

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Consultation Document

Consultation On The Proposed Amendments To
Banking Rule BR/09 -

Credit Risk Provisioning By Credit Institutions
Authorised Under The Banking Act 1994

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

1. Background

- 1.1 In line with the European Council's Recommendation on *Malta's 2012 National Reform Programme and delivering a Council opinion on Malta's stability programme for 2012-2015*¹, the Malta Financial Services Authority, in collaboration with the Central Bank of Malta (the Authorities) and subsequent to January 2013 under the auspices of the MFSA/CBM Joint Financial Stability Board, have taken measures in line with the Country Specific Recommendation 6 (CSR 6) to address specific policy challenges related to the banking sector as highlighted in the said document to address two particular issues.
- 1.2 The topics raised in CSR 6 require the Authorities in Malta to address the potential risks arising from the exposure to the real estate market and to further strengthen the provisions for loan impairment losses².

2. Proposed Amendments

- 2.1 A number of amendments have been proposed to Banking Rule BR/09 (hereunder referred to as the "draft Rule") with the scope of addressing the risk areas mentioned above. Such risks mainly emanate from direct or indirect exposures to the real estate market either through lending facilities to this market segment and/or through the hypothecation of immovable property which serves as collateral against bank lending to all economic sectors in general. The measures also seek to address the strengthening of provisions/impairments on loan exposures.
- 2.2 To mitigate to the extent possible that such potential risks emanating from the above mentioned areas undermine the stability of the local banking sector, the MFSA is proposing amendments to the draft Rule based on three main measures.
- 2.3 The first measure directs institutions to adopt a more conservative stance to accounting for impairment on loan exposures as applicable through

¹ http://ec.europa.eu/europe2020/pdf/nd/csr2012_malta_en.pdf

² http://ec.europa.eu/europe2020/pdf/nd/idr2013_malta_en.pdf

International Financial Reporting Standards (IFRSs). This approach includes, but is not limited to, the implementation of conservative and prudent triggers within IAS 39 to identify and recognise losses within the IFRS framework as early as possible. The draft Rule also lays down specific haircuts that are to be applied by banks to determine the recoverable amount of collateral prior to applying the discounting process required by IFRS. The extent of the haircut is dependent on the number of months past due on such exposures.

- 2.4 The second measure which the draft Rule introduces is in respect of foreborne exposures, whereby a borrower may be considered unable to meet the terms and conditions of the original contract of credit due to financial constraints, so that the institution may decide to modify the terms and conditions of the contract to enable the debtor to service the debt or to refinance, totally or partially, the original contract. This measure mainly addresses the credit re-grading of such exposures.
- 2.5 The third measure proposed within the draft Rule has the scope of bridging the 'gap' between the allocation of impairment allowances in respect of impaired facilities as identified in terms of the prevailing accounting principles (adopted by all licensed credit institutions in terms of the IFRSs, particularly with respect to International Accounting Standard 39 - Financial Instruments: Recognition and Measurement [IAS 39]) versus the level of non-performing loans (doubtful or ninety days past due) as quantified through the regulatory and prudential principles advocated by Banking Rule BR/09. Therefore, to address any latent risk generated by the afore-mentioned 'gap', the draft Rule requires institutions to allocate capital buffers to a specific non-distributable capital reserve.

3. Way Forward

- 3.1 The MFSA is issuing the draft Rule for a one month consultation period to all credit institutions licensed under the Banking Act 1994 and other interested stakeholders, up to the end of September 2013.
- 3.2 Following this consultation period, it is envisaged that Banking Rule BR/09 will come into force during the third quarter of 2013.

3.3 Representatives of all credit institutions are expected to undertake, on a best effort basis, any relevant impact assessments on their asset portfolios in order to determine the effect that the draft requirements would have on the respective credit institutions' financial operations. Such impact assessment should also take into consideration the effects which the forthcoming changes to capital adequacy requirements driven by the implementation locally of Regulation (EU) 575/2013 (Capital Requirements Regulation) would have on the institution's own funds position, particularly the envisaged effect that changes emanating from the alteration of risk weights for particular exposure classes driven by this Regulation³.

Any enquiries which credit institutions may have in this regard and the results of the impact assessments should be presented to Mr Karol Gabarretta – Director Banking Supervision Unit (email- kgabarretta@mfsa.com.mt) by not later than 30 September 2013.

Thank you for your cooperation.

Communications Unit
Malta Financial Services Authority
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³ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:176:0001:0337:EN:PDF>