

16 December 2014

**To: Recognised Fund Administrators**

**Attn. Compliance Officer**

Dear Sir/Madam,

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

During 2013 and 2014, the Securities and Markets Supervision Unit conducted a thematic review on Governance and Compliance through focused visits at the offices of a number of recognised fund administrators varying in size and business model in order to obtain a representative picture of the sector as a whole, which is comprised of 27 recognised fund administrators regulated by the MFSA. The compliance visits that were conducted during the last two years amounted to 37% of the fund administration sector.

These reviews were designed to verify the extent to which the selected companies have proper governance and compliance procedures in place and the extent to which these are being complied with and applied in practice. This included a review of the key areas of operation including an assessment of the internal controls in place.

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**

There were two common deficiencies noted when reviewing the written procedures manual of the selected companies:

- The manuals were either merely a replication of the wording in Part B I of the Investment Services Rules for Recognised Persons ("the Rules") and did not seem to be tailored to reflect the specific circumstances of the relevant companies; or
- The manuals provided, in the main, for procedures on AML/CFT without addressing other key areas of operations, administration and finance.



In both cases, the manuals were not in accordance with SLC 3.4 of the Rules which requires that a recognised fund administrator has adequate operational, administrative and financial procedures in place to reflect its own business and the affairs of the schemes it administers.

In addition, some companies lacked written notification procedures to be followed in the case of valuation errors.

### 2. Outsourcing

Compliance with Section 4 of the Rules in relation to outsourcing was assessed by MFSA officials through the review of the service level agreements in place between the fund administrator and the third parties to which functions were delegated. The internal controls in place in order to assess the services being provided were also reviewed. The main deficiencies noted were as follows:

- MFSA officials noted that not all the fund administrators had a service level agreement in place for critical or important operational functions that are being outsourced to a third party. Recognised fund administrators should ensure that they enter into a written agreement with their service providers whereby the rights and obligations of the relevant operational arrangements are clearly documented for all parties in accordance with SLC 4.6 of the Rules. For the avoidance of doubt this requirement also applies if the service provider is a parent or other related group company;
- Some fund administrators were not clear what constitutes a critical or important operational function. Fund administrators should review their delegated functions to see whether these materially impair their ongoing compliance with conditions and obligations of their recognition or their financial performance, or the soundness or continuity of their business, in accordance with the '*Conditions for Outsourcing Critical or Important Operational Functions or Fund Administration Business*' under Section 4 of the Rules; and
- In most cases, ongoing monitoring of the outsourced functions was not clearly evident. Recognised fund administrators are required to establish methods for assessing the standard of performance of the service provider in accordance with SLC 4.5(a) of the Rules.

### 3. Business Continuity and Disaster Recovery

MFSA officials reviewed the business continuity policy ("BCP") and disaster recovery plan ("DRP") of the recognised fund administrators to assess the contingency procedures in place to address the event of an interruption or disaster. The main deficiencies noted were as follows:

- It is common that recognised fund administrators are part of a group structure, thereby, sharing similar *modus operandi* across the various companies in the group. Therefore, in most instances, local administrators are placing reliance on a

group BCP and DRP which does not adequately refer to the local scenario, in relation to operations, systems, premises and staff of the local office;

- In most cases, testing is carried out in relation to data storage, data back-up and the disaster recovery site, and is performed by the parent company of the group. It is essential that fund administrators also test the local operational aspects of their business, for example: ensuring that remote access is available to senior managers and key staff, calculation of NAV runs smoothly, telephone call trees work, identification of alternate staff members for important operational functions in case of absence of employees, staff drills in case of natural disasters, etc.;
- In certain instances, frequency of testing of the BCP and DRP could not be determined and results of tests carried out could not be evidenced. The BCP and DRP should be tested regularly and as a minimum on an annual basis. It is recommended that the BCP and DRP include the testing frequency, dates of past testing, any deficiencies reported during testing and the corrective action taken; and
- Most recognised fund administrators were unaware whether the key service providers to whom certain functions are delegated maintain a BCP and DRP and if these are regularly updated and tested, in accordance with SLC 4.5 (k) of the Rules.

#### **4. Protection of client and investor data**

MFSA officials assessed the protection of client and investor data by reviewing the service level agreements between the fund administrators and the third parties carrying out the outsourced functions. It was evident that not all service level agreements included confidentiality clauses in this regard. On further review, it was noted that the procedures in place did not adequately address this issue and the systems used allow group access to certain client and investor data. Most functions are outsourced to other jurisdictions and it is important that fund administrators assess the data protection and customer confidentiality implications for all applicable jurisdictions. Recognised fund administrators must also ensure that their systems and procedures safeguard the integrity and confidentiality of information, in accordance with SLC 2.2 (a) of the Rules.

#### **5. Compliance**

MFSA officials assessed the compliance aspect of the business of the recognised fund administrators 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:

- There were instances of poor evidence of compliance checks on regulatory requirements and internal processes and procedures. In certain cases, the Compliance Officer did not maintain any form of compliance monitoring programme and/or did not fulfil regulatory notification requirements such as updates to the MFSA on changes in compliance officer, MLRO and other key business changes; and



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- Breaches and pricing errors were not registered in separate logs. Furthermore, most logs did not include important details such as the date when the breaches and pricing errors were identified and the action taken for their resolution or rectification. The latter was also observed in the case of the complaints log.

### 6. Governance

MFSA officials assessed the governance aspect of the fund administrators' 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:

- The minutes of the meetings of the Board of Directors were reviewed and revealed that the directors did not meet frequently to formally discuss business matters. It is recommended that Board Meetings are held on a quarterly basis;
- The Board packs and minutes reviewed displayed a lack of compliance reporting to the Board and discussion of compliance-related matters. Furthermore, the approval of previous minutes, the action points to be taken and follow-up of their resolution was not always documented;
- Most directors did not declare conflicts of interest during Board Meetings. Moreover, most recognised fund administrators did not have a conflicts of interest policy or maintain a conflicts of interest register; and
- In certain instances, annual general meetings of the shareholders were not conducted. Consequently, neither were AGM minutes kept, nor were the audited financial statements approved by the shareholders of the company in these cases.

### 7. Operations and Internal Controls

MFSA officials reviewed the documents and processes used for internal control of all operations within the various companies. The main deficiencies noted were as follows:

- On review of the checks and reconciliations done in the calculation of the NAV of client funds, it was noted that in many cases the names and signatures of the preparers and checkers of the NAV calculation were not included;
- In certain instances, checklists were not maintained in order to ensure that all required steps were followed while performing NAV calculations;
- The compliance function should not report to an operational role since this may give rise to potential conflicts of interest; and
- Service level agreements were not always kept updated in order to reflect the current business situation.



### 8. Conclusion

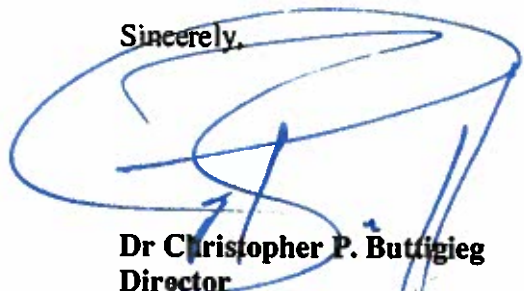
Notwithstanding the above findings, it is pleasing to note that most recognised fund administrators are aware of ongoing regulatory developments and are continuously investing in their systems and staff. In fact, most of our comments during these compliance visits were recommendations on best practice improvements rather than regulatory concerns.

We trust that the guiding principles outlined in this letter will help those recognised fund administrators, 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 J. Agius [[jagius@mfsa.com.mt](mailto:jagius@mfsa.com.mt)] or Ms Tamara Chetcuti [[tchetcuti@mfsa.com.mt](mailto:tchetcuti@mfsa.com.mt)].

Sincerely,



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