TECHNICAL CRITERIA ON GOVERNANCE ARRANGEMENTS AND TREATMENT OF RISKS

1. INTERNAL GOVERNANCE[1]

(a) The Board of Directors shall define, oversee and be accountable for the implementation of the governance arrangements that ensure effective and prudent management of a credit institution, including the segregation of duties in the organisation and the prevention of conflicts of interest.

Those arrangements shall comply with the following principles:

(i) the Board of Directors must have the overall responsibility for the credit institution and approve and oversee the implementation of the credit institution's strategic objectives, risk strategy and internal governance;

(ii) the Board of Directors must ensure the integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant standards;

(iii) the Board of Directors must oversee the process of disclosure and communications;

(iv) the Board of Directors must be responsible for providing effective oversight of senior management;

(iv) the chairperson of the Board of Directors of a credit institution must not exercise simultaneously the functions of a chief executive officer within the same credit institution, unless justified by the credit institution and authorised by the authority.

The Board of Directors shall monitor and periodically assess the effectiveness of the credit institution's governance arrangements and shall take appropriate steps to address any deficiencies.

(1) On 22 November 2012, the European Banking Authority (EBA) published its Guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders (EBA/GL/2012/06). These Guidelines set out the process, criteria and minimum requirements for assessing the suitability of those persons and are ultimately aimed at ensuring robust governance arrangements and appropriate oversight.

2. BOARD OF DIRECTORS[5]

(a) Directors shall at all times be of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties. The overall composition of the Board of Directors shall reflect an adequately broad range of experiences. Directors shall, in particular, fulfil the requirements set out in subparagraphs (b) to (h).

(b) All directors shall commit sufficient time to perform their functions in the credit institution.

(c) The number of directorships which may be held by a director at the same time shall take into account individual circumstances and the nature, scale and complexity of the credit institution's activities. A director of a credit institution that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities shall, from 1 July 2014, not hold more than one of the following combinations of directorships at the same time:

(i) one directorship having an executive role with two directorships having a non-executive role;

(ii) four directorships having a non-executive role.

(d) For the purposes of subparagraph (c), the following shall count as a single directorship:

(i) directorships having an executive or non-executive role held within the same group;

(ii) directorships having an executive or non-executive role held within: (aa) credit institutions which are members of the same institutional protection scheme provided that the conditions set out in Article 113(7) of the CRR are fulfilled; or

(bb) undertakings (including non-financial entities) in which the credit institution holds a qualifying holding.

(e) Directorships in organisations which do not pursue predominantly commercial objectives shall not count for the purposes of subparagraph (c).

(f) The authority may authorise directors to hold one additional directorship having a non-executive role. The authority shall regularly inform the EBA of such authorisations.

(g) The Board of Directors shall possess adequate collective knowledge, skills and experience to be able to understand the credit institution's activities, including the main risks.

(h) Each director shall act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of the senior management where necessary and to effectively oversee and monitor management decision-making.

(i) Credit institutions shall devote adequate human and financial resources to the induction and training of directors.

(j) Credit institutions and their respective nomination committees shall engage in a broad set of qualities and competences when recruiting directors and for that purpose shall put in place a policy promoting diversity on the Board of Directors.

(k) The authority shall collect the information disclosed in accordance with Article 435(2)(c) of the CRR and shall use it to benchmark diversity practices. The authority shall provide the EBA with that information.

(l) Credit institutions are to be guided by any guidelines issued by the EBA in accordance with Article 91(12) of the CRD, in particular, on the following:

- (i) the notion of sufficient time commitment of a director to perform his functions, in relation to the individual circumstances and the nature, scale and complexity of activities of the credit institution;
- (ii) the notion of adequate collective knowledge, skills and experience of the Board of Directors as referred to in subparagraph (g);
- (iii) the notions of honesty, integrity and independence of mind of a director as referred to in subparagraph (h);
- (iv) the notion of adequate human and financial resources devoted to the induction and training of directors as referred to in subparagraph (i);
- (v) the notion of diversity to be taken into account for the selection of directors as referred to in subparagraph (j).

3. NOMINATION COMMITTEE

(a) Credit institutions which are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities shall establish a nomination committee composed of members of the Board of Directors who do not perform any executive function in the credit institution concerned.

The nomination committee shall:

- (i) identify and recommend, for the approval of the Board of Directors or for approval of the general meeting, candidates to fill vacancies of the Board of Directors, evaluate the balance of knowledge, skills, diversity and experience of the Board of Directors and prepare a description of the roles and capabilities for a particular appointment, and assess the time commitment expected.

Furthermore, the nomination committee shall decide on a target for the representation of the underrepresented gender in the Board of Directors and prepare a policy on how to increase the number of the underrepresented gender in the Board of Directors in order to meet that target. The target, policy and its implementation shall be made public in accordance with Article 435(2)(c) of the CRR;

(ii) periodically, and at least annually, assess the structure, size, composition and performance of the Board of Directors and make recommendations to the Board of Directors with regard to any changes;

(iii) periodically, and at least annually, assess the knowledge, skills and experience of individual members of the Board of Directors and of the Board of Directors collectively, and report to the Board of Directors accordingly;

(iv) periodically review the policy of the Board of Directors for selection and appointment of senior management and make recommendations to the Board of Directors.

In performing its duties, the nomination committee shall, to the extent possible and on an ongoing basis, take account of the need to ensure that the decision making of the Board of Directors is not dominated by any one individual or small group of individuals in a manner that is detrimental to the interests of the credit institution as a whole.

The nomination committee shall be able to use any forms of resources that it considers to be appropriate, including external advice, and shall receive appropriate funding to that effect.

4. AUDIT COMMITTEE

(a) Credit institutions shall have an audit committee. The audit committee shall be a stand-alone committee, shall be composed of non-executive directors, and shall have at least three members.

(b) At least one member of the audit committee shall have competence in accounting and/or auditing:

Provided that the chairperson of the audit committee shall have competence in accounting and/or auditing.

(c) The members of the audit committee as a whole shall have competence relevant to the financial sector in which the audited credit institution is operating.

(d) The members of the audit committee shall be appointed by the Board of Directors. The majority of the members of the audit committee shall be independent[1] of the audited credit institution.

(e) The chairperson of the audit committee shall, subject to paragraph 4(b) above, be appointed by the members of the audit committee or by the Board of Directors and shall be independent of the audited credit institution.

(f) Without prejudice to the responsibility of the members of the Board of Directors, the audit committee shall, *inter alia*:

(i) inform the Board of Directors of the audited credit institution of the outcome of the statutory audit and explain how the statutory audit contributed to the integrity of financial reporting and what the role of the audit committee was in that process;

(ii) monitor the financial reporting process and submit recommendations or proposals to ensure its integrity;

(iii) monitor the effectiveness of the credit institution's internal quality control and risk management systems and, where applicable, its internal audit, regarding the financial reporting of the audited credit institution, without breaching its independence;

(iv) approve and monitor the internal auditor's work programme, and receive internal audit reports or a periodic summary;

(v) monitor the methods used by senior management to account for significant and unusual transactions where the accounting treatment may be open to different approaches, paying particular attention to both the existence of, and the justification for, any activity carried out by the credit institution in offshore centres and/or through special purpose vehicles;

(vi) monitor the responsiveness of senior management to the findings and recommendations of the internal audit function and make

[1] For the purposes of this paragraph, a director shall be considered to be independent only if such a director is a non-executive member who does not have any management responsibilities within the audited credit institution or within the Group to which that institution pertains. Furthermore, such a member of the Board of Directors should be free of any business, family, or other relationship ties including but not limited to, managerial responsibilities with such audited credit institution, its controlling shareholders or any member of the group of which the credit institution forms part, and is not under any other undue influence, internal or external, political or ownership, which would impede the board member's exercise of objective judgement.

recommendations on the selection, appointment, reappointment and removal of the head of the internal audit department and on the department's budget;

(vii) monitor the statutory audit of the annual and consolidated financial statements, in particular, its performance, taking into account any findings and conclusions by the Accountancy Board established by the Accountancy Profession Act (Chapter 281 of the Laws of Malta), pursuant to Article 26(6) of Regulation (EU) No 537/2014;[2]

(viii) review and monitor the independence of the statutory auditors or the audit firms in accordance with Articles 22, 22a, 22b, 24a and 24b of Directive 2006/43/EC[3] and Article 6 of Regulation (EU) No 537/2014, and in particular the appropriateness of the provision of non-audit services to the audited entity in accordance with Article 5 of Regulation (EU) No 537/2014;

(ix) review the statutory auditor's or audit firm's compliance with applicable guidance relating to the rotation of audit partners, the level of fees paid by the credit institution, and other related regulatory requirements;

(x) review the effectiveness of the external audit process, and the responsiveness of senior management to the recommendations made in the statutory auditor's or audit firm's management letter;

(xi) monitor the statutory auditor's or audit firm's work programme and ensure it obtains timely information about any issues arising from the audit;

(xii) be responsible for the procedure for the selection of statutory auditor(s) or audit firm(s) and recommend the statutory auditor(s) or the audit firm(s) to be appointed in accordance with Article 16 of Regulation (EU) No 537/2014;

(xiii) investigate issues giving rise to any resignation of the statutory auditor or audit firm, and make recommendations as to any required action;

(xiv) act as the principal point of contact between the internal auditors, the statutory auditor or audit firm and the Board of Directors in order to ensure that in addition to having an effective working relationship with senior management, both internal and statutory auditors are guaranteed free access to the Board of Directors;

[2] Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC.

[3] Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, as amended by Directive 2008/30/EC of the European Parliament and of the Council of 11 March 2008 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, as regards the implementing powers conferred on the Commission; Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC; and Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts; and as may be further amended from time to time.

(xv) review the process whereby the credit institution complies with existing provisions regarding the possibility for employees to report alleged significant irregularities in the credit institution, by way of complaints or through anonymous submissions, normally to an independent director, and ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action;

(xvi) decide whether and, if so, when the Chief Executive Officer or Chairperson of the Board of Directors, the Chief Financial Officer (or senior employees responsible for finance, accounting, and treasury matters), the internal auditor and the statutory auditor or audit firm, should attend its meetings;

(xvii) be entitled to meet with any relevant person outside the presence of executive and managing directors who do not form part of the Audit Committee, if it so wishes.

(g) The audit committee shall present the yearly and, if applicable, half-yearly statements, to the Board of Directors for approval. The audit committee shall meet at least quarterly and shall report to the Board of Directors on its activities:

(i) at least quarterly in the case of credit institutions which are deemed to be significant in terms of Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions;

(ii) at least bi-annually in the case of credit institutions which are deemed by the authority to be high-priority less significant institutions ("LSIs") in accordance with the methodology of the Single Supervisory Mechanism ("SSM")[4]; and

(iii) at least annually for all other credit institutions not falling under points (i) and (ii).

(h) In order to ensure the well-functioning of the audit committee, credit institutions shall, *inter alia*:

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[4] Article 97 of Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities
(SSM Framework Regulation), requires the ECB to "define general criteria, in particular taking into account the risk situation and potential impact on the domestic financial system of the less significant supervised entity concerned, to determine for which less significant supervised entities which information shall be notified." In this regard, the ECB considers that an LSI can be deemed to be of "high priority" for various reasons. LSIs that are close to being classified as significant institutions due to their size are, de facto, considered "high priority". Also, a minimum of three high-priority LSIs per country applies. Additionally, the intrinsic riskiness and the impact on the national economy are also taken into account in determining the high-priority LSIs. For the intrinsic riskiness dimension, the national competent authorities perform a risk assessment of the LSIs in the context of their ongoing supervisory activity and using the common SSM methodology. This assessment takes into account several elements, such as: the business model of the institution, its internal governance and risk management, its risks to capital, and its risks to liquidity and funding. The impact assessment of an LSI

(i) ensure that the audit committee is not prohibited from obtaining advice and assistance from outside legal, accounting or other advisors as it deems necessary to carry out its duties, and provide the audit committee with appropriate funding to this effect;

(ii) provide an induction programme for new audit committee members, and subsequent relevant training on an ongoing and timely basis; and

(iii) ensure that all audit committee members are provided with full information relating to the credit institution's specific accounting, financial and operational features.

(i) In so far as the requirements relating to the audit committee are concerned, paragraphs 4(a) to 4(h) shall be read in conjunction with Regulation (EU) No 537/2014. Particular consideration should be given to Title III (Articles 16 to 19) of the said Regulation, relating to the appointment of statutory auditors or audit firms and to the transitional provisions set out in Article 41 of the same Regulation.

(j) Notwithstanding the provisions pertaining to the requirements of the Audit Committee set out in the Listing Rules, paragraphs 4(a) to 4(i) shall also apply to credit institutions listed on a regulated market. In case of any conflict between the provisions of paragraphs 4(a) to 4(i) and the Listing Rules, pertaining to the requirements of the audit committee, a credit institution listed on a regulated market shall comply with the requirements set out in paragraphs 4(a) to 4(i).

5. RISK COMMITTEE

(a) The Board of Directors of a credit institution shall approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks that the credit institution is, or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle.

aims to evaluate its impact on the domestic financial system and on the SSM. For this purpose, it is not only the institution's size (total assets) that is considered, but also its interconnectedness with the rest of the financial system. [Source: <https://www.bankingsupervision.europa.eu/about/ssmexplained/html/hplsi.en.html> last accessed on 01/8/2016]

(b) The Board of Directors of a credit institution shall devote sufficient time to the consideration of risk issues. The Board of Directors shall be actively involved in and ensure that adequate resources are allocated to the management of all material risks addressed in the Act and any regulations and Banking Rules issued thereunder transposing the CRD and in the CRR as well as in the valuation of assets, the use of external credit ratings and internal models relating to those risks. The credit institution shall establish reporting lines to the Board of Directors that cover all material risks and risk management policies and changes thereof.

(c) Credit institutions that are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities shall establish a risk committee composed of directors having a non-executive role in the credit institution concerned. Members of the risk committee shall have appropriate knowledge, skills and expertise to fully understand and monitor the risk strategy and the risk appetite of the credit institution.

The risk committee shall advise the Board of Directors on the credit institution's overall current and future risk appetite and strategy and assist the Board of Directors in overseeing the implementation of that strategy by senior management. The Board of Directors shall retain overall responsibility for risks.

The risk committee shall review whether prices of liabilities and assets offered to clients take fully into account the credit institution's business model and risk strategy. Where prices do not properly reflect risks in accordance with the business model and risk strategy, the risk committee shall present a remedy plan to the Board of Directors.

The authority may allow a credit institution which is not considered significant as referred to in the first subparagraph to combine the risk committee with the audit committee as referred to in Article 41 of Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC (Listing Rules 5.117, 5.127 and 5.129). Members of the combined committee shall have the knowledge, skills and expertise required for the risk committee and for the audit committee.

(d) The Board of Directors and, where a risk committee has been established, the risk committee, shall have adequate access to information on the risk situation of the credit institution and, if necessary and appropriate, to the risk management function and to external expert advice.

The Board of Directors and, where one has been established, the risk committee shall determine the nature, the amount, the format, and the frequency of the information on risk which it is to receive. In order to assist in the establishment of sound remuneration policies and practices, the risk committee shall, without prejudice to the tasks of the remuneration committee, examine whether incentives provided by the remuneration system take into consideration risk, capital, liquidity and the likelihood and timing of earnings.

(e) In accordance with the proportionality requirement laid down in Article 7(2) of Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (SLCs 1.24 and 1.42 of Part BI: Standard Licence Conditions Applicable to Investment Services Licence Holders which Qualify as MiFID Firms), credit institutions shall have a risk management function independent from the operational functions and which shall have sufficient authority, stature, resources and access to the Board of Directors.

The risk management function shall ensure that all material risks are identified, measured and properly reported. They shall ensure that the risk management function is actively involved in elaborating the credit institution's risk strategy and in all material risk management decisions and that it can deliver a complete view of the whole range of risks of the credit institution.

Where necessary, the risk management function may report directly to the Board of Directors, independent from senior management, and can raise concerns and warn the Board of Directors, where appropriate, where specific risk developments affect or may affect the credit institution, without prejudice to the responsibilities of the Board of Directors pursuant to the Act and any regulations and Banking Rules issued thereunder transposing the CRD and pursuant to the CRR.

The head of the risk management function shall be an independent senior manager with distinct responsibility for the risk management function. Where the nature, scale and complexity of the activities of the credit institution do not justify a specially appointed person, another senior person within the credit institution may fulfil that function, provided there is no conflict of interest.

The head of the risk management function shall not be removed without prior approval of the Board of Directors and shall be able to have direct access to the Board of Directors where necessary.

6. INTERNAL APPROACHES[5] FOR CALCULATING OWN FUNDS REQUIREMENTS

[5] 'Internal Approaches' means the internal ratings based approach referred to in Article 143(1), the internal models approach referred to in Article 221, the own estimates approach referred to in Article 225, the advanced measurement approaches referred to in Article 312(2), the internal models method referred to in Articles 283 and 363, and the internal assessment approach referred to in Article 259(3) of the CRR.

(a) The authority encourages credit institutions that are significant in terms of their size, internal organisation and the nature, scale and complexity of their activities to develop internal credit risk assessment capacity and to increase use of the internal ratings based approach for calculating own funds requirements for credit risk where their exposures are material in absolute terms and where they have at the same time a large number of material counterparties. Subparagraphs (a) to (c) are without prejudice to the fulfilment of criteria laid down in Part Three, Title II, Chapter 3, Section I of the CRR.

(b) The authority shall, taking into account the nature, scale and complexity of credit institutions' activities, monitor that credit institutions do not solely or mechanistically rely on external credit ratings for assessing the creditworthiness of an entity or financial instrument.

(c) The authority encourages credit institutions, taking into account their size, internal organisation and the nature, scale and complexity of their activities, to develop internal specific risk assessment capacity and to increase use of internal models for calculating own funds requirements for specific risk of debt instruments in the trading book, together with internal models to calculate own funds requirements for default and migration risk where their exposures to specific risk are material in absolute terms and where they have a large number of material positions in debt instruments of different issuers. Subparagraphs (a) to (c) are without prejudice to the fulfilment of the criteria laid down in Part Three, Title IV, Chapter 5, Section 1 to 5 of the CRR (Articles 362 to 377).

7. SUPERVISORY BENCHMARKING OF INTERNAL APPROACHES[1] FOR CALCULATING OWN FUNDS REQUIREMENTS

(a) Credit institutions permitted to use internal approaches for the calculation of risk weighted exposure amounts or own funds requirements, except for operational risk, shall report the results of the calculations of their internal approaches for their exposures or positions that are included in the benchmark portfolios. Credit institutions shall submit the results of their calculations, together with an explanation of the methodologies used to produce them, to the authority at an appropriate frequency, and at least annually.

(b) Credit institutions shall submit the results of the calculations referred to in point (a.) above in accordance with the template developed by the EBA in accordance with the relevant implementing technical standards to the authority and to the EBA. Where the authority chooses to develop specific portfolios, it shall, do so in consultation with the EBA and ensure that credit institutions report the results of the calculations separately from the results of the calculations for EBA portfolios.

(c) The authority shall, on the basis of the information submitted by credit institutions in accordance with point (a.) above, monitor the range of risk weighted exposure amounts or own funds requirements, as applicable, except for operational risk, for the exposures or transactions in the benchmark portfolio resulting from the internal approaches of those credit institutions. At least annually, the authority shall make an assessment of the quality of those approaches paying particular attention to:

   (i) those approaches that exhibit significant differences in own fund requirements for the same exposure;

   (ii) approaches where there is particularly high or low diversity, and also where there is a significant and systematic under- estimation of own funds requirements.

(d) Where particular credit institutions diverge significantly from the majority of their peers or where there is little commonality in approach leading to a wide variance of results, the authority shall investigate the reasons therefor and, if it can be clearly identified that a credit institution's approach leads to an underestimation of own funds requirements which is not attributable to differences in the underlying risks of the exposures or positions, the authority shall take corrective action.

(e) The authority shall ensure that its decision on the appropriateness of corrective actions as referred to in point (d.) above comply with the principle that such actions must maintain the objectives of an internal approach and therefore do not:

   (i) lead to standardisation or preferred methods;

   (ii) create wrong incentives; or (iii) cause herd behaviour.

(f) Credit institutions are to refer to any guidelines and recommendations the EBA may issue. In particular, the EBA may issue such guidelines and recommendations where it considers them necessary on the basis of the information and assessments referred to in points (b) and (c) above in order to improve supervisory practices or practices of credit institutions with regard to internal approaches.

8. CREDIT AND COUNTERPARTY RISK

(a) Credit-granting shall be based on sound and well-defined criteria. The process for approving, amending, renewing, and re-financing credits shall be clearly established.

(b) Credit institutions shall have internal methodologies that enable them to assess the credit risk of exposures to individual obligors, securities or securitisation positions and credit risk at the portfolio level. In particular, internal methodologies shall not rely solely or mechanistically on external credit ratings. Where own funds requirements are based on a rating by an External Credit Assessment Institution (ECAI) or based on the fact that an exposure is unrated, this shall not exempt credit institutions from additionally considering other relevant information for assessing their allocation of internal capital.

(c) The ongoing administration and monitoring of the various credit riskbearing portfolios and exposures of credit institutions, including for identifying and managing problem credits and for making adequate value adjustments and provisions, shall be operated through effective systems.

(d) Diversification of credit portfolios shall be adequate, given the credit institution's target markets and overall credit strategy.

(e) Credit institutions engaged in foreign currency lending may be exposed to indirect exchange risk as a component of credit risk though currency mismatches on their customers' balance sheets. To this effect, credit institutions are expected to apply the principles found in MFSA Rule 01/2012 – Foreign Currency Lending Rule through the implementation of appropriate and apposite internal risk management and governance frameworks.[7]

9. RESIDUAL RISK

The risk that recognised credit risk mitigation techniques used by the credit institution prove less effective than expected shall be addressed and controlled by means of written policies and procedures.

[7] On 20 December 2013, the European Banking Authority (EBA) published its Guidelines on Capital Measures for FX Lending to Unhedged Borrowers under the Supervisory Review and Evaluation Process (SREP). These Guidelines bring forward supervisory convergence across the EU and address the ESRB Recommendation, following their 2011 Report on lending in Foreign Currencies mandating the EBA to draft Guidelines on this specific aspect.

10. CONCENTRATION RISK

The concentration risk arising from exposures to each counterparty, including central counterparties, groups of connected counterparties, and counterparties in the same economic sector, geographic region or from the same activity or commodity, the application of credit risk mitigation techniques, and including in particular risks associated with large indirect credit exposures such as a single collateral issuer, shall be addressed and controlled including by means of written policies and procedures.

11. SECURITISATION RISKS

(a) The risks arising from securitisation transactions in relation to which the credit institutions are investor, originator or sponsor, including reputational risks, such as arise in relation to complex structures or products, shall be evaluated and addressed through appropriate policies and procedures, to ensure that the economic substance of the transaction is fully reflected in the risk assessment and management decisions.

(b) Liquidity plans to address the implications of both scheduled and early amortisation shall exist at credit institutions which are originators of revolving securitisation transactions involving early amortisation provisions.

12. MARKET RISK

(a) Policies and processes for the identification, measurement and management of all material sources and effects of market risks shall be implemented.

(b) Where the short position falls due before the long position, credit institutions shall also take measures against the risk of a shortage of liquidity.

(c) The internal capital shall be adequate for material market risks that are not subject to an own funds requirement.

Credit institutions, which have, in calculating own funds requirements for position risk in accordance with Part Three, Title IV, Chapter 2, of the CRR, netted off their positions in one or more of the equities constituting a stock-index against one or more positions in the stock-index future or other stock-index product shall have adequate internal capital to cover the basis risk of loss caused by the future's or other product's value not moving fully in line with that of its constituent equities. Credit institutions shall also have such adequate internal capital where they hold opposite positions in stockindex futures which are not identical in respect of either their maturity or their composition or both.

Where using the treatment in Article 345 of the CRR, credit institutions shall ensure that they hold sufficient internal capital against the risk of loss which exists between the time of the initial commitment and the following working day.

13. INTEREST RATE RISK ARISING FROM NON-TRADING ACTIVITIES

Credit institutions shall implement systems to identify, evaluate and manage the risk arising from potential changes in interest rates that affect a credit institution's non-trading activities.

14. OPERATIONAL RISK

(a) Credit institutions shall implement policies and processes to evaluate and manage the exposure to operational risk, including model risk, and to cover low-frequency high-severity events. Credit institutions shall articulate what constitutes operational risk for the purposes of those policies and procedures.

(b) Contingency and business continuity plans shall be in place to ensure a credit institution's ability to operate on an ongoing basis and limit losses in the event of severe business disruption.

15. LIQUIDITY RISK

(a) Credit institutions shall have robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, including intraday, so as to ensure that credit institutions maintain adequate levels of liquidity buffers. Those strategies, policies, processes and systems shall be tailored to business lines, currencies, branches and legal entities and shall include adequate allocation mechanisms of liquidity costs, benefits and risks.

(b) The strategies, policies, processes and systems referred to in subparagraph (a) shall be proportionate to the complexity, risk profile, scope of operation of the credit institutions and risk tolerance set by the Board of Directors and reflect the credit institution's importance in each Member State in which it carries out business. Credit institutions shall communicate risk tolerance to all relevant business lines.

(c) Credit institutions shall, taking into account the nature, scale and complexity of their activities, have liquidity risk profiles that are consistent with and, not in excess of, those required for a well-functioning and robust system. The authority shall monitor developments in relation to liquidity risk profiles, for example, product design and volumes, risk management, funding policies and funding concentrations. The authority shall take effective action where developments may lead to individual credit institution or systemic instability. The authority shall inform the EBA of any actions carried out pursuant to this point.

(d) Credit institutions shall develop methodologies for the identification, measurement, management and monitoring of funding positions. Those methodologies shall include the current and projected material cash-flows in and arising from assets, liabilities, off-balance sheet items, including contingent liabilities and the possible impact of reputational risk.

(e) Credit institutions shall distinguish between pledged and unencumbered assets that are available at all times, in particular during emergency situations. They shall also take into account the legal entity in which assets reside, the country where assets are legally recorded either in a register or in an account as well as their eligibility and shall monitor how assets can be mobilised in a timely manner.

(f) Credit institutions shall also have regard to existing legal, regulatory and operational limitations to potential transfers of liquidity and unencumbered assets amongst entities, both within and outside the EEA.

(g) Credit institutions shall consider different liquidity risk mitigation tools, including a system of limits and liquidity buffers in order to be able to withstand a range of different stress events and an adequately diversified funding structure and access to funding sources. Those arrangements shall be reviewed regularly.

(h) Credit institutions shall consider alternative scenarios on liquidity positions and on risk mitigants and review the assumptions underlying decisions concerning the funding position at least annually. For these purposes, alternative scenarios shall address, in particular, off-balance sheet items and other contingent liabilities, including those of Securitisation Special Purpose Entities (SSPE) or other special purpose entities, as referred to in the CRR, in relation to which the credit institution acts as sponsor or provides material liquidity support.

(i) Credit institutions shall consider the potential impact of credit institution-specific, market-wide and combined alternative scenarios. Different time periods and varying degrees of stressed conditions shall be considered.

(j) Credit institutions shall adjust their strategies, internal policies and limits on liquidity risk and develop effective contingency plans, taking into account the outcome of the alternative scenarios referred to in subparagraph (h).

(k) Credit institutions shall have in place liquidity recovery plans setting out adequate strategies and proper implementation measures in order to address possible liquidity shortfalls, including in relation to branches established in another Member State. Such plans shall be tested by the credit institutions at least annually, updated on the basis of the outcome of the alternative scenarios set out in subparagraph (h), reported to and approved by senior management, so that internal policies and processes can be adjusted accordingly. Credit institutions shall take the necessary operational steps in advance to ensure that liquidity recovery plans can be implemented immediately. For credit institutions, such operational steps shall include holding collateral immediately available for central bank funding. This includes holding collateral where necessary in the currency of another Member State, or the currency of a third country to which the credit institution has exposures, and where operationally necessary within the territory of a host Member State or of a third country to whose currency it is exposed.

(l) The authority recognises that the US Dollar has proven to be a material funding currency for certain credit institutions, and throughout the past years, 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 a credit institution, where short-term funding is used to finance longer term assets in the said currency.

(m) Accordingly, the authority requires credit institutions, particularly those which utilise the US Dollar as a material funding currency for their operations, to apply the provisions of MFSA Rule 02/2012 on US Dollar Funding which outlines the general principles regulating US Dollar denominated funding.

16. RISK OF EXCESSIVE LEVERAGE

(a) Credit institutions shall have policies and processes in place for the identification, management and monitoring of the risk of excessive leverage. Indicators for the risk of excessive leverage shall include the leverage ratio determined in accordance with Article 429 of the CRR and mismatches between assets and obligations.

(b) Credit institutions shall address the risk of excessive leverage in a precautionary manner by taking due account of potential increases in the risk of excessive leverage caused by reductions of the credit institution's own funds through expected or realised losses incurred in accordance with statutory IFRS. To that end, credit institutions shall be able to withstand a range of different stress events with respect to the risk of excessive leverage.

17. ICT AND SECURITY RISK

Credit institutions shall comply with the provisions set out in the EBA Guidelines on ICT and security risk management (EBA/GL/2019/04). Credit institutions shall also, taking into account their size, nature, scale and complexity and on a best effort basis, refer to the Guidance on Technology Arrangements, ICT and Security Risk Management, and Outsourcing Arrangements.