

# What is a Collective Investment Scheme? By Franklin Cachia

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## **What is a Collective Investment Scheme?**

By virtue of Chapter 370 of the Laws of Malta, Investment Services Act, a collective investment scheme is defined as:

“any scheme or arrangement which has as its object or as one of its objects the collective investment of capital acquired by means of an offer of units for subscription, sale or exchange”

The offer need not necessarily be a public one; it could also be a private offer. Several people pool in cash or non-cash for it to be held by a competent person. In turn the person will invest that property, for their own benefit but also at their own risk. Investment includes: shares, bonds or other instruments, broad range of securities and other eligible property so as to spread risk.

A commercial joint venture company is not a CIS. Fundamental elements caught up by the ISA must be accomplished to achieve a collective fund.

One fundamental element is the element of risk spreading. If there isn't this element for risk-spreading then it is not subject to the ISA.

The authority to allow such a scheme is the MFSA (Malta Financial Services Authority). The MFSA can allow a CIS without having the element of risk-spreading in certain specified cases established by law. This is however an exception to the general norm.

From the definition the following points are speculated:  
Collective investment of capital

By means of an offer for subscription, sale or exchange

Principle of risk-spreading

Pooling of funds

Units are to be re-purchased or redeemed at the request of the holder.

Units issued continuously or in blocks at short intervals.

**Capital is acquired** by means of an offer to the prospective participants of units in the scheme. The offeror will comply with certain minimum standards and be bound by certain regulations. The offer has to consist of UNITS i.e. a certificate representing participation in an underlying value.

**Units are** a representation of rights and interest in the scheme. The capital placed within the scheme is converted into something else and the holder of the unit loses his ownership of the asset placed. The unit represents his share in the scheme. His only rights are to receive what the unit entitles him to in terms of the deed or the applicable law.

**Participants share** in the profit but also share the risk of devaluation of investments. Investing in several different units reduces the risk. An individual investor lacks monitoring of the investment and may not have contact with the investors on the daily basis. Collective investment schemes reduce the above and information is delivered to the participants more often. Guidelines developed by the MFSC (Malta Financial Services Centre) are delivered so as to reduce unnecessary risks. All schemes must have the element of risk spreading otherwise they are not licensed. An exception to this include holders of investment services licenses and person whose ordinary business involves the acquisition and disposal of instruments of the same kind as the instrument/s, property, in which the scheme or arrangement invests. Some persons are exempt from obtaining a license.

**Pooling involves** participants' income are combined in a common account or receipt and before distribution. The scheme property is aggregated into a common fund. The pooled funds are then invested in assets. The Fund maybe increased with the introduction of new participants.

### **Structural Body of a CIS**

We find autonomy of functions imposed for investor's protection. The fund may or may not be a separate juridical person.

**Managers of the Scheme-** appointed by the fund to manage the assets of the scheme. There will be a **management agreement** between the scheme and the mangers. It is also possible to have an administrator, which is a distinct office form that of the manger.

**The custodian** – an independent party, usually a bank. His office is one

of a depository or trustee, holding the assets for the benefit of the participants. He also acts as a monitor for the investment. The manager and the custodian would enter into an agreement so as to have his function, together with his rights and obligations are clearly defined. Another agreement taken up by the manager is one contracted with the registrar of the scheme. The registrar is responsible for the upkeep of records of the units/shares issued by the scheme, their owners and transfers, cancellation or substitution of units.

**Investment advisors** – advice on investment strategy to be adopted for the investment of funds.

Other personnel include **auditors and regulators**.

### **Legal structures for CIS- SICAV and INVCO.**

Sicav- Investment scheme with a variable share capital.

Invco- investment scheme with a fixed share capital.

### **SICAV- Subsidiary Legislation 386.02**

**One should note that this scheme is the most attracted to in Malta. This is mainly because it is highly regulated and offers a clear view with regards to its operation and functions.**

Under Maltese law this is an open-ended CIS vested with a separate legal personality and it is formed under the Companies Act as an investment company with a variable share capital. The SICAF can be either private or public and must have the word SICAF when it is registered at the Malta registry of companies.

Article 84 of the Companies act- The object of a SICAV must be limited to the collective investment of funds with the aim of spreading risk. The companies act goes on to say certain requirements for the establishing of a SICAF together with certain exemptions.

The investment services guidelines issued by the MFSA require certain clauses to be laid down in the Memorandum and Articles of a SICAF, for it to obtain a licence.

One such requirement establishes that the share capital has to be of equal value of the issued share capital. The latter is to be divided into a number of specified numbers of shares WITHOUT a nominal value.

SICAVs can only issue fully paid up shares and they do not need to have a minimum authorized share-capital. The Memorandum must provide that the actual value of the share capital shall be at all times equal to the value of the underlying investments after deduction of liabilities. The net asset value of the shares is changing according to the value of the SICAV.

The Articles of Association will contain:

Repurchase and redemption of shares upon request; duties involved and terms contemplated.

Not to redeem on the same day the request is issued.

Method and currency of payment and deduction of commission which may be due.

Temporary suspension of redemption of shares; to be notified to the MFSA within a specified working day.

Possibility of borrowing, under the ISG- a scheme may not borrow more than 10% of the value of the said scheme.

Establish limits within which the stock exchange value and the net asset value of the shares can deviate. The percentage cannot be higher than 5%- the SICAV can ensure that the percentage doesn't go any higher.

Valuation of assets- formulation by "Single-Pricing".

Method of determination of the share price, to be approved by the MFSA.

The restrictions which are applicable to the Maltese Companies for any reduction to the share capital do not apply to SICAV. This applies to the increase of share capital.

SICAV structured as an umbrella fund – the shareholders in such a structure may have established in their M&A that the assets and liabilities of the sub-funds may be treated as a separate patrimony from each other sub-fund. Investment Companies with a Variable share capital regulations. The Memorandum & Articles of Association will also have the description of the structural body of the scheme. This will also have to list down a clear demonstration of how offices are to be appointed and removed.

The method of valuation of the assets of the scheme requires the prior approval of the MFSA.

#### **INVCO- Subsidiary Legislation 386.04**

**The provisions of article 84(10) of the Companies Act shall apply in this case.**

These are closed-ended collective investment schemes. These must be public companies with a fixed share capital.

Requirements:

Investing funds in securities with the intention of risk spreading together with giving participants the benefit of the management of its funds. This is identical to the way a SICAV operates.

None of the holdings in other companies should exceed 15% by value of INVCO investments.

It is prohibited to distribute its capital assets.

Has not retained more than 15% of its income from the securities in any one accounting period.

The provisions in the companies act relating to share-capital of a limited

liability company apply in the case of INVCOs. The INVCO must have a limit on its authorized share-capital and each share must have a nominal share value.

The reduction and the increase of the capital need a prior approval from the MFSA. Moreover, any reduction to the share capital will not take effect before the lapse of 3 months, from the date of publication of the relevant notice informing 3<sup>rd</sup> parties of the proposed reduction.

Distribution is regulated by the companies act: these may be made at any time from the accumulated, realized revenue profits so far as previously not utilized by a distribution of capitalization. Before distribution, INVCO must deduct its accumulated losses.

By way of conclusion, CIS attract a number of tax benefits and exemptions from tax liabilities laid down in various Maltese legislations; one of which includes Chapter 123 of the Laws of Malta, Income Tax Act under article 12.