MFSA MALTA FINANCIAL SERVICES AUTHORITY

Media Release

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MFSA Highlights Shortcomings in Liquidity Risk Management and Investment Processes of Management Companies, while Noting Areas of Good Practice

A thematic review by the Malta Financial Services Authority (MFSA) has identified shortcomings in how management companies of Alternative Investment Funds (AIFs) and UCITS carry out their investment management function and manage liquidity risk. In response, the Authority has issued a "Dear CEO Letter" outlining its findings and setting clear expectations for stronger governance, improved oversight, and more robust integration of liquidity considerations into investment process.

Key shortcomings identified in the thematic review include:

- Inadequate record keeping
- Unrealistic assumptions in liquidity stress testing
- Weak suitability assessments for Investment Committee members
- Limited follow-up on findings raised by control functions
- Insufficient integration of environmental, social, and governance (ESG) risks into investment strategies.

At the same time, the MFSA observed a number of good practices across the sector. Notably, 87% of management companies confirmed that they conduct pre-trade liquidity checks on prospective investments, to ensure that the addition of new assets does not compromise a fund's ability to meet redemption requests. Many companies also demonstrated structured procedures and comparative analyses, such as redemption coverage ratios, to monitor the ongoing liquidity profile of funds. These practices reflect the industry's commitment to embedding forward-looking liquidity assessments in daily investment decisions.

The MFSA is cognisant of the critical role management companies play to safeguarding investor interests. Management companies are expected to regularly monitor liquidity of all funds managed and take appropriate actions to address liquidity mismatches between the assets and liabilities side of the funds under management. This can only be achieved through robust governance arrangements and regular oversight by the management body, taking into consideration the dynamics of the fund and the exposures arising out of the portfolio.

Commenting on the review, the MFSA's Head of Investment Services Supervision, Ian Meli said: "*The investment process is key to ensuring that the investment strategy implemented is aligned with the interests of investors. It is the primary tool for managing risks, whilst managing a framework to monitor risks*."

Looking ahead, the Authority recognises the progress made in certain areas, such as pre-trade controls and structured risk management practices, and encourages management companies to build on these foundations. The MFSA will continue to monitor developments through ongoing supervision and provide support through guidance, supervisory meetings, and further reviews.

About MFSA

The Malta Financial Services Authority (MFSA) is the single regulator of financial services in Malta, covering banks, insurance companies, investment services, trusts and pensions. In 2018, the MFSA became the first European regulator to develop a framework to regulate virtual financial assets. The MFSA's mission, as enshrined in its Strategic Statement, is to enhance its position as an independent, proactive and trustworthy supervisory authority with the main purpose of safeguarding the integrity of markets and maintaining stability within the financial sector, for the benefit and protection of consumers. The MFSA licenses over 2,000 entities to operate in the financial services sector.