

27 March 2018

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Attn: The Directors and Compliance Officers of Collective Investment Schemes

Dear Sir/ Madam,

Re: Outcome of Supervisory Meetings with Collective Investment Schemes

Introduction

During 2017 the Securities & Markets Supervision Unit (“SMSU”) conducted a series of supervisory meetings with the board of directors and compliance officers of a number of UCITS collective investment schemes (thereafter referred as “schemes”). The aim of these supervisory meetings was to review the extent to which the Scheme has proper governance and compliance procedures in place and the extent to which these are being complied with.

The purpose of this document is to inform the industry of the most common findings identified from these meetings and to share the expectations of the Authority, particularly with respect to the monitoring on service providers.

1. Oversight on Service Providers

In many cases schemes did not conduct onsite and/or offsite monitoring on their service providers, particularly on custodians, investment managers and administrators. In other cases, oversight was being conducted not in a formal manner, whilst in other instances, the boards of the schemes relied completely on the monitoring conducted by third parties.

It is expected that schemes establish and maintain a compliance monitoring programme (“CMP”), which includes the monitoring on service providers. The CMP needs to detail how the frequency of monitoring of each risk is being determined by the Schemes, explaining whether any compliance risk ratings are being used/ calculated as a basis for selecting frequency and areas for compliance review.

The CMP needs to provide details clarifying the method of such monitoring, such as whether the schemes intend conducting onsite inspections and/or offsite monitoring. Schemes adopting a risk-based assessment are to document such assessment accordingly. It is also important that when the CMP is drawn up, this is done in liaison with the Board, and the progress of the programme undertaken throughout the year needs to be adequately documented, presented and discussed by the Board during meetings.

2. Procedures Record-Keeping

In most of the cases, the schemes did not have complete procedures in place in relation to the monitoring of their service providers. It is recommended that the schemes establish and maintain adequate procedures on when and how such monitoring is to be conducted. Proper records on the monitoring of service providers are to be kept on file.

3. Board Meetings Proceedings – Detailed Discussions

The majority of the schemes subject to this exercise did not record regular active discussions by the board of directors on the presentation of key reports presented at board meetings, such as the manager's reports, the risk management reports and the custodian reports. Although the contents of these reports were comprehensive, it is expected that such reports are not just '*noted*' but actually discussed and debated thoroughly. Most of the schemes under review advised that lengthy discussions were held but not formally recorded. In rare instances no discussion at all was recorded on the presentation of particular reports.

In terms of point 7.13 of the MFSA's Corporate Governance Manual for Directors of Investment Companies and Collective Investment Schemes ("the MFSA's Corporate Governance Manual"), schemes are to ensure that detailed discussions are held at board meetings on important decisions and hence more comprehensive board minutes are kept. Board minutes should be a true representation of the discussions held during the board meetings including any questioning and challenging by the schemes' directors. It is important that all periods are covered in reports by service providers.

It is also expected that schemes include in their standard agenda regulatory and legal updates, as indicated in point 7.6 of the MFSA Corporate Governance Manual.

4. Participation in the Scheme's Board Meetings by External Parties

The attendance of certain third parties, such as consultants, advisors etc. at board meetings of schemes may be justified, especially in order to present the relevant reports to the board of directors. Nevertheless, it is expected that no external parties to the board of directors of schemes exercise undue influence or control on the schemes or their board of directors.

In such situations, schemes should take the necessary measures to ensure that any external parties attending board meetings have supporting written agreements with the scheme clearly setting out their responsibilities, accountabilities and obligations vis-à-vis the scheme, as well as appropriate confidentiality clauses. It is also expected that external parties attend board meetings only for the relevant discussions rather than for the entire meetings. Any potential or actual conflicts of interest arising from the participation of external parties is to be duly recorded and accordingly managed.

5. Board Meetings Proceedings - Presence of Directors & Compliance Officers

In some instances, board meetings were held without any of the board members being physically present at the registered office of the schemes. It is recommended that in terms of clause 7.9 of the MFSA Corporate Governance Manual board meetings are held in person, with at least the local directors being present at the registered office of the schemes.

The compliance officers of schemes are expected to attend board meetings, particularly those at which the six monthly compliance reports are presented to the board.

6. Training

Directors of the schemes are expected to attend regular training, particularly in order to keep up to date with the legislative and regulatory developments. Records of training attended by the directors are to be kept updated at all times. Clause 24.6 of the MFSA's Corporate Governance Manual refers.

7. Compliance - Standard Board Meeting Agenda Item

The six-monthly compliance reports prepared by the compliance officers of schemes need to be formally tabled at board meetings of schemes, discussed and minuted accordingly. It is therefore expected that compliance matters feature as a standard board agenda item.

8. Administrator Reports

Administrator reports were not consistently being presented to the board of directors of the schemes. The schemes are to ensure that their boards are presented with a report from the Administrator, ideally on quarterly basis. The board of directors and the compliance officers may wish to refer to the MFSA Corporate Governance Manual for more guidance on this subject.

9. Conclusion

Although this supervisory exercise targeted a sample of UCITS schemes, the above findings/recommendations may apply to other types of collective investment schemes. Therefore, the Authority expects the Directors and Compliance Officers of all collective investment schemes to carry out a gap analysis of their current processes and procedures and implement remedial measures if they do not confirm with the above recommendations.

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Contacts

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