23 October 2024

Banking Supervision Office
Tel: (356) 2144 1155

Dear Chief Executive Officer,

Re: Compliance with the Capital Requirements Regulation: Pillar 3 disclosures

The Basel Committee on Banking Supervision has developed an internationally agreed set of measures aimed at strengthening the regulation, supervision and risk management of the banking sector. This framework is built on three main pillars: minimum capital requirements (Pillar 1), supervisory review (Pillar 2) and market discipline (Pillar 3).

Pillar 3 of the Basel framework is specifically designed to promote market discipline by mandating disclosure requirements for banks. These requirements necessitate that banks regularly disclose specific qualitative and quantitative information, either as part of their financial reports or through separate Pillar 3 reports. The EU has implemented the Basel Pillar 3 framework through Part Eight of Regulation (EU) No 575/2013 (the Capital Requirements Regulation, hereinafter referred to as the 'CRR'). These disclosure obligations apply to all institutions in accordance with Articles 6, 10 and 13 of the CRR, with proportionality measures applied based on the risk profile and significance of their operations. Large institutions[1] are required to provide comprehensive disclosures across all key areas, including detailed metrics on own funds, leverage, liquidity, core banking risks and information on their remuneration policies and ESG risks. Regular institutions[2] must disclose similar metrics, however the level of detail and reporting frequency are reduced compared to large institutions, reflecting their moderate size and complexity. Small and non-complex institutions[3] benefit from simplified disclosure requirements. They focus on core areas such as own funds, leverage ratios, and liquidity risk, but are exempt from more detailed or granular disclosures required from larger institutions. Since mid-2021, Commission Regulation (EU) 2021/637 has further detailed these Pillar 3 requirements by setting out uniform formats and tables as mandated by the CRR.

[1] As defined in point (146) of Article 4(1) of CRR
[2] Refers to institutions not classified as large institutions or as small and non-complex institutions
[3] As defined in point (145) of Article 4(1) of CRR

For more detailed information and updates, the European Banking Authority (EBA) provides resources on its webpage dedicated to Transparency and Pillar 3.

Ensuring compliance with Pillar 3 disclosure requirements is crucial for maintaining transparency and stability within the banking sector, thereby reinforcing market discipline. Accurate and timely disclosures are fundamental to fostering trust among stakeholders, including regulators, investors, and the public. Credit institutions are expected to meet these requirements not only to fulfil regulatory obligations but also to enhance their credibility and accountability.

Banking Package CRD6/CRR3

The CRR3 introduces the final set of Basel III standards, resulting in significant changes to the CRR Pillar 3 framework. These amendments aim to further enhance transparency and market discipline by refining disclosure requirements and aligning them more closely with international standards. To implement Article 434a of the CRR and provide institutions with integrated, uniform disclosure formats, the EBA has proposed replacing the current disclosure regulation with a new one. In June 2024, the Final Draft Implementing Technical Standard (ITS) implementing CRR3 requirements was published by the EBA and submitted to the European Commission for approval, ahead of publication in the Official Journal. It is expected to apply from 1 January 2025.

This EBA webpage provides access to this final draft ITS and includes details on recent developments in the Pillar 3 framework. To note that further enhancements to the Pillar 3 framework are anticipated in the coming months.

As mandated by Article 434 of the revised CRR, the EBA will be required to publish all prudential disclosures for institutions subject to Pillar 3 requirements, making them readily accessible to stakeholders through a centralised electronic access point on its website. To comply with this mandate, the EBA is developing a Pillar 3 Data Hub (P3DH) to consolidate all disclosures required under Part Eight of the CRR. The P3DH aims to promote more efficient use of prudential information by stakeholders across the EU and to strengthen the EBA's role in promoting market discipline. The P3DH will incorporate proportionality measures by differentiating the reporting processes for large institutions, regular institutions and small and non-complex institutions (SNCIs).

For large and regular institutions, disclosures will be submitted directly to the EBA in a standard format, ensuring a high degree of data comparability and transparency.

The Consultation Paper launched by the EBA on 11 October 2024 focuses on the draft Implementing Technical Standards (ITS) that outline the IT solutions and processes to be followed by large and regular institutions for submitting their Pillar 3 disclosures. This includes guidance on the IT systems to be used, data exchange formats, and the technical validations that will be performed by the EBA.

In contrast, for SNCIs, the EBA is planning to calculate and derive disclosure figures based on the supervisory reporting data already submitted by these institutions, thus reducing the reporting burden for smaller banks. This approach not only facilitates the centralised publication of SNCIs' data but also aligns with the proportionality principle, ensuring that these institutions face reduced administrative requirements while maintaining transparency. A separate public consultation concerning the draft ITS for SNCIs and the resubmission policy is expected to follow at a later stage.

Furthermore, the P3DH is expected to feed credit institutions' Pillar 3 information into the European Single Access Platform (ESAP), which aims to centralize the disclosure of public corporate information in the financial market. More detailed information on the P3DH is available in the dedicated EBA webpage.

Article 434 of the revised CRR also requires the EBA to maintain a tool that maps Pillar 3 disclosures with Supervisory Reporting. This tool is designed to facilitate the collation of information in disclosure templates and tables by banks, ensure accuracy and consistency with data submitted to regulators and support competent authorities in their supervisory assessments.

Credit institutions are expected to implement the new requirements introduced by the final draft ITS in a timely and accurate manner, adapt to upcoming changes in the operational aspects of the Pillar 3 framework in a timely manner and comply with all stringent disclosure requirements to ensure transparency and effective market discipline. Beyond regulatory obligations, adherence to these new requirements is a vital component of the broader prudential framework, essential for maintaining confidence in the financial system, with proportionality ensuring that the burden on smaller institutions is balanced against their size and risk profile.

Stocktake Questionnaire

In May 2024, the Malta Financial Services Authority (the 'Authority') distributed a questionnaire to Compliance Officers of Less Significant Institutions (LSIs) to take stock and gather feedback on their compliance with the general disclosure requirements set out in Articles 431 to 434 of the currently applicable CRR, as

supplemented by Commission Regulation (EU) 2021/637. The purpose of this questionnaire was to assess LSIs' current state of compliance and identify areas for improvement.

Following the collection of responses, the Authority conducted a thorough review to verify the institutions' compliance with the current disclosure requirements and to evaluate the alignment of the responses with LSIs' actual practices. It should be noted that the findings outlined in this letter are largely based on the institutions' responses to the questionnaire. This letter provides insights into the aspects of focus from the stocktake questionnaire and outlines observed positive practices and compliance issues, while also putting forward a number of recommendations.

1. Arrangements to publish required disclosure information (Articles 433a, 433b, and 433c of the CRR)

It is considered best practice for an institution to have formal arrangements in place for publishing required disclosure information. Such structures ensure consistency, accuracy, and timeliness in meeting regulatory obligations. Formalised processes help standardise the preparation and review of disclosures, reducing the risk of errors and ensuring that all relevant information is appropriately captured. Additionally, these arrangements facilitate internal accountability by clearly defining roles and responsibilities within the institution, ensuring a well-coordinated disclosure process. This approach not only helps maintain compliance with regulatory requirements but also strengthens the institution's transparency and credibility with stakeholders, reinforcing trust and market confidence.

Observed positive practices and compliance:

- A majority of banks have generally arranged for the required disclosure information to be included in their Annual Reports and/or made available on their websites.
- A majority of banks are compliant with the disclosure requirements, demonstrating a clear understanding and implementation of Articles 431 to 434 of the CRR.

Compliance issues:

- Discrepancies and absent information in publicly available disclosures have been observed for some institutions.

Recommendations:

- Ensure accurate size and complexity classification of the institution in line with CRR criteria and adherence to the applicable disclosure requirements.

- Align public disclosures with declared compliance and make all required information publicly available in a readily accessible format.

2. Implementation of formal policies and procedures (Article 431(3) of the CRR)

In line with Article 431(3) of the CRR, having formal policies and procedures to publish required disclosure information is an obligation. Such formalised documentation ensures that the disclosure process is systematic and repeatable, minimising the risk of omissions, inconsistencies or delays. By clearly outlining the steps, roles and responsibilities involved in preparing and publishing disclosures, these policies promote internal accountability and enable the institution to respond efficiently to regulatory changes or emerging risks. Additionally, formal policies and procedures enhance the institution's ability to demonstrate transparency and due diligence to regulators, investors and other stakeholders, thereby reinforcing trust and safeguarding its reputation in the market.

Observed positive practices and compliance:

- Most banks have established comprehensive policies and procedures that align with Article 431(3) of the CRR.
- Institutions have demonstrated a commitment to maintaining transparency and accountability through robust internal processes.

Compliance issues:

- Some institutions are partially compliant or non-compliant with their obligations under Article 431(3).

Recommendations:

- Ensure the development of formal policies and procedures where these are currently absent.
- Conduct periodic thorough assessments of relevant existing policies and procedures to ensure full and continued compliance with Article 431(3) of the CRR.

3. Audit of information subject to disclosure publication

Auditing the information subject to publication ensures the accuracy, completeness, and reliability of the data presented to stakeholders. An independent audit provides an objective evaluation of the disclosure process, identifying any potential errors, inconsistencies, or gaps that could undermine the institution's compliance with regulatory requirements. By subjecting disclosures to rigorous scrutiny, the institution mitigates the risk of regulatory measures and reputational damage, as

well as reinforces the trust of regulators, investors and the public in its commitment to high standards of governance and accountability.

Observed positive practices and compliance:

- A majority of institutions have declared a robust approach towards auditing disclosure information before publication and have made necessary arrangements.

Recommendations:

- Institutions are highly encouraged to consider having disclosures audited to enhance transparency and accountability.
- Ensure robust internal verification procedures to maintain the integrity and accuracy of disclosures.

4. Frequency and intervals of disclosures (Article 433 of the CRR)

Ensuring consistency in the required frequency and intervals of disclosure publications reinforces transparency and reliability in the institution's communication with stakeholders. Regular and timely disclosures, in accordance with regulatory schedules, enable stakeholders to make informed decisions based on the most current and relevant information. Consistency in disclosure timing also demonstrates the institution’s commitment to meeting its regulatory obligations, helping to build and maintain trust with regulators, investors and the public. Moreover, adhering to a predictable disclosure cadence reduces the risk of oversight or delays, ensuring that all required information is shared promptly and that the institution remains in full compliance with regulatory expectations.

Observed positive practices and compliance:

- Banks have declared compliance with the required frequency and intervals for annual and quarterly disclosures, ensuring timely and regular updates of relevant information.

Compliance Issues:

- Non-compliance with semi-annual disclosure requirements was noted among a few institutions.

Recommendations:

- Institutions are reminded of their semi-annual disclosure obligations under Article 433.
- Ensure correct interpretation of the obligations and alignment with the relevant considerations for proportionality.

5. Location and availability of publication (Article 434 of the CRR)

Ensuring a clear and consistent location for the publication of disclosures, such as on the institution's website, facilitates easy access and transparency for stakeholders. When disclosures are consistently published in a dedicated and well-organised section of the website, it simplifies the process for regulators, investors and the public to find and review the necessary information. This practice aligns with CRR requirements and other regulatory expectations, which mandate that disclosures are readily accessible. By maintaining a reliable and centralised platform for disclosure publications, the institution demonstrates its commitment to openness and accountability while enhancing the efficiency of stakeholder communication.

Observed positive practices and compliance:

- The majority of institutions have completed the necessary arrangements to make their disclosures publicly available through the Annual Report and a dedicated area on their website.

Compliance issues:

- Several institutions need to finalise arrangements for a specific location for disclosures, ensuring they are readily accessible to the public.

Recommendations:

- Institutions are reminded of their obligations under Article 434. Those still in the process of finalising the necessary arrangements should ensure compliance at the earliest possible, keeping in mind the upcoming developments related to the P3DH.

Conclusion and way forward

The analysis highlights a number of compliance issues among Less Significant Institutions, particularly concerning semi-annual disclosure requirements and the implementation of formal policies. While the Authority expects all banks to adhere to the Pillar 3 requirements as set out in the CRR and other applicable legal instruments, the principle of proportionality ensures that the volume, granularity and frequency of disclosures are aligned with the size, complexity and risk profile of each institution. However, this does not diminish the requirement for all banks to meet adequate standards. These include implementing formal policies and procedures, as well as maintaining consistent publication practices. The Authority calls on all banks to review and enhance their current practices where necessary to ensure full

alignment with these expectations, demonstrating their commitment to transparency, accountability and the highest standards of governance. Furthermore, the Authority encourages external audits of disclosures to promote transparency and accountability.

The MFSA would like to thank all institutions for their responses to the questionnaire and for their attention to the above recommendations.

As a way forward, the Authority intends to conduct thorough assessments of LSIs' quantitative and qualitative information published in Pillar 3 disclosures. The assessment process will commence in November 2024 and continue throughout 2025. Institutions will be expected to fully cooperate during this assessment process, providing any requested feedback and information promptly. The insights gained from these assessments will help identify areas for improvement and ensure that all institutions adhere to best practices and requirements, thereby reinforcing transparency, market discipline, and the overall stability of the financial system. In addition, such assessments will support local banks' preparedness for the implementation of the P3DH and ESAP.

Should you have any questions or require further clarification, please do not hesitate to contact us.

Yours sincerely,

Malta Financial Services Authority

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