

# MFSA

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## MALTA FINANCIAL SERVICES AUTHORITY

### **Publication of new Rules which transpose the Fourth Capital Requirements Directive (CRD IV) and implement the Capital Requirements Regulation (CRR)**

**4<sup>th</sup> February 2014**

#### **1. Introduction**

Reference is made to the MFSA circulars issued on the 28<sup>th</sup> October 2013 and 4<sup>th</sup> November 2013 relating to the proposed transposition of the [CRD IV](#) and the implementation of the Automated COREP Return for Investment Services Licence Holders (hereinafter referred to as “Licence Holders”) subject to the requirements of the [CRR](#).

In conjunction with this circular, the MFSA is today publishing the revised version of Part B I of the Investment Services Rules for Investment Services Providers, together with a set of appendices (hereinafter referred to as “the Rules”). The purpose of this circular is to provide the investment services industry with: [a] a brief outline of the amendments to the Rules, which were effected as a consequence of the requirements introduced by CRD IV; and [b] a notification of the rules which have now been repealed with the entry into force of the CRR.

The following sections provide a detailed explanation of the amendments to the Rules, which transpose the provisions of CRD IV specifically: Articles 3 (in part), 28, 29, 31, 63, 73, 74(1) & (2), 76, 77(1), 78(1), 78 (2), 79 to 96 inclusive, 121, and 123(2).

Licence Holders should note that these changes will not have a significant impact on Category 1 Licence Holders (because they are not authorised to hold or control clients’ monies or clients’ assets and are therefore outside the general remit of CRD IV). However Category 1 Licence Holders are required to calculate their financial resources requirement in accordance with CRD IV as explained in the sections below.

#### **2. Changes to Part BI of the Rules**

##### **Section 1 to Part B I of the Rules has been amended primarily to:**

- [i] Confirm the less onerous Risk Management Policies for Category 1 Licence Holders. In this regard SLCs 1.23 and 1.24 will only apply to Category 1 Licence Holders and will no longer have application to Category 2 and Category 3 Licence Holders.
- [ii] Introduce a new Section 1A which comprises supplementary requirements for Category 2 and Category 3 Licence Holders arising from the CRD, *which are in addition* to the SLCs in Section 1.

(a) The new SLCs 1.30 to 1.38 set out the requirements regarding the composition of the Management Body and the enhanced role of the Management Body in matters pertaining to governance and risk. The term ‘management body’ is the new terminology for the “Board of Directors” and has been incorporated in the Glossary, to align with the terminology with recent EU Directives. The new SLCs require that:

- The Licence Holder is to devote adequate human and financial resources for the training of members of the Management Body.
- The Licence Holder ensures that the Management Body comprises of people of good repute with sufficient skills, expertise and experience collectively, to perform their duties and to understand the activities in particular the main risks of the Licence Holder.
- The composition of the Management Body reflects a broad set of skills and promote a policy of diversity.
- All members of the Management Body devote sufficient time to perform their functions and that the number of directorships which may be held by a member at the same time take into account the individual circumstances and the nature, scale and complexity of the Licence Holders’ activities.
- The Chairperson of the Management Body does not simultaneously act as the Chief Executive Officer.
- All members of the Management Body act with integrity and independence in relation to decision making and if necessary challenge the decisions of Senior Management.
- The Management Body has overall responsibility to uphold the strategic objectives of the Licence Holder and to oversee *inter alia* the risk strategy, internal governance, accounting, reporting disclosure and communications functions.
- Licence Holders who are deemed to be significant in terms of internal organisation, and the nature, scope and complexity of their activities apply prescriptive limitations on the number of directorships their Board Members may hold at one time and establish Nomination Committees for the filling of vacancies on the Management Body. Nomination Committees will be composed of members of the Management Body who do not perform any executive function in the Licence Holder concerned.

**(b) Recovery and Resolution plans (SLCs 1.39 to 1.40)**

Licence Holders are expected to develop and maintain recovery plans for the restoration of their financial situation following a significant deterioration, and to work closely with the resolution authority in the implementation of resolution plans.

**(c) Risk Management and Remuneration Policies (SLCs 1.41 to 1.53)**

These SLCs set out the more detailed requirements regarding risk management and remuneration policies now applicable. Some new elements include:

- The requirement of the Risk Management Function to develop the Licence Holders' risk strategy and to participate in all material risk management decisions, including communicating with the Management Body independently of Senior Management where appropriate.
- The Licence Holder is to appoint a head of Risk Management who will be an independent Senior Manager with distinct responsibility for the Risk Management Function, and who cannot be removed without the prior approval of the Management Body. Licence Holders may apply to the Authority for a derogation from the requirement to appoint a dedicated independent Risk Manager on the grounds that this would be disproportionate to the nature, scale and complexity of its business.
- Licence Holders who are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities are required to establish a Risk Committee.
- Licence Holders which are not considered significant may be allowed to combine the Risk Committee with the Audit Committee.
- The requirements for the increased involvement of Management Body in the Risk Management of the Licence Holder are set out in these SLCs. The Management Body will have ultimate responsibility for risk management strategies and will need to devote sufficient time to consideration of risk issues.

**(d) Procedures for Reporting of Breaches (SLC 1.54)**

This SLC sets out the new requirement for Licence Holders to develop and maintain appropriate procedures for employees to report breaches committed internally.

- [iii] Emphasize the requirement for Licence Holders to obtain the written prior consent of the Authority for the appointment of a Compliance Officer, Money Laundering Reporting Officer and Risk Manager where applicable, based on its review of the PQ and the Competency Forms submitted, which forms are now required for these activities. (See SLC 1.07 (g))
- [iv] Amend existing Financial Resources Requirements, Accounting and Record Keeping (Section 7).

The existing Section 7 is being retained with applicability to Category 1 Licence Holders only (subject to some deletions identified below).

- Existing SLC 7.05 (i) which states that Licence Holders (except for category 1) are required to maintain such insurance policies of such classes and types to provide (unless otherwise agreed with the MFSA) at least the minimum level of protection set out in Section 2 of appendix 6 to these Rules), is being deleted as this does not apply to Category 1 Licence Holders.
  - Existing SLCs 7.11 to 7.14 relating to Customers Accounting Records are being deleted as these are not applicable to Category 1 Licence Holders.
  - SLC 7.23 (e) sets out a new obligation on the Auditor of the Licence Holder to immediately report the matters specified therein to the Management Body in addition to the Authority.
  - Existing SLCs 7.36 to 7.38 inclusive, dealing with Supplementary Conditions for a Licence Holder subject to the Investor Compensation Scheme have been moved to the new Section 7A as they are not applicable to Category 1 Licence Holders.
  - Existing SLCs 7.39 to 7.44 inclusive, dealing with the conditions applicable to a Licence Holder which forms part of an Investment Services Consolidation Group have been moved to Section 7A (and further extended to comply with CRD/ CRR) as they are not applicable to Category 1 Licence Holders.
  - Existing SLCs 7.45 to 7.48 inclusive, have been removed as the RMICAAP is not applicable to Category 1 Licence Holders.
  - The existing SLCs 7.49 to 7.51 inclusive, have been removed as these disclosure requirements are not applicable to Category 1 Licence Holders.
- [v] Introduce the new Capital Resources, Accounting and Record Keeping for Category 2 and Category 3 Licence Holders which are subject to the CRD and the CRR.

## **Section 7A**

This is a new section which amalgamates the relevant requirements from the existing Section 7 and the new requirements under CRD/CRR for Category 2 and Category 3 Licence Holders. The SLCs on insurance, accounting/ record keeping, customers accounting records and the Investors Compensation Scheme, remain unchanged.

### **The following is an outline of the changes:**

The term *Financial* Resources Requirement has been replaced by the term *Capital* Resources Requirement in this section to reflect the new capital adequacy ratios applicable to MiFID investment firms subject to CRR. The Capital Resources Requirement applicable is set out in Appendix 1B (which has been substantially amended as explained below) and in Appendix 3 (for Licence Holders which form part of a Consolidated Group).

### **Reporting Requirements (SLCs 7.42 – 7.51)**

The SLCs on reporting requirements have been altered to refer to the automated Annual COREP Return, and the time frames for reporting have been brought in line with the Draft Implementing Technical Standards with regard to supervisory reporting according to the CRR.

- The automated Annual COREP Return (ACR) is to be submitted within 42 days of the Accounting Reference Date.
- The automated Annual Audited COREP Return (AACR) needs to be submitted to the Authority without undue delay and by not later than four months of the Accounting Reference Date.
- The audited annual financial statements together with the auditors' management letter and report will also need to be submitted to the Authority without undue delay and by not later than four months of the Accounting Reference Date.
- SLC 7.49(g) now stipulates the submission of the updated ACR without undue delay and by not later than four months of the Accounting Reference Date, where it has been submitted before the relevant audited annual financial statements have been produced.
- The automated Interim COREP Return (ICR) has to be submitted to the Authority within 42 days of the date from which it has been prepared.
- Existing SLCs 7.22 and 7.24 have been deleted as these exceed the requirements of the CRR.

### **Audit Requirements (SLCs 7.52 – 7.60)**

- SLC 7.55 (e) places a new obligation on the Auditor of the Licence Holder to simultaneously report the matters specified therein to the Authority and the *Management Body*.
- SLC 7.57 (b) & (c) replace the existing SLC 7.32 (b) & (c) and refer to the requirement to prepare the ACR and to calculate the Capital Resources Requirement in accordance with the CRR, and the Implementing Technical Standards issued from time to time by the European Commission and to satisfy the Licence Holders' Capital Resources Requirement.

### **Requirements for Licence Holders forming part of a Consolidated Group: (SLCs 7.64-7.69)**

- The term “Investment Services Consolidation Group” has been replaced by the term “Consolidated Group” as defined in the Glossary.
- SLC 7.65 now refers to the auditors' *confirmation* which ought to provide *inter alia* whether the Consolidated Group *satisfies* the Capital Resources Requirement.
- SLC 7.66 now refers to the requirement of the Licence Holder to maintain consolidated own funds *at least equal to* the Capital Resources Requirement on a consolidated basis.
- SLC 7.67 and SLC 7.68 refer to the Annual Consolidated COREP Return and the Interim Consolidated COREP Return which are to be submitted within 42 days of the Accounting Reference Date.
- SLC 7.69 obliges Licence Holders who are members of a group to comply with the SLCs transposing Articles 74 to 96 of CRD where applicable, on a consolidated or sub-consolidated basis and to ensure that parent undertakings and subsidiaries implement these arrangements, processes and mechanisms in their subsidiaries which are not subject to CRD. There is an exemption for third country subsidiaries if the Licence Holder can demonstrate to the Authority that the application of this provision is contrary to the laws of the third country where the subsidiary is established.

### **Risk Management and the Internal Capital Adequacy Assessment Process (SLCs 7.70 – 7.77)**

The existing RMICAAP regime has been retained but Licence Holders should note that the provisions of Appendix 10 are now prescriptive for Category 2 and Category 3 Licence Holders and are no longer in the form of Guidelines.

SLCs 7.74 to 7.77 inclusive outline the circumstances when the requirement to prepare an RMICAAP are to apply on an individual basis, consolidated basis or sub consolidated basis.

### **Regulatory Disclosure by Licence Holders (SLCs 7.78 -7.83)**

This section has been edited to align it with the requirements of the CRD / CRR.

- The information which the Licence Holder must publicly disclose in accordance with CRD/CRR is stipulated in the updated Appendix 4 (see below) and the further information required by Part Eight of the CRR will need to be disclosed annually.
- SLC 7.80 indicates that Licence Holders will have to disclose in their Annual Report among the key indicators, its return on assets, calculated as its net profit divided by its total balance sheet.
- SLC 7.83 provides that where the Licence Holder maintains a website it has to disclose thereon the manner in which it complies with the corporate governance, reporting and remuneration requirements set out in these SLCs.

### **3. Minor Change to Part B IV**

SLC 1.02 (f) has been amended to include the correct reference to CRD IV and the CRR.

### **4. Amendment of the Appendices of the Rules**

Changes to Appendix 1, Appendix 2, Appendix 3, Appendix 4, Appendix 5, Appendix 6, and Appendix 10 have been made to align these with the requirements of the CRD and the CRR.

#### **4.1 Restructure of Appendix 1**

Appendix 1 has been divided into two parts: [i] Appendix 1A which provides guidance on the financial resources requirement and the compilation of the Financial Return for Category 2 Licence Holders which qualify as Fund Managers and Category 1 and Category 4 Investment Services Licence Holders; and [ii] Appendix 1B which details the capital resources requirement and provides guidance on the compilation of the Automated COREP Return for Category 2 and Category 3 Licence Holders which qualify as MiFID Firms.

##### **4.1.1 A new Appendix 1A – Category 1, Category 2 (Fund Managers only) and Category 4 Licence Holders**

- The capital resources requirement of Category 1 and Category 4 Licence Holders has been amended as follows:

The Capital Resources Requirement shall be the higher of (a) and (b) below:

- a. Initial Capital; and

b. Fixed Overheads Requirement.

- Both the definition of initial capital, own funds and the calculation of the fixed overheads requirement in the Rules have been aligned to the EU definition. This also applies to Fund Managers.
- The transitional provisions allowed by the CRR in relation to the calculation of own funds are provided in this Appendix.
- As a result of the new definition of own funds: **[i]** Tier 1 capital consists of the sum of Common Equity Tier 1 capital and Additional Tier 1 capital; **[ii]** Tier 2 items will be amortised during the final five years of maturity of the instruments; and **[iii]** Tier 3 capital has been eliminated.
- The ‘initial capital’ will comprise only of Common Equity Tier 1 items and will include accumulated other comprehensive income as defined in point (100) of article 4 (1) of the CRR.
- The calculation of the fixed overheads requirement will be based on the new concept of ‘eligible capital’ which means the sum of the following:
  - a. Tier 1 capital;
  - b. Tier 2 capital that is equal to or less than one third of Tier 1 capital.

In addition, the EU sought to harmonise the calculation and the definition of fixed overheads through regulatory technical standards. These will be adopted by the European Commission by means of a regulation or decision, which will be binding in its entirety, and directly applicable in all Member States. The [Final draft RTS on fixed overheads](#) has been published by the European Banking Authority on the 29<sup>th</sup> January 2014.

#### **4.1.2 A new Appendix 1B- Category 2 (excluding Fund Managers) and Category 3 Licence Holders**

- Category 2 and Category 3 Licence Holders which qualify as ‘investment firms’ in terms of article 4 (1) (2) the CRR are therefore subject to the prudential rules provided for in this EU Regulation. In this regard, the calculation of own funds, the risk components and the fixed overhead requirement have been amended to be in line with the CRR, as explained in the previous section.
- For the purposes of complying with the CRR, Licence Holders should note the following amendments to the calculation of the minimum capital requirement:



[i] Licence Holders are required at all times to maintain own funds at least equal to their capital resources requirement. The own funds of the Licence Holder may not fall below the amount of initial capital required at the time of its authorisation.

[ii] Both Category 2 and Category 3 Licence Holders must at all times satisfy the following Capital Resources Requirement:

- a. A Common Equity Tier 1 capital ratio of 4.5%, which relates to the Common Equity Tier 1 capital expressed as a percentage of the total risk exposure amount;
- b. A Tier 1 capital ratio of 6%, which relates to the Tier 1 capital expressed as a percentage of the total risk exposure amount;
- c. A total capital ratio of 8%, which relates to the own funds expressed as a percentage of the total risk exposure amount.

[iii] Perpetual non-cumulative preference shares which used to form part of Tier 1 capital in terms of the existing rules will be subject to grandfathering provisions, i.e.

Perpetual non-cumulative preference shares issued on or prior to 31 December 2011 and the related share premium account which qualified as Tier one capital under the national transposition measures for point (a) of article 57 of Directive 2006/48/EC, will qualify as Common Equity Tier 1 items, subject to the following limits (determined in accordance with article 486 (5) of the CRR):

- a. 80% during the period from 1 January 2014 to 31 December 2014;
- b. 70% during the period from 1 January 2015 to 31 December 2015;
- c. 60% during the period from 1 January 2016 to 31 December 2016;
- d. 50% during the period from 1 January 2017 to 31 December 2017;
- e. 40% during the period from 1 January 2018 to 31 December 2018;
- f. 30% during the period from 1 January 2019 to 31 December 2019;
- g. 20% during the period from 1 January 2020 to 31 December 2020;
- h. 10% during the period from 1 January 2021 to 31 December 2021.

The proportion of perpetual non-cumulative preference shares and the related share premium account, which exceeds the above percentages, will be considered as Tier 2 capital during the period 1 January 2014 to 31 December 2021.

[iv] As from 1 January 2014, Licence Holders are required to deduct deferred tax assets that rely on future profitability from Common Equity Tier 1 items.

For a transitional period from 1 January 2014 to 31 December 2017, Licence Holders will not be required to deduct deferred tax assets that are dependent on future

profitability and arise from temporary differences that in aggregate are equal to or less than 10% of relevant Common Equity Tier 1 items, which in aggregate are equal to or less than 15% of relevant Common Equity Tier 1 items.

For the purposes of the above paragraph, relevant Common Equity Tier 1 items comprise the Common Equity Tier 1 items of the Licence Holder calculated after applying the provisions of articles 32 to 35 and making the deductions pursuant to points (a) to (h), k (ii) to (v) and (l) of article 36 (1) of the CRR, excluding deferred tax assets that rely on future profitability and arise from temporary differences.

[v] Transitional provisions similar to those related to deferred tax assets are also provided in the CRR with respect to the deduction of direct, indirect, and synthetic holdings by the Licence Holder of Common Equity Tier 1 instruments of financial sector entities where the Licence Holder has a significant investment in those entities.

[vi] In terms of article 35 of the CRR, Licence Holders must not make adjustments to remove from their own funds unrealised gains or losses on their assets or liabilities measured at fair value. Unrealised gains are subject to the following transitional arrangements:

By way of derogation from article 35 of the CRR, during the period from 1 January 2014 to 31 December 2017, Licence Holders are required to remove from their Common Equity Tier 1 items the following applicable percentages of unrealised gains related to assets or liabilities measured at fair value, and reported on the balance sheet, excluding those referred to in article 33 and all other unrealised gains with the exception of those related to investment properties reported as part of the profit and loss account, in terms of article 468 (2) of the CRR:

- a. 100% for the period from 1 January 2014 to 31 December 2014;
- b. 60% for the period from 1 January 2015 to 31 December 2015;
- c. 40% for the period from 1 January 2016 to 31 December 2016;
- d. 20% for the period from 1 January 2017 to 31 December 2017.

The resulting residual amount is not to be removed from Common Equity Tier 1 items.

[vii] Licence Holders that provide investment services in relation to OTC derivatives (except for credit derivatives recognised to reduce risk-weighted exposure amounts for credit risk) are required to calculate the new credit valuation adjustment (CVA) risk. Certain transactions are exempt from the calculation of the CVA risk component. Licence Holders are requested to refer to article 382 of the CRR to determine which transactions are excluded from the scope of this calculation.

[viii] The large exposure limits, similar to the calculation of the fixed overheads requirement is based on the new concept of 'eligible capital' which means the sum of the following:

- a. Tier 1 capital;

b. Tier 2 capital that is equal to or less than one third of Tier 1 capital.

[ix] Exemption from the calculation of the liquidity risk component

In terms of the CRR, Category 3 Licence Holders are subject to particular obligations relating to liquidity risk.

For the purpose of article 6 (4) of the CRR, a Category 3 Licence Holder, which is not significant in terms of the nature, scale and complexity of its investment services activities, is exempt from compliance with the obligations in Part Six of the CRR (Liquidity) on an individual basis.

#### 4.1.3 The Annexes to Appendix 1

- The rules provided in **Annex I A – Credit Risk Mitigation** are superseded with the rules set out in Part Three, Title II, Chapter 4 of the CRR and **are now repealed**.
- The treatment of counterparty credit risk of derivative instruments, repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions set out in **Annex I B** is superseded with Part Three, Title II, Chapter 6 of the CRR and **is now repealed**.
- Bank or third party guarantees which formed part of Lower Tier 2 Capital in terms of the existing rules and which had to be in the form set out in **Annex II – Specimen Qualifying Undertaking & Annex III – Specimen Bank Guarantee**, will **no longer be considered as part of own funds under the revised rules**.

Guarantees may be used as eligible unfunded credit protection, which is a technique of credit risk mitigation where the reduction of the credit risk on the exposure of an institution derives from the obligation of a third party to pay an amount in the event of the default of the borrower or the occurrence of other specified events.

Licence Holders are requested to contact the MFSA for guidance if they wish to use credit risk mitigation techniques in accordance with Part Three, Title II, Chapter 4 of the CRR for reducing their exposure to the credit risk component.

The specimen guarantees set out in Annex II and Annex III to Appendix 1 have been removed from the Rules as they no longer comply with Part Three, Title II, Chapter 4 of the CRR.

- The Authority is currently working on a revised specimen subordinated loan agreement (currently **Annex IV**) to ensure it is compliant with the characteristics of articles 63 and 64 of the CRR. The revised specimen will be published by the Authority in due course.

- The provisions in **Annex V – Securitisation** are superseded with Part Three, Title II, Chapter 5 of the CRR and **are now repealed**.
- The methodology relating to the credit risk – internal ratings based approach included in **Annex VI** is superseded with the rules in Part Three, Title II, Chapter 3 of the CRR and **is now repealed**.
- The calculation of the position risk component on credit derivatives included in **Annex VII** is superseded with Part Three, Title IV, Chapter 2 of the CRR and **is now repealed**.
- The different approaches to the calculation of operational risk included in **Annex VIII** are superseded with Part Three, Title III of the CRR and **is now repealed**.
- The conditions required for Licence Holders to implement an internal model to calculate Capital Requirements are set out in **Annex IX**. These are superseded by the rules provided in Part Three, Title IV, Chapter 5 of the CRR and are **now repealed**.

## 4.2 Amendments to Appendix 2

Appendix 2 is now subdivided into:

**[i] Appendix 2A** includes the automated Financial Return for Category 1 and Category 4 Licence Holders (only), taking into account the changes in the definition of own funds and the calculation of the fixed overheads requirement.

**[ii] Appendix 2B** includes the revised automated Financial Return for Fund Managers, taking into account the changes in the definition of own funds and the calculation of the fixed overheads requirement.

**[iii] Appendix 2C** includes the automated COREP Return for Category 2 and Category 3 Licence Holders, which qualify as MiFID Firms.

## 4.3 Restructuring of Appendix 3

Appendix 3 is no longer divided into Appendix 3A & Appendix 3B, but now comprises one Appendix. The Financial Return for Consolidations which was set out in Appendix 3B is now being replaced with the return in Appendix 2C – The Automated COREP Return which is to be used by Licence Holders to report regulatory data, both on an individual and on a consolidated basis.

Licence Holders which form part of a Consolidated Group are required to complete an additional report, which is included in the Automated COREP Return, and is titled the Group Solvency Template. This template requires different information on the entities included in the scope of consolidation and is subject to a semi-annual frequency only.

The new Appendix 3 provides the consolidated capital resources requirement and includes guidance on the compilation of the automated COREP Return for Consolidations.

Note: This Appendix applies to Category 2 and Category 3 Investment Services Licence Holders which are subject to the CRD and the CRR and which are not credit institutions. Therefore, this Appendix does not apply to Category 1 Licence Holders and Investment Services Licence Holders which qualify as UCITS Fund Managers, Alternative Investment Fund Managers or Custodians.

Appendix 3A has been amended as follows:

- This Appendix provides examples of scenarios where a Licence Holder may be categorised as forming part of a ‘Consolidated Group’, as defined in the Glossary.
- The list of entities which could be considered as members of a Consolidated Group has been updated and aligned with CRD IV & CRR.
- Both Category 2 and Category 3 Licence Holders must at all times satisfy the following Consolidated Capital Resources Requirement:
  - a. A Consolidated Common Equity Tier 1 capital ratio of 4.5%, which relates to the Consolidated Common Equity Tier 1 capital expressed as a percentage of the consolidated total risk exposure amount;
  - b. A Consolidated Tier 1 capital ratio of 6%, which relates to the Consolidated Tier 1 capital expressed as a percentage of the consolidated total risk exposure amount;
  - c. A consolidated total capital ratio of 8%, which relates to the consolidated own funds expressed as a percentage of the consolidated total risk exposure amount.
- Exemption from the calculation of the liquidity risk component on a consolidated basis.

A Category 3 Licence Holder which forms part of a Consolidated Group is required to comply with Part Six (Liquidity) on a consolidated basis.

For the purpose of article 11 (3) of the CRR, a Consolidated Group, which comprises only of investment firms, that are not significant in terms of the nature, scale and complexity of their investment services activities, are exempt from compliance with the obligations in Part Six of the CRR (Liquidity) on a consolidated basis.

#### **4.4 Amendments to Appendix 4**

Licence Holders should note that Appendix 4 is not exhaustive and that further disclosure obligations arise from Part Eight of the CRR which because it is a Regulation has direct applicability.

The requirements of Appendix 4 have been aligned with the disclosure requirements arising from the CRR, in particular with respect to disclosure requirements on the:

- governance arrangements of the Licence Holder, including Licence Holders which form part of a Consolidated Group;
- new CVA risk;
- the new provisions relating to the remuneration policies;
- rules on country-by-country reporting applicable to Consolidated Groups.

#### **4.5 Amendments to Appendix 5**

Minor changes have been made to this Appendix to bring it in line with the current ISA maximum penalty of €150,000 for non CRD/ CRR infringements. It shall continue to have general application to all Licence Holders. The Authority wishes to emphasise that the tables therein containing samples of infringements and their corresponding penalties are non-exhaustive and are for purpose of guidance only.

Reference is made in the Appendix to the Investment Services Act [CRD \(Administrative Penalties, Measures and Investigatory Powers\) Regulations, 2014](#) which came into force on the 24<sup>th</sup> January 2014. These regulations implement articles 64 (2), 65, 67, 68, 69, 70, 71 and 72 of the CRD and introduce higher maximum penalties and extend the authority's powers *in the context of breaches of CRD IV and CRR only*.

#### **4.6 Amendments to Appendix 6**

This has been amended to reflect the professional indemnity insurance requirements of CRD IV in particular with regard to the territories which must be covered by the policy and the minimum limits of cover.

#### **4.7 Amendments to Appendix 10**

The original appendix was designed as a guidance note. Its provisions are now prescriptive.

- Additional risk components specified in the CRD have been included. These are residual risk, concentration risk, interest risk from non-trading book activities, credit valuation adjustment risk and risk of excessive leverage. The manner in which Licence Holders are to treat these risks is also described.
- Details on the treatment of operational risk, liquidity risk, and remuneration risk have been supplemented in line with the requirements of articles 85, 86, and 92 to 95 inclusive of CRD IV.
- The changes in the remuneration provisions which merit particular attention mostly apply to the variable element of the remuneration package, namely:

- Remuneration policies must make a clear distinction between the criteria for setting basic fixed remuneration and variable remuneration.
- Guaranteed variable remuneration is not considered consistent with sound risk management or the pay for performance principle, and is not to be a part of a remuneration plan.
- Firm limits are now introduced on ratios between the fixed and variable component of remuneration. The variable component will not normally exceed 100% of the fixed component. The Authority has adopted the discretion to allow shareholders approve a higher ratio, not exceeding 200%, in accordance with the specific procedure set out in Appendix 10.
- The Authority has adopted the discretion to permit Licence Holders apply the discount rate to a maximum of 25% of total variable remuneration provided it is paid in instruments that are deferred for a period of not less than five years.
- Remuneration packages relating to compensation or buy out from contracts in previous employment must be aligned with the long term interests of the Licence Holder.
- Up to 100% of total variable remuneration is to be subject to clawback to include situations where the staff member participated in, or was responsible for, conduct which resulted in significant loss or failed to meet the fit and proper test.

## **5. Additions and amendments to the Glossary**

The Glossary contains new definitions now incorporated in the Rules as a result of the transposition of CRD IV, such as the definition of ‘Ancillary Services Undertaking’, ‘Asset Management Company’, ‘Consolidated Basis’, ‘Consolidated Group’, ‘Consolidated Situation’, ‘Consolidated Supervisor’, ‘CRD’, ‘CRR’, ‘EBA’, ‘ESMA’, ‘EU Parent Financial Holding Company’, ‘EU Parent Institution’, ‘EU Parent Mixed Financial Holding Company’, ‘European Regulatory Authority’, ‘Financial Holding Company’, ‘Financial Institution’, ‘Institution’, ‘Licence Holder’, ‘Management body in its supervisory function’, ‘Mixed Financial Holding Company’, ‘Mixed Activity Holding Company’, ‘Parent Financial Holding Company in a Member State’, ‘Parent Investment Firm’, ‘Parent Institution’, ‘Parent Mixed Financial Holding Company in a Member State’, ‘Participation’, ‘Sub-consolidated basis’, ‘Systemically Important Institution’, and ‘Systemic Risk’.

Certain existing definitions have been aligned with the definitions provided in CRR and CRD IV, such as the definition of ‘Branch’ and ‘leverage’.

## 6. The Integration of the MFSA Financial Returns with the CBM Returns

In their circular of the 28<sup>th</sup> October 2013, the Authority informed Licence Holders that the Automated COREP Return incorporates a set of CBM reporting requirements. Fund Managers, Category 1 and Category 4 Licence Holders should note that the CBM Returns have also been integrated in the new financial returns applicable to these Licence Holders.

The CBM has prepared a set of guidance notes in order to assist Licence Holders to complete the relevant applicable sheets. These guidance notes may be accessed from the CBM website through the following link <http://www.centralbankmalta.org/site/statistics6.html>.

Any queries or requests for clarifications in relation to the CBM returns should be sent to: [sis@centralbankmalta.org](mailto:sis@centralbankmalta.org)

## 7. Applicability

The revisions to the Rules are applicable as from today and may be downloaded from the Authority's website located at [www.mfsa.com.mt](http://www.mfsa.com.mt), under the section: *Legislation & Regulation/ Regulation/ Securities and Markets/ Investment Services/ Rules for Investment Services Providers & related Guidance Notes/Part B-Standard Licence Conditions-Applicable to Licence Holders licensed on or after 1 January 2014*.

**Category 1 Licence Holders:** The Authority expects the financial returns (both in original and excel copy) for the period ending 30<sup>th</sup> June 2014 and which are due to be submitted to the Authority by end July 2014, to be prepared using Appendix 2A to Part B of the Rules (the electronic version of the financial return should be sent by email on the following address: [smsuфинret@mfsa.com.mt](mailto:smsuфинret@mfsa.com.mt)).

**Category 2 (Fund Managers):** The Authority expects the financial returns (both in original and excel copy) for the period ending 31<sup>st</sup> March 2014 and which are due to be submitted to the Authority by end April 2014, to be prepared using Appendix 2B to Part B of the Rules (the electronic version of the financial return should be sent by email on the following address: [smsuфинret@mfsa.com.mt](mailto:smsuфинret@mfsa.com.mt)).

**Category 2 and Category 3 Licence Holders (MiFID Firms):** The Authority expects the first financial returns for the period ending 31<sup>st</sup> March 2014 (to be reported on an individual basis) and which are due to be submitted to the Authority by end May 2014, to be prepared using Appendix 2C to Part B of the Rules.

Licence Holders which prepare their financial returns on a consolidated basis are required to prepare the consolidated COREP Return for the period ending 31<sup>st</sup> March 2014 using Appendix 2C to Part B of the Rules. The first consolidated COREP Return should be submitted to the Authority by end June 2014 at the latest.

Both the individual COREP Return and the consolidated COREP Return should be submitted by their due date in electronic format by use of the FRE/D Interface accessed through the following link: <http://fredisu.mfsa.com.mt/>.



Licence Holders are advised to refer to the *FRE/D Financial Institution Representative Instructions* for guidance on the use of the FRE/D Interface. These instructions may be downloaded from the Authority's website located at [www.mfsa.com.mt](http://www.mfsa.com.mt), under the section: *Legislation & Regulation/ Regulation/ Securities and Markets/ Investment Services/ Rules for Investment Services Providers & related Guidance Notes/Guidance*.

**For the purpose of ensuring correct implementation of the COREP Return, the Authority requires Licence Holders to submit an electronic version of the automated financial return set out in Appendix 2A of the existing Rules, for the period ending 31<sup>st</sup> March 2014 (or as applicable depending on the Accounting Reference Date) on a once off basis, in addition to the submission of the first COREP Return. The electronic version of the financial return should be sent by email on the following address: [smsuфинret@mfsa.com.mt](mailto:smsuфинret@mfsa.com.mt)**

Should you have any difficulties in this regard, please contact the Authority's officials as further detailed below.

## **8. Publication of two Legal Notices**

Reference is made to the circular issued by the Authority on the 4<sup>th</sup> November 2013, wherein it was indicated the proposed adoption of the following regulations: [i] Investment Services Act (Supervisory Review) Regulations, 2013; and [ii] Supervisory Consolidation Regulations, 2013. Both regulations have now been published.

The [Investment Services Act \(Supervisory Review\) Regulations, 2013](#) came into force on the 24<sup>th</sup> January 2014.

The Banking Act /Investment Services Act [Supervisory Consolidation Regulations, 2014](#) shall come into force on such date as the Minister for Finance may by notice in the Government Gazette establish (this is expected to occur imminently).

## **9. Regulatory and Implementing Technical Standards**

Licence Holders should note that both the CRD IV and the CRR include a number of articles with specific mandates for the European Banking Authority to develop draft implementing technical standards and draft regulatory technical standards. Technical standards will be adopted by means of EU regulations or decisions and serve the purpose of enhancing regulatory harmonisation in Europe.

EU regulations are binding in their entirety and are directly applicable in all Member States. Once adopted by the European Commission, technical standards will be published in the Official Journal of the European Union.

## **10. Contacts**

Any queries or requests for clarifications are to be addressed to Ms Mellyora Grech, Analyst, Securities and Markets Supervision Unit Tel: 2548 5193 or by e-mail on [mgrech@mfsa.com.mt](mailto:mgrech@mfsa.com.mt) or Ms Monica Nally Hennessy, Analyst, Securities and Markets Supervision Unit Tel: 2548 5233 or by e-mail on [mnallyhennessy@mfsa.com.mt](mailto:mnallyhennessy@mfsa.com.mt).

Any queries in relation to the implementation of COREP to investment firms should be sent directly to Mr Andrew Said, Analyst, Securities and Markets Supervision Unit Tel: 2548 5457 or by email on [asaid@mfsa.com.mt](mailto:asaid@mfsa.com.mt)

**Communications Unit**  
**Malta Financial Services Authority**  
**4<sup>th</sup> February 2014**