

# MFSA

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MALTA FINANCIAL SERVICES AUTHORITY

**ASSET QUALITY REVIEW  
REQUEST FOR PROPOSAL FOR  
ASSET QUALITY REVIEW  
REAL ESTATE APPRAISAL**

**January 2014**

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Contacts:

NPMO Lead: Mr Karol Gabarretta (MFSA Banking Supervision Unit)

Significant Banks selected for AQR are:

HSBC Bank Malta plc;

Bank of Valletta plc;

Deutsche Bank (Malta) plc.

## **Introduction: Background and objectives**

The Heads of State or Government of the euro area have announced the establishment of a Single Supervisory Mechanism (SSM), entrusting the European Central Bank (ECB) with responsibility for the supervision of banks in the euro area. Prior to the inception of the SSM, the ECB, together with the National Competent Authorities (NCAs), will carry out a comprehensive assessment (CA), including an Asset Quality Review (AQR), of the credit institutions of the participating Member States. The SSM Regulation sets out in Article 33 (4), in conjunction with Article 6 (4), that the CA shall be carried out at least for the significant credit institutions referred to in this document. The AQR, in the form of a risk-based, targeted exercise, will include an analysis of the selected banks' data on relevant credit and securities portfolios and the review of banks' related risk processes. The nature and scope of the exercise will be defined by a methodology devised centrally by the ECB, in close cooperation with NCAs. The AQR will be completed before the SSM assumes supervisory responsibility in November 2014. The methodology referred to above, to which applicants will have to adhere, prescribes and details the tasks to be performed.

As part of this AQR, the Malta Financial Services Authority (MFSA), in coordination with the ECB, will carry out an appraisal on Real Estate collateral backing the significant banks' loan portfolios. This list of banks has been defined according to the SSM regulation (Article 6(4)) and made public by ECB press release dated 23 October 2013. Please note that the number of banks in scope of this exercise may be changed in the Single Supervisory Mechanism perimeter, to be finalised during 2014.

A sample of Real Estate assets of different types will be delivered to the contracted parties for appraisal. This sample may contain random collaterals and foreclosed assets.

The work will be focused on the most recently available accounting and prudential figures i.e December 2013.

It is envisaged that this part of the AQR exercise will be conducted entirely through and with the support of external experts (hereinafter referred to as applicants). In this regard, the MFSA invites applicants to submit proposals regarding the tasks that need to be undertaken. The MFSA envisages that applicable tasks will include the following:

- Applicants would carry out the valuation of Real Estate properties backing credit operations (collaterals), with the rationale of verifying the correctness of the information and the accuracy and recency of the valuation that banks provide as input to the Asset Quality Review;
- With the same rationale, applicants would carry out the valuation of other Real Estate assets on banks' Balance Sheets, i.e. foreclosed assets.

This audit is expected to commence in early February and shall be concluded by end July 2014.

The latest date for the submission of proposals by applicants is **17.00 hours, 27<sup>th</sup> January, 2014**. Following this date, the MFSA will open a process of Q&A in which the applicants might be requested to amend part of their proposals or to provide additional information. The tentative period for this Q&A process is between the **30<sup>th</sup> January, 2014 and the 31<sup>st</sup> January, 2014**. The award will be communicated to the applicants and the general public by not later than the **6<sup>th</sup> February, 2014**.

## **1. Key tasks of the exercise**

- The contracted party will be required to perform a Real Estate properties' appraisal for a sample of assets that will include housing, office buildings, commercial facilities, developments in progress and land of all kinds;
- The basis for the appraisal should be 'market value', consistent with internationally accepted best practices, such as the Royal Institute of Chartered Surveyors (RICS) etc;
- ECB will define specific guidelines about the valuation methodology in order to homogenise criteria across the different jurisdictions. As an illustrative example, these guidelines may refer to discount rates – the contracted party will be expected to adhere to them, in substitution or in addition to their own approaches;
- The contracted party will be required to run desktop and drive-by valuations, following a risk-based selection of assets;
- Statistical valuation of assets and/or groups of assets will also be considered. Applicants with these capabilities are expected to describe them in their proposal, detailing at least the scope and minimum requirements for this type of assessment;
- Although it is envisaged that the main tasks of the contracted party would be focused on the valuation of properties within Malta, the contracted party may also be required to value properties held as collateral by the entities in other countries. The applicant binds himself to carry out market valuations in foreign countries.

In their proposal, applicants should also explain whether they would be able to provide historical time-series of Real Estate properties. The breakdown would at a minimum include different asset types and, if applicable, regions.

## **2. Key delivery dates**

This exercise shall be concluded by not later than the **31<sup>st</sup> July, 2014**.

## **3. Elements to be included in the proposal document**

Applicants interested in carrying out this mandate should submit a proposal including, at least, the following items:

- Details of experience in carrying out large scale exercises of this nature within Europe or elsewhere;
- Details of market knowledge in Malta and understanding of historic and current local market conditions;
- Details of the composition of the proposed team including CVs of the key personnel who will take responsibility for the instruction;
- Details of the composition and number of the proposed team available for audits (citing relevant experience) together with CVs of the key personnel who will take responsibility

for the entire exercise (including compilation of report) during the period between 7th February, 2014 and 31st July, 2014;

- A detailed project plan as to how the applicant proposes to undertake the exercise holistically;
- A methodology statement setting out details of how you will ensure that the timetable is met, and the quality assurance process that you have in place;
- The ability of applicant to provide results in phases prior to the deadline;
- Details of terms and conditions. Concerning your professional fees, they should be expressed as fees for carrying out a single valuation (differentiating by type of valuation), with detail of volume discounts if applicable;
- A schedule of your proposed rates per appraisal (based on the average number of man hours it would take to review relevant documentation);
- An explanation of how the results of the review would be delivered;
- Full disclosure as to how any conflicts of interest will be managed or eliminated;
- Full disclosure as to how confidentiality would be safeguarded.

The selected external party/parties would, for the purposes of this exercise, be appointed as inspectors in terms of Article 22 of the Banking Act and would be bound by the relevant provisions of the Banking Act (specifically Article 34 of the said Act) and the Professional Secrecy Act.

#### **4. Next steps and contacts**

Latest date for the submission of proposals is **17.00 hours of the 27<sup>th</sup> January, 2014.**

The Authority is prepared to consider any reservations or limitations made by the applicant in its proposal.

The final decision will be communicated to the applicants and the general public by not later than the **6<sup>th</sup> February, 2014.**

All the elements included in this Terms of Reference, such as proposals, reports, results, etc. will be disclosed to the ECB and to any other experts acting as the latter's agents. The contact person at the MFSA is Mr Karol Gabarretta (NPMO Lead), while the National Steering Committee (NSC) Chairman is Prof Joseph Bannister.

## 5. Selection Criteria to be applied by MFSA

CRITERIA	RECOMMENDED WEIGHTING	KEY CONSIDERATIONS
<b>Plan of Approach</b>	<b>45%</b>	<ul style="list-style-type: none"> <li>• Understanding and meeting of business needs by the applicant.</li> <li>• The methodology of approach the applicant proposes to use to deliver the required services on time, efficiently and to the highest standard.</li> <li>• References with respect to Asset Quality Review for regulatory and / or supervisory authorities.</li> </ul>
<b>Pricing/Cost</b>	<b>30%</b>	
<b>Quality of Team</b>	<b>20%</b>	<ul style="list-style-type: none"> <li>• The professional and international capabilities/ expertise of each member of the team including relevant market experience in SSM countries/ Europe.</li> <li>• Capacity to guarantee continuity and act as a team with NCA throughout AQR exercise.</li> <li>• Details of relevant contracts including past experiences undertaken by the proposed team.</li> </ul>
<b>Extension of activities to other asset classes</b>	<b>5%</b>	<ul style="list-style-type: none"> <li>• In what way does the applicant intend to deliver the services for other asset classes on time, efficiently, to the highest standard and in an integrated manner.</li> <li>• Single firm providing all the services or demonstrating strong ability to lead and manage a group of suitably experienced experts.</li> </ul>

Selection of the applicant shall be effected in accordance with the weighting specified in the table above.

## **6. Deliverables**

The final deliverables within the report to be submitted by the contracted party shall include, at least, the following components:

- Introduction and context;
- Scope of the work and purpose of the report;
- Main limitations to the analysis;
- Methodology used and assumptions made;
- Results of the appraisal exercise, which will be presented in a homogenized manner, i.e. pre-defined templates will be delivered by the ECB that will be used to feedback results.

The contracted party is expected to provide interim reports to the NPMO (email: kgabarretta@mfsa.com.mt) if requested:

- At least every two weeks, a report shall be submitted on the progress of the work and compliance with the scheduled deadlines;
- The contracted party will need to be available to discuss interim results on specific cases both locally and abroad with the NPMO and/or the ECB (and their representatives);

All the intermediate and final deliverables have to be submitted in English.

**The contracted party shall be bound by the contractual obligations that will be published on the MFSA website.**

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**National Project Management Office  
c/o Banking Supervision Unit  
Malta Financial Services Authority**

## **Appendix 1: Conflicts of interest**

The MFSA is duty bound to adhere to the highest possible standards to avoid conflicts of interest. As such, in the context of this Real Estate assets valuation, the MFSA will review and analyse these potential conflicts of interest as a key element for the selection of the contracted party. The conflicts of interest can be either absolute or partial. Applicants are expected to report both, and in the case of the latter, explain how they plan to mitigate them. Additionally, applicants will be required to explain how they will avoid potential upcoming conflicts of interest, should they be awarded.

Absolute conflicts of interest - There shall be presumed to be a conflict of interest if:

- The applicant has an economic interest that depends on the value of the real estate properties in question;
- The applicant is involved in any cause of absolute incompatibility or recusal according to the professional deontological codes;
- The applicant considers that a cause of absolute conflict of interest applies, following its internal codes and ethics.

Partial conflicts of interest – A potential partial conflict of interest may exist if:

- Applicant's subsidiaries or affiliates are held in any of the absolute conflicts of interest described above;
- The applicant, its subsidiaries or affiliates have had during the past two financial years, or have on-going business relationships with any of the Entities;
- The applicant, its subsidiaries or affiliates are involved in any cause of partial incompatibility or recusal according to the professional deontological codes;
- The applicant considers that a cause of partial conflict of interest applies, following its internal codes and ethics
- An individual member of the team proposed for this engagement is held in any of the causes of conflict of interest, either absolute or partial, acting as an individual professional or under the on-going professional relationship with the applicant or past professional relationships with other service providers.

In order to avoid conflicts of interest, applicants are required to submit, at least, the following information:

- A list of the Entities with which the applicant have conflicts of interest, either absolute or partial, according to any of the causes described above. This list should contain enough detail about the nature, scope, parties involved and timeframe of the mandate



- A description of how the applicant intends to mitigate existing partial conflicts of interest, considering alternatives such as those included in the following illustrative and non-exhaustive list: Ensure that there are strict Chinese walls around the execution team; Give the MFSA the option to recuse individual members of the team based on their past professional relationships with any of the Entities; Ensure the highest confidentiality standards
- A description of how the applicant plans to avoid potential conflicts of interests arising during the timeframe of this mandate and six months after it, at least until the results of the AQR are put into the public domain. The following illustrative and non-exhaustive list includes some of the options that could be considered: Routinely conduct conflict checks; Establish internal control process to ensure that upcoming engagements are not conflicted with this one; Inform the MFSA promptly if any potential conflict of interest emerges and agree with the MFSA on the subsequent course of action; Restrict the nature and scope of upcoming engagements during the timeframe of this mandate; Ensure that any subcontractor will respect the same conditions.

Should an applicant have a (potential) conflict of interest and should the applicant not be able to prove that it has safeguarded that this will not in any way have any adverse effect on the delivery of the services, this may lead to either the limitation of the scope of the mandate or the exclusion of the applicant.