
- 3.4 Notes on the Draft MFSA Rules and Licence Conditions relating to the use of locally established SPVs by contractual funds are outlined in Appendix 1. *A draft copy of these Rules is also being published and circulated along with this Feedback Statement. Comments in this respect are also invited by the same deadline.*

ⁱ "collective investment scheme" means any scheme or arrangement which has as its object or as one of its objects the collective investment of capital acquired by means of an offer of units for subscription, sale or exchange and which has the following characteristics:

(a) the scheme or arrangement operates according to the principle of risk spreading; and either
(b) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled; or

(c) at the request of the holders, units are or are to be repurchased or redeemed out of the assets of the scheme or arrangement, continuously or in blocks at short intervals; or

(d) units are, or have been, or will be issued continuously or in blocks at short intervals:

Provided that the competent authority may issue a licence with respect to a scheme or arrangement whose units are to be offered for subscription, sale or exchange to:

(i) licence holders; or

(ii) persons whose ordinary business involves the acquisition and disposal of instruments of the same kind as the instrument or instruments in which the scheme or arrangement invests; or

(iii) persons whose ordinary business involves the acquisition and disposal of property of the same kind as the property, or a substantial part of the property, in which the scheme or arrangement invests; or

(iv) persons who by regulation under this Act are exempt from the requirement of an investment services licence provided that the scheme or arrangement invests in instruments or property in respect of which such persons are exempt;

Notwithstanding that such a scheme or arrangement does not have the characteristic listed in paragraph (a), and in any such case, such scheme or arrangement shall be deemed to be a collective investment scheme.

APPENDIX A:

Notes on the Proposed Rules relating to the use of SPVs by Contractual Funds

Application of Rules

The following licence conditions will apply to an SPV formed and incorporated under the laws of Malta by an MFSA licensed contractual fund. Without prejudice to any other Rules or Regulations that may apply to the use of SPVs generally by contractual funds established in Malta, these Rules will not apply to SPVs formed and incorporated in another jurisdiction.

Similar Licence Conditions will apply under the Rules for Retail CISs.

Rules on the use of SPVs established in Malta by MFSA-licensed Contractual Funds

Format of CIS licence

The Licence granted to the fund will specify that this is a licence granted by the MFSA to the Fund established in terms of the ISA (Contractual Funds) Regulations and to a specific SPV or SPVs established locally under the Fund.

Nature of Licence Conditions which apply to the SPV as part of the licence conditions applicable to the contractual fund.

The objects of company shall be restricted to act as SPV to the contractual fund, that is, the constitutional document of the SPV would need to state that its objectives are limited to the receipt of monies from [name of the contractual fund] and the investment of such monies in accordance with the investment objective and policy of [the contractual fund] with the aim of maximising the return on such monies for the benefit of unit-holders of [the contractual fund] and subject to the investment and borrowing and/or leverage restrictions applicable to the contractual fund.

The SPV shall be considered to be an integral part of the fund and shall, in so far as applicable, be subject to all legal and contractual obligations applicable to the fund

such as the need to notify the MFSA of any change in the directorship of the SPV and the duty to provide MFSA with access to any records maintained by the SPV, and the fund shall also be ultimately responsible for ensuring that these obligations are met. The SPV would also be required to submit a certificate of compliance signed by its Directors on a six monthly basis attesting that it is complying with the investment objective policies applicable to the fund. This certificate shall be submitted to the Manager of the Contractual Fund.

The Offering Memorandum of the contractual fund should disclose clearly the use being made of special purpose vehicles in order to meet the objectives of the fund.

The financial reports of the contractual fund would also need to include full details of the SPV's assets and liabilities, in addition to any other obligations of the SPV which directly arise under the Companies Act.

The Authority shall have the right, from time to time, and following advance notification to the Contractual fund and/or SPV, to vary or revoke any licence condition or to impose any new conditions as it may deem appropriate.

The Rules shall also include the nature and type of documentation needed to be submitted by the contractual fund in respect of the approval of any SPV to be set up under the fund. This will be required jointly with the application for the licensing of the fund, or following a specific request for the approval of the SPV under the licence if it is envisaged that the SPV may be set up after the commencement of operations of the fund.