

INVESTMENT SERVICES RULES FOR RETAIL COLLECTIVE INVESTMENT SCHEMES

PART B

APPENDIX VIII: ADDITIONAL RULES APPLICABLE TO SELF-MANAGED SCHEMES ESTABLISHED AS UCITS

This Appendix includes the additional rules which must be fulfilled by a scheme which is set up as a self-managed Maltese UCITS. This Appendix is divided in five sections as follows:

Section 1 on general licencing requirements which must be implemented by the scheme;

Section 2 includes the provisions regulating the conflicts of interest policy which must be implemented on an ongoing basis by a scheme;

Section 3 includes the conduct of business rules which must be implemented on an ongoing basis by a scheme;

Section 4 includes the provisions regulating the establishment and the role of the Investment Committee which must be set up by a scheme;

Section 5 stipulates the provisions regulating the risk management function which must be implemented on an ongoing basis by a scheme.

For the purposes of this Appendix, any reference to the term “scheme” shall be understood as referring to a retail collective investment scheme set up as a self-managed UCITS in Malta.

SECTION I : GENERAL LICENCING REQUIREMENTS

1 LICENCING REQUIREMENTS

1.01 Without prejudice to the generality of the provisions of the Act, the MFSA will only grant a licence to a self-managed scheme if it satisfies the conditions prescribed hereunder, which conditions shall apply on an ongoing basis:

- (a) the scheme shall be operated in or from Malta, as agreed with the MFSA.
- (b) the scheme shall have an initial capital which is equivalent to EUR 300,000;
- (c) the application for authorisation shall be accompanied by a programme of operations setting out at least the organisational structure of the scheme;
- (d) the directors of the scheme must be fit and proper to perform their functions, be of sufficiently good repute and be sufficiently experienced also in relation to the type of business pursued by the scheme;
- (e) the conduct of the business of the scheme must be decided by at least two persons meeting the conditions stipulated in paragraph (d) above to the satisfaction of the MFSA. Furthermore the MFSA will be notified of the names of the directors and of every person succeeding them in office.

1.02 The scheme shall at all times have the financial resources required for the proper performance of its functions. Furthermore, the net asset value of the scheme shall be expected to exceed EUR 300,000 on an ongoing basis:

Provided that the scheme shall notify the MFSA as soon as its net asset value falls below the level prescribed in this Rule.

1.03 The scheme shall commence its business as soon as the licence has been granted.

1.04 The scheme and the custodian shall be separate persons independent of each other. They shall act independently and solely in the interests of the unit-holders. A majority of the directors of the scheme shall be independent of the custodian. Since independence may be compromised in a variety of ways, any facts, relationships, arrangements, or circumstances which may at any stage bring that independence into question shall be declared to the MFSA as soon as the scheme becomes aware of any such matter.

1.05 Where close links exist between the scheme and other natural or legal persons, the MFSA shall only grant a licence to the applicant if those close links do not prevent the effective exercise of its supervisory function as stipulated in Article 6(8) of the Act.

1.06 In the case of an application for a licence as a self-managed scheme, the MFSA shall inform the applicant within six months of the submission of a complete application,

whether or not the licence has been granted. The MFSA shall provide reasons where a licence is refused.

- 1.07 The scheme shall on a continuing basis ensure that it has sufficient management resources to effectively conduct its business.
- 1.08 The scheme shall keep such accounting and other records, in particular regarding the whole process of the investment management function and its monitoring thereof, as are necessary to enable it to comply with the Rules and to demonstrate that compliance has been achieved. Records are to be retained in Malta and made available to MFSA's review as the need arises. Records shall be retained for a minimum period of ten years. During the first two years they shall be kept in a place from which they can be produced within two working days of their being requested. After the first two years they shall be kept in a place from which they can be produced within five working days of their being requested.
- 1.09 In respect of each annual accounting period, the scheme shall require its auditor to prepare a management letter in accordance with International Standards on Auditing. The management letter shall be sent to MFSA.

SECTION II: CONFLICTS OF INTEREST POLICY

1. REQUIREMENTS ON CONFLICTS OF INTEREST APPLICABLE TO SCHEMES

- 1.01. The scheme shall organise and control its affairs in a responsible manner and shall have adequate operational, administrative and financial procedures and controls to ensure compliance with all regulatory requirements and shall provide the MFSA with all the information it may require from time to time. The scheme shall be required to observe the relevant requirements prescribed hereunder:
- (a) acts honestly and fairly in conducting its business activities in the best interests of the unit-holders and the integrity of the market;
 - (b) acts with due skill, care and diligence, in the best interests of the unit-holders and the integrity of the market;
 - (c) has and employs effectively the resources and procedures that are necessary for the proper performance of its activities;
 - (d) tries to avoid conflicts of interest and, when they cannot be avoided, ensures that the unit-holders are treated fairly; and
 - (e) complies with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of its unit-holders and the integrity of the market.

2. CRITERIA FOR THE IDENTIFICATION OF CONFLICTS OF INTEREST

- 2.01. For the purposes of identifying the types of conflict of interest that arise in the course of providing services and activities and whose existence may damage the interests of a scheme, it must take into account, by way of minimum criteria, the question of whether it, or a relevant person, or a person directly or indirectly linked by way of control thereto, is in any of the following situations, whether as a result of providing collective portfolio management activities or otherwise:
- a. the scheme or that person is likely to make a financial gain or avoid a financial loss at the expense of the scheme;
 - b. the scheme, or that person has an interest in the outcome of a service or activity provided to the scheme or another client or of a transaction carried out on behalf of the scheme or another client, which is distinct from the scheme's interest in that outcome;
 - c. the scheme or that person has a financial or other incentive to favour the interest of another client or group of clients over the interests of the scheme;
 - d. the scheme, or that person carried on the same activities for the scheme and for another client or clients which are not the scheme;
 - e. the scheme or that person receives or will receive from a person other than the scheme, an inducement in relation to collective portfolio management activities provided to the scheme, in the form of monies, goods or services other than the standard commission or fee for that service.

- 2.02. When identifying the types of conflict of interest, the scheme shall take into account:
- a. its interests, including those deriving from its belonging to a group or from the performance of services and activities, the interests of the clients and the duty of the scheme;
 - b. the interests of two or more managed schemes.

3. CONFLICTS OF INTEREST POLICY

- 3.01. A scheme shall establish, implement and maintain an effective conflicts of interest policy.
- 3.02. The conflicts of interest policy shall be set out in writing and shall be appropriate to the size and organisation of the scheme and the nature, scale and complexity of its business.
- 3.03. Where the scheme is a member of a group, the conflicts of interest policy shall also take into account any circumstances of which the company is or should be aware which may give rise to a conflict of interest resulting from the structure and business activities of other members of the group.
- 3.04. The conflicts of interest policy established in accordance with Rules 3.01 to 3.03 shall include the following:
- a. the identification of, with reference to collective portfolio management activities carried out by or on behalf of the scheme, the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of the scheme or one or more other clients;
 - b. procedures to be followed and measures to be adopted to manage such conflicts.

4. INDEPENDENCE IN CONFLICTS MANAGEMENT

- 4.01. The procedures and measures provided for in Rule 3.04(b) are designed to ensure that the relevant persons engaged in different business activities involving a conflict of interest carry on those activities at a level of independence appropriate to the size and activities of the scheme and of the group to which it belongs and to the materiality of the risk of damage to the interests of clients.
- 4.02. The procedures to be followed and measures to be adopted pursuant to Rule 3.04(b) shall include the following where necessary and appropriate for the scheme to ensure the requisite degree of independence:
- a. effective procedures to prevent or control the exchange of information between relevant persons engaged in collective portfolio management

- activities involving a risk of a conflict of interest where the exchange of that information may harm the interests of one or more clients;
- b. the separate supervision of relevant persons whose principal functions involve carrying out collective portfolio management activities on behalf of, or providing services to, clients or to investors whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the scheme;
 - c. the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;
 - d. measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out collective portfolio management activities;
 - e. measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate collective portfolio management activities where such involvement may impair the proper management of conflicts of interest.
- 4.03. Where the adoption or the practice of one or more of the aforementioned measures or procedures does not ensure the requisite degree of independence, the scheme will adopt such alternative or additional measures and procedures as are necessary and appropriate for those purposes.
- 5. MANAGEMENT OF ACTIVITIES GIVING RISE TO DETRIMENTAL CONFLICTS OF INTEREST**
- 5.01. A scheme shall keep and regularly update a record of the types of collective portfolio management activities undertaken by it in which a conflict of interest entailing a material risk of damage to its interests or other clients has arisen or, in the case of an ongoing collective portfolio management activity, may arise.
- 5.02. A scheme shall ensure that where the organisational or administrative arrangements made by same for the management of conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the scheme or of its unit-holders will be prevented, the senior management or other competent internal body of the scheme is promptly informed in order for them to take any necessary decision to ensure that in any case the scheme acts in its best interests and of its unit-holders.
- 5.03. The scheme shall report situations referred to in Rule 5.02 to investors by any appropriate durable medium and give reasons for its decision.

6. STRATEGIES FOR THE EXERCISE OF VOTING RIGHTS

- 6.01. A scheme shall develop adequate and effective strategies for determining when and how voting rights attached to instruments held in the managed portfolios are to be exercised, to its exclusive benefit.
- 6.02. The strategy referred to in Rule 6.01 shall determine measures and procedures for:
- a. monitoring relevant corporate events;
 - b. ensuring that the exercise of voting rights is in accordance with the investment objectives and policy of the relevant scheme; and
 - c. preventing or managing any conflicts of interest arising from the exercise of voting rights.
- 6.03. A summary description of the strategies referred to in Rule 6.01 shall be made available to investors.
- 6.04. Details of the actions taken on the basis of the aforementioned strategies shall be made available to the unit-holders free of charge and on their request.

SECTION III: OPERATIONAL ARRANGEMENTS OF SCHEMES

1. GENERAL PRINCIPLES

- 1.01 This Section stipulates the provisions regulating the conduct of business rules which must be implemented on an ongoing basis by a scheme.
- 1.02 The scheme shall have sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing and adequate internal control mechanisms. This shall include, in particular, rules for personal transactions by its employees or for the holding or management of investments in financial instruments in order to invest its initial capital and ensuring at least that each transaction involving the scheme may be reconstructed according to its origin, the parties to it, its nature, and the time and place at which it was effected and that the assets of the scheme are invested according to the instruments of incorporation, prospectus and legal provisions in force.
- 1.03 Where a scheme delegates to third parties, for the purpose of a more efficient conduct of its business, the carrying out on its behalf of one or more of its functions, the scheme shall comply with the following requirements:
- (a) the scheme shall submit to the MFSA the details of such delegation in an appropriate manner;
 - (b) such delegation shall not prevent the effectiveness of supervision over the scheme and in particular shall not prevent the scheme from acting, or the scheme from being managed in the best interests of the investors;
 - (c) the scheme shall have measures in place that enable the persons who conduct its business to monitor effectively, at any time, the activities of the undertaking to which functions are delegated;
 - (d) such delegation shall not prevent the persons who conduct the business of the scheme from giving further instructions to the undertaking to which functions are delegated at any time or from withdrawing such delegation with immediate effect when this is in the interest of investors;
 - (e) the undertaking to which functions are delegated shall be qualified and capable of undertaking the functions being delegated;
 - (f) the prospectus of the scheme shall list the functions being delegated in the form and manner specified in these Rules.
- 1.04 Where a delegation in accordance with Rule 1.03 is made in respect of the function of investment management, such delegation shall only be given to undertakings authorised or licensed to provide asset management services and subject to prudential supervision. Such delegation shall be in accordance with investment-allocation criteria periodically laid down by the scheme.

- 1.05 A delegation of the core function of investment management shall not be made to the custodian or to any other undertaking whose interests may conflict with those of the scheme or of the unit-holders.
- 1.06 Where a delegation in accordance with Rule 1.03 is made in respect of the function of investment management to an undertaking licensed in a third country, co-operation between the MFSA and the supervisory authority of such third country shall be ensured.
- 1.07 A scheme shall not delegate its function to the extent that it becomes a letter-box/brass-plate entity.
- 1.08 A scheme shall manage only assets of its portfolio and shall not under any circumstances receive any mandate to manage assets on behalf of a third party.

2. DUTY TO ACT IN THE BEST INTERESTS OF THE SCHEME AND ITS UNIT-HOLDERS

- 2.01. A scheme shall ensure that unit-holders are treated fairly.
- 2.02. A scheme shall refrain from placing the interests of any group of unit-holders above the interests of any other group of unit-holders.
- 2.03. A scheme shall apply appropriate policies and procedures for preventing malpractices that might reasonably be expected to affect the stability and integrity of the market.
- 2.04. A scheme shall ensure that fair, correct and transparent pricing models and valuation systems are used, in order to comply with the duty to act in the best interests of the unit-holders.
- 2.05. A scheme must be able to demonstrate that its portfolios have been accurately valued.
- 2.06. A scheme shall act in such a way as to prevent undue costs being charged thereto and its unit-holders.

3. DUE DILIGENCE REQUIREMENTS

- 3.01. A scheme shall ensure a high level of diligence in the selection and ongoing monitoring of investments, in its best interests and in the interest of the integrity of the market.
- 3.02. A scheme shall ensure it has adequate knowledge and understanding of the assets in which it invests.

- 3.03. A scheme shall establish written policies and procedures on due diligence and implement effective arrangements for ensuring that its investment decisions are carried out in compliance with the objectives, investment strategy and risk limits of the scheme.
- 3.04. When implementing its risk management policy, and where it is appropriate after taking into account the nature of a foreseen investment, a scheme shall formulate forecasts and perform analysis concerning the investment's contribution to the scheme's portfolio composition, liquidity and risk and reward profile before carrying out the investment:

Provided that the analysis must only be carried out on the basis of reliable and up-to-date information, both in quantitative and qualitative terms.

- 3.05. A scheme shall exercise due skill, care and diligence when entering into, managing or terminating any arrangements with third parties in relation to the performance of risk management activities. Before entering into such arrangements, a scheme shall take the necessary steps in order to verify that the third party has the ability and capacity to perform the risk management activities reliably, professionally and effectively. The scheme shall establish methods for the on-going assessment of the standard of performance of the third party.

4. HANDLING OF SUBSCRIPTION AND REDEMPTION ORDERS: REPORTING OBLIGATIONS IN RESPECT OF EXECUTION OF SUBSCRIPTION AND REDEMPTION ORDERS

- 4.01. Where a scheme has carried out a subscription or redemption order from a unit-holder, it must notify the unit-holder, by means of a durable medium, confirming execution of the order as soon as possible, and no later than the first business day following execution or, where the confirmation is received by the scheme from a third party, no later than the first business day following receipt of the confirmation from the third party.
- 4.02. Rule 4.01 shall not apply where the notice would contain the same information as a confirmation that is to be promptly dispatched to the unit-holder by another person.
- 4.03. The notice referred to in Rules 4.01 and 4.02 shall, where applicable, include the following information:
- a. the investment company's /the scheme's identification;
 - b. the name or other designation of the unit-holder;
 - c. the date and time of receipt of the order and method of payment;
 - d. the date of execution;
 - e. the nature of the order (subscription or redemption);
 - f. the number of units involved;
 - g. the unit value at which the units were subscribed or redeemed;

- h. the reference value date;
 - i. the gross value of the order including charges for subscription or net amount after charges for redemptions; and
 - j. a total sum of the commissions and expenses charged and, where the investor so requests, an itemised breakdown.
- 4.04. Where orders for a unit-holder are executed periodically, a scheme shall either take the action specified in Rules 4.01 and 4.02 or provide the unit-holder, at least once every 6 months, with the information provided in Rule 4.03 above in respect of those transactions.
- 4.05. A scheme shall provide the unit-holder, upon request, with information about the status of his order.
- 5. EXECUTION OF DECISIONS TO DEAL ON BEHALF OF THE SCHEME**
- 5.01. A scheme shall act in its best interests when executing decisions to deal in the context of the management of its portfolios.
- 5.02. For the purposes of Rule 5.01 above, a scheme shall take all reasonable steps to obtain the best possible result, taking into account price, costs, speed, likelihood of execution and settlement, order size and nature, or any other consideration relevant to the execution of the order.
- 5.03. The relative importance of such factors as referred to in Rule 5.02 above shall be determined by reference to the following criteria:
- a. the objectives, investment policy and risks specific to the scheme, as indicated in the prospectus or as the case may be in the fund rules or instruments of incorporation;
 - b. the characteristics of the order;
 - c. the characteristics of the financial instruments that are the subject of that order; and
 - d. the characteristics of the execution venues to which that order can be directed.
- 5.04. A scheme shall establish and implement effective arrangements for complying with the obligation referred to in Rules 5.02 and 5.03. In particular, a scheme shall establish and implement a policy to allow it to obtain, for its orders, the best possible result in accordance with Rules 5.02 and 5.03 taking into account price, costs, speed, likelihood of execution and settlement, order size and nature, or any other consideration relevant to the execution of the order.
- 5.05. A scheme shall make available appropriate information on the execution policy to unit-holders in accordance with these Rules and on any material changes to their policy.

- 5.06. A scheme shall monitor on a regular basis the effectiveness of its arrangements and policy for the execution of orders in order to identify and, where appropriate, correct any deficiencies.
- 5.07. A scheme shall review the execution policy on an annual basis. A review shall also be carried out whenever a material change occurs that affects the scheme's ability to continue to obtain the best possible result.
- 5.08. A scheme shall be able to demonstrate that it has executed orders in accordance with its execution policy.
- *Placing orders to deal on behalf of the scheme with other entities for execution*
- 5.09. A scheme shall act in its best interests when placing orders to deal with other entities for execution, in the context of the management of its portfolios.
- 5.10. A scheme shall take all reasonable steps to obtain the best possible result taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. The relative importance of such factors shall be determined by reference to Rules 5.02 and 5.03.
- 5.11. For those purposes, a scheme shall establish and implement a policy to enable it to comply with the obligation referred to in Rule 5.10. The policy shall identify, in respect of each class of instruments, the entities with which the orders may be placed. The scheme shall only enter into arrangements for execution where such arrangements are consistent with obligations laid down in this Section.
- 5.12. A scheme shall make available to unit-holders appropriate information on the policy established in accordance with these Rules and on any material changes to this policy.
- 5.13. A scheme shall monitor on a regular basis the effectiveness of the policy established in accordance with Rules 5.10 to 5.12 and, in particular, the execution quality of the entities identified in that policy and, where appropriate, correct any deficiencies.
- 5.14. A scheme shall review the policy on an annual basis.
- 5.15. Such a review shall also be carried out whenever a material change occurs that affects the ability of the scheme to continue to obtain the best possible result.
- 5.16. A scheme shall be able to demonstrate that it has placed orders in accordance with the policy established in accordance with Rules 5.10 to 5.12.

6. HANDLING OF ORDERS - GENERAL PRINCIPLES

- 6.01. A scheme shall establish and implement procedures and arrangements which provide for the prompt, fair and expeditious execution of portfolio transactions.
- 6.02. These procedures and arrangements as referred to in Rule 6.01 shall satisfy the following conditions:
- a. ensure that orders executed are promptly and accurately recorded and allocated; and
 - b. execute otherwise comparable scheme orders sequentially and promptly unless the characteristics of the order or prevailing market conditions make this impracticable, or the interests of the scheme require otherwise.
- 6.03. Financial instruments or sums of money, received in settlement of the executed orders shall be promptly and correctly delivered to the account of the scheme.
- 6.04. A scheme shall not misuse information relating to its pending orders, and shall take all reasonable steps to prevent the misuse of such information by any of its relevant persons.

➤ *Aggregation and allocation of trading orders*

- 6.05. A scheme shall not be permitted to carry out an order in aggregate with an order of another scheme or another client or with an order on its own account, unless the following conditions are met:
- a. it must be unlikely that the aggregation of orders will work overall to the disadvantage of any scheme or clients whose order is to be aggregated; and
 - b. an order allocation policy must be established and implemented, providing in sufficiently precise terms for the fair allocation of aggregated orders, including how the volume and price of orders determines allocations and the treatment of partial executions.
- 6.06. Where a scheme aggregates an order with one or more orders of other schemes or other clients and the aggregated order is partially executed, it allocates the related trades in accordance with its order allocation policy.
- 6.07. A scheme which has aggregated transactions for own account with one or more schemes or other clients' orders, shall not allocate the related trades in a way that is detrimental to the scheme or another client.
- 6.08. Where a scheme aggregates an order of a scheme or other clients with a transaction for own account and the aggregated order is partially executed, it shall allocate the related trades to the scheme or other client in priority over those for own account.

- 6.09. If the scheme is able to demonstrate to the other scheme or its other clients on reasonable grounds that it would not have been able to carry out the order on such advantageous terms without aggregation, or at all, it may allocate the transaction for own account proportionally, in accordance with the policy as referred to in Rule 6.05(b).

7. INDUCEMENTS - SAFEGUARDING THE BEST INTERESTS OF THE SCHEME

- 7.01. A scheme shall not be regarded as acting honestly, fairly and professionally in accordance with its best interests if, in relation to the activities of investment management and administration thereof, it pays or is paid any fee or commission, or provides or is provided with any non-monetary benefit, other than the following:
- a. a fee, commission or non-monetary benefit paid or provided to or by the scheme or a person on behalf of the scheme;
 - b. a fee, commission or non-monetary benefit paid or provided to or by a third party or a person acting on behalf of a third party, where the following conditions are satisfied:
 - i. the existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating that amount, must be clearly disclosed to the scheme in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant service;
 - ii. the payment of the fee or commission, or the provision of the non-monetary benefit must be designed to enhance the quality of the relevant service and not impair compliance with its duty to act in its best interests;
 - c. proper fees which enable or are necessary for the provision of the relevant service, including custody costs, settlement and exchange fees, regulatory levies or legal fees, and which, by their nature, cannot give rise to conflicts with the duties of the scheme to act honestly, fairly and professionally in accordance with the best interests of the scheme.
- 7.02. For the purposes of Rule 7.01(b)(i), a scheme shall be able to disclose the essential terms of the arrangements relating to the fee, commission or non-monetary benefit in summary form, provided that the scheme undertakes to disclose further details at the request of the unit-holder and provided that it honours that undertaking.

8. REMUNERATION POLICIES AND PRACTICES

- 8.01. The scheme shall establish and apply remuneration policies and practices that are consistent with, and promote sound and effective risk management and that neither encourage risk taking which is inconsistent with its risk profile, rules or instruments of incorporation.

- 8.02. The remuneration policies and practices shall include fixed and variable components and salaries and discretionary pension benefits.
- 8.03. The remuneration policies and practices shall apply to those categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls within the remuneration bracket of senior management and risk takers whose professional activities have a material impact on the risk profiles of the scheme.
- 8.04. The scheme shall further refer to and comply with the provisions of the ESMA Guidelines on sound remuneration policies and practices under the UCITS Directive and the AIFMD.
- 8.05. When establishing and applying the remuneration policies referred to in Rules 8.01 to 8.04, the scheme shall comply with the following principles in a way and to the extent that is appropriate to its size, internal organisation and the nature, scope and complexity of its activities:
- (a) the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk taking which is inconsistent with the scheme's risk profile, its rules or instruments of incorporation;
 - (b) the remuneration policy is in line with the business strategy, objectives, values and interests of the scheme and of the scheme's investors, and includes measures to avoid conflicts of interest;
 - (c) the remuneration policy is adopted by the management body of the scheme in its supervisory function, and that body adopts, and reviews at least annually, the general principles of the remuneration policy and is responsible for, and oversees their implementation:

Provided that the tasks referred to in paragraph (c) shall be undertaken only by the members of the management body who do not perform any executive functions in the scheme and who have expertise in risk management and remuneration;
 - (d) the implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its supervisory function;
 - (e) staff engaged in control functions are compensated in accordance with the achievement of the objectives linked to their functions, independently of the performance of the business areas that they control;

- (f) the remuneration of the senior officers in the risk management and compliance functions is overseen directly by the remuneration committee, where such a committee exists;
- (g) where remuneration is performance-related, the total amount of remuneration is based on a combination of the assessment as to the performance of the individual and of the business unit or scheme concerned and as to their risks and of the overall results of the scheme when assessing individual performance, taking into account financial and non-financial criteria;
- (h) the assessment of performance is set in a multi-year framework appropriate to the holding period recommended to the scheme's investors in order to ensure that the assessment process is based on the longer-term performance of the scheme and its investment risks and that the actual payment of performance based components of remuneration is spread over the same period;
- (i) guaranteed variable remuneration is exceptional, occurs only in the context of hiring new staff and is limited to the first year of engagement;
- (j) fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy on variable remuneration components, including the possibility to pay no variable remuneration component;
- (k) payments relating to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure;
- (l) the measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes a comprehensive adjustment mechanism to integrate all relevant types of current and future risks;
- (m) subject to the scheme's legal structure and its fund rules or instruments of incorporation, a substantial portion, and in any event at least 50% of any variable remuneration component consists of the units of the scheme concerned, equivalent ownership interests, or share-linked instruments or equivalent non-cash instruments with equally effective incentives as any of the instruments referred to in this paragraph:

Provided that the instruments referred to in this paragraph shall be subject to an appropriate retention policy designed to align incentives with the interests of the scheme and the scheme's investors;

Provided further that the MFSA may place restrictions on the types and designs of those instruments or ban certain instruments as appropriate;

Paragraph (m) shall apply to both the portion of the variable remuneration component deferred in line with paragraph (n) and the portion of the variable remuneration component not deferred;

- (n) a substantial portion, and in any event at least 40% of the variable remuneration component, is deferred over a period of at least three years, which is appropriate in view of the holding period recommended to the scheme's investors and is correctly aligned with the nature of the risks of the scheme in question:

Provided that remuneration payable under deferral arrangements vests no faster than on a pro-rata basis; in the case of a variable remuneration component of a particularly high amount, at least 60% of the amount shall be deferred.

- (o) the variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the scheme's financial situation as a whole, and justified according to the performance of the business unit, the scheme and the individual concerned:

Provided that the total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the scheme concerned occurs, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

- (p) the pension policy is in line with the business strategy, objectives, values and long-term interests of the scheme:

Provided that if the employee terminates employment with the scheme before retirement, discretionary pension benefits shall be held by the scheme for a period of five years in the form of instruments referred to in paragraph (m). In the case of an employee reaching retirement, discretionary pension benefits shall be paid to the employee in the form of instruments referred to in paragraph (m) subject to a five-year retention period;

- (q) staff are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;
- (r) variable remuneration is not paid their vehicles or methods that facilitate the avoidance of the requirements prescribed in these Rules.

- 8.06. The principles outlined in Rule 8.05 shall apply to any benefit of any type paid by the scheme, to any amount paid directly by the scheme itself, including performance fees, and to any transfer of units or shares of the scheme, made for the benefit of those categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls into the remuneration bracket of senior management and risk takers, whose professional activities have a material impact on the risk profile of the scheme.
- 8.07. A scheme that is significant in terms of its size, its internal organisation and the nature scope and complexity of its activities shall establish a remuneration committee. The remuneration committee shall be constituted in a way that enables it to exercise competent and independent judgement on remuneration policies and practices and the incentives created for managing risk.
- 8.08. The remuneration committee that is, where appropriate, established in accordance with the ESMA Guidelines referred to in Rule 8.04 shall be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the scheme concerned and which are to be taken by the management body in its supervisory function. The remuneration committee shall be chaired by a member of the management body who does not perform any executive functions in the scheme. The members of the remuneration committee shall be members of the management body who do not perform any executive functions in the scheme concerned.
- 8.09. If employee representation on the management body is provided for by Maltese law, the remuneration committee shall include one or more employee representatives. When preparing its decisions, the remuneration committee shall take into account the long-term interest of investors and other stakeholders and the public interest.

SECTION IV: ESTABLISHMENT AND ROLE OF THE INVESTMENT COMMITTEE

1. GENERAL

- 1.01. This Section stipulates the provisions regulating the establishment and role of the Investment Committee which must be set-up by a self-managed scheme.
- 1.02. The board of directors of the scheme shall be responsible for the management of the assets of the scheme.
- 1.03. At least one of the members of the board of directors shall be resident in Malta.
- 1.04. Unless otherwise agreed with the MFSA, the board of directors of the scheme shall establish an in-house Investment Committee which shall be composed of at least three members and whose composition may include board members of the scheme.

2. ESTABLISHMENT OF THE INVESTMENT COMMITTEE

- 2.01. The board of directors of a scheme shall establish an in-house Investment Committee.
- 2.02. The Investment Committee shall be made up of at least three members and may also include members of the board of directors of the scheme.
- 2.03. The terms of reference of the Investment Committee and any changes thereto shall be subject to the prior approval of the MFSA.
- 2.04. The role of the Investment Committee will be that of:
 - a. monitoring and reviewing the investment policy of the scheme;
 - b. establishing and reviewing guidelines for investment by the scheme;
 - c. issuing rules for stock selection;
 - d. setting up the portfolio structure and asset allocation; and
 - e. making recommendations to the board of directors of the scheme.
- 2.05. The majority of Investment Committee meetings – the required frequency of which should depend on the nature of the scheme’s investment policy, but which should be at least quarterly – are to be physically held in Malta:

Provided that Investment Committee meetings are deemed to be physically held in Malta if the minimum number of members that form a quorum necessary for a meeting are physically present in Malta.

- 2.06. The minutes of the Investment Committee meetings shall be available in Malta for review during MFSA’s compliance visits.

- 2.07. Where the scheme has not appointed an Investment Committee, the functions referred to in Rule 2.04 shall be undertaken by the directors of the scheme and thereafter any reference to the Investment Committee in these Rules and any other applicable laws and regulations shall be construed as a reference to the board of directors of the Scheme.
- 2.08. The Investment Committee may delegate the day-to-day investment management of the assets of the scheme to at least two officials of the scheme (hereinafter referred to as the “portfolio managers”).
- 2.09. The portfolio managers will effect day-to-day transactions within the investment guidelines set by the Investment Committee and in accordance with the investment objectives, policy and restrictions described in the prospectus.
- 2.10. The scheme may also delegate the day-to-day investment management of its assets to a third-party manager appointed by the scheme.
- 2.11. The scheme shall obtain the written consent of the MFSA before the appointment or replacement of a member of the Investment Committee or a portfolio manager. The request for consent of the appointment or replacement of a member of the Investment Committee or a portfolio manager, where applicable shall be transmitted to the MFSA at least twenty-one business days prior to the proposed date of appointment.
- 2.12. The MFSA reserves the right to object to the proposed replacement or appointment and to require such additional information as it considers appropriate.
- 2.13. The MFSA shall be satisfied, on a continuing basis, of the fitness and properness, including competence, of the members of the Investment Committee and of the portfolio managers.
- 2.14. The request for consent of the appointment or replacement of a member of the Investment Committee or of a portfolio manager shall be accompanied by the required documentation as prescribed in the Investment Services Rules.
- 2.15. The scheme shall notify the MFSA in writing of the departure of a member of the Investment Committee and/or portfolio manager within 14 days from the departure.
- 2.16. The scheme shall also request the Investment Committee and/or portfolio manager, as applicable, to provide the MFSA with the relevant details concerning the individual’s resignation. A copy of such request shall be provided to the MFSA.
- 2.17. The scheme shall have adequate arrangements, in agreement with and subject to the approval of the MFSA, to ensure the adequate monitoring of the activities of portfolio managers and the Investment Committee.

- 2.18. The scheme shall on a continuing basis ensure that it has sufficient management resources to effectively conduct its business.

SECTION V: RISK MANAGEMENT FUNCTION

1. GENERAL

- 1.01. This Section stipulates the provisions regulating the risk management function which must be implemented on an ongoing basis by a scheme.
- 1.02. A scheme shall establish and maintain a permanent risk management function which shall be hierarchically and functionally independent from the operating units.

2. PERMANENT RISK MANAGEMENT FUNCTION

- 2.01. A scheme shall establish and maintain a permanent risk management function which shall be hierarchically and functionally independent from the operating units.
- 2.02. Without prejudice to Rule 2.01, the MFSA may allow the scheme to derogate from the obligation referred to in Rule 2.01, where the derogation is appropriate and proportionate in view of the nature, scale and complexity of the scheme's business:

Provided that the scheme must be able to demonstrate that appropriate safeguards against conflicts of interest have been adopted so as to allow an independent performance of risk management activities and that its risk management process satisfies the requirements prescribed in Appendix VI of these Rules on risk management, counterparty risk exposure and issuer concentration applicable to Maltese retail collective investment schemes established as Maltese UCITS.

- 2.03. The permanent risk management function shall:
- a. implement the risk management policy and procedures;
 - b. ensure compliance with the scheme's risk limit system, including statutory limits concerning global exposure and counterparty risk in accordance with Part BII of these Rules stipulating risk management processes, counterparty risk exposure and issuer concentration;
 - c. provide advice to the board of directors as regards the identification of the risk profile of the scheme;
 - d. provide regular reports to the board of directors and, where possible, the supervisory function, on:
 - i. the consistency between the current levels of risk incurred by the scheme and the risk profile agreed for that scheme;
 - ii. the compliance of the scheme with relevant risk limit systems;

- iii. the adequacy and effectiveness of the risk management process, indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies;
 - e. provide regular reports to the senior management outlining the current level of risk incurred by the scheme and any actual or foreseeable breaches to their limits, so as to ensure that prompt and appropriate action can be taken;
 - f. review and support where appropriate, the arrangement and procedures for the valuation of OTC derivatives as referred to in Appendix VI stipulating risk management processes, counterparty risk exposure and issuer concentration.
- 2.04. The permanent risk management function shall have the necessary authority and access to all the relevant information necessary to fulfil the tasks set out in Rule 2.03.

3. RISK MANAGEMENT POLICY

- 3.01. A scheme shall establish, implement and maintain an adequate and documented risk management policy which identifies the risks the scheme is or might be exposed to.
- 3.02. The risk management policy shall comprise such procedures as are necessary to enable a scheme to assess its exposure to market, liquidity and counterparty risks, and its exposure to all other risks, including operational risks, which may be material for the scheme.
- 3.03. A scheme shall address at least the following elements in the risk management policy:
- a. the techniques, tools and arrangements that enable them to comply with the obligations stipulated in Appendix VI;
 - b. the allocation of responsibilities within a scheme pertaining to risk management.
- 3.04. A scheme shall ensure that the risk management policy referred to in Rules 3.01 to 3.03 above states the terms, contents and frequency of reporting of the risk management function set out in Rules 2.01 to 2.04 above to the board of directors and to senior management and, where appropriate, to the supervisory function.
- 3.05. For the purposes of Rules 3.01 to 3.04, a scheme shall take into account the nature, scale and complexity of its business.

4. ASSESSMENT, MONITORING AND REVIEW OF THE RISK MANAGEMENT POLICY

- 4.01. A scheme shall assess, monitor and periodically review:
- a. the adequacy and effectiveness of the risk management policy and of the arrangements, processes and techniques set out in Appendix VI;
 - b. the level of compliance by the scheme with the risk management policy and with arrangements, processes and techniques set out in Appendix VI;
 - c. the adequacy and effectiveness of measures taken to address any deficiencies in the performance of the risk management process.
- 4.02. A scheme shall notify the MFSA of any material changes to the risk management process.
- 4.03. The requirements prescribed in Rule 4.01 above shall be subject to review by the MFSA on an on-going basis and accordingly when granting a licence.