MFSA

MALTA FINANCIAL SERVICES AUTHORITY

25 March, 2015

Securities and Markets Supervision Unit

Unit Tel: (+356) 21441155
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To: Investment Services Licence Holders

Attn: Compliance Officer

By e-mail

Dear Sir/Madam,

Re: Educational Clinic for Investment Firms on the CRD IV Package and Other Supervisory Matters

[I] Educational Clinic for Investment Firms on the CRD IV Package

Reference is made to the educational clinic organised by the MFSA in collaboration with Finance Malta on the 12 December 2014.

This educational clinic was well-attended by various stakeholders including service providers operating in the financial services industry. However, the MFSA expected more Compliance Officers of Investment Services Licence Holders to attend this event given the importance of these regulatory provisions and the impact they have on the operations of investment firms.

The Authority is concerned to note that the knowledge of the CRD IV Package is below expected levels, even one year after the entry into force of these regulations.

Investment Services Licence Holders which are in possession of a Category 2 or a Category 3 investment services licence are required to ensure compliance with regulatory provisions arising from CRD IV Package, including the related EU technical standards and any guidelines issued by the European Banking Authority. In this regard the Authority is planning to conduct more CRD IV focused compliance visits during the year 2015. In the event that the Investment Services Licence Holders concerned fail to ensure proper compliance with the new prudential regulations, the Authority will be left with no other option but to consider taking regulatory action.

We attach, for your information and perusal, copies of the relevant presentations delivered during the educational clinic:

1) CRD IV Investment Firms in Malta: the Regulatory Framework – Ms. Mellyora Ellul;
2) CRD IV Investment Firms: the Common Reporting (COREP) Framework – Mr Andrew Said; and

3) CRD IV Investment Firms: the Off-Site Compliance Work – Ms. Stephanie Buhagiar Camilleri.

The salient points that were discussed during the educational clinic are set out in Attachment No 1 to this letter.

[II] Other Supervisory Matters

[A] Inclusion of Retained Earnings as part of Own Funds Computation

The Authority would like to bring to your attention the following rule regarding the inclusion of retained earnings as part of the own funds computation: Section 3.1.1.1 (A) (iii) of Appendix 1 A and Section 4.1.1.1 (A) (iii) of Appendix 1 B of the Investment Services Rules for the Investment Services Providers, which states:

"For the purposes of this point, Licence Holders shall include interim or year-end profits before a formal decision has been taken only if these profits have been verified by persons responsible for the auditing of the accounts (i.e. external auditors) and if it is proved to the satisfaction of the Authority that the amount thereof has been evaluated in accordance with International Financial Reporting Standards as adopted by the European Union.

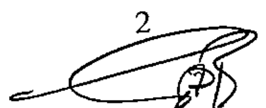
Interim or year-end profits shall be included after deduction of any foreseeable charge, tax or dividend. Licence Holders should refer to the Regulatory Technical Standards on Own Funds for the meaning of foreseeable when determining whether any foreseeable charge or dividend has been deducted."

This rule emanates from article 26 (2) of the CRR. In order for Licence Holders to ensure that the interim or year-end profits (which have not yet been subject to audit) qualify as regulatory capital, they must take the necessary steps to ensure that these profits have been **verified** by the auditors. Putting it differently, in the absence of verification by the auditors, interim and year-end profits are **not** to be included as part of the own funds computation.

As stated in article 26 (2) of the CRR, *"a verification of the interim or year-end profits of the institution shall provide an adequate level of assurance that those profits have been evaluated in accordance with the principles set out in the applicable accounting framework."*

For further guidance on the inclusion of interim profits in own funds, Licence Holders are required to refer to the European Banking Authority's Q & A (Question ID: 2013_384), which is attached for your perusal.

Please note that going forward, the Authority will be monitoring the inclusion of interim and year-end unaudited profits as part of own funds and it will be undertaking random checks to ensure that licence holders have the necessary auditor verification on file (in cases where such profits are being reported as part of Own Funds). Moreover, checks will also be undertaken during regulatory onsite compliance visits undertaken by the Authority. Needless to say, the Authority will take a very serious view should own funds be misreported as a



result of the inclusion of interim or unaudited year end profits which are not duly supported by auditors' verification as required by the CRR.

Appendix 2A – Financial Return for Category 1 & Category 4b (only)

When completing the Financial Return, Licence Holders are expected to input the profits made during the year (and which have not yet been subject to audit but which have been **verified** by the auditors) in Section 6 (h) of the Input Sheet:

h) The Financial Return is showing a Profit or Loss of:	-
Kindly input the profits which been verified by persons independent of the institution that are responsible for the auditing of the accounts of that institution	

Appendix 2B – Financial Return for Fund Managers

When completing the Financial Return, Fund Managers are expected to input the profits made during the year (and which have not yet been subject to audit but which have been **verified** by the auditors) in Section 6 (j) of the Input Sheet:

j) The Financial Return is showing a Profit or Loss of:	-
Kindly input the profits which been verified by persons independent of the institution that are responsible for the auditing of the accounts of that institution	

Appendix 2C – Automated COREP Return

When completing the Automated COREP Return, Licence Holders (which are subject to CRD IV) are expected to input the profits made during the year (and which have not yet been subject to audit but which have been **verified** by the auditors) in Section 6 (r) of the Input Sheet:

r) The Automated COREP Return is showing a Profit or Loss of:	-
Kindly input the profits which been verified by persons independent of the institution that are responsible for the auditing of the accounts of that institution	-

[B] Bank and cash balances deposits – Automated COREP Return

The Authority has considered in more detail the exposures which investment firms may have to banks through their bank and cash deposits, as worked out in the Automated COREP Return.

In this regard, Section 3 (m) of the Input Sheet has been re-worded to be more in line with the terminology used in the CRR, as indicated below:

m) Bank and cash balances	
i) Balances which can be withdrawn within 3 Months	
ii) Balances which can be withdrawn only after 3 Months	

In addition, Licence Holders which complete the Automated COREP Return, are advised that bank and cash deposited at banks is to be treated as exposures to institutions in accordance with article 119 of the CRR.

[C] Market Trends

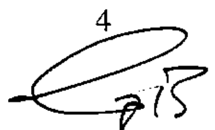
The MFSA is carrying out an ongoing review to evaluate trends in the markets. In this respect, the Automated COREP Return has been updated to include a section, "Market Trends".

The Authority will be publishing the revised version of the Financial Returns and the Automated COREP Return (with the above updates) on 1st April 2015. Please ensure that you invariably adopt the revised template for any reports after this date and submit as part of your Financial / COREP reporting package.

Contacts

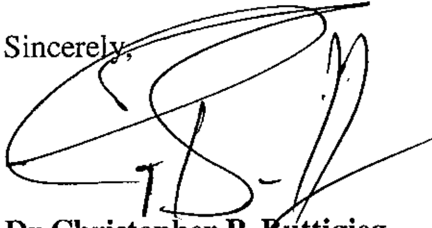
Please refer any queries relating to the CRD IV framework and other supervisory matters as set out below:

Nature of query	Official	Contact details
CRD IV regulatory framework	Ms Mellyora Ellul	mellul@mfsa.com.mt
Off-site compliance work	Ms Stephanie Buhagiar Camilleri	scamilleri@mfsa.com.mt
Specific queries relating to the COREP framework	Mr Andrew Said	asaid@mfsa.com.mt.



Within the Securities and Markets Supervision Unit we remain committed to support the industry on the adoption of the CRD IV framework as may be necessary.

Sincerely,



Dr Christopher P. Buttigieg
Director
Securities and Markets Supervision Unit

MFSA: Attachment to MFSA Letter dated 25 March 2015 regarding the educational clinic for investment firms on the CRD IV Package – Attachment No 1

[I] The Regulatory Framework of CRD IV Investment Firms

Ms. Mellyora Ellul's presentation covered: **[a]** an update on two particular issues relating to the transposition of CRD IV; i.e. the revision of the specimen subordinated loan agreement, the established definition of a 'significant' investment firm, and the MFSA findings in relation to the CRD IV compliance visits which were conducted in 2014; **[b]** an overview of MFSA's current priorities on the recovery and resolution of investment firms and the new category of investment firms introduced in the Capital Requirements Regulation (CRR); and **[c]** MFSA's work plans on capital buffers and the updating of the Investment Services Rules for the year 2015.

Subordinated loan agreement

Investment Services Licence Holders which enter into a subordinated loan agreement for the purpose of meeting the capital resources requirement are required to ensure that the subordinated loan is in the revised new form provided by the MFSA. Prior to the entry into force of CRD IV, the specimen subordinated loan agreement had to be in the form set out in Annex IV to Appendix 1 of the Investment Services Rules for Investment Services Providers ("the Rules").

In order to ensure compliance with the characteristics outlined in article 63 of the CRR as regards subordinated loans, the MFSA has effected certain amendments to the specimen subordinated loan agreement and included the revised specimen in Annex 1 to Appendix 1 of the Rules. The amendments include the following:

a) Article 63(n) of the CRR contemplates a scenario where an entity which is part of the consolidation pursuant to Chapter 2 of Title II of Part One of the CRR can raise a loan on behalf of or for the benefit of, a licence holder in its consolidated group. In this regard, the specimen subordinated loan agreement has been revised to include another 'party' to the agreement, which we are referring to it as the 'beneficiary'. Any clauses relating to the 'beneficiary' should be struck out where the licence holder is not raising the subordinated loan through intra group financing.

b) The agreement should be entered into for a period of at least five years.

c) The annual rate of interest on the loan should be declared. In the previous agreement, we only indicated that the rate of interest should not exceed 8% or any other maximum rate set by the Authority.

d) The loan shall be repayable by the borrower to the lender on the redemption date.

e) The loan may be redeemed early only if the borrower/ beneficiary is the subject of liquidation / insolvency proceedings or if on the application of the borrower, the

f) MFSA allows early redemption of the loan i.e. prior to the date of their contractual maturity / before five years of the date of issue, for certain reasons, as set out in article 78 (4) (a) & (b) of the CRR.

g) The Redemption Date may be deferred by a written agreement of all the parties involved.

h) In the situations set out in (e) and (f) above, prior MFSA written consent should be obtained.

i) The agreement should be dated, as this will have an impact on when the subordinated loan should be amortised. During the final five years of maturity of the loan, the loan is subject to the amortisation provisions as set out in article 64 of the CRR. Therefore, during the final five years, the amount of the subordinated loan which should be treated as regulatory capital is lower than the extent of the loan.

   In order to facilitate the reporting requirements of Investment Services Licence Holders, the MFSA has automated the amortisation calculation of subordinated loans, which form part of Tier 2 capital instruments.

'Significant' investment firm

On the 30 June 2014, the MFSA issued for consultation its proposed definition of a 'Significant Licence Holder'. During the 30 day consultation period, we did not receive any feedback from the industry.

Accordingly, it was decided to apply the following definition of a 'significant' Investment Services Licence Holder:

For the purpose of SLCs 1.34[1], 1.38[2] and 1.46[3], a Licence Holder is considered significant in terms of size, internal organisation and the nature, the scope and the complexity of its Investment Services and activities, if it meets all of the following conditions:

*a. its total balance sheet assets exceed **EUR 43 million;***

*b. the annual turnover relating to its investment services activities exceeds **EUR 50 million;***

*c. the clients' money that it holds or controls exceeds **EUR 100 million;** and*

[1] SLC 1.34 refers to limit on directorships.
[2] SLC 1.38 refers to the establishment of a nomination committee.
[3] SLC 1.46 refers to the establishment of a risk committee.

*d. the assets belonging to its clients that it holds or controls in the course of, or connected with its investment services activities exceeds **EUR 3 billion**.*

If a Licence Holder is considered to be 'significant', the following rules arising from CRD IV apply:

- the limit on the number of directorships which are held by members of the management body;
- the requirement to establish a risk committee / a nomination committee / remuneration committee;
- certain quantitative information relating to the remuneration of members of the management body should be made available to the public; and
- the applicability of the liquidity risk component as referred to in Part Six of the CRR.

The rules relating to a 'Significant Licence Holder' are included in SLC 1.55 to SLC 1.58 of the Rules and are not applicable to credit institutions that provide investment services.

CRD IV compliance visits

In January of last year, the MFSA started conducting CRD IV focused compliance visits. During these visits, the MFSA officials assessed the Licence Holders' preparedness for the implementation of the new requirements arising from the CRD IV and the CRR. For the purpose of achieving this objective, interviews were conducted with Company officials including Company Directors and Compliance Officers.

Our findings indicate that, in the main, the investment firms visited were not yet prepared for CRD IV implementation and that they had not started familiarising themselves with the new Rules relating to CRD IV.

Bank Recovery and Resolution Directive (BRRD)

As part of the CRD IV transposition process, the MFSA had to transpose the requirement of article 74 (4) of CRD IV in the Rules. In terms of article 74 (4), investment firms (subject to CRD IV) were required to develop and maintain a recovery plan for the restoration of their financial situation following a significant deterioration. In contrast to the BRRD, CRD IV did not restrict the application of this requirement to investment firms that deal on own account or that place or underwrite financial instruments on a firm commitment basis.

For the purposes of transposing the provisions of BRRD, the MFSA will be carrying out slight amendments to the relevant standard licence conditions in the Rules to apply the

requirement to prepare a recovery plan only to Category 3 Investment Services Licence Holders.

For further guidance on how to prepare and what to include in a recovery plan, Investment Services Licence Holders should refer to the final draft regulatory technical standards on the contents of recovery plans, which are adopted by the European Banking Authority and submitted to the European Commission for endorsement. This information can be sourced from the following link:

http://www.eba.europa.eu/documents/10180/760167/EBA-RTS-2014-11+Draft+RTS+on+content+of+recovery+plans.pdf/60899099-2dcb-4915-879d-8b779a3797cc

New Category of Investment Firms

In Malta, we have a number of Licence Holders which are authorised to provide collective portfolio management, but which do not require a licence under the Alternative Investment Fund Managers Directive (AIFMD). These licence holders are being referred to as De minimis licence holders.

De minimis Licence Holders only require registration in terms of the AIFMD. That said, MFSA has opted to apply a minimum licensing regime rather than registration to these types of firms as it considers that it is in the best interest of fund managers to be licensed as opposed to being merely registered.

Some of these De minimis licence holders are also being authorised to provide other investment services falling under the Markets in Financial Instruments Directive (MiFID). When this is the case, these investment services licence holders are being required to comply with two separate rulebooks given that collective portfolio management to investment funds does not qualify as a MiFID investment service:

- Part B I of the Rules, which is applicable to the MiFID services provided.

- Section 1 of Part B III of the Rules, which is applicable to the collective portfolio management service.

Therefore, even though De minimis licence holders only require registration under the AIFMD, they do qualify as a MiFID firm (when they provide a MiFID investment service). This means, that De minimis licence holders which are involved in the provision of MiFID investment services, will have to ensure compliance with the requirements of the CRD IV or CRR.

In contrast, where De minimis licence holders are providing collective portfolio management and individual portfolio management but are not actually holding clients' money or assets, they may be excluded from the definition of an 'investment firm' in terms of the CRR.

This is possible since article 4 (2) (c) of the CRR introduces a new category of investment firms, which are exempt from the definition of an 'investment firm' as set out in the CRR. These are investment firms that provide the following services:

1. Execution of orders on behalf of clients; and/or

2. Individual portfolio management;

To qualify for this exemption they must not be authorised to:

1. Provide safekeeping and administration of financial instruments (MiFID ancillary service); and

2. Hold money or securities belonging to their clients.

Firms which do not fall within the definition of "investment firm" as set out in CRR are not subject to the full CRD IV.

They are only required to comply with the minimum capital requirement equivalent to that of a Category 2 Investment Services Licence Holder and to complete the COREP templates (Pillar 1 requirements). Other parts of the CRD IV requirements such as the preparation of the Risk Management Internal Capital Adequacy Assessment Process Report (Pillar 2 requirements) and the public regulatory disclosures (Pillar 3 requirements) would not apply.

That said, please note carefully that the MFSA has the discretion to keep such firms under the previous Capital Requirements Directive (i.e. as it stood on 31 December 2013), before the CRD IV entered into force. In this case, firms would have to comply with the Pillar 1 requirements (but with the previous definition of own funds and without completing the COREP templates). Investment firms would need to complete the previous financial return and would also have to comply with the Pillar 2 and Pillar 3 requirements.

The MFSA is still considering the above issue for the following reasons:

- The current local legislative framework treats the "holding" or "controlling" of clients' money or assets as an activity that is undertaken simultaneously. For the purposes of the implementation of the new category of investment firms in the local legislation, it may be required to establish separate definitions for "holding" and "controlling" clients' money or assets. In this regard, MFSA is evaluating the

possibility of making distinctions between "holding" and "controlling" clients' money and assets and the Authority may create another category of licence with this in mind.

- The implementation of the new category of investment firms may also require the establishment of a separate Investment Services licence.

- The European Commission is to review the appropriateness of the prudential regime for all investment firms carrying out MiFID investment services by the end of 2015. The MFSA believes it is more appropriate to minimise changes for the time being until it is more clearly established that the new category of investment firms is going to be retained in the CRR and the treatment of these investment firms is confirmed.

Binding technical standards

The EU has decided to supplement CRD IV with binding technical standards, which aim to provide guidance on particular aspects of the EU legislative text (Directive or Regulation) and ensure consistent harmonisation in specific areas.

Technical standards are first drafted by the European Banking Authority (EBA), which are then submitted to the European Commission for endorsement. Once they are adopted by the European Commission, they are then enacted through their publication in the EU Official Journal. Once they become EU law, they become part of the national law of the Member States and no transposition is required from our part.

There are approximately 27 Implementing Technical Standards, 50 Regulatory Technical Standards, 2 Delegated Acts, 3 Implementing Acts and a number of guidelines issued by EBA.

Licence Holders are expected to keep themselves updated on the status of these technical standards by referring to the European Commission's website, as per link set out below:

http://ec.europa.eu/finance/bank/regcapital/acts/index_en.htm

The MFSA intends to update any links and references in the Investment Services Rules to the EBA guidelines or EU technical standards, which at the time of publication of the transposed CRD IV provisions in the Rules were still in draft form, but which have now been finalised.

Capital buffers

CRD IV sets out five possible different capital buffers, which together make up the Combined Buffer (CB) requirement. The Combined Buffer Requirement must be met by holding Common Equity Tier 1 (CET 1) capital and must be in addition to the minimum capital requirement of 8%.

1. **The Capital Conservation Buffer** (article 129) is a fixed amount of 2.5% of the investment firm's total risk exposures. The objective of the capital conservation buffer is as its name implies, to conserve a bank's capital;

2. **The Institution-Specific Countercyclical Capital Buffer** (article 130) is a variable amount between 0 and 2.5%, depending on where the credit exposures of the investment firm are located. This buffer aims to ensure that firms accumulate capital during periods of economic growth that can then be released during less favourable conditions. It is calculated as the weighted average of the countercyclical capital buffers set by Member States depending on the investment firms' credit exposures to the said Member States.

3. **The Systemic Risk Buffer** (article 133) is intended to prevent and to mitigate long term non-cyclical systemic or macroprudential risks, which are not covered by the CRR. It specifically addresses the risk of disruption to the financial system and the potential for serious negative consequences to Malta's real economy. The Systemic Risk Buffer is not decided on an individual firm basis but rather is to be applied either to the whole financial sector, or to one or more sub-sets of it;

4. **The Global Systemically Important Institution Buffer** (article 131) relates to a mandatory systemic risk buffer of Common Equity Tier 1 capital for institutions

5. which represent a higher risk to the global financial system and which are identified by the designated authority as globally systemically important institutions. This buffer ranges between 1 and 3.5% of the investment firm's total risk exposures;

6. **The Other Systemically Important Institution Buffer** (article 131) is intended for "other" systemically important institutions. This includes domestically important institutions as well as EU important institutions. The optional O-SII buffer is maximised to 2% of the investment firm's total risk exposures and shall consist of and shall be supplementary to Common Equity Tier 1 capital.

CRD IV gave an option to Member States to designate the authority in charge of the application of these buffers.

The MFSA will be acting as the competent authority for the Capital Conservation Buffer, the Institution-specific Countercyclical Capital Buffer and jointly with the Central Bank of Malta for the Global Systemically Important Institution Buffer and Other Systemically Important Institution Buffer.

The Central Bank of Malta through Legal Notice 29 of 2014, Central Bank of Malta Act (Appointment of Designate authority to implement Macro-Prudential Instruments) Regulations, 2014 has been appointed as the designate authority:

1. For the purposes of article 133(2) of the CRD IV to set the systemic risk buffer and identify the sets of institutions to which it applies;

2. For the purposes of article 136(1) of the CRD IV to set the countercyclical buffer rate for Malta, which shall be applied by institutions when calculating the institution-specific countercyclical capital buffer.

3. Jointly with the competent authority for the purposes of article 131(1) of CRD IV to identify, on a consolidated basis, global systemically important institutions, and, on an individual, subconsolidated or consolidated basis, as applicable, other systemically important institutions, which have been authorised within Malta.

Directive 2013/36/EU (CRDIV)	**Designated Authority**
Capital Conservation Buffer	MFSA
Institution-specific Countercyclical Capital Buffer	MFSA
Countercyclical Capital Buffer Rate	CBM
Global and other systemically important institutions Buffer	CBM jointly with MFSA
Systemic Risk Buffer	CBM

The Central Bank of Malta was therefore responsible for transposing certain provisions of the CRDIV for credit institutions and investment firms (relating to capital buffers). The transposition of these provisions was carried out in the Central Bank of Malta Directive No.11 on macro-prudential policy, which is publicly available on the website of the Central Bank of Malta.

The MFSA intends to transpose the rules relating to the capital buffers in a new Appendix of the Investment Services Rules. These rules will be applicable only to Category 3 Investment Services Licence Holders, since investment firms that are not authorised to deal on own account or underwrite or place financial instruments on a firm commitment basis are being exempt from these buffers under CRD IV.

However, by way of derogation, Member States may also exempt small and medium-sized investment firms from the requirement of the capital conservation buffer and the institution-specific countercyclical capital buffer if such an exemption does not threaten the stability of the financial system of Malta.

A firm will be categorised as small and medium-sized if it meets the definition and conditions outlined in the European Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises. If an investment firm falls within the definition of a small to medium enterprise, it will not be required to meet the rules on capital buffers.

[II] The COREP Framework

Mr Andrew Said provided a detailed overview of the new Automated COREP Return, which includes the standardised reporting templates, as drafted by EBA and endorsed by the

European Commission, for the purposes of reporting the capital requirement that is held by investment firms in terms of the CRR.

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. The introduction of COREP has significantly increased the level of information provided to the MFSA, especially with regards to the calculation of the risk components, such as credit risk and market risk.

The Automated COREP Return has grown in size, when compared to the previous Automated Financial Return due to the incorporation of the validation rules, the workings relating to the amortisation of subordinated loan capital, the percentages applicable to grandfathered instruments, the new set of Central Bank BOP Returns, new FRE/D mappings, and the workings relating to credit risk and market risk.

In addition, Mr. Said provided the audience with an overview of salient changes undertaken in 2014, addressing issues tackled during the year in relation to risk calculation and the compilation of the Automated COREP Return.

The Industry was also provided with an update on the Electronic Submission of the Automated COREP Return, including an introduction of the LH Portal which will replace FRE/D in 2015.

[III] The Off-Site Compliance Work

Ms. Stephanie Buhagiar Camilleri provided an update on particular aspects relating to off-site supervision, namely the definition of consolidated groups, regulatory disclosures and the fixed overheads requirement.

For the purpose of assessing whether Licence Holders form part of a Consolidation Group, reference should be made to the definition provided in the Glossary to the Rules. Licence Holders may obtain further guidance on how to determine consolidation status by referring to regulation 3 of the Banking Act and the Investment Services Act (Supervisory Consolidation Regulations), 2014.

In terms of SLC 7.64 of Part B I of the Rules, Category 2 and Category 3 Licence Holders which qualify as MiFID investment firms, shall assess on an annual basis whether they form part of a Consolidated Group and provide the MFSA with an explanation to this effect. The Licence Holder's consolidation assessment is also subject to confirmation by the auditor.

As regards regulatory disclosures, Licence Holders are required to publicly disclose all the information outlined in Appendix 4 to the Rules. Since the Pillar 3 regulatory disclosures requirements emanate from the CRR, Licence Holders shall also refer to: **[a]** articles 431 to 455 and 492 of the CRR; **[b]** the relevant Technical Standards on regulatory disclosures issued by the European Commission from time to time; and **[c]** the Guidelines which the EBA may issue on this matter.

A set of standardised own funds disclosure templates have been published in the Implementing Technical Standards on Disclosure of Own Funds Requirements which include: **[a]** Balance Sheet Reconciliation Methodology that provides information on the reconciliation between balance sheet items used to calculate own funds and regulatory own funds; **[b]** Capital Instruments' Main Features Template which aims to disclose the features of an institution's capital instruments; and **[c]** Own Funds Disclosure Template.

Prior to the implementation of CRD IV, Licence Holders which determined that the regulatory disclosures were not material, or were of a proprietary or confidential nature, had to state in the annual audited financial statements that the required information has not been disclosed and the reason for non disclosure. However, as from 1 January 2014, Part Eight of the CRR applies to the regulatory disclosures of investment firms. As required by article 432 (1) of the CRR, some of the required disclosures such as disclosures on own funds and disclosures on the remuneration policy cannot be omitted.

Licence Holders are recommended to make use of the Guidelines on Materiality, Proprietary and Confidentiality and on Disclosure Frequency issued by EBA in preparation of the upcoming annual regulatory disclosures.

Lastly, Ms. Buhagiar Camilleri highlighted the importance for the industry to note that the basis of the calculation of the fixed overhead requirement has changed to refer to the most recent past audited data rather than the current data, as indicated in EBA Final draft Regulatory Technical Standards on Fixed Overheads.

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

MFSA: Attachment to MFSA Letter dated 25 March 2015 regarding the European Banking Authority's Final Q & A on the inclusion of interim profits – Attachment No 2

Question ID:	2013_384
Legal act :	Regulation (EU) No 575/2013 (CRR)
Topic :	Own funds
Article:	26(2) / 36(1)(a)
Paragraph:	
Subparagraph:	
Article/Paragraph :	-
COM Delegated or Implementing Acts/EBA RTS/EBA ITS/EBA GLs:	Not applicable
Subject matter :	Inclusion of interim profits / Deduction of losses in own funds
Question:	1. How should the interim profits be calculated for the purposes of inclusion in own funds? E.g. if the bank has monthly P/L as follows: Jan -10, Feb -20, March +100 (Year-to-date +70). The results are not verified by external audit. Should the bank take deduct the losses from Jan and Feb, but ignore the March gain as it is unaudited (capital impact compared to IFRS equity -100) or can the losses be netted with the gains and the YTD gain (unaudited) be filtered out (capital impact -70)? 2. What constitutes 'adequate level of assurance' in context of verification by external auditors? Is a full audit required or is an interim review sufficient?
Background on the question:	P/L is calculated on various frequencies (monthly, quarterly, half-yearly). The gains and losses can offset (gain in one month can turn an YTD loss to a profit) and due to the asymmetrical treatment of gains and losses (no audit requirement for losses), the eligibility of the interim profits in own funds is not clear.
Date of submission:	13/10/2013
Published as Final Q&A:	20/02/2015

<table>
<tr>
<td>EBA answer:</td>
<td>
1. For the purposes of Article 26(2) of Regulation (EU) No. 575/2013 (CRR), interim profits can only be included in Common Equity Tier 1 (CET1) capital with the prior permission of the competent authority if those profits have been verified by the external auditor and if any foreseeable charge or dividend has been deducted.
In the example above, assuming that the bank has a December year-end, the relevant figure to be considered for inclusion in CET1 capital at end-March is 0, i.e. not including the net interim profit of +70 generated from January to March, as these have not been verified by an external auditor. Therefore, the amount of the interim profit to consider at the end of March is the amount generated since the end of the last financial year.

Although the example given in the question does not reflect the typically quarterly reporting frequency, the principle to be applied is the same, regardless of the reporting frequency.

It is expected that for cases corresponding to the specific example in the question, i.e. where interim losses incurred in earlier periods are followed by subsequent unverified interim profits, this is subject to some supervisory scrutiny.

Institutions shall maintain own funds requirements at all times pursuant to Article 92(1) of the CRR and Article 13(1) of the Commission Delegated Regulation (EU) No 241/2014, which states that 1cfor the purpose of calculating its Common Equity Tier 1 capital during the year, and irrespective of whether the institution closes its financial accounts at the end of each interim period, the institution shall determine its profit and loss accounts and deduct any resulting losses from Common Equity Tier 1 items as they arise 1d. Following the example above, with the institution calculating own funds on a monthly basis, it is therefore required to make deductions from its CET1 capital of -10 and -20 in January and February respectively.

2. Verification of the interim profits of an institution shall be undertaken as frequently as that institution requests permission from their competent authorities to include interim profits in Common Equity Tier 1 capital before the institution has taken a formal decision confirming the final profit or loss of the institution for the year. 1cAdequate level of assurance 1d to be sought by an institution involves at least a review of interim financial information by the external auditor of the annual accounts of that institution in order to express a conclusion whether, on the basis of the review, the interim financial information subject to the review have been prepared, in all material respects, in accordance with the applicable accounting framework.

The review should cover any material deviation from the accounting policies applied in the last audited financial statements.
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