



**FINANCIAL SUPERVISORY AUTHORITY**

**BOARD**

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**REGULATION**

**ON RISK MANAGEMENT OF THE MANAGEMENT COMPANY OF COLLECTIVE  
INVESTMENT UNDERTAKINGS**

*Approved by Board Decision No.110, dated 19.07.2016*

**Article 1**

**Scope**

This regulation determines rules on management and functioning of risk management system established by the management company of collective investment undertakings.

**Article 2**

**Legal basis**

This regulation is drafted pursuant to Article 19 (6) of Law No. 10198, dated 10.12.2009 “On collective investment undertakings”, as amended.

**Article 3**

**Scope of Application**

This regulation applies to all collective investment undertakings management companies licenced referred to Article 10, of Law No. 10198, dated 10.12.2009 “On collective investment undertakings”, as amended.

## **Article 4**

### **Definitions**

For the purposes of this regulation the following terms shall have this meaning:

1. “FSA” means the Financial Supervisory Authority referred to Law No. 9572 of 3 July 2006 “On the Financial Supervisory Authority”, as amended;
2. “new financial instrument” means a recognised financial instrument related to a credit risk or market risk, which is an eligible investment asset pursuant to Article 87 of this Law, which the management company has not yet rated it amongst CIU’s assets, but intends to rate and use it as part of CIU’s investments;
3. “Law” means the Law No.10198 of 10 December 2009 “On collective investment undertakings” as amended;
4. “back testing” based on historical data, is the process of testing the performance of a strategy model on previous time periods;
5. “Portfolio manager” means a staff member of the management company who as part of the investment management unit manages the investments of a CIU.
6. “Stress testing” means a simulation technique used on asset and liability portfolios to determine the influence thereof, related to different financial situations. Tests are simulation models which test the reaction based on hypothetical scenarios.
7. “equity risk” is the risk an investor faces that it may lose value on its capital caused by cost variation of the capital’s instruments and their effect on the value of a CIU’s asset;
8. “credit risk”, means the risk of loss due to the inability of the financial derivative’s entity, as part of the CIU’s asset, to meet partially or fully the liabilities in accordance with the accepted conditions;
9. “currency risk”, means the risk of loss due to the exchange rate movements and their effect on the value of the assets in a CIU, which are denominated in the respective currency; in case CIU’s assets are invested in a different currency from the currency used to calculate the return on investment.
10. “counterparty risk or related party risk” means the risk to each party of a contract that arises from the failure to meet contractual obligations from the counterparty or the contracting party of the management company;
11. “liquidity risk” is the risk that asset position in the fund’s portfolio cannot be sold, liquidated or closed at low cost within a sufficient short time span, compromising the ability of the fund to fulfil redemption liabilities set out in its prospectus;
12. “concentration risk”, means the risk of loss from CIU’s assets concentrated with an issuer, a group of issuers in the form of contracting parties, entities in a particular geographic area, or issuers as part of a particular sector of the economy;
13. “redemption risk”, meaning the risk of loss due to a transaction of CIU’s asset, which cannot be redeemed in accordance with the agreed conditions;

14. “event risk”, means the risk of loss due to unexpected circumstances that will cause the immediate or sudden fall of the market value of a financial derivative, compared to general market behaviour, in a way which goes well beyond the normal range of fluctuations in market value;
15. “interest rate risk”, meaning the risk of loss arising from interest rate movements and their effect on the asset value of CIU;
16. “market risk”, is a risk to a CIU resulting from fluctuation in the market value of positions in the fund’s portfolio, attributable to changes in market variables, such as interest rates, foreign exchange rates, shares and commodity prices or an issuer’s credit rating;
17. “country risk” means the risk of loss arising from a national competent authority or central bank not being able or willing to fulfil responsibilities towards non-resident entities, and from other debtors resident in that country not being able, due to their residency, to meet liabilities towards non-resident entities;
18. “operational risk” means the risk of loss resulting from inadequate internal processes and failures in relation to people and systems of the management company or from external events, which includes legal and documentation risk and all risks resulting from the trading, redemption and assessment procedures implemented by the CIU.
19. “CIU” means collective investment undertaking pursuant to Law No. 10198, dated 10.12.2009 “On collective investment undertakings”, as amended.
20. “risk mitigation” means a procedure used by the fund's management company in the management of CIU’s assets to reduce risk, in compliance with the fund's risk profile.

## **Article 5**

### **Risk management system**

The management company creates and applies a system related to the risk management, including all processes related to the risk management specified in Article 4 of this Regulation, and other risks that the management company encounters during the exercise of its activity. The risk management system consists mainly of:

- a) Strategy development and written policies, suitable approved by the Administration Council, related to the risk management specified in Article 6 of this Regulation;
- b) Organization and risk management responsibilities should be proportional to the nature, level and complexity of the management company’s activities and managing CIU, underway the strategies and approved policies of risk management;
- c) Information provision on risk management and requirements for presentation, content and frequency of reports specified in Article 8 of this Regulation;

- c) Setting up of recovery and continuity plans suitable for the crisis management, during the company's activity and of every CIU under management;
- d) Setting up a suitable system for the execution of transactions;;
- dh) Setting up a system for the application of new financial instruments, as part of a CIU investments' management, specified in Article 10 of this Regulation;
- e) Identification, measurement, monitoring and mitigation of the risks of a CIU portfolio, including, in particular:
  - i) Specified methods for the identification of risks;
  - ii) Specified methods for the measurement of risks compliant to the nature, scale and complexity of the management company's activities and those of the CIU it manages; a selected risk measurement method may not be changed without a reason;
  - iii) Specified methods for the setting of limits and monitoring of risks;
  - iv) Specified procedures for risk mitigation.
- ë) Establishing suitable procedures for the regular review of the risk management system, in order to carry out necessary adjustments and improvements on time;
- f) Adapting the risk management system to the mechanisms of internal audit, specified in Article 11 of this Regulation.

## **Article 6**

### **Risk management strategy and policy**

1. The management company through its policy and strategy establishes the objectives and fundamental principles, used in the management of risks facing investors in a CIU including minimally:
  - a) Definition and accurate formulation of risks as part of the risk management system
  - b) Objectives related to exposure towards risks set by the management company of every CIU, according to their risk profiles, which should include:
    - i. The acceptable degree of risk;
    - ii. Expected consequences resulting from exposure to the acceptable degree of risk

- c) Principles and methods for periodic identification of risks;
  - ç) Procedures and instruments that enable the appropriate measurement of risks;
  - d) Roles' assignment and responsibilities among responsible entities for the risk management system of the management company;
  - dh) Terms of interaction between the risk management unit and the management investment unit, to keep under control the risk profile of CIU and consistent with its investment strategy;
  - e) Terms, content and frequency of reports on the performance of the risk management unit submitted to the Administrators and Administration Council.
  - ë) Types of limits the management company applies and the principles for the selection and determination of other limits;
  - f) Principles for the classification and use of new financial instruments, as specified in Article 10 of this Regulation.
2. The management company reviews and approves the strategy and policy for the administration of the risk in the form of a separate internal regulation, or as part of other internal regulations, which clearly identify risk management tasks, responsibilities and operating procedures.
  3. The management company reviews at least once a year and submits to the AFSA the strategy and policy for risk management, within January of each year and when changes have been ascertained.

## **Article 7**

### **Risk management organization and responsibilities**

1. The management company throughout its organization and separation of responsibilities includes:
  - a) Setting up of specific unit for the risk management in the management company structure, which informs regularly the administrators of the management company, at least once a month. This unit presents a report to the Administrative Council on the duties' implementation of the risk management unit, at least once every three months;
  - b) Separation of activities and responsibilities of the management company's risk management unit and its staff members at organisational and personnel level,

appropriate to the nature, scale and complexity of the activities of the management company and the CIUs it manages, in order to prevent conflicts of interest.

- c) Ensuring the adequate resources necessary for the implementation of the approved risk management strategy and policy, in particular the financial resources and the personnel in charge for the execution of the risk management function, with the skills, knowledge and expertise needed to fulfil the duties placed upon them, as defined by the Law and ensuring each time their substitution;
  - ç) Motivational policies for the responsible staff on the execution of the risk management functions;
  - d) Generate appropriate information by the risk management unit to other organizational units of the management company, as specified in Article 8 of this Regulation;
  - dh) Establishment of regular communication channels between the risk management unit and portfolio managers, in order to assure the effective functioning of the risk management system. Portfolio managers are responsible for taking investment decisions, compatible with the risk' limits. The risk management unit is responsible for the risk measurement and the monitoring of their limits;
  - e) Ensuring that the strategy and the risk management policies are acquainted and implemented by all levels and structures of the management company;
2. The management company ensures the clear separation and the implementation in all management levels of the functions of investment management and risk management.

## **Article 8**

### **Risk management information provision and reporting requirements**

1. Risk management unit provides complete information monthly to the Administrators and Administrative Council, related to the risks' analysis, towards which CIU is exposed. The currency in which assets are held and granularity of the other information provided, shall enable efficient management of risks, that significantly affect the performance and results of a CIU. The provided information shall include:
  - a) Evaluation of levels and trends in risk development;
  - b) Comparison of risks with their results defined by the company;
  - c) Verification whether the risk level is in line with the internal limits, where applicable;
  - ç) Evaluation of the validity, appropriateness and fulfilment of assumptions used in risk measurement, where applicable;
  - d) Assessment of the "stress testing" and "back testing" results.
2. Staff members responsible for the performance of the risk management shall have access to current and reliable information for risk management.

3. The management company provides the setting up of regular channels of communication between the responsible staff for the execution of the risk management functions and other units of the management company, especially among the responsible staff for the execution of the investment management function and Administrators.
4. Administrative Council after evaluating risk level information, informs the responsible staff members for the execution of the risk management function, , and other units of the management company.
5. The management company reports periodically to the Authority, every time it identifies the breach of the risk level limits specified in paragraph 1(c) of this Article. The Authority may request to the management company to review the internal limits, set out by the management company, when deemed necessary.

## **Article 9**

### **Mitigation of principal risks**

The management company shall mitigate principal risks, specifically, credit risk, market risk;

- Operational risk;
- Liquidity risk.

2. The management company shall mitigate the credit risk of a CIU by undertaking the following actions:
  - a) Adopting internal limits on the credit risk exposure of CIUs in accordance with the risk profiles adopted for the funds and checking compliance with these internal limits;
  - b) Adopting separate internal limits for counterparties on over-the-counter (OTC) transactions of financial derivatives and adopting conditions where collateral is received or provided to the credit or debit of a CIU portfolio and checking compliance with the established separate internal limits;
  - c) Evaluating the economic situation of the securities' issuers held by CIUs and of other counterparties to OTC financial derivatives;
  - ç) Adopting methods and procedures for credit risk management;
  - d) Identifying, measuring, monitoring and mitigating the credit risk;
  - dh) Processing and providing information on credit risk for the purposes of credit risk management and the decision-making processes of the management company.

3. The management company shall mitigate the market risk by undertaking the following actions:

- a) Adopting internal limits on the market risk exposure of CIUs, in accordance with the risk profiles adopted; and checking compliance with these internal limits;
- b) Adopting methods and procedures for market risk management;
- c) Adopting methods, procedures and models for assessing the value of positions giving rise to market risk;
- ç) Assessing the valuation of positions giving rise to market risk;
- d) Identifying, measuring, monitoring and mitigating market risk;
- dh) Processing and providing information on market risk for the purposes of market risk management and decision-making processes of the management company.

4. The management company shall mitigate the operational risk by undertaking the following actions:

- a) Adopting methods and procedures for operational risk management;
- b) Identifying, estimating and monitoring the operational risk;
- c) Classifying events of operational risk;
- ç) Taking measures to minimise operational risk, processing and providing information on operational risk for management and decision-making purposes.

5. The management company shall mitigate the liquidity risk by implementing the requirements stipulated in the Regulation No. 45 of 30 June 2015 “On the liquidity management for the investments fund”.

6. Besides the above mentioned principal risks, the management company undertakes the necessary actions for the mitigation of all the other risks, under the provisions of this Regulation.



## **Article 10**

### **New financial instruments**

The management company for risk management purposes comprises in the procedures for adoption, classification and use of new financial instruments, as part of the investments management of a CIU, the following:

- a) A description of the new financial instrument and of the activities related to it;
- b) Identification of the risk' factors associated with the financial instrument;
- c) An analysis of impacts of the proposed financial instrument on the CIU portfolio;
- ç) Implementation of procedures to be used for the measurement, monitoring and audit of risks associated with the proposed financial instrument;
- d) An evaluation of preparedness of particular units of the management company for implementing the new financial instrument.

## **Article 11**

### **Internal control system**

1. The management company adapts internal control system in accordance with the requirements of the risk management system by:

- a) Establishing an appropriate audit environment for the performance of the management company's activities, in particular:
  - ii. Control activities and mechanisms performed by the Administrative Council and Administrators;
  - iii. Control activities and mechanisms performed by the management company' staff members in accordance with their duties and responsibilities.

b) Verifying regularly the functionality of the risk management system by the internal audit of the management company, and evaluating the efficiency of the internal control system.

2. The internal control system of the management company to the findings of any deficiencies in the area of risk management shall:

- a) Inform the competent units and the managerial staff members about the findings associated with the risk management system of the management company;
  - b) Include in the report recommendations regarding the remedial measures for the findings;
  - c) Propose necessary adjustments of the risk management system in a timely way.
3. The management company submits to AFSA the annual report of the internal control on the risk management system, every January of each year.

## **Article 12**

### **Transitory provisions**

The management companies of CIU licensed before the entry into force of this Regulation shall take the necessary measures, in order to adapt their activity and their internal rules, in compliance with the requirements of this Regulation, as well as to submit to AFSA supporting documentation six (6) months after the entry into force of this Regulation.

## **Article 13**

### **Entry into Force**

This regulation shall enter into force immediately.