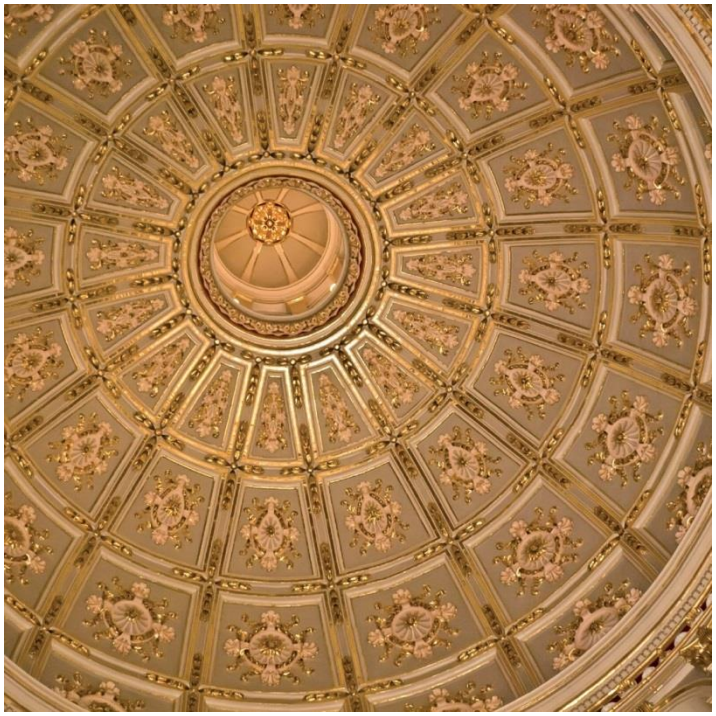
SECURITISATION OF ASSETS

SECURITISATION CELL COMPANIES IN MALTA



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MALTA – MANDARIS' PREFERRED JURISDICTION FOR SECURITISATION

Malta, since its independence from Great Britain in 1964, is an independent Republic with a population of around 420 thousand. The official language are English and Maltese and the currency is the Euro.

Malta started developing as a financial centre in 1994. Following EU accession in 2004 it has gained a reputation as a robust EU and OECD compliant jurisdiction, with a highly approachable regulatory authority. It has been internationally recognised that the Maltese regulations provide a secure and stable framework for prudential supervision, consumer protection, market surveillance and prevention of money laundering. The financial sector contributes approx. 8.5 % to the GDP of Malta.

Recent events in Europe have heightened perceptions about risks of a banking sector in a small country. In the case of Malta, these risks are contained as the large international banking segment has limited balance sheet exposures to the Maltese economy and negligible contingent claims on the deposit compensation scheme. The authorities are, nonetheless, continuing to monitor closely developments in all banks, including links between foreign parent banks and their Maltese entities. The financial and regulatory stability of Malta has been confirmed by various international organisations:

1. In the first credit rating assessment for 2014, Standard and Poor's confirmed Malta's rating at BBB+/A-2, while re-affirming the island's stable outlook. Focusing on the financial services sector, S&P noted that the domestically owned financial system appeared to be stable while the presence of foreign, internationally oriented banks posed little threat to the government as these institutions have little or no impact on the domestic economy.

2. Following an extensive review of Malta's economic and financial position, credit rating Agency Moody's changed the outlook on Malta's A3 government bond rating to stable. Turning on government's funding markets, Moody's notes that the funding difficulties evident in the international financial markets over the last few years have been absent from Maltese financial markets.

3. In 2013 the OECD has concluded that Malta is in full conformity with the requirements related to international transparency standards and exchange of information for tax purposes.

4. In May 2013 the IMF attested that Malta has shown remarkable resilience in the face of the major crisis in Europe. Average growth of the Maltese economy has been the best in the euro area since the beginning of the crisis, and the unemployment rate remains one of the lowest.

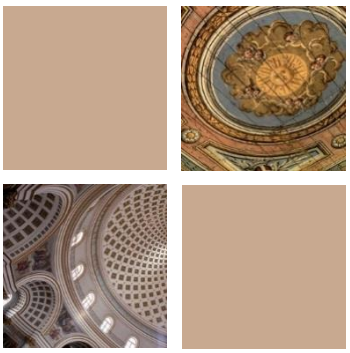
5. In 2012, with respect to the previous year, all Euro area countries but Luxembourg and Malta recorded a decrease in the number of credit institutions. This was one of the key conclusions of the Banking Structures Report, published by the European Central Bank.

6. It was recently announced in the Global Competitiveness Report drawn up by the World Economic Forum that Malta is a top 15 financial services jurisdiction.

7. Malta has been named European domicile of choice in the illustrious Hedge Funds Review Service Provider Rankings 2013.

Moreover, significant progress was made in general sectors which enhance the attractiveness of Malta as an investment location, with improvements in health, primary education and the quality of education, which now ranks 8th best in the world. For the fifth consecutive year, Switzerland topped the table, followed by Singapore, Finland, Germany, and the United States.

SECURITISATION – THE ESSENCE



Malta has introduced a legal framework for Securitisation Cell Companies (SCC) in November 2014. A SCC is a single legal entity that can establish within itself segregated cells or compartments for the purpose of entering into completely ring-fenced securitisation transactions. Mandaris has incorporated a SCC as a securitisation "platform", offering the advantage of lower costs and speedier set-up time for each transaction.

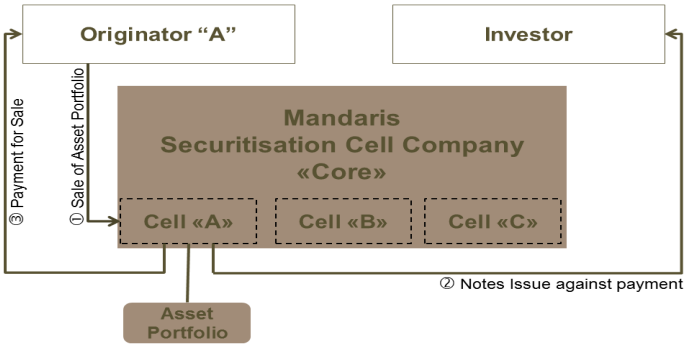
Securitisation is a structured finance transaction involving sophisticated financial engineering, whereby the original owner of an asset, the Originator, truly sells an asset (virtually any kind of debt, securities such as shares or bonds, intellectual property, life insurance policies, real estate etc., whether diversified or not) to an unrelated securitisation company. In turn, it issues notes to investors in order to finance the acquisition of the asset. In so-called synthetic transactions the securitisation vehicle assumes the credit risk of the Originator through credit derivatives. Hence, the assets are repackaged into debt securities. Securitisation is regularly offered by financial institutions for companies with very unique financing needs. These can usually not be answered by conventional financial products such as equity or a loan.

The objective of securitisation is to achieve real remoteness between the Originator and the asset acquired by the securitisation company. The assets are detached from the Originator's balance sheet, both legally and accounting wise.

In its most basic form, the process involves two steps:

In step one, the Originator, typically a company, identifies the assets it wants to remove from its balance sheet. It then sells this asset to an Issuer (the unrelated SCC), by which the asset is removed off the balance sheet of the Originator and transferred to the balance sheet of the securitisation company.

In step two, the SCC issues, in respect of its cell, tradable debt securities in order to finance the acquisition. The debt securities are sold to investors. The Originator is not precluded from also being an investor, even though securitisation transactions are usually also made for risk transfer reasons. The debt securities can be structured as needed, e.g. as fixed or floating rate notes, as zero-coupon notes or as convertibles, which are funded by the cash flows generated by the securitised asset. These cash flows can either be regular, such as in the case of royalty, interest, dividend or rental income, or accrue at a specific point in time, e.g. when the asset is sold or a loan reimbursed.



The result is a new debt security, the note, backed up by the underlying assets. This note can be sold to any investor. Furthermore, the asset can be divided into a number of different parts, referred to as tranches. These tranches can be structured in virtually any way the Issuer sees fit, allowing the Issuer to tailor a single asset-backed security into senior (or preferential) or junior (subordinated) notes.

SECURITISATION CELL COMPANIES – KEY FEATURES

Malta is the only EU member state that offers the Securitisation Cell Company structure. In addition, Malta's Securitisation Act provides statutory solutions and greater security for securitisation transactions and reflects their specificities and variety, including true sale, bankruptcy remoteness and the privileges of creditors over the vehicle's assets.

The Securitisation Act specifically addresses the requirement of a true sale. In a true sale, the Originator is allowed to remove the transferred assets from its balance sheet. If securitisation is structured as a true sale, the investors get a legal right over the securitised asset. In case a transaction would not be structured as a true sale, investors may be either at par with unsecured lenders, or even worse. The true sale structuring is fundamental for off-balance-sheet accounting treatment, regulatory relief, bankruptcy remoteness etc. Securitisation vehicles established under the Securitisation Act are bankruptcy remote from the Originator by law.

The Securitisation Cell Companies Regulations provide an effective and legally entrenched framework for segregation of different sets of assets and risk instruments within a single special purpose vehicle, thereby allowing for the launch of multiple securitisation transactions through a single legal entity without incurring any risk of cross-contamination between the different transactions and the securitisation company itself.

A SCC is a single legal entity that is structured in two parts, the core and an unlimited number of cells. It is one company with one board of directors and one set of memorandum and articles of incorporation. The key differentiating element between a cell company and the traditional non-cellular company is that the former provides a flexible corporate vehicle within which assets and liabilities can be ring-fenced, or segregated, so as to be only available to the creditors (and shareholders, if any) of each particular cell.

Therefore a SCC is able to limit its liability in respect of a particular transaction to a specified pool of assets rather than exposing all of the assets of the SCC, as would be the case with a non-cellular company. A cell of a SCC does not have a separate legal personality, and each cell transacts through the SCC. When a SCC enters into a contract, the directors must specify in the contract which particular pool of assets is to be bound by the obligations under the agreed contract.

A SCC may create cells by means of a resolution of its board of directors. A new cell will be created for the purpose of entering into a distinct securitisation transaction. Each cell of a SCC must have its own distinct designation, which shall include the word 'cell'. A SCC may enter into one or more securitisation transactions in respect of a cell.

It may issue debt instruments in one or more tranches, in respect of any of its cells, and the proceeds of the issue are comprised in the cellular assets attributable to the cell in respect of which the debt instruments were issued. Such debt instruments issued in respect of a cell may be denominated in different currencies.

Furthermore, a SCC may, in respect of any of its cells, create and issue cell shares (no minimal capital requirement), the proceeds of the issue of which ("cell share capital") are comprised in the cellular assets attributable to the cell in respect of which the cell shares were issued.

A SCC may not carry securitisation transactions through its non-cellular assets. Asset-based and risk-based securitisation transactions may therefore only be carried out in respect of specific cells and securitisation assets have to be allocated to a particular cell.

The directors of a SCC have the duty to keep:

a) cellular assets separate and separately identifiable from non-cellular assets;
b) cellular assets attributable to each cell separate and separately identifiable from cellular assets attributable to other cells; and
c) separate records, accounts, statements and other documents as may be necessary to evidence the assets and liabilities of each cell as distinct and separate from the assets and liabilities of other cells in the same company, and those from the non-cellular assets and liabilities.

The directors of a SCC may choose the base currency of a cell, which may be different from the currency of the non-cellular share capital.

A SCC shall draw up its annual accounts in either the currency of its non-cellular share capital or the base currency of one of its cells.

A creditor of a cell has rights to the assets of that particular cell only and has no recourse to the assets of other cells or the non-cellular/core assets. Apportionments may be made out of the assets attributable to the individual cells towards the costs of the day-to-day administration of the SCC.

The SCC Regulations provide for the winding up of individual cells separately from the SCC itself as a whole. The winding up proceedings prescribed under the Companies Act apply mutatis mutandis to a cell as though it were a distinct legal entity, whereby the dissolution of one cell has no effect on the other cells, even in case of bankruptcy. As mentioned before, securitisation vehicles established under the Securitisation Act are bankruptcy remote from the Originator by law.

A SCC may list its securities on the Gibraltar Stock Exchange (GSX), which operates the Main Market, an EU regulated market recognised by ESMA dedicated to the needs of arrangers and issuers of wholesale debt products, as well as on the Malta Stock Exchange.

Securitisation vehicles are specifically exempt from licensing or authorisation requirements of any kind, irrespective of the kind of activities carried out by the vehicle, including where such activities would ordinarily require authorisation (under the Investment Services Act or the Banking Act, for example). Of particular relevance to transactions with a managed or dynamic portfolio of assets, the before mentioned act provides that Maltese securitisation vehicles are not to be considered collective investment schemes (including in the form of an 'alternative investment fund' under the AIFMD), thereby exempting them from the local regulatory regime applicable to collective investment schemes (including the regime for alternative investment funds).

Securitisation vehicles are merely required to notify the Maltese Regulator of their intent to enter into one or more securitisation transactions. The only exception is for a securitisation vehicle that issues financial instruments to the public on a continuous basis, which would require authorisation by the MFSA prior to issuing financial instruments to the public. Securitisation vehicles also qualify as financial vehicle corporations pursuant to Regulation (EU) 1075/2013 of the European Central Bank, with attendant quarterly statistical reporting requirements to the Central Bank of Malta in accordance.

TAX SYSTEM

Even though, as a rule, securitisation vehicles are ordinarily taxed companies liable to tax in Malta at 35%, substantial deductions are available, which effectively eliminate any taxable income in Malta. Therefore, a Maltese securitisation vehicle enjoys in effect tax neutral status, thereby optimising the investors' return and the originator's cost of funding.

Specifically enacted tax rules provide for the following deductions:

- Cost of acquisition: expenses payable to the Originator for the acquisition of securitisation assets or the assumption of risk are deductible;
- Finance expenses: premiums, interest or discounts relating to financial instruments issued or funds borrowed to finance the acquisition of securitisation assets or the assumption of risks are deductible;
- Operating expenses: costs incurred in the day-to-day administration of the securitisation vehicle and the management of the securitisation assets, including the collection of any relevant claims, are deductible.

After the aforementioned deductions are taken, the securitisation vehicle may opt to claim a further deduction on its remaining taxable income, thereby ensuring no taxation at the level of the securitisation vehicle.

According to Maltese tax law the deductions, including the further deduction, constitute deemed income for the Originator. However, no Malta tax is payable on such deemed income where the Originator is not resident in Malta for tax purposes.

Malta does not impose any withholding tax on the outbound payment of dividends and interest to non-resident investors. Also, the transfer of securities is not taxable, unless the transferor is, directly or indirectly a Maltese resident individual. Finally, a securitisation vehicle established in Malta qualifies for a stamp duty exemption, if more than 90% of its business interest is situated outside Malta.

Irrespective of the effectively tax neutral status, securitisation vehicles set up as companies can obtain a tax residency certificate from the Maltese tax authorities in order to accede to EU Directives and Malta's extensive tax treaty network.

In the case assets should be owned through underlying Special Purpose Vehicles (usually a company), Malta has an imputation system of taxation resulting in an effective tax charge of usually 5%. While companies pay corporate tax at 35 %, this tax is regarded as a prepayment for the tax due by the shareholder upon the eventual distribution of profits by way of dividend. On declaration of the dividend the shareholders receive a refund of usually 6/7 of the corporate tax paid by the company, hence bringing down the effective tax burden to 5% (going up to 11% in the case of interest income or income for which the benefits of tax treaties are used). This tax refund mechanism is Malta's general system of taxation for all companies. Further, Malta applies participation exemption rules to holding companies, thus exempting from tax dividend income and capital gains from qualifying participations.

The tax system of Malta has been approved by the OECD and by the EU in 2007 under State Aid and Code of Conduct.

Malta has a continuously expanding worldwide network of over 70 tax treaties (with all EU and most OECD members) and new treaties are being negotiated on an ongoing basis, currently with various Latin American countries. Malta was one of a group of jurisdictions that was placed immediately on the OECD's "white list" of countries and territories that had both embraced and substantially implemented the tax standards.

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