

# An introduction to funds





# Types of funds



## UCITS

### Undertakings for Collective Investment in Transferable Securities

A UCITS is a mutual fund based in the EU that can be sold to any investor within the European Union under a harmonised regulatory regime. Designed to enhance the single market while maintaining high levels of investor protection, UCITS funds have also been successful in Asia and Latin America primarily because they provide regulatory and investor protection assurance to investors governed by the EU. Thanks to the single European regulatory framework in place for UCITS, this investment vehicle is also popular amongst fund managers, because they are not required to create a new investment vehicle for each country in which the product is marketed.

UCITS schemes are retail in nature and invest in transferable securities such as shares in companies and other securities equivalent to shares in companies, bonds and other forms of debt securities, or any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange.

## PIFs

### Professional Investor Funds

Professional Investor Funds (PIF) are Maltese regulated investment funds for professional and sophisticated investors, benefitting from a lighter regulatory regime. PIFs do not benefit from passporting rights within the EU or EEA similar to UCITS and AIFs, but they are still regulated EU structures and are suitable for all investment strategies, including both traditional and alternative, applicable for all asset classes. The PIF regime is targeted at qualifying investors who must satisfy criteria, largely based on the participating investors' wealth and experience. PIFs enjoy a more flexible regulatory regime since PIFs are not intended for the general public. They also enjoy a fast-track licensing process and offer the possibility to be self-managed.

In order to be classified as a qualifying investor one must:

1. invest a minimum of €100,000, or its currency equivalent which may not be reduced below such threshold
2. declare in writing to the manager and the fund that they are aware of and accept the risks associated with the proposed investment

## AIFs

### Alternative Investment Funds

An Alternative Investment Fund is an entity or other type of collective investment scheme where funds are raised from a number of investors with a view to invest them in accordance with a defined investment policy. AIFs include all investment funds that do not qualify as a UCITS, instead falling under the Alternative Investment Fund Manager Directive (AIFMD). They are suitable for all investment strategies, including both traditional and alternative, covering all asset classes - including hedge funds, funds of hedge funds, venture capital, private equity funds and real estate funds.

As a rule, AIFs are only marketed to professional customers and if marketed to non-professional customers, the alternative investment fund manager (AIFM) must, as a rule, have an authorisation from the country where the fund is registered, or a similar authorisation granted in another EU or EEA state.

AIFs benefit from marketing passporting provisions and can also be self-managed.

3. satisfy at least one of the following:
  - body corporate with net assets in excess of €750,000 or the currency equivalent
  - an unincorporated body of persons with net assets in excess of €750,000, or the currency equivalent
  - a trust where the net value of the Trust's assets is in excess of €750,000, or the currency equivalent
  - an individual whose net worth or joint net worth with that of a person's spouse exceeds €750,000, or the currency equivalent
  - a senior employee or a director of a service provider to the PIF.

## NAIFs

### Notified Alternative Investment Funds

NAIF refers to a fund where participating AIFs only require their AIFM to notify the governing authority (MFSA) of their set up. NAIFs do not require authorisation or approval by the authority and are not subject to ongoing supervision. The authority does however maintain a public registry of all Notified AIFs.

Notified AIFs may be established as any structure allowed under the applicable law and the AIFM holds full responsibility for the fund and for the fulfilment of the fund's obligations. All EU/EEA AIFMs may submit a notification to the MFSA to be included on the list of NAIF managers, whilst third country AIFMs can also be listed, subject to the country where these are established having been granted EU pass-porting rights.

Notified AIFs may only be marketed to professional investors, and qualifying investors who must invest a minimum of €100,000 or its currency equivalent and declare in writing to the AIFM and the NAIF that they are aware and accept the risks associated with the proposed investment.

## Private funds

### Private collective investment schemes

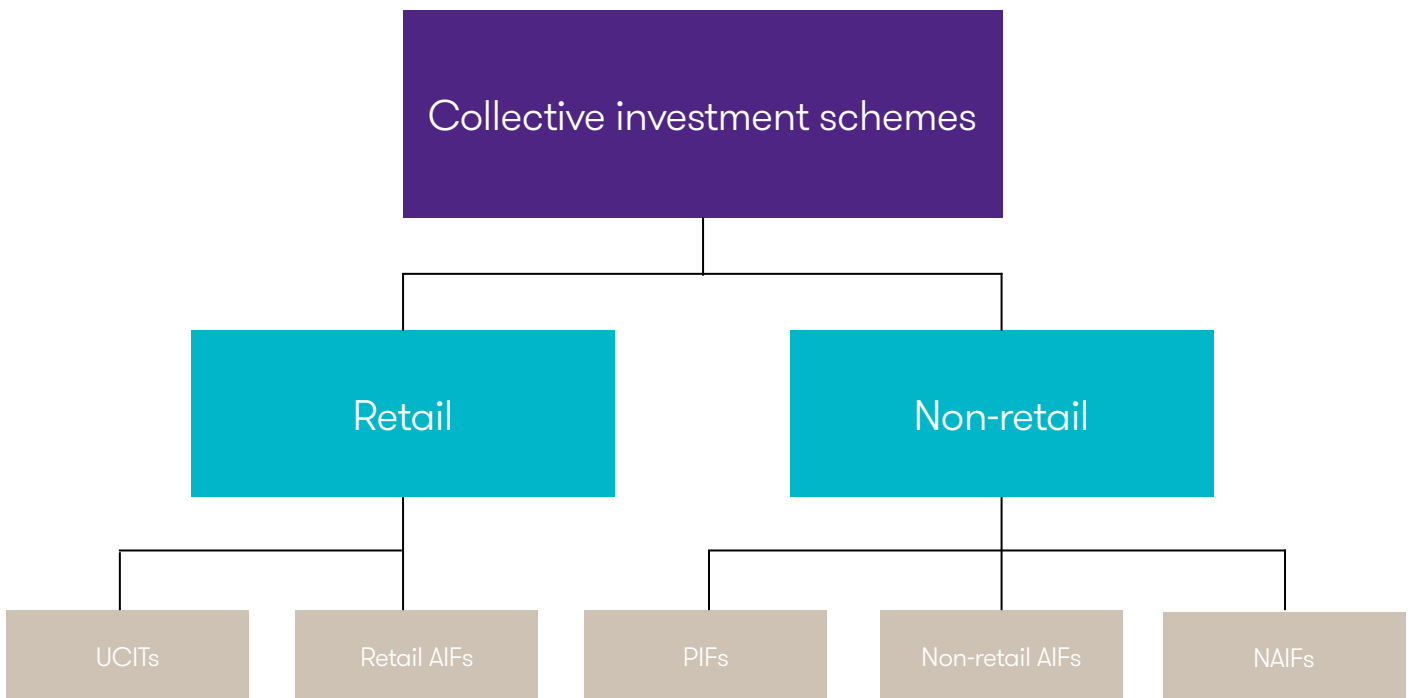
Private funds refer to collective investment schemes which limit the total number of participants to fifteen individuals and where the competent authority is satisfied that:

- i. the participants are close friends or relatives of the promoters
- ii. that the scheme is essentially private in nature and purpose, and
- iii. the scheme does not qualify as a professional investor fund.

When dealing with Private collective investment schemes, the Authority limits its due diligence procedures to determining the integrity of the persons concerned and unlike in the case of licensed schemes, it will not assess the competence of the persons responsible for managing the Scheme; nor would it subject the private fund to any investment or borrowing restrictions or other conditions other than those which may be specified in the recognition certificate issued by the Authority.

The authority may allow for one participant to be a company if it satisfies the following:

- i. taking into account the ultimate individual beneficial owners of such company, the maximum number of fifteen participants is still satisfied
- ii. the company's ultimate individual beneficial owners are close friends or relatives of the promoters
- iii. the company is in no manner involved in the management or administration of the fund and its connection with the fund is merely that of an investor.



## Comparison of the different types of funds

Type of fund	Retail/ non-retail	Licensable	Manager/ self-managed	Timeframes	Particular requirements/features
UCITS	Retail	Licence from regulator is required	Maltese/EU/EEA manager or self-managed	Authority to grant /refuse licence within 2 months from submission of complete application; 6 months for self-managed funds.	Heavily regulated funds; supplementary conditions apply for self-managed funds and also to some particular structure types.
Retail AIFs	Retail	Licence from regulator is required	Third party manager or self-managed	Authority to grant /refuse licence within 6 months from submission of complete application; may be reduced to 3 months for self-managed AIFs.	There are supplementary licence conditions to those of a non-retail AIF.
PIF	Non-retail	Licence from regulator is required	Third party manager or self-managed	Authority to grant /refuse licence within 6 months from submission of complete application.	Target base of investors: <ul style="list-style-type: none"> <li>i. Investing min. €100,000</li> <li>ii. Declare they are aware of and accept risks, and</li> <li>iii. Net worth/assets of €750,000 or senior employee/director of service provider to the PIF.</li> </ul>
Non-retail AIFs	Non-retail	Licence from regulator is required	Third party manager or self-managed	Authority to grant /refuse licence within 6 months from submission of complete application; may be reduced to 3 months for self-managed AIFs	Target base of investors equivalent to that of a PIF.
NAIFs	Non-retail	Notification to regulator is required	Managed by licenced AIFM	AIFM shall submit notification to regulator within 30 calendar days from resolution of governing body of NAIF certifying that prospectus satisfies minimum requirements.  Regulator to include NAIF in List of NAIFs within 10 working days.	Target base of investors: <ul style="list-style-type: none"> <li>i. professionals as defined in MiFID Annex II, or</li> <li>ii. €100,000 minimum investment and declaring they are aware of, and accept the risks</li> </ul> AIFM is required to be: <ul style="list-style-type: none"> <li>i. licenced in Malta, or</li> <li>ii. authorised to offer fund management services in Malta under passporting rules</li> <li>iii. NAIF may not invest in non-financial assets or loans.</li> </ul>
Private funds	n/a	Recognition by regulator is required	n/a	Draft application is submitted and regulator provides preliminary feedback within 3 weeks; the applicant will be asked to resolve any issues and once these are resolved to the satisfaction of the regulator, recognition shall be granted.	Participants are required to: <ul style="list-style-type: none"> <li>i. be not more than 15 individuals, and</li> <li>ii. be close friends or relatives to the promoters.</li> </ul> The fund is required to: <ul style="list-style-type: none"> <li>i. be private in nature, and</li> <li>ii. not qualify as a PIF.</li> </ul> One company may be allowed to be a participant only if it satisfies particular criteria.

# The Markets in Financial Instruments Directive (MiFID) II

MiFID II aims to protect investors and make sure that financial markets operate in the fairest and most transparent way possible. Building on stock and investment trading regulation introduced in 2007 it sets to ensure a more integrated financial market.

In 2007, a key EU legislation was introduced aimed at regulating firms who provide services to clients linked to financial instruments, as well as the venues where those instruments are traded. Commonly referred to as MiFID, it created a single market for investment services and activities and ensured a high degree of coherent protection for investors in financial instruments.

Amongst other things, MiFID set out:

- conduct of business and organisational requirements for investment firms;
- authorisation requirements for regulated markets
- regulatory reporting to avoid market abuse
- trade transparency obligation for shares, and
- rules on the admission of financial instruments to trading.

The original MiFID was a great contribution to a more competitive and harmonised EU financial market; however, rapid technological advances and the increasing diversity in

financial instruments and methods of trading called for the need of an extensive review. These issues have been tackled with the new MiFID II directive and the Markets in Financial Instruments Regulation (MiFIR) which came into force in January 2018. MiFID II relates to the framework of trading venues/structures in which financial instruments are traded. MiFIR is concerned with regulating the operation of these trading venues and the processes, systems and governance measures adopted by market participants.

In general, MiFID II only applies to investment firms that are physically present in EU members states or countries that are regulated by a European regulator. However, third country investment firms that manage European mandates or compete for European clients' assets will face competitive pressure as clients come to expect the level of transparency that they are receiving from investment firms in Europe.





## The Key Aspects of MiFID II

### Market infrastructure and transparency

MiFID II makes a range of significant changes in relation to market infrastructure. It introduces the concept of an Organised Trading Facility (OTF) which captures trading in non-equity instruments which previously operated outside the scope of MiFID.

The rules around Regulated Markets (RMs) and Multilateral Trading Facilities (MTFs) have been aligned, and a range of organisational requirements currently applying to RMs and MTFs have been extended to the newly introduced OTFs. There are also new requirements for high frequency and algorithmic trading in relation to pre- and post-trade transparency.

### Product governance

Investment firms that create products are now obliged to identify and specify their target market and take reasonable steps to distribute the product. They will need to put in place a product approval process and review the target market and the performance of the investment products they offer on a periodic basis. They will also need to make sure that distributors have sufficient understanding of the manufacturers' products and product approval processes to sell to their own identified target market. Identification criteria include:

- what type of clients are the products being targeted to?
- what are the clients' objectives and what is their experience or knowledge of the products in question?
- what is the clients' risk appetite and tolerance to risk?

### Investor protection and best execution

MiFID II seeks to enhance the best execution framework which was introduced under MiFID I, whereby MiFID II requires investment firms to take all sufficient steps to obtain best results for their clients.

Investment firms are also required to publish data relating to execution quality (i.e. cost, speed, etc.) at least annually without charge. Investment firms will have to publish, on an annual basis, their top five execution venues for the previous year, along with specific data relating to the quality of execution of transactions on that venue.

### Rules on inducements

Pursuant to the MiFID II general inducement rule, most incentives, including commissions and rebates for independent advisors have been banned, with few exceptions, such as where the payment or benefit is designed to enhance the quality of service to a client.

MiFID II also seeks to unbundle the purchase of research from execution services.

### Transaction reporting

Transaction reporting which had been introduced under MiFID I and concerns trade detail reporting which is provided by investment firms to regulators has been strengthened, now allowing regulators to better monitor for market abuse. The scope of products which need to be reported has been extended with transaction reporting now being required for all products traded on European RMs, OTFs and MTFs. Additional data needs to be provided by investment firms including amongst others details of the person executing the transaction, details of the algorithm used to make trading decisions, whether the transaction is a short sale and whether any illiquid instruments are being engaged.

Transaction reporting will no longer be an issue only for sell-side firms, such as brokers and dealers, but will also become the responsibility of the counterparty who initiates the transaction, typically buy-side firms.

## your contact



### Wayne Pisani

Partner - Tax and Regulatory

T +356 9942 3253

E [wayne.pisani@mt.gt.com](mailto:wayne.pisani@mt.gt.com)

Grant Thornton  
Fort Business Centre  
Mriehel Bypass, Birkirkara BKR 3000, Malta



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