

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

CONSULTATION DOCUMENT

CONSULTATION ON THE IMPLEMENTATION OF AUDIT COMMITTEE REQUIREMENTS WITH RESPECT TO CREDIT INSTITUTIONS

[MFSA REF: 06-2016]

9th June 2016

Closing Date: 23rd June 2016

Note: The documents circulated by the MFSA for the purpose of consultation are in draft form and consist of proposals. Accordingly, these proposals are not binding and are subject to changes and revisions following representations received from Licence Holders and other involved parties. It is important that persons involved in the consultation bear these considerations in mind.

1. Introduction

In view of the significant public relevance of public-interest entities,¹ which arises from the scale and complexity of their business or from the nature of their business, Directive 2006/43/EC² (the “Statutory Audit Directive”) has been amended by Directive 2014/56/EU³ in order to reinforce the credibility of the audited financial statements of public-interest entities. Moreover, the special provisions for the statutory audits of public-interest entities set out in the Audit Directive have been further developed in Regulation (EU) No 537/2014⁴ (the “Statutory Audit Regulation”).

As a result of the above-mentioned amendments, credit institutions, as public-interest entities, are to abide by the requirements set out in Article 39 of the Statutory Audit Directive, relating to the composition and functions of the audit committee and the duties of its members. In addition, consideration should also be given to the recommendations relating to the audit committee prescribed in Commission Recommendation of 15 February 2015 on the role of the non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (the “Commission Recommendation”).

The Statutory Audit Directive, as amended, is primarily being transposed in the Accountancy Profession Act (Chapter 281 of the Laws of Malta) and the Companies Act (Chapter 386 of the Laws of Malta). The Statutory Audit Directive was brought to the attention of the Malta Financial Services Authority (“MFSA”) in April 2016, and subsequently, the MFSA was entrusted with the transposition of Article 39 of the said Directive.

In relation to credit institutions, the MFSA is proposing to implement the requirements pertaining to the audit committee in paragraph 4 of Annex 2B of Banking Rule BR/12, as amended and re-structured. In this regard, it is to be noted that while Annex 2B of Banking Rule BR/12 is being amended and re-structured, the MFSA will not be affecting any material changes to the said Annex, other than the introduction of the requirements pertaining to the audit committee. Moreover, pursuant to the Commission Recommendation, the MFSA is proposing to introduce additional requirements

¹ Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, as amended by, *inter alia*, Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, defines “public-interest entities” as:

“(a) entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;
(b) credit institutions as defined in point 1 of Article 3(1) of Directive 2013/36/EU of the European Parliament and of the Council, other than those referred to in Article 2 of that Directive;
(c) insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC; or
(d) entities designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees”.

² Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, as amended by Directive 2008/30/EC of the European Parliament and of the Council of 11 March 2008 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, as regards the implementing powers conferred on the Commission; Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC; and Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

³ Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

⁴ Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC.

concerning the functions of the audit committee. Such additional requirements will also be introduced in the new paragraph 4 of Annex 2B of Banking Rule BR/12.

This Consultation Document consequently lays down the proposed amendments to Banking Rule BR/12 transposing the requirements set out in Article 39 of the Statutory Audit Directive, as amended, as well as introducing additional requirements as prescribed in the Commission Recommendation in relation to the audit committee.

For the avoidance of doubt, such requirements do not apply to branches established in Malta of credit institutions authorised in third countries.

2. Audit Committee Requirements

The proposed amendments to Annex 2B of Banking Rule BR/12 lay down requirements with respect to the composition of the audit committee, the functions and duties of the audit committee, as well as the measures which are to be taken by credit institutions in order to ensure the well-functioning of the audit committee.

As reflected in paragraph 4(h) of the draft provisions, the proposed amendments are to be read in conjunction with Regulation (EU) No 537/2014, in particular with Title III (Articles 16 to 19) thereof, relating to the appointment of statutory auditors or audit firms and the transitional provisions set out in Article 41. Moreover, it is also to be noted that as highlighted in paragraph 4(i) of the draft provisions, credit institutions which are listed on a regulated market shall, in case of any conflict between the provisions of paragraphs 4(a) to 4(h) of Annex 2B of Banking Rule BR/12 as introduced, and the provisions of the Listing Rules, pertaining to the requirements of the audit committee, comply with the requirements set out in Banking Rule BR/12.

2.1 Composition of the Audit Committee

Paragraphs 4(a) to 4(d) of the proposed amendments lay down requirements on the composition of the audit committee. These draft provisions transpose Article 39(1) of the Statutory Audit Directive as amended, and require the audit committee to, *inter alia*, have at least three members. In addition, further to the first paragraph of Article 39(1) of the Statutory Audit Directive, the MFSA is proposing that the members of the audit committee, including the chairperson, are not to be appointed by the general meeting of shareholders of an audited credit institution, but should be appointed by the Board of Directors. Furthermore, pursuant to the second paragraph of Article 39(1) of the Statutory Audit Directive, it is the preference of the MFSA, as set out in paragraph 4(b) of the draft provisions, to require that at least the chairperson of the audit committee is to have competence in accountancy and/or auditing.

2.2 Functions and duties of the Audit Committee

Paragraph 4(e) of the draft provisions lays down a non-exhaustive list of functions to be performed by the audit committee, notwithstanding its members' responsibilities as members of the Board of Directors. This paragraph reflects the requirements set out in Article 39(6) of the Statutory Audit Directive and implements a number of recommendations prescribed in the Commission Regulation regarding the duties of the audit committee.

In addition, paragraph 4(f) of the draft provisions lays down the minimum reporting duties of the audit committee towards the Board of Directors and requires the audit committee to, *inter alia*, meet at least quarterly.

2.3 Credit institutions' duty to ensure the well-functioning of the Audit Committee

Paragraph 4(g) of the proposed amendments lays down measures which credit institutions should, *inter alia*, have in place in order to ensure the well-functioning of the audit committee. The proposed provisions highlight that credit institutions are, *inter alia*, duty bound to ensure that the audit committee is not prohibited from obtaining advice and assistance from outside legal, accounting or other advisors in order to carry out its duties and that, as set out in the Commission Recommendation, it should be adequately funded. Moreover, under the proposed provisions, credit institutions have to ensure that new members of the audit committee are provided with an induction programme, together with subsequent relevant training on an ongoing and timely basis. Furthermore, it is also the responsibility of credit institutions to ensure that audit committee members are provided with full information relating to the credit institution's specific accounting, financial and operational features.

These draft provisions implement requirements prescribed in the Commission Recommendation and are not meant to be exhaustive.

3. Member State Options or Derogations

It is the prerogative of the MFSA to require that all credit institutions are to have an audit committee. As a result, notwithstanding the options or derogations which are available to Member States in Article 39(2), (3), (4) and (5) of the Statutory Audit Directive as amended, the MFSA will not take up such options or derogations with respect to credit institutions.

In addition, it is to be noted that the MFSA does not intend to take up the options found in Article 16(7) and (8) of the Statutory Audit Regulation.

4. Consultation and how to respond

Any feedback on the proposed transposition should reach the MFSA by not later than the 23rd of June 2016. Please send your responses by e-mail (kgabarretta@mfsa.com.mt) addressed to Mr. Karol Gabarretta, Director – Banking Supervision Unit.

Any queries or requests for clarification in respect of the draft provisions should be addressed to Dr. Glenna Montefort (gmontefort@mfsa.com.mt).

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