

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

BANKING UNIT

BANKING RULES

*OWN FUNDS OF CREDIT INSTITUTIONS
AUTHORISED UNDER THE BANKING ACT 1994*

Ref: BR/03/2008

OWN FUNDS OF CREDIT INSTITUTIONS AUTHORISED UNDER THE BANKING ACT 1994

INTRODUCTION

1. In terms of Article 4 of the Banking Act 1994 ('the Act') the competent authority ('the authority') as appointed under Article 3 (1) of the Act may make Banking Rules as may be required for carrying into effect any of the provisions of the Act. The authority may amend or revoke such Banking Rules. The Banking Rules and any amendment or revocation thereof shall be officially communicated to banks and the authority shall make copies thereof available to the public.
2. The Own Funds Rule ('the Rule') is being made pursuant to Article 16 (A)(3) which states that:

“The competent authority shall issue a banking rule as it shall consider appropriate for the regulation of own funds”
3. The Rule provides for a definition for the computation of the Own Funds of a credit institution authorised under the Act. The responsibility for observing the obligations in relation to the maintenance of Own Funds under the Act rests entirely with the credit institution's Board of Directors and its Management.

SCOPE AND APPLICATION

4. The Rule applies to all credit institutions licensed under the Banking Act 1994.
5. Article 7 (1) (a) of the Act requires a credit institution to have Own Funds, whether in EUROS or in another currency acceptable to the competent authority, amount to not less than the value of five million EUROS. As required under paragraph 17 of the Application Procedure for Authorisation of Licences for Banking Activities Rule (BD/01), Appendix 1 of this Rule also applies to an applicant for a licence under the Act in fulfilling the requirements under Article 7 (1) (a).
6. The scope of the Rule is to standardise the rules for the compilation of Own Funds. To achieve this scope in an international context, the Rule has been modelled on the requisites of the Codified European Union Directive 2000/12/EC of 20 March 2000 – Title V: Principles and Technical Instruments for Prudential Supervision, Chapter 2 Technical Instruments of Prudential Supervision, Section 1: *Own Funds*.
7. The Own Funds of a credit institution as calculated under this Rule shall be applied to:
 - (a) the calculation of Large Exposures in accordance with the Large Exposures Rule (BR/02) as provided for under Article 16 of the Act;

- (b) the computation of the Capital Requirement in accordance with the Capital Requirements Rule (BR/04) as provided for under Article 17 of the Act; and
- (c) the computation of the Capital Adequacy Ratio in accordance with the Capital Adequacy Rule (BR/08) as provided for under Article 17 of the Act.

BRANCHES OF OVERSEAS INSTITUTIONS

8. Paragraph 29 of the Application Procedures for Authorisation of Licences for Banking Activities Rule (BR/01) states that a licence issued to a credit institution incorporated outside Malta to carry on its business of banking through a branch in Malta is deemed to having been granted to that institution as a whole and there is therefore no requirement for such a branch to have its Own Funds under Article 7 (1) (a) of the Act. Consequently this Rule does not apply to branches of overseas institutions. The authority however expects the overseas institution to maintain the level of Own Funds required under Article 7 (1) (a) of the Act.

COMPONENTS OF OWN FUNDS

9. Appendix 1 to this Rule sets out and defines the components which make up the Own Funds of a credit institution.

Consolidated Own Funds

- 9A. Further to the provisions of paragraph 8.00 of Appendix 1 of this Rule, in reporting own funds on a consolidated basis pursuant to Banking Rule BR/10 on the Supervision on a Consolidated Basis, credit institutions are required to determine the composition of the banking group to be consolidated in terms of paragraph 6 of the said Rule.

9B. *Paragraph Deleted*

9C. *Paragraph Deleted*

COMPLIANCE

10. Original Own Funds and Additional Own Funds may be used to support both banking and trading book activities as defined in the Capital Adequacy Rule (BR/08).
11. Supplementary Own Funds may only be used to support trading book activities as defined in the Capital Adequacy Rule (BR/08).
12. Compliance with the conditions of this Rule must be proved to the satisfaction of the authority.

OFFENCES AND PENALTIES

13. Any person who commits an offence in terms of this Rule as provided for under Article 35 of the Act is liable to such penalties as may be prescribed pursuant to the said Article.

OWN FUNDS**1.0.0 ORIGINAL OWN FUNDS****1.1.0 Additions****1.1.1 Ordinary Shares**

The nominal paid-up value of the share capital shall be reported. Do not report the unpaid element of partly-paid shares or authorised but unissued share capital. Where shares have been issued at a premium, the premium should be reported separately under the item 1.1.3 - Share premium.

1.1.2 Perpetual non-cumulative preference shares

Report perpetual non-cumulative preference shares. Only shares which have been issued and paid up should be reported.

1.1.3 Share premium account

Report any amount received in excess of the nominal value of any shares issued by the reporting credit institution.

1.1.4 Other reserves

Report capital and revenue reserves not reported elsewhere.

1.1.5 Profit and loss account

Report the balance of the 'Profit and Loss Account' which is available for distribution to the shareholders. A debit balance must be included as a negative amount.

1.1.6 Interim profits

Report only interim profits net of any foreseeable charge or dividend, provided that these profits have been verified by the external auditors of the reporting credit institution. The proviso is only applicable when the solvency ratio is to be published and/or to be made known to the general public. Publication/announcement of the solvency ratio is however allowed if interim profits which have not been verified by the external auditors are completely excluded from the computation.

1.1.7 Minority interests

Report the amount attributable to outside interests reported in capital items forming part of original Own Funds of any partly owned subsidiary company or minority owned company which is included in the computation of Own Funds.

1.2.0 Deductions**1.2.1 Own shares**

Report own shares held at book value by the reporting credit institution.

1.2.2 Intangible assets

Report all intangible assets such as formation expenses and goodwill (including goodwill arising on consolidation) to the extent that it was acquired for a valuable consideration.

1.2.3 Interim losses

Report interim losses.

1.2.4 Shares issued by the capitalisation of property revaluation reserves

Report all shares issued by the capitalisation of property revaluation reserves.

1.3.0 Total Original Own Funds

The total of items 1.1.1 to 1.1.7 less the total of items 1.2.1 to 1.2.4 represent the '*Total Original Own Funds*'.

2.0.0 ADDITIONAL OWN FUNDS**2.1.0 Additions****2.1.1 Revaluation reserves**

Report reserves arising from the revaluation of tangible fixed assets and financial fixed assets. For the purposes of the Rule "financial fixed assets" shall **only** be deemed to include long-term equity investments in subsidiary and associated companies. "Financial fixed assets" shall also exclude all holdings in investment companies with variable or fixed share capital (SICAVs, INVCOs) and any other similar investments of the reporting credit institution.

2.1.2 General provision for bad and doubtful debts

Report general provisions for bad and doubtful debts which do not reflect a known deterioration in the valuation of particular assets. Where, however, provisions have been created against identified losses or in respect of an identified deterioration in the value of any asset or group or subsets of assets, they are not freely available to meet unidentified losses which may subsequently arise elsewhere in the portfolio and do not possess an essential characteristic of capital. Such provisions should therefore not be included under this item.

Therefore all elements in general provisions or general loan loss reserves designed to protect a credit institution from identified deterioration in the quality of specific assets (whether foreign or domestic) should be ineligible for inclusion.

Any provisions which are not eligible for inclusion under this item shall be netted against the value of the asset against which such provisions have been made. In case of doubt on the apportionment of such provisions, the reporting institution should refer the matter to the competent authority for guidance.

2.1.3 Perpetual securities

Report under this item securities and other instruments of indeterminate duration that fulfil the following conditions:

- [a] they may not be reimbursed on the bearer's initiative or without the prior agreement of the competent authority;
- [b] the debt agreement must provide for the reporting credit institution to have the option of deferring the payment of interest on the debt;
- [c] the lender's claims on the reporting credit institution must be wholly subordinated to those of all non-subordinated creditors;
- [d] the documents governing the issue of the securities must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the reporting credit institution in a position to continue trading;
- [e] only fully paid-up amounts shall be taken into account.

Perpetual cumulative preference shares are to be reported under this item.

2.1.4 Fixed term preference shares

Report any fixed term cumulative and non-cumulative preference shares if binding agreements exist under which, in the event of the bankruptcy or liquidation of the reporting credit institution, they rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled. The extent to which fixed term preference shares may rank as own funds must be proportionately reduced during, at least, the last five years before the repayment date.

2.1.5 Subordinated loan capital

Report subordinated loan capital if the following conditions are fulfilled:

- [a] if binding agreements exist under which, in the event of the bankruptcy or liquidation of the reporting credit institution, they rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled;

- [b] only fully paid-up funds may be taken into account;
- [c] the loans involved must have an original maturity of at least five years, after which they may be repaid; if the maturity of the debt is not fixed, they shall be repayable only subject to five years' notice unless the loans are no longer considered as own funds or unless the prior consent of the competent authority is specifically required for early repayment. The permission for the early repayment of such loans may only be granted provided that the request is made at the initiative of the issuer and the solvency of the reporting credit institution in question is not affected;
- [d] the extent to which they may rank as Own Funds must be proportionately reduced during, at least, the last five years before the repayment date; and
- [e] the loan agreement must not include any clause providing that in specified circumstances, other than the winding up of the reporting credit institution, the debt will become repayable before the agreed repayment date.

2.1.6 Shares issued by the capitalisation of property revaluation reserves

Report the amount deducted under item 1.2.4.

2.1.7 Minority interests

Report the amount attributable to outside interests reported in capital items forming part of Additional Own Funds of any partly owned subsidiary company or minority owned company which is included in the computation of own funds.

2.2.0 Total Additional Own Funds

The total of items 2.1.1 to 2.1.7 represent the *'Total Additional Own Funds'*.

3.0.0 TOTAL GROSS OWN FUNDS

The total of Original Own Funds (item 1.3.0) and Additional Own Funds (item 2.2.0) represents the *TOTAL GROSS OWN FUNDS*.

4.0.0 SUPPLEMENTARY OWN FUNDS

4.1.0 Additions

4.1.1 Subordinated loan capital

Report subordinated loan capital if the following conditions are fulfilled:

- [a] if binding agreements exist under which, in the event of the bankruptcy or liquidation of the reporting credit institution, they rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled;

- [b] only fully paid-up funds may be taken into account;
- [c] the loans involved must have an original maturity of at least two years, after which they may be repaid; if the maturity of the debt is not fixed, they shall be repayable only subject to two years' notice unless the loans are no longer considered as own funds or unless the prior consent of the competent authority is specifically required for early repayment. The permission for the early repayment of such loans may only be granted provided that the request is made at the initiative of the issuer and the solvency of the reporting credit institution in question is not affected;
- [d] the extent to which they may rank as Own Funds must be proportionately reduced during, at least, the last two years before the repayment date; and
- [e] the loan agreement must not include any clause providing that in specified circumstances, other than the winding up of the reporting credit institution, the debt will become repayable before the agreed repayment date.

4.1.2 Net trading book profits

Net trading book profits less any foreseeable charges or dividends provided that none of this amount has already been included in item 1.1.6 of this Rule. The competent authority must be satisfied that these trading book profits have been calculated using appropriate techniques.

4.2.0 Deductions

4.2.1 Net losses

Net losses on other business provided that none of this amount has already been included in item 1.2.3 of this Rule.

4.3.0 Total Supplementary Own Funds

The total of items 4.1.1 and 4.1.2 less the item 4.2.1 represent the '*Total Supplementary Own Funds*'.

5.0.0 DEDUCTION OF HOLDINGS IN OTHER CREDIT/FINANCIAL INSTITUTIONS

5.1.0 Holdings amounting to more than 10% of the investee institution's capital

When the reporting credit institution holds more than 10% of the capital of another credit institution or financial institution, for each holding, the following shall be deducted from the total Gross Own Funds:

- [a] the book value amount of the capital which the reporting credit institution holds in the investee credit institution and/or financial institution; and

- [b] the book value amount of:
 - [i] subordinated claims;
 - [ii] fixed term preference shares; and
 - [iii] subordinated loan capital which the reporting credit institution has/holds in the investee credit and/or financial institutions.

5.1.1. Where shares in another credit or financial institution are held temporarily for the purpose of a financial assistance operation designed to reorganise and save the institution, the authority may waive the deductions referred to in item 5.1.0.

5.2.0 Aggregate holdings which exceed 10% of the reporting institution's Total Gross Own Funds

When the total book value amount of:

- [a] up to 10% of the capital;
- [b] subordinated claims;
- [c] fixed term preference shares; and
- [d] subordinated loan capital

which the reporting credit institution has/holds in other credit institutions and/or financial institutions in the aggregate exceed 10% of the reporting institution's Total Gross Own Funds (item 3.0.0), such a total shall be deducted from the Total Gross Own Funds.

5.2.1 Item 5.2.0 shall only apply to investments in credit institutions and/or financial institutions other than those which qualify for a deduction from Own Funds according to item 5.1.0. For the purposes of this paragraph, 'investments' shall be construed to mean any holding of capital, subordinated claims, fixed term cumulative preference shares and subordinated loan capital.

5.2.2 For the purposes of this Rule, the term 'book value' as found in items 5.1.0 and 5.2.0, shall be construed to mean either:

- [a] the historical (acquisition) cost for holdings, other than holdings specified in item 2.1.1, held in the banking book; or
- [b] the market value for holdings held in the trading book.

6.0.0 TOTAL OWN FUNDS

6.1.0 Total Gross Own Funds (item 3.0.0) less holdings in other credit institutions and/or financial institutions (items 5.1.0 and 5.2.0) represent *TOTAL OWN FUNDS* for those credit or financial institutions which are exempted from the trading book requirements under the Capital Adequacy Rule BR/08.

6.2.0 Total Gross Own Funds (item 3.0.0) and Total Supplementary Own Funds (item 4.3.0) less holdings in other credit institutions and/or financial institutions (items 5.1.0 and 5.2.0) represent *TOTAL OWN FUNDS* for those credit and financial institutions which are not exempted from the trading book requirements and therefore subject to the Capital Adequacy Rule BR/08.

7.0.0 LIMITS

7.1.0 The Original Own Funds, Additional Own Funds and Supplementary Own Funds of a credit institution which is subject to the Capital Adequacy Rule BR/08 must be assigned between the banking book and the trading book. Capital must first be assigned to the banking book (including counterparty and settlement risks), and sufficient capital must be left to support the trading book. The bank only meets its requirements if it has sufficient capital for both books.

The Risk Weighted Assets of the banking book should be covered by Original Own Funds and Additional Own Funds. Supplementary Own Funds cannot be used to support the banking book or counterparty and settlement risks under the Capital Adequacy Rule BR/08. Any remaining Original Own Funds will be eligible for the trading book capital requirements.

7.2.0 The following limits shall apply:

7.2.1 The total of item 2.1.4 - Fixed term preference shares and item 2.1.5 - Subordinated loan capital shall not exceed 50% of item 1.3.0 - Total Original Own Funds.

7.2.2 Item 2.2.0 - Total Additional Own Funds, shall not exceed item 1.3.0 - Total Original Own Funds.

7.2.3 Item 2.2.0 - Total Additional Own Funds and item 4.1.1 - Subordinated loan capital used to meet the trading book capital requirements must not in total exceed 200% of Original Own Funds left to meet trading book activities and foreign exchange risk.

7.2.4 It is the policy of the authority that, at overall consolidated group level or at solo level if a credit institution is not part of a consolidated group the sum of Item 2.2.0 - Total Additional Own Funds and Item 4.3.0 - Total Supplementary Own Funds cannot normally exceed 100% of the credit institution's Item 1.3.0 - Total Original Own Funds. This limit cannot be exceeded without the authority's express permission, which will only normally be granted where a credit institution's trading book accounts for a substantial part of its business.

7.2.5 The competent authority shall only authorise credit institutions to exceed the limits laid down in paragraphs 7.2.1, 7.2.2, 7.2.3, and 7.2.4 in temporary and exceptional circumstances.

8.0.0 CONSOLIDATED OWN FUNDS

8.1.0 When a credit institution is reporting consolidated Own Funds the consolidated balance sheet figures shall be used. The balance sheet figures of the reporting credit institution shall be used when reporting unconsolidated Own Funds¹.

8.2.0 When Own Funds are being calculated by the reporting credit institution for unconsolidated purposes, items 1.1.7 and 2.1.7 - Minority interests shall not apply.

8.3.0 When consolidated Own Funds are being reported, item 5.1.0 shall not apply to subsidiary credit and/or financial institutions which are included in the consolidated balance sheet. Holdings of share capital (and other items) of other credit and/or financial institutions as specified in item 5.2.0 shall, however, be deducted from the total of Gross Own Funds.

8.4.0 When minority interests, translation differences and any other differences arising on consolidation are debit balances, they must be shown as negative amounts under the relevant Own Funds items.

¹ Refer to paragraph 9A of the Rule.