5 June 2024

Banking Supervision Office
Tel: (356) 2144 1155

Dear Chief Executive Officer,

Preparedness to Upcoming Changes in the Capital Requirements Regulation (CRR): Industry-Wide Survey

Directive 2013/36/EU ('the Capital Requirements Directive' or 'the CRD') and Regulation (EU) No 575/2013 ('the Capital Requirements Regulation' or 'the CRR'), together, lay down prudential regulatory requirements for the EU banking sector. The framework is supplemented with a number of Implementing and Delegated Acts that are directly applicable, as well as a number of Guidelines issued by the European Banking Authority (the 'EBA') which are implemented by EU Member States. The lists of the currently applicable Acts emanating from the CRD and the CRR are accessible from the European Commission's Website. The EBA Guidelines are available through the Interactive Single Rulebook on the EBA website, for both the CRD and the CRR.

The objective of the entire prudential framework is to enhance the resilience of the sector by strengthening the institutions' solvency and liquidity positions, as well as their risk management practices. In this regard, credit institutions are obliged and expected to abide by these legal requirements on a continuous basis, as this ultimately leads to a safe and robust banking sector.

In October 2021, the European Commission published its proposal for a review of the CRD and the CRR, commonly referred to as the banking package (CRD6/CRR3). Such rules, amongst others, are aimed at implementing the final elements of the Basel III agreement whilst considering the specific context in which EU credit institutions conduct their operations. Following months of negotiations, an agreement on the text was reached between the EU Council and the EU Parliament towards the end of 2023, and the text was published on the respective institutions' websites, thereby ensuring transparency and allowing credit institutions sufficient time to prepare for the implementation of such rules[1].

The final text is expected to be published in the Official Journal of the EU towards the end of Q2 2024[2]. The application date for the CRR3 rules has been set for the 1 January 2025, whilst Member States are provided with an eighteen-month timeframe to transpose and implement CRD6 provisions into national law. Within this context, in December 2023 the EBA published its roadmap on the implementation of the Banking Package. This publication lists the EBA mandates emanating from the banking package which include, amongst others, the delivery of regulatory and implementing technical standards, guidelines, opinions and reports, with the latter potentially leading to other legislative proposals. In addition to the EBA mandates, mandates to the European Commission and the European Securities and Markets Authority ('ESMA') are included in Annex I to this letter. Credit institutions are expected to follow developments related to the banking package mandates, to participate in public consultations and to prepare for any required implementation accordingly.

Industry-wide survey

The Malta Financial Services Authority ('the Authority') is hereby launching an industry-wide survey amongst all licensed credit institutions, with the aim of assessing the institutions' level of preparedness for the new and amended requirements envisaged in the CRR3 text.

Specifically, the survey aims at establishing:

a) the impact on the institutions' overall capital position,
b) the institutions' planned changes from a qualitative perspective including the alterations to the governance frameworks, strategy, risk management, IT infrastructure and training,
c) the more granular impact on capital through the different risks and for specific exposures which are deemed of relevance, and
d) the enhanced reporting capability under the CRR3.

[1] CRD6 text is available at: https://data.consilium.europa.eu/doc/document/ST-15882-2023-INIT/en/pdf whilst the CRR3 text is available at: https://data.consilium.europa.eu/doc/document/ST-15883-2023-INIT/en/pdf

[2] The final text to be published in the Official Journal shall not differ in substance to the text currently available on the websites of the European Council and the European Parliament.

An overview of the most relevant changes being brought about by the CRR3 can be found in Annex II to this letter, thereby providing a high-level description of the updated rules.

Outline of the survey

The excel based survey encompasses two different approaches, catering for both the quantitative and qualitative aspects of the assessment. The first two sheets cover instructions and basic details of the institution, sheet *"1) Self-Assessment"* mainly covers the qualitative aspects, and also some quantitative elements, and sheets *"2) Supervisory Information"* to *"8) Securitization"* require more granular quantitative input.

In anticipating the adoption of CRR3 in early 2025, the qualitative part seeks to understand the envisaged institutional changes in the governance frameworks, strategy, risk management, IT infrastructure and training, for specific areas. On the other hand, the quantitative part delves deeper into some of the specified areas and requires the provision of more granular data in relation to credit risk, operational risk, market risk, leverage and securitisation.

Submission to the Authority

Credit institutions are requested to submit to the Authority the duly completed survey via email on bankingsupervision@mfsa.mt and **by not later than 2 August 2024**. Any queries should also be directed to the same email address, clearly indicating the reference to this survey.

Yours Sincerely,
Malta Financial Services Authority

Christopher Peter BUTTIGIEG (Signature) Digitally signed by Christopher Peter BUTTIGIEG (Signature) Date: 2024.06.04 13:58:57 +02'00'	Catherine GALEA (Signature) Digitally signed by Catherine GALEA (Signature) Date: 2024.06.04 14:40:45 +02'00'
Christopher P. Buttigieg **Chief Officer Supervision**	Catherine Galea **Head – Banking Supervision**

Annex I: Other mandates not identified in the EBA Roadmap

Area	Responsible Party	Regulation	Article	Deliverable
Third Country Branches	European Commission	CRD	48b(2)	Decisions relating to third country's banking regulatory framework so branches of institutions originating from such jurisdictions are deemed as 'qualifying third country branches.'
Market risk	European Commission	CRR	461a	Postponement/Offsetting own funds requirements for market risk due to differences in the implementation of related international standards by third countries.
LGD estimation	European Commission	CRR	500(2a)	Legislative proposal to extend, reintroduce, or amend, as needed, the adjustment for massive disposals.
Prudential treatment of crypto assets	European Commission	CRR	501d(1)	Legislative proposal to introduce a dedicated prudential treatment for exposures to crypto assets.
ESG risks	ESMA	CRR	135(3a)	To prepare a report on whether ESG risks are appropriately reflected in ECAI credit risk rating methodologies and if appropriate, leads to legislative proposals by the Commission.
Framework for prudential requirements	European Commission	CRR	518c	To prepare a report on the appropriateness of the Union regulatory and supervisory frameworks for banking.

Annex II: Overview of the updated Capital Requirements Regulation (CRR3)

The new CRR3 will be impacting credit institutions across the board and include both new and amended provisions with respect to the different risks. This overview provides a high-level outline of the new requirements, which shall not be construed as an exhaustive summary of the new obligations emanating from CRR3.

Credit risk

In the area of credit risk, these include targeted revisions to the standardised approach (SA-CR). These changes are in line with the Basel standards and aim to make the approach more risk sensitive for specific areas. The following are some of the most notable changes:

a) the determination of the exposure value of off-balance sheet items and commitments on off-balance sheet items;
b) the introduction of a specialised lending exposure regime under the standardised approach;
c) a risk weight multiplier for exposures with currency mismatches;
d) the introduction for the preferential treatment of real estate exposures, including for income producing real estate (IPRE) mortgage loans and for loans financing land acquisition, development and construction (ADC); and
e) the revised treatment for equity exposures.

The CRR3 reduces the scope of the Internal Ratings-Based approach for credit risk. The IRB framework has been revised to establish limits to its application, including but not limited to: (a) limiting the use of the Advanced IRB approach only to exposure classes where robust modelling is deemed feasible, while other exposure classes will be migrated to less sophisticated methods (Foundation IRB or Standard method); (b) new treatment for exposures to public sector entities, regional governments and local authorities; and (c) introducing input floors to establish minimum levels of own estimates.

Operational risk

In the context of operational risk, the package also implements the new Basel standards. The calculation of capital requirements for operational risk is made simpler and it mainly relies on the corresponding financial statements of credit institutions. With the introduction of a new single, non-model-based, standardised approach, three main components shall be considered. These are the interest, leases and dividend component (ILDC), the services component (SC), and the financial component (FC). The Business Indicator Component (BIC) will be the unique factor for calculating own funds requirements. Institutions with a BIC greater than Eur750 million shall be required to calculate and disclose their annual operational risk losses. Keeping in mind level playing field considerations and to ensure a simpler calculation, legislators opted not to consider the related historical losses.

Market risk

On the market risk side, the CRR3 updates are mainly linked to the alignment of prudential regulation with the Fundamental Review of the Trading Book (FRTB) standards. Amendments introduce own funds requirements according to FRTB and also lay down the conditions for the use of the different methods namely, the Alternative Standardised Approach (A-SA), the Alternative Internal Model Approach (A-IMA) or the Simplified Standardised Approach (SSA).

The criteria for distinguishing between the Trading Book and the Banking Book have also undergone revisions. Amongst others, these now include dedicated provisions that would allow institutions to distinguish between certain instruments and their correct placement. Certain derogations are being permitted but are generally subject to supervisory approval. For calculating the own fund requirements for Credit Valuation Adjustment (CVA) risk, the CRR3 replaces the current framework with three new approaches; the Standardised Approach, the Basic Approach, and the Simplified Approach.

Internal models

Credit institutions shall take note of the introduction of the output floor, which has been implemented to reduce the excessive variability in the capital requirements of credit institutions that use internal models. This framework sets a lower bound for the minimum capital requirements calculated using the institutions' internal models, equivalent to 72.5% of the standardised approaches. This shall be phased over a transition period before becoming fully applicable in 2032. The current agreement is envisaged to apply at both group level and at subsidiary level. Member States could opt to derogate from the individual level application for banking groups established within their jurisdiction.

Environmental, Social and Governance risks

As expected, the new CRR3 provisions place a lot of emphasis on ESG risks, tied up with the requirements emanating from the Capital Requirements Directive. Such elements support the Union's ambition to move towards a net-zero greenhouse emissions target by the year 2050. ESG risks shall be integrated within the risk management framework of institutions. They are also required to have strategies and processes in place to assess and maintain internal capital for ESG risks, by developing specific plans and quantifiable targets to monitor and address the risks arising from the misalignment of the business model and strategy of the institution with the relevant Union policy objectives. Institutions will also be expected to test their resilience to the long-term negative impacts of ESG factors.

Reporting and disclosure requirements

The CRR3 brings about significant changes to credit institutions' reporting requirements due to the underlying regulatory provisions on the various risk types. It also introduces additional reporting requirements related to ESG risks. In addition, the scope has been widened in the case of disclosures in relation to a number of risks such as CVA, operational risks, and ESG. New disclosures are also present, including those related to exposures to crypto-assets and related activities, and to shadow banking entities.
