

# MFSA

MALTA FINANCIAL SERVICES AUTHORITY

## **Seminar on the Fourth Capital Requirements Directive (CRD IV)**

**25<sup>th</sup> March 2014**

The MFSA has recently held three training sessions regarding the Fourth Capital Requirement Directive and Regulation, (CRD IV package). The sessions targeted auditors, Category 2 (excluding fund managers) and Category 3 Investment Service providers who are impacted by CRD IV. The training sessions were well attended by the industry. The purpose of this note is to provide you with the main points that were presented to the industry.

Mr. Christopher P. Buttigieg explained the background to CRD IV which has its origins in the banking crisis of 2008. The CRD IV applies to banks and investment firms. He explained that given the size, nature, scale and complexity of the activities of Maltese investment firms, during negotiations Malta's position was that the principle of proportionality should be applied throughout the CRD IV proposal. Malta also made the point that in due course the Commission should consider proposing the adoption of a specific framework for investment firms that stipulates prudential capital requirements applicable solely to these type of firms and which caters for the specific risks of this sector of the financial industry.

The final text of the CRD IV package was issued in June 2013 with an effective implementation date of January 2014, allowing just six months for transposition and implementation. Mr. Buttigieg indicated that CRD IV is extremely detailed, complex and lengthy and introduces new onerous obligations for investment firms. There is a possibility for some change depending on the outcome of the Commission's review of the appropriateness of CRD IV to investment firms, which it must complete by December 2015. Therefore feedback from stakeholders will play an important role in influencing the Commission's final approach vis-à-vis investment firms.

Ms. Monica Nally Hennessy provided the audience with a comprehensive presentation on the transposition of the CRD in Malta. Her focus was on the amendments which were implemented to bring the Investment Services Act in line with CRD and the introduction of three new legal notices namely,

- i. the Investment Services Act ( Supervisory Review) Regulations 2014;
- ii. the Banking Act / Investment Services Act (Supervisory Consolidation) Regulations 2014; and
- iii. the Investment Services Act ( Administrative Penalties, Measure and Investigatory Powers) Regulations 2014.

Under the Supervisory Review Regulations the Authority is designated as the competent authority in Malta for the implementation of CRD IV. The Authority will be obliged to carry out a supervisory review and evaluation of how Licence Holders comply with CRD IV. Such a review will focus on ensuring that firms have capital resources and controls in place for the proper mitigation of risks. The frequency and intensity of the review shall have regard to the

size, systemic importance, scale and complexity of the activities of the investment firm concerned. If a firm is identified as problematic there is provision for enhanced supervision under the Supervisory Examination Programme.

The Supervisory Consolidation Regulations set out the situations when a firm may be considered to be part of a Consolidated Group and therefore be subject to supervision on a consolidated basis. Licence Holders will need to review their corporate legal structures to assess if they now come within the terms of Regulation 3 of these Regulations. The Regulations also provide for the Authority to act as consolidating supervisor of the group as a whole in certain circumstances.

Ms Hennessy introduced the Administrative Penalties, the Measures and Investigatory Powers Regulations which contain penalties the higher limits of which are far in excess of those in the ISA, and which apply in respect of breaches of CRD IV. She indicated that the new powers/measures and penalties would be applied by the Authority on a common sense/proportionate basis and that the emphasis of the Authority would be on ensuring satisfactory compliance through on-site and off-site supervision rather than on sanctions.

Ms. Mellyora Grech gave a detailed presentation on the amendments made to the Investment Services Rules for Investment Service Providers. She explained that Part BI has been restructured to make it clearer for Licence Holders to find the provisions that are applicable to them. Section 1 to Part BI has been amended to remove the provisions which do not apply to Category 1 Licence Holders, and has been extended to include the additional SLCs which shall apply to Category 2 and 3 Licence as a result of CRD. Appendices 1-6 incl. and 10 have been amended substantially.

The main changes include:

- i. Changes with respect to the role and composition of the Management Body (Board of Directors). The overarching principal is that the number of directorships which may be held by a member of the Management Body at the same time shall take into account the nature, scale and complexity of the Licence Holder.
- ii. For firms which are considered *significant* (the Authority is to provide guidance on this in the near future) there is a specific limit for such Board Members ie: one executive directorship and two non-executive directorships or four non-executive directorships, from July 2014. Significant firms are required to have a Remuneration Committee, Risk Committee and a Nominations Committee (comprised of non-executive members of the Management Body).
- iii. The provisions on RMICAAP and Remuneration policies in Appendix 10 have been updated. Firms are required to take into account the EBA Regulatory technical standards on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile. New limits on the ratios between the fixed and variable component on remuneration now apply, which are 1:1 or 1:2 (in limited circumstance).
- iv. Firms must now establish appropriate procedures for employees to report breaches internally and need to consider the preparation of a recovery plan for situations where they experience a significant financial deterioration.

- v. Reporting requirements and the introduction of the Automated Annual COREP return (ACR). This will be due 42 days after the Accounting Reference Date and the audited version without undue delay and by not later than four months of the Accounting Reference Date. The reporting deadlines, frequency and templates are set out in implementing technical standards. Reporting frequency of Category 3 is now changed to quarterly instead of monthly returns.
- vi. New definitions of Own Funds, Initial Capital and Fixed Overheads Requirements. Own funds now comprise Tier 1 Capital (Common Equity Tier 1 Capital and Additional Tier 1 Capital) and Tier 2 Capital (which shall be amortised during the final five years of maturity of the instruments). Tier 3 Capital has been eliminated. Initial Capital should be made up of Common Equity Tier 1 items and other accumulated comprehensive income. The Fixed Overheads Requirement must be calculated on the basis of “Eligible Capital” which means the sum of Tier 1 Capital and Tier 2 Capital that is equal to or less than one third of Tier 1 Capital. Own Funds may not fall below the initial capital of the Licence Holder;

The effect of these changes does not increase the current Capital Resources Requirement but improves the quality of the capital. A total capital ratio of 8% of the total risk exposure amount still applies.

Ms. Stephanie Buhagiar Camilleri addressed Consolidated Groups and the main changes that have resulted following CRD IV and CRR. The definition has widened in scope. In terms of the new Appendix 3 the parent company no longer necessarily needs to be established in Malta to fall within the definition of Consolidated Group. Licence Holders need to reassess their position in terms of the revised definitions as additional requirements apply, should a Licence Holder fall part of a Consolidated Group. Such additional requirements include [i] Consolidated COREP returns [ii] additional regulatory disclosures which strictly apply for Consolidated Groups such as the ‘Country-by-country’ reporting and [iii] the extent of involvement that is expected by the Licence Holder’s auditors at Group level. In this respect, Licence Holders are advised to refer to Appendix 3 to Part BI of the Investment Services Rules for Investment Services Providers, to understand the scope of Consolidated Groups as well as the scenarios where Licence Holders would be categorized as belonging to a Consolidated Group.

Mr Andrew Said provided the Industry with a detailed overview of the new Automated COREP Return which includes the harmonised reporting templates issued by the European Banking Authority (EBA) for CRD reporting. The introduction of COREP will significantly increase the level of information provided to the MFSA, as reporting will now offer a more holistic view of the risks being taken. Licence Holders will now need to show how they arrived at certain numbers and not just produce them. The reporting framework consists of the following set of templates, namely: Capital Adequacy, Group Solvency for Consolidated Groups, Credit Risk, Operational Risk, Market Risk, Large Exposures and Leverage.

Mr Said also gave a thorough description by use of practical examples, of the automation achieved within the excel file. Approximately 80% of the information required for regulatory reporting is gathered from the modified Cover Sheet, Index Sheet and Input Sheet. Other new additional input sheets were also incorporated within the Return. These include the newly incorporated Operational Risk calculation, the modified Foreign Exchange Risk

calculation and the Fixed Overhead Calculation. A separate excel file was also introduced to licence holders who require to report numerous market risk exposures. The Automated COREP Return has grown in size, when compared to the previous IFR due to new EBA Validations, amortisation of Subordinated Loan Capital workings, percentages due to grandfathering of instruments, new set of Central Bank BOP Returns, New FRE/D mappings, Credit Risk workings and Market Risk workings.

The Industry was also provided with a detailed view of the new FRE/D database used for electronic submission purposes.

## **Presentations**

All the seminar presentations are available on the MFSA web-site:  
<http://www.mfsa.com.mt/pages/viewcontent.aspx?id=287>

## **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), 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), or Ms Stephanie Buhagiar Camilleri, Analyst, Securities and Markets Supervision Unit Tel: 2548 5438 or by e-mail on [scamilleri@mfsa.com.mt](mailto:scamilleri@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**  
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