MFSA

MALTA FINANCIAL SERVICES AUTHORITY

MFSA RULE 2 of 2012

US DOLLAR FUNDING

US DOLLAR FUNDING RULE ISSUED UNDER THE MFSA ACT

INTRODUCTION

1. In terms of Article 16(2)(a) of the MFSA Act [CAP 330] ('the Act'), the Competent Authority ('the Authority') as established under Article 3 of the Act may make Rules regulating the procedures and duties of persons licensed or authorised by it, or falling under its regulatory or supervisory functions.

2. The US Dollar Funding Rule ('the Rule') issued under the MFSA Act [CAP 330] is being implemented pursuant to Article 16(2)(a) of the Act.

3. The Rule is modelled on the Recommendation of the European Systemic Risk Board (ESRB/2011/2) published as Notice No. 2012/C 72/01 of the Official Journal of the European Union, which was approved by the General Board of the European Systemic Risk Board (ESRB) on 22 December 2011, in accordance with Regulation (EU) No. 1092/2010.

DEFINITIONS

4. For the purposes of this Rule the following definitions shall apply:

   Authority: shall mean the Malta Financial Services Authority established by Article 3 of the Act;

   Credit Institution: shall have the same meaning as is assigned to it in the Banking Act [CAP 371];

   ICAAP Report refers to the report on the findings of the internal capital adequacy assessment process undertaken by every credit institution as required by Article 17C of the Banking Act and in accordance with BR 12/2012

   A **maturity mismatch** means a mismatch that occurs when a financial institution uses short term funding to finance long-term lending

   Funding concentrations refer to funding concentrated from few or similar sources as monitored for the purposes of controlling concentration risk as defined in BR/12/2012

   Material level of US Dollar funding means an amount of US Dollar funding as a percentage of the credit institution's total liabilities as may be determined by the Authority.

A US Dollar Currency swap is a foreign exchange agreements between two parties to exchange principal or interest payments of a loan in one currency for those in another currency, where the base currency is the Euro and the other currency is the US Dollar.

SCOPE AND APPLICATION

5. The Rule applies to all credit institutions licensed under the Banking Act [CAP 371].

6. The Authority recognises that the US Dollar has proven to be a material funding currency for certain credit institutions in the European Union. As highlighted by the European Systemic Risk Board (ESRB) in its Recommendation on US Dollar denominated funding of credit institutions (ESRB/2011/2), there have been on-going strains in the US Dollar funding markets. These strains may create key direct potential system-wide risks: in particular, material maturity mismatches between the US Dollar assets and liabilities of credit institutions, where short-term funding is used to finance longer term assets in the said currency.

7. The scope of this Rule is therefore to outline the general principles regulating US Dollar ("USD") denominated funding and provide for risks inherent therein.

8. Credit institutions shall implement the principles found within this Rule in a manner proportionate to their size, nature and complexity of operations undertaken.

9. The Authority shall monitor and control US Dollar funding at both consolidated and unconsolidated (solo basis) level, as it considers appropriate, in accordance with BR/10/2011 and other provisions of relevant legislation.

10. The Authority reserves the right to request any information which a credit institution is required to gather under this Rule.

PART 1: PRINCIPLES TO BE FOLLOWED BY CREDIT INSTITUTIONS

Principle 1: Monitoring of US Dollar Funding and Liquidity

11. Credit institutions shall monitor US Dollar funding and liquidity risk as part of their overall monitoring assessment exercise of funding and liquidity positions in accordance with Banking Rule BR/05, and where applicable and merited, Banking Rule BR/12.

12. Credit institutions shall, in particular monitor:
    (i) The source and utility of US Dollar funding;
    (ii) Maturity mismatches in US Dollars, resulting from (i);
    (iii) Funding concentrations by counterparty type, with a focus on short-term funding from such counterparties;

(iv) Use of US dollar currency swaps, including currency interest rate swaps;
(v) Intra-group exposures

Principle 2: Internal risk management.

13. Credit institutions shall have in place risk strategies and policies which determine their risk tolerance with respect to USD liquidity and funding. The risk tolerance shall be commensurate with the bank's risk bearing and risk management capacities.

14. Where and if required, credit institutions shall take the necessary action to limit exposures to US Dollar funding and manage risks arising from maturity mismatches appropriately.

Principle 3: Contingency Funding Plans

15. Credit Institutions shall have in place contingency funding plans which :
    (i) provide for management actions to handle a shock in US Dollar funding;
    (ii) consider the feasibility of the actions under (i) if more than one credit institution tries to undertake similar actions at the same time;
    (iii) consider the contingency funding sources available in the event of a reduction in supply from different counterparty classes.

PART 2: SUPERVISORY PROCESS

16. Whilst noting that the Rule is addressed to credit institutions, the Authority still deems it appropriate to implement the procedures hereunder. The disclosure of the Authority's supervisory process in the Rule is aimed to provide licence holders and other stakeholders with a transparent viewpoint as to how the Authority would carry out the monitoring of US Dollar funding in credit institutions.

17. The Authority shall review US Dollar source of funding and liquidity management by credit institutions as part of its monitoring of the overall funding and liquidity positions.

18. The Authority shall draw up a monitoring procedure to identify the level and significance of US Dollar funding in credit institutions. The Authority will thereby monitor more closely institutions with material exposure in US Dollar and where necessary request detailed liquidity information in this regard.

19. The Authority may, where necessary, require credit institutions to limit their exposure to US Dollar funding and liquidity risk, before excessive levels are reached.

20. The Authority shall review the credit institutions' ability to have effective contingency funding plans in place, and assess the feasibility of management actions taken within such plans. If simultaneous action by credit institutions is assessed as likely to create potential systemic risks, the Authority shall consider taking action to diminish those risks and the impact of those actions on the stability of the banking sector.

21. The Authority may take appropriate supervisory action if the result of the review process undertaken by the relevant credit institution is considered inadequate.

SUBMISSIONS TO THE AUTHORITY

22. Credit institutions identified by the Authority as having a material level of US Dollar funding shall fill in the template specified in Annex A and submit it to the Authority on a semi-annual basis, or as may be specified by the Authority. The template should be submitted within one month from the end of each reporting period.

23. Credit institutions with material US Dollar funding shall include the respective and inherent risk management actions and procedures within their ICAAP report.

IMPLEMENTATION

24. This Rule shall come into force on 1st January 2013.