

# MFSA

## MALTA FINANCIAL SERVICES AUTHORITY

### Securities & Markets Supervision Unit

29<sup>th</sup> September 2014

Unit Tel: (+356) 21441155  
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**To: Investment Services Licence Holders**

**Attn. Compliance Officer**

Dear Sir/Madam,

**Re: Thematic Review on compliance with the requirements on Governance, Compliance and Risk Management**

During 2013 and 2014, the Securities and Markets Supervision Unit conducted a thematic review on Governance, Compliance and Risk Management through focused visits at the offices of a number of investment services licence holders. A broad range of licence holders varying in size, type and business model were selected in order to obtain a representative picture of the sector as a whole.

These reviews were designed to verify the extent to which selected licence holders have proper governance, compliance and risk management procedures in place and the extent to which these are being complied with and applied in practice.

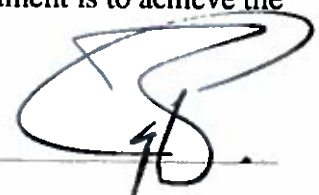
The purpose of this letter is to inform the industry about the common findings of these focused reviews in order to encourage licence holders to take corrective action and avoid the common pitfalls in relation to lack of observance of regulatory and compliance standards. In this regard, you are encouraged to consider carefully the key findings set out below and undertake an assessment of your company's current position vis a vis these findings, making sure that any remedial action is taken in a timely manner.

### **Key Findings**

#### **1. Procedures Manual**

The main deficiency identified by the Authority was that the written procedures manual was not always tailored to suit the specific circumstances of the reviewed licence holder. On more than one occasion, we noted that the procedures merely replicated, on a cut and paste basis, the wording of the Investment Services Rules.

It is critical that the procedures manual of a licensed entity reflects the current situation and the actual procedures of the organisation; the procedures must be relevant to cater for the specific business carried by the licence holder if such an important document is to achieve the purpose for which it is drawn up.



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## 2. Governance

MFSA officials assessed the '*governance*' aspect of the investment firms' business by conducting a review of the procedures manual and related documentation as well as by interviewing the board of directors. The main deficiencies noted were as follows:

- Internal reporting lines were not clearly defined and were not formalised in the procedures manual. We expect that the respective responsibilities of the persons in charge of making decisions are properly defined and explained in the investment firm's procedures manual;
- The Business Continuity Plan ('BCP') was not in line with the Guidance Notes to the Investment Services Rules for Investment Services Providers. Moreover logs of business continuity testing were not always maintained. We expect investment firms to be familiar with the referred Guidance Notes as well as to maintain appropriate business continuity logs;
- The board of directors' minutes did not reflect material issues and often lacked the necessary detail in relation to salient and important business issues which would typically have a high impact on the financial performance and other key aspects (including regulatory compliance) of the business. We strongly recommend that minutes provide a better reflection of the issues discussed during board meetings as well as action points arising therefrom, responsible parties for implementing such action points with agreed timescales for implementation.

## 3. Compliance

MFSA officials assessed the '*compliance*' aspect of the investment firms' business by conducting a review of the procedures manual and related documentation as well as by interviewing the Compliance Officer. The main deficiencies noted were as follows:

- In certain instances, the Compliance Officer was not fully involved in material business affairs of the investment firm and lacked the necessary access to the investment firms' systems. This scenario raises serious regulatory concerns, given that the Compliance Officer is not able to monitor and on a regular basis assess the adequacy and effectiveness of the measures and procedures in place as well as to address any deficiencies which the investment firm might have. Investment firms are expected to rectify such scenarios by involving the Compliance Officer in the Company's operations and by providing him/her with unhindered access to the IT systems. A Compliance Officer should not be left in the dark about key business issues and the strategic direction that a business is taking; more often than not, apart from ensuring regulatory compliance, their involvement is likely to add value to the business in the key decisions that it takes;



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- Certain Compliance Officers were not aware of the distinction between the suitability and the appropriateness test, as set-out in the 'Client Profile Requirements' section of the Investment Services Rules. We are very concerned about this lack of awareness, since it implies that the Compliance Officer will not be able to determine whether sales are MiFID compliant or not;
- We noted that certain Compliance Officers were not aware of the "*ESMA Guidelines on certain aspects of the MiFID compliance function requirement*". This guideline was brought to your attention by way of a circular dated 19<sup>th</sup> October 2012. These guidelines are a very important guide for the compliance function and we strongly recommend Compliance Officers to integrate these guidelines in their practices. Moreover these guidelines offer guidance on the implementation of formalised compliance risk assessments and monitoring programmes. Compliance Officers are urged to familiarise themselves with these guidelines;
- The procedures manual did not establish, implement and maintain adequate policies and processes designed to detect its risk of failure to comply with all relevant regulations. In a similar vein, the level of compliance risk as experienced by the investment firm was not specified in the manual;
- We came across situations wherein compliance reports were not being prepared and presented to the directors. Proper compliance reports should be periodically presented to senior management, at least annually. It is recommended that compliance reports are prepared in accordance with the ESMA Compliance Guidelines.

#### **4. Risk Management [including Remuneration Policy]**

MFSA officials assessed the '*risk management*' aspect of the investment firms' business by conducting a review of the risk management procedures, RMICAAP and Remuneration Policy. MFSA officials also conducted interviews with the risk manager or person(s) responsible for risk management. The main deficiencies noted were as follows:

- The risk management policies and procedures were of a general nature and did not reflect the actual and specific circumstances of the investment firm;
- In certain instances, the RMICAAP report was not endorsed by two directors, as required by SLC 7.72 of the Investment Services Rules. It is important to note that the RMICAAP report should be structured in accordance with Appendix 10 of the Investment Services Rules;
- We noted that certain Category 2 and 3 investment firms did not have a remuneration policy in place. Such firms are obliged to have a remuneration policy in place, in accordance with SLC 1.41 of the Investment Services Rules. Appendix 10 to the Investment Services Rules, (*'Additional technical criteria on the treatment of*



*remuneration risk*') provides further detail on the structure of the Remuneration Policy.

## 5. Conclusion

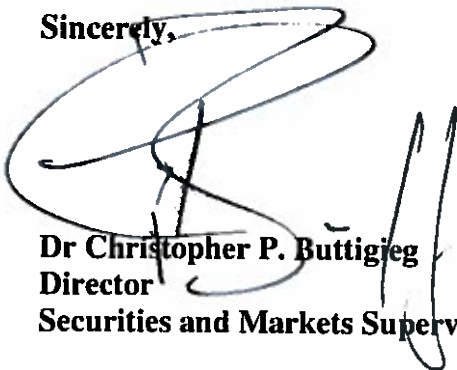
In the course of our regulatory visits, we were pleased to note that a number of licence holders promoted a strong compliance and risk culture with ongoing investment, notably in resources, training and technology. In these cases, our recommendations would have typically been non-material in nature where we would recommend best practice improvements rather than regulatory concerns.

On the other hand, we trust that the guiding principles outlined in this letter will help those licence holders, which have not yet been visited, to identify common pitfalls that we have seen in recent visits and to take the appropriate actions.

We remain committed to continue helping you in accomplishing your plans for adherence to compliance and regulatory standards.

Should you have any queries regarding the above, please do not hesitate to contact: undersigned or Mr Joseph Agius [[jagius@mfsa.com.mt](mailto:jagius@mfsa.com.mt)] or Ms Sara Antonia Borg [[saborg@mfsa.com.mt](mailto:saborg@mfsa.com.mt)].

Sincerely,



**Dr Christopher P. Buttigieg**  
Director  
Securities and Markets Supervision Unit