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Opalesque Roundtable Series '14

MALTA

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Editor's Note

A stable jurisdiction

The 2008 financial crisis had no effect on Malta. The banking system is solid and none of the banks required any assistance. In addition, there is political consensus on the importance of its financial industry.

While Professor Bannister, Chairman of the Malta Financial Services Authority, the single regulator for financial services, does not believe anymore in the "marketing of jurisdictions as regulations are standard -- everybody is being controlled, and more or less there is no regulatory arbitration", firms doing business in Malta like Innocap praise the island's efficiency and time to market, which is offering the company a "real advantage".

EU or non-EU regulations? The relevance of the larger regulatory domain

The EU is made up of 28 Member States with each national supervisor having different supervisory priorities depending on the nature, scale and complexity of the market for which it is responsible. However today, for many global investors the question of regulations isn't really about specific countries, but rather about the larger regulatory domain -- the decision is really about following an EU or non-EU regulation. However, once a pro-EU decision is made, Malta is a very good place to set up, according to the participants of the Opalesque 2014 Malta Roundtable.

The Malta Financial Services Authority aims to be very proactive and innovative in the field of regulation. Some of the recent innovations the MFSA introduced include Incorporated Cell Companies, sophisticated limited partnership regulations that for example allow to have segregation of assets in partnership structures, retaining the "old" Professional Investor Fund regime as an alternative to AIFMD, and the dis-application of Section 18 of the remuneration, meaning that sub-managers are not included within the scope.

The Opalesque 2014 Malta Roundtable was sponsored by Eurex and Investment Data Services (IDS) and took place at the office of the Malta Financial Services Authority with:

1. Professor Bannister, Malta Financial Services Authority
2. Christopher Buttigieg, Malta Financial Services Authority
3. Xavier Urli, Innocap Global Investment Management
4. Daniele Cop, MAMO TCV
5. Bernadine Sciberras, Active Compliance
6. Ian Hamilton, Investment Data Services
7. Markus-Alexander Flesch, Eurex

The group also discussed:

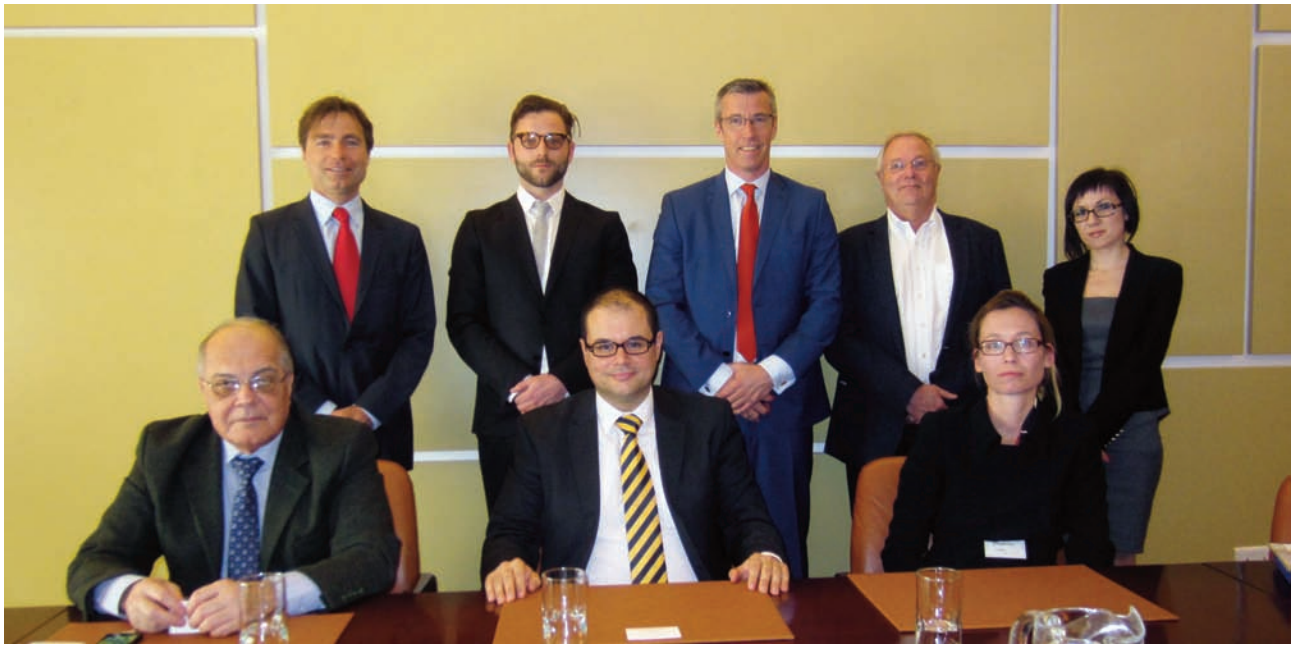
- Are good practices driven by investors or regulations?
- Is EU regulation putting an end to the multi-prime model the industry adopted after the Lehman and Bear Sterns shocks?
- With AIFMD, who is responsible for valuations? Are AIFM depositary rules a "political game"?
- Why is proportionality of regulations important, and how can it be implemented?
- Does a company responsible for telephone directories have to comply with EMIR reporting?
- How can smaller managers still make it in today's environment?
- How "OTC2CCP" helped OTC derivative market participants to eliminate over $375 trillion in notional principal.

Enjoy the read!

Matthias Knab
Knab@Opalesque.com

Cover Photo: Kalkara Harbour

Participant Profiles



(LEFT TO RIGHT)

Matthias Knab, Xavier Urli, Markus-Alexander Flesch, Ian Hamilton, Bernardine Sciberras

Joe Bannister, Christopher Buttigieg, Danièle Cop

Introduction

Ian Hamilton
IDS Group / Scotstone Group

Ian Hamilton; I head up two groups; one is IDS Group, which is a fund administration company. We are based in Cape Town and also run a very fast growing satellite office here in Malta that caters to the funds industry. I also have an alternative fund investment group called Scotstone Group which provides investment platforms, hosting and fund management for fund managers who would like to either have funds domiciled in Malta, or for fund managers who would like to use a fund management group within the EU.

Bernardine Sciberras
Active Services Malta Limited

I am Bernardine Sciberras. I am representing Active Services Malta Limited where I am a Compliance Services Executive. The Active Group is a multi-jurisdictional leading provider of support services with offices established in Guernsey, Jersey, Isle of Man, Malta and Cyprus. We provide professional, independent outsourcing support services to small, medium and large entities. Active Services (Malta) Limited provides specialist compliance consultancy both at pre-licensing and post-licensing stages to clients wishing to establish or who have already established a financial services business in Malta.

Danièle Cop
MAMO TCV Advocates

My name is Danièle Cop. I work with the Financial Services Department at MAMO TCV Advocates. We are a tier 1 law firm in Malta, specializing in commercial and corporate law. In my department – Financial Services – we assist clients with the setting up of funds, management companies and firms providing financial services and advise local and foreign clients, including custodians and prime brokers, on financial services legislation and regulation in Malta.

Christopher Buttigieg
Malta Financial Services Authority

Christopher Buttigieg. I am the Deputy Director within the Securities and Markets Supervision Unit of the Malta Financial Services Authority, where I am responsible for funds, supervision, collective investment schemes, fund measures, and also markets.

Joe Bannister
Malta Financial Services Authority

I am Joe Bannister. I am the Chairman of the Malta Financial Services Authority, which is the single regulator for financial services in Malta.

Markus-Alexander Flesch
Eurex

Markus-Alexander Flesch, I am representing Eurex, the most active and most prominent derivative exchange in Europe. I am very excited to be here as Malta is part of the region I am covering for Eurex, in fact we just added a new exchange member who is based in Malta, and we received several requests from other local institutional clients. But as we know, the derivatives market is global and goes beyond many borders.

Xavier Urli
Innocap

I am Xavier Urli from Innocap Global Investment Management Ltd. ("Innocap"), a global Managed Account Platform. Innocap has been on the island since 2005 and became an investment manager in Malta in 2010. Characterized by its specialized legal knowledge and its operational and risk management skills, the firm facilitates institutional investment decisions via an enhanced investment framework that is flexible and capable of meeting evolving needs. The firm has the advantage of leveraging the infrastructure and network of its affilates and parent company while still remaining flexible.

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Matthias Knab As a funds domicile, what is the position and the future of Malta within the global financial industry? What benefits is Malta offering?

Joe Bannister: **The Authority was set up some 12 years ago. The fund industry is one of the main industries that has developed on the island since then, we have a number of very good names that are active or operate from here.**

But what is probably most important is that we are very active in different European fora. We have an extremely high level of transparency in respect to the practitioners. Everybody can meet us at any time they wish – I believe a number of you here can confirm this, so the door is always open and appointments take place very quickly.

The Board of Governors of the MFSA has always encouraged the regulator to be proactive and not simply tick boxes, but work with the companies and help them develop their products.

Our aim is to be very proactive and innovative in the field of regulation. We tend to look at regulation every couple of years, basically to remove any gold plating, because of all the changes that have taken place and accumulated over time. While we have to add more regulations, at the same time we are also very careful not to necessarily start introducing new layers of regulation. But equally, we also look at how we can introduce new features or developments that may be still within the scope of the existing directives.

To give you an example, we have introduced the Incorporated Cell Companies for the funds area. If you look at the hedge fund or AIFM directive, also there we have taken quite a number of positive steps in response to discussions with the industry.

For example, we dis-applied Section 18 of the remuneration, so sub-managers are not included within the scope. We are trying to develop and offer the best remuneration packages that managers can have.

In terms of de minimis, we also after extensive consultation with the industry, we are not applying de minimis, because managers felt that they should have a license rather than being registered. For example, if a manager is selling funds, the investor will naturally ask "where is your license, and who is licensing the fund?" If they now say they are registered, they are giving a wrong impression.

To address this issue, we kept the existing legislation, which is more or less a MiFID type of legislation. To further help the funds management companies, we have also kept the old Professional Investor Fund regime as opposed to the Alternative Investment Fund. This offers them options with a few less restrictions to work with, obviously until they reach de minimis.

Our industry has been growing, particularly since joining the European Union in 2004. I must say Switzerland is one of the countries from where we see a large number of funds being registered, because Malta is an ideal jurisdiction for startup funds in terms of cost and services available.

We also see more managers who want to be AIFM in Malta. Existing managers licensed here – my guess is 90% of them – are going to restructure and become AIFM in Malta, and they run more operations from here like, for example, risk management.

Together with the fund management companies we are also seeing more funds setting up here. For example, last week I was having

discussions with a provider of management services – he is going to be an AIFM in Malta, but now he is looking to also bring in the billion-plus funds over here.

Funds open, close, merge, etc. - at the moment, we have some 700 active funds in Malta, so we keep expanding funds and sub-funds; you can establish any type of structure here.

Another area we are working on is to refine our limited partnership to enable private equity. The limited partnership can be with shares, without shares, unitized, whatever you wish.

One more thing – some time ago we discovered that our partnership seems to be the only partnership structure where you can have segregation of assets, contrary to partnerships in other jurisdictions.

Everybody has to go through a due diligence if he wants to be licensed in Malta. No due diligence, no license. In each case, we ourselves determine the level of due diligence, how far we go, whether we conduct due diligence ourselves – if there is another regulator involved, then we work with that regulator, or, if the manager comes from certain jurisdictions, we go to crime agencies and security agencies.

Matthias Knab Can you tell us more about the health and stability of Malta as a financial jurisdiction?

Joe Bannister: Malta is very stable jurisdiction. There is political consensus on the finance centre. The political parties in Parliament continuously pledge their consensus and they never vote on financial services legislation. The regulation is strong and robust and the MFSA is perceived as an efficient and progressive regulator. The 2008 financial crisis had not effect on Malta. The banking system is solid and none of the banks required any assistance. The liability of the finance centre represents 800% of GDP, however, in reality the liability is only 250% [which is lower than the EU average] as the remaining comes from banks which have no connection with the economy.

Matthias Knab What are the perceived efficiencies in Malta's financial sector?

Xavier Urli: The efficiency and time to market that Malta is offering is a real advantage for Innocap. We are a multi-administrator, multi-jurisdiction platform, so we also have one in Ireland, for example. As such, Innocap is often requested to compare different jurisdictions.

Our analysis has always shown that although Luxembourg, Ireland and Malta may have some local particularities (for instance requirements pertaining to the residency of the funds' directors or independence of such directors), most of the key points of applicable funds' regulation (such as the types of vehicles available, segregation of sub-funds assets, and AIFMD requirements) put Malta on the same level playing field as other jurisdiction within the EU.

Malta's understanding of hedge fund managed account platform activities and realities as well as the MFSA's knowledge of hedge funds strategies and structures explains the efficiency that may be reached in terms of "time-to-market" for launching funds in Malta. The regulator works hard, which helps us in our business. That is a good advantage for Malta.

However, what we see coming through recently, when talking to investors, is that

the question of regulations isn't really about specific countries but rather about the larger regulatory framework. The decision is really about being in an EU or non-EU jurisdiction. Clients will look at the EU, and take into account regulations like EMIR, AIFMD and its European-wide reimplementation, and the decision is then boiling down to an EU or a non-EU type of regulation. Of course, once a pro-EU decision is made, Malta is a very good place to set up.

Matthias Knab You said you came here in 2005. I remember that event and back then found it quite remarkable that a large player like Innocap was opting for Malta for its European presence and sending very senior people over here to set it up. Could you please add more detail and color for us about your experience here in Malta, and what type of developments have you seen as an asset manager operating from here over that time?

Xavier Urli In 2005, the funds were launched in Malta, but they were still managed from another jurisdiction. In 2010, we decided redomiciled here. The sense we have after doing business in Malta for almost ten years is that it is striving to be remarkably efficient while keeping the investors protected, and that the regulator is really listening to what the industry is trying to achieve.

Over the past ten years, we have also seen an increase in skills, quantity and diversity of offerings from the service provider legal and accounting side as well and from the other financial institutions that have set up shop here in Malta over these years. We have been advocating this jurisdiction for a while – ever since we moved the funds here in 2005 – as an efficient, solidly regulated jurisdiction.

Markus-Alexander Flesch: From the perspective of an exchange, allow me to add some additional observations regarding regulations. On the one side, we all know that regulation could be very positive since it enforces more transparency, but on the other side, regulation can also provoke exactly the inverse.

There are two examples of the recent regulation having opposite implications: one of the biggest lessons learned as a consequence from the 2008 crisis is to increase transparency and to reduce the complexity stemming from complicated OTC structures. Therefore the born project "OTC2CCP" has already a very positive impact on the market and all its participants, just for the fact that bringing OTC structures into a CCP will increase transparency and reduce capital requirements. Through portfolio compression, as just one positive consequence from the OTC2 CCP regulation, OTC derivative market participants have eliminated more than $375 trillion in notional principal through 2013.

Recognized as best practice by the industry, portfolio compression has also been incorporated into the new regulatory landscape. EMIR and Dodd-Frank rulemaking require that firms analyze their OTC swap portfolios for compression opportunities in all asset classes. This is clearly a big step forward and a benefit for all market participants.

But on the other side, and this is my critical point here, the regulation here in Europe, which still tends to be very fragmented, can damage growth and even initiate money to invested abroad: best example here is the German HFT law. Companies and clients operating business models in the HFT space are forced to comply with the German HFT law, which is very cumbersome and drives cost, without increasing trading opportunities. Such a regulation, while pushing some firms out of the market, are reducing diversity and therefore are deemed to reduce liquidity.

So while generally regulation is a good thing, legislators and regulators also need to take into account what kind of consequences it will have to the financial markets.

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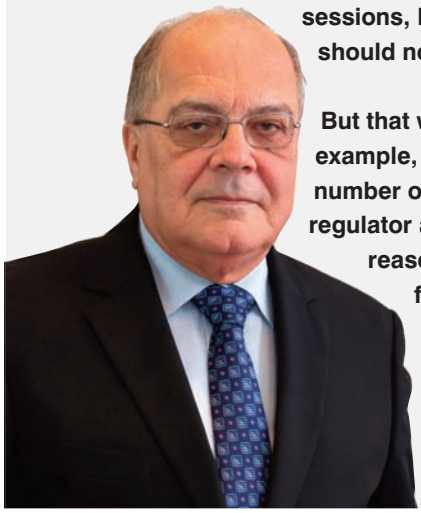
Joe Bannister: I have no doubt this is happening. If you look at the bigger picture, not only do we have quite a bit of regulation, it's also a fact that regulation is costly per se. Both regulators and operators are affected by these costs, and indeed somebody has to pay for them.

But having said that, the way you work in applying the regulation is also important. Here in Malta, we have developed the let's call it culture of working quite a lot with the industry. I had picked this up when the first regulations were coming in on insurance in the UK. And everybody was complaining that the regulator is issuing regulations and the industry can't beat the regulator. This was how we were setting the authority up, because there it was a bit fragmented.

We started to have industry meetings on a regular basis, and those that want to see us can call in and make an appointment. If someone comes from South Africa, we can't leave him waiting six months for an appointment or require him to ask for a meeting six months in advance.



However, in the initial phase when we started attending European Fora in the pre accession sessions, I noticed that certain European regulators were not happy with this and they said they should not meet the industry, otherwise it becomes too incestuous or whatever.

But that was many years ago, and what we are seeing now is the complete opposite. For example, what you see in various fora is that there is always a regulators' panel where a good number of us are there and meet the industry. So there should be more contact between regulator and industry, and indeed this now has become the norm. I think that is also one of the reasons why also we had no problems during the financial crisis here in Malta. Of course, funds do open, close, some make mistakes – these things happen, but they were not the result of regulatory failures. I think that's very important.

Still, let me also add that I don't believe anymore in marketing of jurisdictions, that's gone. Today the regulations are standard, everybody is being controlled, and more or less there is no regulatory arbitration.

Christopher Buttigieg: A number of difficulties are being encountered with regard to implementation in view of the apparent lack of regulatory and supervisory convergence at European level. Convergence of regulation and supervision at European level is critical for the proper functioning of the internal market and to achieve the systemic stability and investor protection objectives of financial regulation. Differences in the interpretation of regulation across the EU could have an impact on the level of cross-border business within the internal market and the degree of investor protection afforded in the different Member States.

Regulatory and supervisory convergence is also a means to address regulatory and supervisory arbitrage, which weaken the overall structure of European system for financial supervision. Post the financial crisis achieving a sufficient degree of convergence is one of the primary objectives of the European Securities and Markets Authority ('ESMA') and the other European supervisory authorities. This was also one of the objectives of ESMA's predecessor, the Committee of European Securities Regulators ('CESR'), however while CESR focused primarily on regulatory convergence, ESMA is also concentrating on achieving some degree of supervisory convergence.

Nonetheless, in certain areas of finance such as high frequency trading ('HFT') some countries have taken the lead in the absence of harmonization and convergence. This has led to a fragmented approach to regulation and supervision which, however, is now being addressed through specific regulatory requirements in the MiFID II package. The specific regulatory requirements at national level were a valuable source of information for

policy makers at European level to determine which mechanisms should be applied to control this specific type of financial activity thereby addressing the lessons learnt from the flash crash.
Europe has yet to achieve the degree of regulatory and supervisory convergence envisaged by policy makers post the financial crisis. For example with regard to the regulation of derivative contracts, the interpretation of which derivative contracts fall within the scope of the European Markets Infrastructure Regulation ('EMIR') varies in the different jurisdictions, which, regrettably, is causing difficulties for the industry and for large operators that are providing cross-border services in different EU Member States. These difficulties are exacerbated when the operator is also providing services across the Atlantic and is, as a consequence, required to comply with Dodd-Frank. However, it is appropriate to acknowledge the efforts for more convergence which are being made.

Ian Hamilton: I welcome the fact when a regulator like Christopher is talking about convergence, because one of the issues we are facing is having to comply with different forms of regulations like ESMA, AIFMD, etc., and parts of those regulations are in conflict with each other. What particular lead do you take then? That is becoming very confusing for the market, and participants are impeded. When I see how some of the banks apply things like AML, it becomes obvious that there are just so many different interpretations on issues. But this is not a Malta, but a European or global challenge.

It's fine to be bringing out lot of regulations, it's great to have transparency and so on, but I think there is a danger at this point of overregulation without the convergence into a simple and general standard. The other sector that is severely affected by this situation is compliance which has to monitor these different regulations.

Bernardine Sciberras: Yes, compliance staff and service providers are under a constant influx of new demands from all these regulations, just like I would think the MFSA is.

As a result, compliance costs have risen, and unfortunately financial services and investors have to allocate substantial costs for compliance, because this is a sector nobody can neglect. We see that clients need a lot of assistance, there is lot of work and unfortunately it is made even more difficult with the different interpretation amongst the jurisdictions, which brings us to the point of convergence just mentioned.

This is not to say that regulations are not needed, because the rationale behind their enactment is understandable and an asset to the stability of the financial industry, however convergence would be ideal at this stage when the industry and affected jurisdictions are faced with so many regulations. It would ultimately reduce some of the problems being encountered and moreover achieve the level of harmonization aimed at by ESMA.

Christopher Buttigieg: In the aftermath of the financial crisis and the recent Euro banking crisis, it was a natural reaction for policymakers to propose and adopt more regulations. More forceful, robust and updated regulation was crucial to instill market confidence, which had been dented as a consequence of serious failures such as Lehman, Reserve Primary Fund and AIG. However, the zeal to make things right and to address the serious failures of the crisis may have led policy makers to overlook the principle of proportionality which requires that regulation must be limited to what is necessary to achieve the objectives of regulation. In other words, the content and form of the action must be in keeping with the aim pursued.

The application of the principle of proportionality is important to ensure that regulations are applied proportionally to

small operators in order not to overburden their activity and specifically avoid the potential for over-regulation.

A specific field where unfortunately we are not seeing a sufficient degree of proportionality at EU level is with regard to the regulation of capital. Banks and investment firms are subject to capital requirements in terms of the same legislative framework, the CRDIV package. The nature of the activity of an investment firm is different from the activity of a bank. Moreover, investment firms tend to be small set-ups when compared to banks. We are of the view that there should be a separate piece of regulation for investment firms, which focuses specifically on their activities and the risks which arise from the activity of such firm.

There are also differences between investment firms and the types of products which they distribute and therefore the risks to investor protection. It might be worthwhile considering the creation of a capital framework which recognizes the differences in the risks and imposes a higher capital to those firms whose activities may pose a greater threat to investor protection. Furthermore, there are other examples where the principle of proportionality might have been discounted. For example, with regard to trade reporting, EMIR does not distinguish between volume and size of transactions. Therefore, whether an entity is doing ten transactions a year of a small size or carrying out hundreds of transactions of a significant size, the reporting requirements under EMIR must still be complied with.

A company in Malta which is responsible for telephone directories carries out one or two transactions of a small size every year. They queried with us whether they were required to comply with transaction reporting requirement of EMIR. Regrettably, our answer was 'YES' as the Regulation does not provide for any exemptions from the reporting requirement. On another occasion an individual who makes a small amount of trades in derivative transactions a year for the purpose of an economic activity asked us whether he had to comply and again our answer was YES. Indeed, EMIR doesn't make a distinction between an individual or a company.

Therefore, we are of the view that proportionality should be applied, and as part of this process the differences in business models between the different types of operators should also be taken into account.

We talked about the cost aspect of regulation before - I do believe that applying proportionality will have positive effects with regard to the cost of regulation, while still ensuring that the financial system is safe and that proper investor protection is achieved.

Danièle Cop: I totally agree with Chris, I am all for the principle of proportionality, which is in fact a general principle of EU law. Seeing the scope and the level of detail of Directives such as the AIFMD and EMIR and the implementing measures, one wonders however if small business will be able to cope with the added compliance burden and if the end really justifies the means: ultimately will the investors and the real economy benefit from this?

Malta happens to be an EU jurisdiction that has carved out a niche market for small to medium sized operators in the funds industry, and also in other areas, such as payment services, FX brokerage etc. This seems to be because Malta is a cost effective jurisdiction, compared to say Luxembourg or Ireland, and also because we have an approachable and pro-active regulator, the MFSA. Still, Malta has to apply the same EU laws as say, the UK, France and Germany.

We also have to be honest about the fact that because of the way legislation is made in Europe, we don't always end up with good quality legislation. Taking the example of AIFMD again: it is very detailed and prescriptive, but the way it is drafted raises various interpretation issues.

It is true that the European institutions need to produce EU law which will apply in 28 countries now, with different legal systems and practices, and are bound by procedures which requires them to achieve a compromise.

But we also have to acknowledge that sometimes there is a political game going on. For instance, what happened with the rules on depositories under the AIFMD goes against the whole concept of free movement in an internal market, in my personal opinion. While the EU tried unsuccessfully to harmonize the depositary function years ago, the AIFMD imposes a the general rule that the depositary of an alternative investment fund needs to be established in the same country as the fund itself. It seems clear to me that that was a political decision, if you consider in which jurisdictions the large custodians and banks are located and the way such jurisdictions try to protect their national interests.

It is one thing trying to protect investors or restore confidence in the financial system; and it is another thing creating legislation which has consequences, perhaps unintended, that go against the objectives it tries to achieve. Introducing rules that will lead to consolidation in the global custody sector for instance does not seem to be desirable if you wish to mitigate systemic risk.

On a more positive note: the MFSA allows AIFs to appoint a credit institution established in another Member State to act as depositary, until 22 July 2017.

Ian Hamilton: Another aspect is how the new and substantially increased regulations and costs are changing the fund management industry. Individuals and smaller firms setting up new funds find that the ladder is so well above their heads. That is something I am focusing and working on solutions here in Malta i.e. to be able to provide solutions making it affordable for smaller and emerging managers to set up, and I think Malta is a very good jurisdiction for that.

But what I find amazing is that regulators – I am not referring here to Malta, but the EU and the US – don't seem to have learned the lesson from "too big to fail". We are creating super financial monsters who are inefficient, whereas the smaller funds are better performers and tend to be efficient, but they are now getting excluded from the market through just the whole measure of regulations and compliance.

My message through a column that I write for Opalesque's NewManagers publication is that the smaller hedge fund managers now may have to put their pride in their pocket and talk to other hedge fund managers to be able to team up or share facilities etc., so that they can actually meet all regulatory requirements.

There is no way that the smaller company – say less than ten people – can actually survive in the current environment. And those are not only the good and innovative managers at this stage, but are also the future leaders in the industry, which are getting stifled.

Xavier Urli: I agree with you that the whole compliance burden and costs are very heavy for a small firm, and unfortunately those costs are incompressible; the reporting must be done, the division of tasks must be done, and so on. This burden does not only hit the investment firm but might end up being transferred to the investors as well.

The whole situation is then not only a drag on the manager, but also on the investor side who at some point may be saying, "Well, do I really need all this regulation, protection and the cost that comes with it? Do I really want to accept the restriction of my investment universe?" When you think about AIFMD and the Securitization Rule, which restrict credit strategies that an investor may want, this is the kind of interrogation we hear.

Then there is the remuneration requirements that may discourage some offshore manager and eliminate them from your investable universe as well, or the depository issue, another added cost. Sure, while it might be an added safeguard but, some investors might think they don't need that or they don't see the value in it.

In the end, the whole regulatory journey we are on might create sort of two worlds; one which would be the highly regulated EU space; and then an unregulated or non-EU sector on the other side. Of course, the compliance costs put a drag especially on the hedge fund industry, and possibly in an uneven or nonuniform way, depending where the manager is located.

Matthias Knab That is a good point. When I talk to U.S. managers or Americans, they often comment on the European regulatory developments with words like "confusion", or "brouhaha", and in a way we are touching on the same aspect here where within the European member states legislation can be differently interpreted or even differently transposed in national law.

On the one hand this can be seen as an advantage, as a positive because it may offer a certain flexibility or options within Europe, but it can also tremendously hinder the industry.

I wonder how the regulators perceive this situation, and what will be the future course? To maintain a certain flexibility through divergence or diversity, or are you looking to create more uniformity?

Joe Bannister: You said the different countries may transpose legislation differently, but that actually can't be done anymore, because what you transpose into national law is essentially seen by or monitored by the European Supervisory Authorities, and even by Brussels itself.

What we need to see is, as Chris was already referring to, is more diversity in terms of bringing in more proportionality, more scope within the definitions, and not being prescriptive.

Christopher Buttigieg: As Professor Bannister was explaining, the situation post the financial crisis is that Europe is pushing for a single rulebook. A single rulebook means that the same piece of legislation would apply to all across the EU. Nevertheless, in our view, and we have expressed this in various European fora, such a rulebook should be proportionate and cater for the specific situation of small and mediums sized firms and also the difference in business model.

Moreover, difficulties arise with regard to interpretation in the different EU Member States and how regulation is being applied. As I already explained, differences in interpretation and application may result in fragmentation and regulatory arbitrage which could in turn be of detriment to the protection of investors and the stability of the financial system. Therefore, more regulatory convergence could sustain the current push for linearity. On the other hand, one should not be very prescriptive with regard to supervisory convergence.

The EU is made up of 28 Member States; the National Supervisor has different supervisory priorities depending on the nature, scale and complexity of the market for which it is responsible. Therefore, while identifying best practices in supervision and encouraging the application of such practices might be a good idea, flexibility in terms of how National Supervisors establish the priorities in different member states, on where we focus our supervision, depending on the national differences with regards to our markets, should in the end remain.

Markus-Alexander Flesch: You mentioned convergence. I have my doubts if we are heading into the right direction, or making real progress. When I look at the volume numbers of derivatives exchanges in say the two big markets, the U.S. and Europe – allow me to exclude Asia for a moment – I see big flows from my institutional clients going away from Europe and into the U.S. just particular for the simple reason that the US regulation and jurisdiction – though being as well perceived as a burden – are more "manageable and more "trustworthy" as there is only one regulator and only one market and not 20 different individual selfish acting EU countries and politicians increasing complexity and the level of compliance.

It deems that the financial investor can rather cope with known – though unpleasant – regulatory hurdles than unknown markets barriers, which will be raised immediately once it is opportunistic for politicians to increase their own profile by just pretending to make the financial markets more safe.

Yes, I agree with Christopher on convergence of the two regimes – EMIR and Dodd Franck – since there are ongoing consultations, but that is still a long way and it will take time for both regimes to align on common goals and a common path. But as long as there is not even an alignment and coordination of the different regulators here in Europe – and since I'm wearing my Swiss hat, I'm referring to Switzerland, as not being part of the EU – how can we then expect an overall agreement between the US and a joint Europe?

With respect to Europe there is one simple example here, which demonstrates that there is no coordination amongst European countries, and even more, the different legislators are only acting uncoordinated.

EMIR and ESMA installed the LEI, the Legal Entity Identifier, and everybody in Europe is supposed to have this particular little three digit number in order to identify himself when undertaking some derivative trades. However, my Swiss members – institutional clients and banks – need to be compliant with the Swiss regulation, and we all know that despite Switzerland belongs to Europe, but is not part of the EU. ESMA initially stated by mid of 2013 that especially Swiss members don't necessarily need a LEI, if they identify themselves by disclosing the executing name of the bank. However without informing the local Swiss regulator FINMA, this statement was then changed by the end of 2013 and Swiss counterparties are now forced to have the LEI, otherwise CCPs are obliged to exclude them from trading and clearing.

I believe this little example shows that there is no European unity and that there is a lack of regulatory acceptance of the local rules and regulation, although EU politicians always – at least verbally – pretend to support the idea of federalism and autonomy of the local jurisdiction.

Ian Hamilton: I do find it quite rich when the United States compares itself with Europe and what's going on in Europe. If you go back in time and make your analysis of the hedge fund industry, most of the failures have actually occurred in America, because there is no form of regulation. And even prior to current regulatory push, Europe has had very much an unblemished reputation in the hedge fund world.

What you can further see is that a lot of things that are good practice are not driven by regulation – it is driven by *investors*. I am quoting now from the South African example, where we have had no regulations and yet no failures, because we have had institutional investors who have driven best practice from day one when he hedge fund industry got started there some 12 years ago.

Unfortunately, bureaucrats often don't understand what is best practice, what is working in

the industry, but start imposing on regulations which can be unworkable. In general practice there is actually good governance, good reporting, risk management, which is investor led and demanded. If a manager does not comply with those, he won't get the money.

Xavier Urli: I agree. When you look at it, AIFMD is to a certain extent the spirit or philosophy of Innocap's business model which we have been already following for years now – separating the risk taking from the risk managing side, having tight cash control, all these ideas that are behind AIFMD and what you are calling good practice, we have been working on that standard already for years.

When looking at the regulation itself, these types of rules do not constitute an unmanageable challenge for Innocap. To bounce back on Ian's comment, there is a need for regulation and investment protection, and we have been trying to do it for years now, and it has been driven by the market. Regulation might not be the right answer for this need.

Danièle Cop: Let me add some examples to this discussion. For instance, a practice that was developing before AIFMD, at least from what we have seen in Malta, was to have an independent administrator who in a way almost monitors the fund manager, and reconciles pricing information and valuations provided by the custodian or the prime brokers, and the manager. But now with AIFMD, the manager is responsible for valuations, and the responsibility to monitor the manager is shifted onto the custodian. Because of the synergies between the administration and the depository function, the large depositories are likely to try to keep administration as part of the package of services they provide to their fund clients.

Another good practice that some hedge fund managers started to adopt already a while back is the multi-prime model, whereby a manager would use different prime brokers in order to spread risk and to better manage counterparty risk for his funds. Now, under AIFMD the fund needs to appoint a single depository, which concentrates the risk for loss of assets with one entity. Together with that, the relationship between the depository and the prime brokers is changing: the fact that the depositary remains liable for the loss of securities that can be held in custody as long as they belong to the fund, even when they are provided as collateral or margin to a prime broker, probably means that the prime broker will need to be appointed as a sub-custodian, or accept that those securities are kept by the depositary. Again, multi-prime was a developing model which made sense, but which now needs to be revisited because of rules that may not necessarily achieve the objectives they were supposed to be designed for.

Ian Hamilton: There is another danger. When people invest in a highly regulated framework, the investor can become lazy and does not read the fine print but relies on the regulations to carry out the due diligence, and that is a big danger.

Xavier Urli: On that point, on the protection of investors, Innocap deals mostly with very sophisticated institutional investors. The investors have whole teams dedicated to their investments. The added protection brought by more stringent regulations is something these investors had already implemented (by using platforms like Innocap for instance) or that they had considered and considered overly burdensome and costly in light of their own specific needs (the addition of a depositary to their investment for instance). What we see is that if you are a pension fund that spends a lot of resources monitoring your investments, you might not want to pay for this excess protection.

Matthias Knab Let's look at new stuff now – who of you is working on new products, new initiatives, new ideas? Any new trends you want to comment on?

Markus-Alexander Flesch: For the last two years, most markets have enjoyed a fairly low volatility environment, irrespective of the augmented European volatility regimes driven by the Crimea crisis. However, it can be said that volatility has established itself as an asset class of its own. One of the drivers for this success was indisputably the broad acceptance of the CBOE product, but as well the increased daily volume of our own European product, the European volatility benchmark VSTOXX.

Volatility becomes mainstream and probably Xavier can confirm it by talking to his clients: volatility is not just pure Equity volatility, but it becomes tradable for all asset classes, be it the credit market, fixed income or commodities. As a provider, I see more and more distribution here in Europe, the penetration continues even into smaller hedge funds who are searching for hedging and alpha generating sources. This recent trend seems to be acknowledged as well by our competition where the CBOE will bundle its operational effort to make the VIX tradable for 24 hours. This is one trend which we can definitely confirm from our derivatives perspective since even Eurex is scrutinizing trading hours for our VSTOXX.

Another trend which Eurex will follow is FX derivatives, although this is already an established asset class. However, driven by the OTC regulation, more and more clients are requesting FX to be traded on a listed portfolio.

Another focal point of the Eurex Index Initiative will be a further regional expansion of our MSCI index derivatives, which Eurex has already successfully started last year and which will be continued through the year 2014.

Xavier Urli: One trend we have observed as an investment manager is that clients now really look at the regime or product regulation like UCITS or AIFMD. That leads to a real sort of segmentation within the offerings of a fund manager, where according to the client's needs the solutions you are tailoring for them will be driven not only by the investment strategies but also by the regime under which the client wants the investment to be done.

Especially in the EU, the discussion is now revolving around deciding what type of regime and product you'll be using – UCITS, AIFMD, PIF – what distribution, what jurisdiction, etc. These discussions will only become more relevant going forward, until, maybe, at some point things settle down a bit.

Ian Hamilton: I rather doubt if we will ever settle down in these matters, because markets evolve and develop all the time. Why are we actually talking about UCITS, AIMF and PIFs at the moment? The traditional, old long-only portfolios have been around for a while, but then we started developing and using derivatives, new strategies etc., so the markets will always be in an evolution, and it may be a bit difficult for regulators to keep up on that particular suggestion to settle or in a way simplify things again.

However, a company like mine, we enjoy such times, because we see that our clients' hurdles are also opportunities, and we try and actually develop the solution before you get to the hurdle.

Malta for me is a great place for incubation activities, that is why we have set up an operation which now also has an AIFMD license to assist the smaller managers to come onto the market.

I found Malta to be a good place to be innovative. In that context, I will actually argue with people who say Malta is cheap – I don't like the word cheap, because people may associate inferior value, while it is the opposite – you do get a lot of good value for what you pay. This good relative value comes through good local lawyers; it also comes through an MFSA who is approachable, and good overall skills and structures. You can get inexpensive, excellent hotels, it is a pleasant place to come to. That all contributes to providing a better relative value than other European jurisdictions.

Bernardine Sciberras: If I may add to what Mr. Hamilton has just said, Malta can pride itself of hard-working and active Maltese professionals within the financial services industry who are pro-active and dynamic. All these attributes complimented with the current price tags for services provided by such professionals ultimately result in the conclusion that fundamentally what clients are paying is good value for money in comparison to other jurisdictions. One might also note the political and economic stability of the Maltese islands coupled with the multi-lingual culture of the country.

Matthias Knab Are there also tax advantages when operating out of Malta?

Joe Bannister: There are a lot of misconceptions on the tax in Malta. In some places we are classified as an offshore jurisdiction. But, we are only offshore geographically, we are not offshore in the terms of the implications of an offshore regime, Malta is a European member state and has to abide by the European rules. For example, we are part of the Savings Directive, and we report as necessary under that directive.

In all our tax treaties we have now introduced the OECD clause on exchange of information, and recently this has been tested by the OECD in all jurisdictions, and Malta is largely compliant. We have also signed the multilateral exchange of information, that means a tax treaty is not required to exchange information.

Regarding our tax system, everybody talks about a 5% rate. It's really an effective 5%, because our tax system here is an imputation system, not a corporate tax. Imputation system means it's an income tax and companies get refunded on declaring a dividend. The system includes are anti-abuse mechanisms.

Our tax system was agreed with the EU under Code of Conduct and State Aid in 2007/2008, and what people seem not to realize is that there is a look through in the system.

Funds pay no tax. There is no tax on the NAV or any other levy on the NAV, as you see in Luxembourg. We also do not apply any withholding tax on nonresidential holders. Those then obviously become subject to the Savings Directive.

Matthias Knab In that context, Professor Bannister, maybe if you also want to elaborate a little bit more in-depth on the renumeration of hedge managers Malta is going to implement - you referred to that to at the beginning.

Joe Bannister: Yes, essentially sub-managers in third countries will not be subject to the same remuneration rules as managers based in Malta. However, we will ensure that they adhere to the Directive. For the local managers we are looking at the principle of proportionality. The UK has recently issued remuneration rules, but we are looking for possibly more proportionality and clarity in those rules.

We also understand through our discussions with some managers that they also wanted deferment. Here we are in touch with the tax authority how to handle that and what regulatory advice we can apply. We work closely also with the international tax authority, although we have no jurisdiction in that matter, in order to help companies that are based here, so they can give advice while we are working on structures as part of our interaction with the promoters.

Furthermore also, sometimes tax authorities talk to us directly, particularly in the case of transfer pricing, where they see companies leaving more money here than repatriating under transfer pricing arrangements. Sometimes a company may then say that this would be imposed by the regulator, and then of course we need to explain why the regulators have determined that more money is left here. But all this happens within the regular exchange of information.

We also have a large variety of MOUs with many jurisdictions to exchange of information. Here, we do have a lot of interaction with the UK, BaFin in Germany and FINMA where we have also regulator meetings. FINMA just recently signed the multilateral MOU under AIFMD, and about two weeks ago we also signed an agreement with FINMA regarding the sale of retail funds.

Ian Hamilton: Coming back to the discussion about renumeration for a moment where we can see that from many corners the hedge fund industry gets attacked on its costs and things like performance fees, and now you have got this whole remuneration cap theme everyone is looking at.

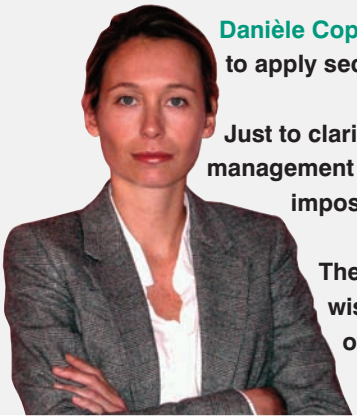
To me this is an interference of the free market, because nobody forces anybody to buy a hedge fund. As long as there is transparency in the cost and as long is it meets the hurdle rates and outperforms. I don't know many other instances where, if you have a unique product, you are going to penalized for doing well by putting all kinds of caps on the price of the product.

If you look at the luxury goods market; does a firm like BVLGARI get taxed at a higher rate than the guy who produces plastic goods and cheap leatherette

handbags? Are their earnings capped? Why should the hedge fund industry be treated different in any way as to what the managers earn, particularly as there full disclosure of fees?

Hedge fund managers rely on the performance fees. If you are not performing, you don't earn. But now you are penalizing the people who actually do well. When it comes to the single managers, there is lot of research coming out now that shows that the bigger funds tend to underperform. Hedge fund managers are traditionally performance chasers, not asset gatherers. Of course, you also see some big houses who want manage as much as they can get and charge a high management fee, but the investor always has the choice where he puts his money, and under which conditions.

Xavier Urli: Also for us here at Innocap in Malta, this remuneration policy under AIFMD was a big issue, because of the Sub-Delegates outside of EU who are not subject to this restriction on their other investment vehicle. Again, also here, the danger is that European investors will be cut off from parts of the investment management talent. That is why Malta's approach to remuneration is a good example of how you can be a strong, but not dogmatic regulator.



Danièle Cop: From a practitioner's point of view, we are obviously happy with the MFSA's decision not to apply section 18 of the ESMA Guidelines on sound remuneration policies under the AIFMD.

Just to clarify for your readers, section 18 essentially requires AIFMs that delegate portfolio or risk management activities to ensure that the delegate is subject to rules on remuneration similar to those imposed under AIFMD, in its own jurisdiction or through contractual arrangements.

The disapplication of this rule for Maltese AIFMs is an interesting proposition for managers wishing to set up shop in an EU jurisdiction, and for fund management companies in Malta offering incubation and platform solutions.

Matthias Knab Are there any comments regarding FATCA?

Joe Bannister The danger of FATCA if there is going to be a European FATCA.

Ian Hamilton I am sure there is going to be FATCA. I think every country is going to go for FATCA, and it's going to become a fat fry in the whole process.

Matthias Knab Anyone of you have a question?

Danièle Cop: Yes, I would like to add something to the discussion on new trends. We have seen quite a number of enquiries of managers who are looking to set up structures possibly as a fund to invest through loans or trade finance, for example in the market for corporate accounts receivable.

The issue there is that we have to be careful in view of the regulation on lending under the Financial Institutions Act

while at the same time there is the debate at EU level on shadow banking. Still, those managers want to tap into a need that exists in the market with banks pulling out from this business especially for SMEs, and I believe we need to be innovative and proactive and work with the industry to find ways to serve the market with the appropriate guidance on how to do this properly. In fact, I understand that the MFSA is working on guidance regarding loan funds, and perhaps Professor Bannister could give some input on this point.

Joe Bannister: This can be a conflicted area. Some 20 years ago Malta wanted to introduce a sort of non-bank financial institutions, but to be honest, what was left was drown into the snow and became a great big mess, and even the regulators were confusing each other.

Now, it is being cleaned up. We have done things like to encourage more treasury companies, worked on the definition of groups, we removed money broking, in fact we removed lots of other things.

We discussed these changes with a panel of practitioners in a so-called "mini forum" format, where we meet with a select group of practitioners who then take the discussion to their wider group. We are now essentially doing some amendments to improve the framework.

In the discussion about shadow banking we are being pushed all over the place, and we didn't want to be in the same situation as Ireland, where now I understand there is a lot of confusion about their money market funds. We here in Malta were essentially waiting until there were clear pronouncements from the EU and the ECB. The ECB came out with a number of position papers which we have worked on, also in consulting with local companies which do things like loan funds.

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