

APPENDIX VIII

Brief Overview of the Special Funds
(Regulation) Act, 2002 and Supporting
Draft Directives and Legal Notices

VIII

Introduction

The Special Funds (Regulation) Act, 2002 (“the Law”) came into force on 1st October 2002 and is intended to facilitate the establishment of funded second pillar retirement arrangements. The Law provides a regulatory framework for:

- o The arrangement pursuant to which an employer or contributor promises the employee or beneficiary retirement benefits (called a Retirement Scheme). The Law requires a Retirement Scheme to be registered.
- o The types of funds (called Retirement Funds) that are required to be used as investment vehicles by a Retirement Scheme and which require registration under the Law.
- o The types of service providers that may provide services in connection with a registered Retirement Scheme and / or Retirement Fund.

The Law is an enabling law and is to be supported by means of subsidiary legislation in the form of Legal Notices containing more detailed regulations. The Law is also to be supplemented by Directives which do not have legal force but constitute registration conditions and which are issued by the Competent Authority under the Law. The supporting Legal Notices and Directives were issued for consultation with the industry in July 2003 by the Malta Financial Services Authority (“MFSA”), as the appointed Competent Authority under this Law.

As the Competent Authority, the MFSA has the role of monitoring the ongoing compliance of registered Retirement Schemes and Retirement Funds, as well as related service providers, with the requirements of the Law, the proposed Legal Notices and Directives.

Structure of the Law

The Law is divided into three main parts as follows:

- (i) Part I Contains the Basic Definitions
 - o Contributors may be the employer or the employer together with employees.
 - o Beneficiaries are the members of the scheme eligible for retirement benefits.
 - o Retirement Benefits are defined as a pension or other benefits that are payable to a beneficiary after retirement, permanent invalidity or death.
 - o A Retirement Scheme is a contract between the Contributors and the Beneficiaries with the Retirement Scheme Administrator.
 - o A Retirement Fund is the investment vehicle where contributions paid under the Retirement Scheme are to be invested.
- (ii) Part II contains the essential requirements for the registration and operation of Retirement Schemes and Retirement Funds, as well as related service- providers

The SFA stipulates the structure to be followed in the establishment of Occupational Pension Scheme, as well as applicable registration requirements. The Law also stipulates the operational conditions that need to be satisfied by Retirement Schemes, Retirement Funds and their related parties. Operational conditions include the carrying out of specific duties, funding requirements, permitted investments, disclosure requirements and rights arising from the Retirement Scheme. Further details of these requirements are provided below.

- (iii) Part III contains general provisions describing the powers of the Minister and the MFSA and the various penalties for non-compliance

The Law also grants various powers to the Competent Authority as follows:

- o Power to levy penalties and public statements of misconduct.
- o Power to carry out regular as well as ad-hoc inspections.
- o Power to issue Directives.

This part of the Law also determines what constitute offences under the Law and contains various powers to prescribe detailed requirements, including provisions relating to the advertising and promotion of Retirement Schemes and Retirement Funds, the spread of investments to be included in a Retirement Fund and the extent to which investments or loans may be made in or to Contributors.

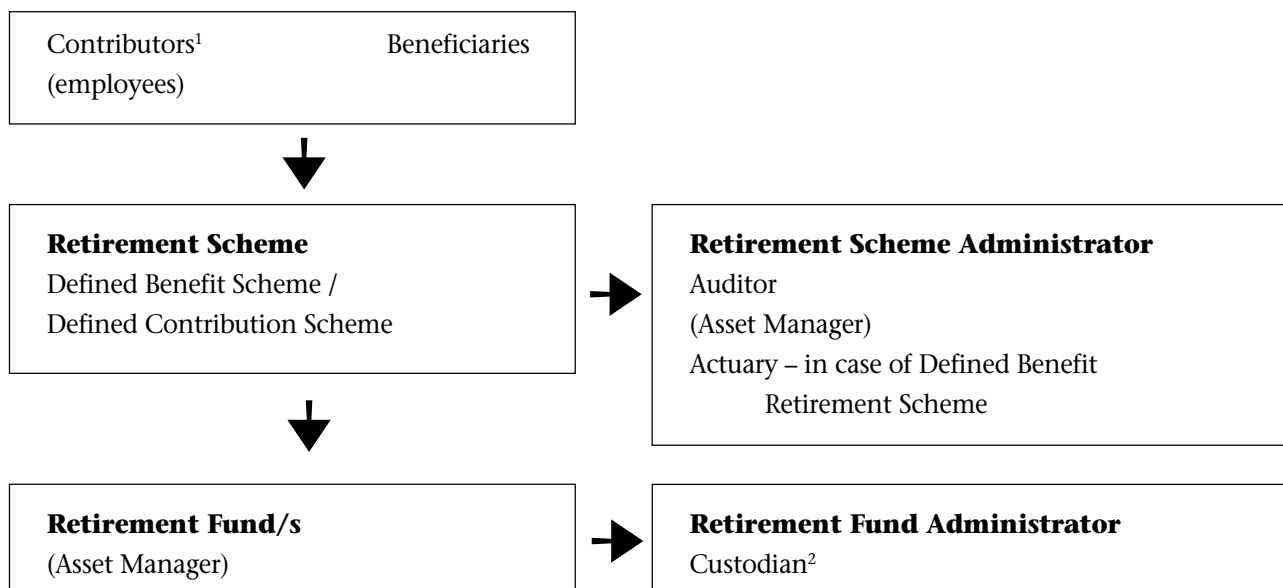
Structure of the Directives issued under the Law

The proposed directives are divided into five main parts (parts A to D of which are herewith attached):

- o Part A provides an introductory overview of the Law and specifies the registration process and registration criteria applicable to Retirement Schemes, Retirement Funds and related parties.
- o Part B sets out the standard operational conditions for Retirement Schemes and Retirement Funds and related parties registered under the Law.
- o Part C contains Other General Guidelines, relating to areas such as outsourcing and penalties.
- o Part D includes the reporting Schedules for Retirement Schemes and Retirement Funds and related parties.
- o Part E contains application forms and related information.

Structure of Retirement Schemes and Related Parties

The structure established by the Law for Occupational Retirement Schemes is as follows:



A Retirement Scheme:

- Is constituted by way of contract under Maltese law, which governs the rights and responsibilities of a Retirement Scheme Administrator and Contributors thereto, and under which payments are made to Beneficiaries for the principal purpose of providing Retirement Benefits. Retirement Benefits means pension or other benefits payable to a Beneficiary after retirement, permanent invalidity or death.
- Requires registration under the Law.
- May be either a Defined Benefit Scheme or a Defined Contribution Scheme.
- Is required to appoint a Retirement Scheme Administrator to manage its affairs.
- Is required to invest its Contributions into one or more Retirement Funds also registered under the Law.

The Retirement Scheme Administrator:

- Requires registration under the Law.
- Must have at least three Directors.
- Is primarily responsible to manage the affairs of the Retirement Scheme in terms of the contract with the Contributors and Beneficiaries. Duties (which are defined by Law) typically include:
 - investing all contributions in Retirement Funds according to the terms of the Scheme document;
 - ensuring that the retirement scheme collects all payments that are owed to it by its contributors;
 - ensuring that all disbursements are effected in accordance with the Retirement Scheme documents; and
 - maintaining accurate records.
- May appoint an Asset Manager to advise on or manage the investment of all or any of the Retirement Scheme's assets or may undertake such functions itself (if duly registered as Asset Manager).

A Retirement Fund:

- Is a collective investment company with fixed or variable share capital incorporated under the Companies Act, 1995, set up for the principal purpose of holding and investing the Contributions made to one or more Retirement Schemes.
- Requires registration under the Law.
- Is required to appoint a Retirement Fund Administrator to administer its affairs and custody of its assets.
- The appointment of an Asset Manager to the Fund is at the discretion of the Retirement Fund. Where an Asset Manager is not appointed, the asset management function shall be undertaken by the Board of Directors of the Retirement Fund who need to demonstrate competence in relation to this activity.

Retirement Fund Administrator:

- Requires registration under the Law.
- Performs duties associated with the ordinary day-to-day operations of the Retirement Fund and may carry out the custody function itself, where it satisfies the criteria applicable to custodians of Retirement Funds. Otherwise, assets must be entrusted to an entity which is registered under the Law as Custodian of Retirement Funds. The duties (as defined by Law) of a Retirement Fund Administrator. Administrator typically include:
 - managing the Retirement Fund;
 - ensuring compliance with all statutory and contractual obligations;
 - arranging for the necessary financial control of the Retirement Fund;
 - providing for the audit and actuarial examination of the Retirement Fund; and
 - carrying the overall day-to-day responsibility for the Retirement Fund.

Asset Manager:

- Requires registration under the Law.
- Performs investment management duties related to the Retirement Scheme or Retirement Fund.

Overseas Plan:

The Law also makes reference to Overseas Retirement Plans - which are bona fide schemes or arrangements, organised under the laws of a country outside Malta, which govern the rights and responsibilities of the parties related thereto, and under which payments are made to Beneficiaries for the principal purpose of providing retirement Benefits. An Overseas Retirement Plan does not require registration under the Law. However, it may either decide to establish a Retirement Fund registered under the Law or else invest its Contributions in an already established Retirement Fund registered under the Law.

Overview of Registration Requirements

- Retirement Scheme
 - The Law establishes certain disclosure requirements to be met by the Retirement Scheme Document (i.e. the contract establishing the occupational pension arrangement), which is to be approved by the Competent Authority.
 - The Law requires that a Retirement Fund is used as the investment vehicle of the Retirement Scheme.
- Retirement Scheme Administrator
 - The administrative role may be carried out by insurance companies authorised to carry out long term business in 'pension fund management' under the Insurance Business Act, 1998, or by Category 2 or 3 Investment Services Licence Holders under the Investment Services Act, 1994, having the appropriate organisational set-up, systems and resources. In these cases, an abridged application process shall apply. Other entities may also apply, in which case a full application process shall apply.
 - The entity registered as a Retirement Scheme Administrator under the Law may carry out asset management function itself (if also duly registered as asset manager under the Law) or delegate this function to a third party asset manager.
- Retirement Fund
 - Scheme Particulars - which describes the nature and objectives of the Retirement Fund – needs to comply with certain disclosure requirements.
 - May carry out asset management function itself or delegate this function to a third party asset manager.
- Retirement Fund Administrator
 - Role (excluding the custody function) may be undertaken by Category 2 or 3 Investment Services Licence Holders under the Investment Services Act, 1994. In these cases an abridged (rather than a full) application process shall apply. Other applicants will need to follow the full application process under the Law.
 - If the Retirement Fund Administrator wants to maintain custody, it would need to satisfy the criteria for custodians (as described below).

- Asset Manager
 - If acting for a Retirement Scheme Administrator, must be:
 - authorised to carry out long-term business under the Insurance Business Act in ‘pension fund management’; or
 - licensed under the Investment Services Act, 1994 to provide discretionary portfolio management services; or
 - an overseas based firm which the MFSA is satisfied is subject to adequate regulatory supervision in the jurisdiction where based.
 - If acting for a Retirement Fund, it must fall within either of the preceding two categories.
- Retirement Fund Custodian – Must be an entity in possession of:
 - A Category 4 investment services licence under the Investment Services Act, 1994, or
 - Licensed under the Banking Act, 1994, or
 - A credit institution licensed in a country where in the opinion of the MFSA it is subject to an adequate level of regulatory supervision, having an established place of business in Malta, or
 - Such other entity acceptable to the MFSA having the business systems, experience and expertise deemed necessary by the MFSA for it to maintain custody of assets.

Overview of On-Going Registration Requirements

- The Shareholders, Directors and senior management of parties applying for registration, are required to satisfy the Fit and Proper Test, which involves the test of solvency, integrity and competence.
- The Parties are also required to satisfy various independence requirements, which are described further below.
- The Retirement Scheme Administrator, the Retirement Fund Administrator and the Retirement Fund Custodian are required to comply with minimum Financial Resources and Reporting Requirements - unless already subject to appropriate requirements under other licensing regimes. This exemption is intended to avoid duplication of requirements. Record keeping requirements also apply.
- Retirement Scheme Administrator and Retirement Fund Administrator are both subject to:
 - Various disclosure requirements to the Contributors and Beneficiaries and the MFSA, including:
 - Ensure that Contributors and Beneficiaries are sufficiently informed of the conditions of the Retirement Scheme, in particular of the contractual rights and obligations; the financial, technical and other risks embedded in the Retirement Scheme; the distribution of risks embedded in the Scheme to contracting parties.
 - Provide any Contributor or Beneficiary upon request with detailed information on applicable target level of benefits, actual financing of accrued pension entitlements, range on investment possibilities and actual investment portfolio and the investment policy and principles of the Retirement Scheme; a copy of the Scheme’s annual report.
 - Information regarding pension rights and choice available to employees moving to other EU member country.
 - Submission of annual reports to the MFSA by the Retirement Scheme and Retirement Fund. The Retirement Fund is also required to submit monthly returns to the MFSA.
 - The MFSA is also to be notified of any under-financing of Defined Benefit Schemes, and provided with an actuarial report.
 - Related Parties are required to submit financial returns on a half-early basis to the MFSA regarding their financial status. An auditor’s report is also required together with the annual audited accounts.

- Conduct of Business rules, including inter alia:
 - Regarding the custody of assets by Retirement Fund Administrator or Custodian.
 - Defined Benefit Schemes are subject to Minimum Funding Requirement to ensure that there are sufficient assets to cover the inherent liabilities and hence ensure that promised benefits are delivered. The Directives place a high degree of reliance on monitoring carried out by the Retirement Scheme Administrator and the Actuary in this regard.

Where it is likely that the Funding Requirement will not be met (or where a deficit materialises), the Law obliges the Retirement Scheme Administrator to levy additional contributions in order to remedy the shortfall.
 - The Law imposes various reporting requirements on auditors and actuaries of Retirement Schemes and Retirement Funds, including whistle blowing obligations.

Independence Requirements

In order to provide additional safeguards and segregation of duties the following general principles were taken into account in establishing the independence requirements:

- The involvement of the employer (as a Contributor) with the other parties to the structure should be limited.
- With regards to a Retirement Fund, the administration/ custody function undertaken by the Retirement Fund Administrator and the asset management function shall be kept separate (in line with the independence requirements imposed for retail collective investment scheme in the Investment Services Act, 1994).
- A person shall not be appointed as auditor to a Retirement Scheme if he / she is employed under a contract of service by the Retirement Scheme Administrator or any Contributor or is a Contributor or Beneficiary to or of the Retirement Scheme.

In summary, the following independence requirements shall be applied:

Retirement Fund	Independent From:
Retirement Fund	<ul style="list-style-type: none"> - Retirement Scheme Administrator - Retirement Fund Administrator - Contributor (where this is a business concern)
Asset Manager	<ul style="list-style-type: none"> - Retirement Fund Administrator - Contributor (Where this is a business concern)

Except as may be authorised by the MFSA, a person shall not act as a member of the Board of Directors of the Retirement Fund or of the Asset Manager or as an officer responsible for the administration and management of the Asset Manager and at the same time hold a similar position with the Retirement Fund Administrator or the Retirement Fund Custodian as applicable

Independence between parties	Independent From:
Retirement Scheme Administrator	<ul style="list-style-type: none"> - Contributor(s) (While such independence does not preclude a Contributor from being represented on the Board of the Retirement Scheme Administrator, there should be a majority of Directors on the Board who are independent of any Contributor) - Retirement Fund - Retirement Fund Administrator

	Independent From:
Retirement Scheme Administrator	<ul style="list-style-type: none"> - Contributor(s) of Retirement Scheme (While such independence does not preclude a Contributor from being represented on Fund Administrator, there should be a majority of Directors on the Board who are independent of any Contributor) - Retirement Fund - Asset Manager - Retirement Scheme Administrator

Retirement Fund Custodian (where appointed)	<ul style="list-style-type: none"> - Contributor to a Retirement Scheme (where this is a business concern) - (Except as may be authorised by the MFSA, a person shall not act as a member of the Board of Directors of the Retirement Fund or of the Asset Manager or as an officer responsible for the administration and management of the Asset Manager and at the same time hold a similar position with the Retirement Fund Custodian).
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Proposed Legal Notice regarding the Custody of Assets

Legal Notice establishes:

- A registration requirement for entities providing custody services to OPSs, stipulating the criteria of appointment.
- The power of the MFSA to refuse a registration of a Retirement Fund Custodian.
- The duties of a Retirement Fund Custodian.
- That the assets held by the administrators on behalf of the OPSs are a distinct legal patrimony from assets of Retirement Fund Administrator or any other entity that is entrusted with the custody of such assets.

¹ Employer / Employer and Employees

² The Retirement Fund Administrator may act as Custodian subject to satisfaction of relevant criteria