

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Securities and Markets Supervision Unit

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18 September 2017

Attn: The Directors and Compliance Officers of Collective Investment Schemes, Fund Managers, Custodians and Fund Administrators

Dear Sir/ Madam,

Re: Circular on Critical Supervision and resulting Administrative Measures

Introduction

In the recent years the Securities and Markets Supervision Unit has been managing a number of cases which required critical and close supervision in view of breaches of regulatory requirements.

The purpose of this circular is to bring to the attention of the industry the most common deficiencies so as to serve as a learning experience to all licence holders. Below is a summary of some of the major deficiencies which were identified in collective investment schemes, fund managers, custodian and/or fund administrators. Please be aware that certain deficiencies mentioned below apply only to certain categories of licence holders, e.g. AIFs, UCITS, etc. in line with the regulatory regime they operate in.

1. Governance

- Lack of co-operation with the Authority, including failing to act in an open and honest manner with the regulator;

- Failure to seek written consent from the Authority with respect to appointments of senior management roles¹;
- Lack of internal control mechanisms and effective internal reporting;
- Lack of assessment and periodic review of the effectiveness of policies, procedures and arrangements;
- Failure to appoint an entity responsible for the administration function of a collective investment scheme;
- Failure to appoint a new auditor after the resignation or removal of an outgoing auditor;
- Failure to notify the Authority of any other material information concerning the licence holder, its business or its officials in Malta or abroad upon becoming aware of such material information;
- Failure to act honestly, fairly and with integrity, in the best interest of its investors/shareholders and of the market;
- Failure to comply with all Maltese and overseas regulations under which licence holders operate;
- Failure to establish an Investment Committee of a self-managed collective investment scheme composed of a minimum of three individuals;
- Failure to obtain the Authority's approval prior to implementing changes to the administration function;
- Failure to update information on (i) service providers, and (ii) the net asset value calculation function in the offering documentation;
- Failure to have in place a third party manager until a collective investment scheme is converted into a self-managed scheme;
- Failure to comply promptly with MFSA directives;
- Failure to undertake due diligence and ongoing monitoring of the critical service providers up to the required and acceptable standards;
- Failure to monitor that any internal risk limits established by the investment management function are being adhered to;
- Failure to ensure that any remedial action in relation to breaches of investment restrictions and asset eligibility are implemented in a timely manner and in the best interest of investors.

2. Risk Management

- Failure to establish and maintain a risk management function which is hierarchically and functionally independent from the operating units;
- Failure to notify the Authority of material changes to the risk management process;
- Shortcomings regarding risk reporting and lack of adherence to the risk management policies;

¹ 'Senior Manager' should be interpreted as the person occupying the most senior role following that of Director, so that in the case where there are various management grades, it is the most senior manager who will require the MFSA's authorisation.

- Failure to adopt adequate and effective arrangements, processes and techniques in order to measure and manage the risks that a collective investment scheme is exposed to.

3. Investment Management

- Failure to ensure fair, correct and transparent pricing models and valuation systems;
- Failure to formulate forecasts and perform analysis of illiquid assets;
- Failure to undertake initial assessment/ due diligence and ongoing monitoring of investments within a collective investment scheme's investment portfolio;
- Failure to ensure adequate knowledge and understanding of the assets in which a collective investment scheme are invested in;
- Failure to comply with the custodian's directions;
- Failure to comply with investment objectives, policies and restrictions outlined in offering documentation;
- Failure to ensure that the valuation of the assets of a collective investment scheme is accurate and fair and that an independent valuer is appointed to obtain a reliable valuation of illiquid securities.

4. Conflicts of Interest Management

- Failure to record, disclose and manage effectively conflicts of interests that arise, making reference to provisions in constitutional documents and/or internal processes and procedures which relate to conflicts of interest management, as the case may be.

5. Capital Requirements & Financial Reporting

- Non-rectification of deficit in financial resources requirement in a timely manner;
- Failure to submit audited financial statements at all or with significant delays beyond the regulatory deadlines.

6. Compliance

- Failure to have in place a Compliance Officer and a Money Laundering Reporting Officer at all times;
- Failure to ensure that the compliance function has access to all relevant information;
- Failure to approve and review on periodic basis the adequacy of internal procedures for undertaking investment decisions;
- Failure to notify the Authority of breaches of SLCs, and/or of statutory provisions, and/or constitutional documents of a licence holder;
- Failure to establish and maintain a permanent and effective compliance function which monitors the adequacy and effectiveness of the measures, policies and procedures; and to advise and assist the relevant persons for carrying out their activities.

Conclusion

We believe that the contents of this circular shed a light on what the Authority expects as minimum standards in respect to the various regulatory obligations, such as governance, risk management, compliance, capital requirements and financial reporting, as well as investment management and conflicts of interest management. Please note that the above mentioned shortcomings are not exhaustive.

The industry is advised that in certain instances the identified deficiencies were serious and as a result enforcement action was taken by the Authority. Accordingly, licence holders are urged to review their processes and procedures to ensure that any failures, as those indicated above, are addressed and sound governance and compliance culture is established and retained across all levels of licence holders.

Contacts

Any queries or requests for clarifications in relation to this circular are to be addressed to Mr Joseph J Agius - Deputy Director, Securities & Markets Supervision Unit, on +356 2548 5535 or jagius@mfsa.com.mt, or Ms Jeanelle Newell – Analyst, Securities & Markets Supervision Unit, on +356 2548 5526 or jnewell@mfsa.com.mt.

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