

INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS

PART B: STANDARD LICENCE CONDITIONS

Appendix 1B

Capital Resources Requirement and Guidance on the compilation of the automated COREP Return for Category 2 (which qualify as MiFID Firms), Category 3 and Category 4a Investment Services Licence Holders

This Appendix:

- a. details the capital resources requirement;
- b. explains and distinguishes between trading and non-trading book business;
- c. defines the various elements which make up the calculation of Own Funds, each of the risk components, and the fixed overheads requirement; and
- d. explains the manner in which the automated COREP Return which Licence Holders are required to submit to the Authority in terms of the Investment Services Rules, should be completed.

1.0 *The Capital Resources Requirement*

- 1.1 In terms of SLC 7.29 of Part BI of these Investment Services Rules, the Licence Holder is required at all times to maintain own funds at least equal to their capital resources requirement. The own funds of the Licence Holder may not fall below the amount of initial capital required at the time of its authorisation.

In terms of SLC 2.30 of Part B IV, a Category 4a Licence Holder shall apply the requirements set out in SLC 7.29 to 7.30 and 7.42 to 7.60 of Part BI of these Investment Services Rules for the maintenance and reporting of capital resources.

- 1.2 The components of the capital resources requirement vary depending on the Category of the Licence Holder. The following tables summarise the components of the capital resources requirement:

A. *Category 2*

Category 2 Licence Holders shall at all times satisfy the following Capital Resources Requirement:

- i. A Common Equity Tier 1 capital ratio of 4.5%, which is calculated as follows:

Common Equity Tier 1 capital

The sum of the non-trading book business risk components, the trading book business risk components, the commodities instruments - risk component, the foreign exchange risk component, the settlement risk component, the credit valuation adjustment risk component and the fixed overheads requirement

- ii. A Tier 1 capital ratio of 6%, which is calculated as follows:

Tier 1 capital

The sum of the non-trading book business risk components, the trading book business risk components, the commodities instruments - risk component, the foreign exchange risk component, the settlement risk component, the credit valuation adjustment risk component and the fixed overheads requirement

- iii. A total capital ratio of 8%.

Own Funds

The sum of the non-trading book business risk components, the trading book business risk components, the commodities instruments - risk component, the foreign exchange risk component, the settlement risk component, the credit valuation adjustment risk component and the fixed overheads requirement

B. Category 3 – including Operators of MTFs

Category 3 Licence Holders shall at all times satisfy the following Capital Resources Requirement:

- i. A Common Equity Tier 1 capital ratio of 4.5%, which is calculated as follows:

Common Equity Tier 1 capital

The sum of the non-trading book business risk components, the trading book business risk components, the commodities instruments - risk component, the large exposures risk component, the foreign exchange risk component, the settlement risk component, the credit valuation adjustment risk component and the operational risk component

- ii. A Tier 1 capital ratio of 6%, which is calculated as follows:

Tier 1 capital

The sum of the non-trading book business risk components, the trading book business risk components, the commodities instruments - risk component, the large exposures risk component, the foreign exchange risk component,

the settlement risk component, the credit valuation adjustment risk component and the operational risk component

- iii. A total capital ratio of 8%.

Own Funds

The sum of the non-trading book business risk components, the trading book business risk components, the commodities instruments - risk component, the large exposures risk component, the foreign exchange risk component, the settlement risk component, the credit valuation adjustment risk component and the operational risk component

C. Category 4a

Category 4a Licence Holders shall at all times satisfy the Capital Resources Requirement applicable to Category 3 Licence Holders.

General Outline of the Initial Capital and the Risk Components

- 1.3 This section is aimed at explaining the elements which make up the capital resources requirement. Firstly a definition of initial capital is given and this is followed by the minimum capital requirements for the two categories of Licence Holders. A description of each of the risk components is given in section 1.3.2 to 1.3.7. This is followed by an illustration of all the applicable risk components for Licence Holders.

1.3.1 Categories of Licence Holders and Initial Capital

For the purpose of these Rules, '*initial capital*' shall comprise only of Common Equity Tier 1 items which consist of one or more of the items referred to in points (a) to (e) of article 26 (1) of the CRR:

- i. capital instruments provided that the conditions laid down in article 28 of the CRR or, where applicable, article 29 of the CRR are met;
- ii. share premium accounts as defined in point (124) of article 4 (1) of the CRR relating to the instruments referred to in point (i);

- iii. retained earnings as defined in point (123) of article 4 (1) of the CRR;
- iv. accumulated other comprehensive income as defined in point (100) of article 4 (1) of the CRR;
- v. other reserves as defined in point (117) of article 4 (1) of the CRR.

Provided that for the period 1 January 2014 to 31 December 2021, perpetual non-cumulative preference shares issued on or prior to 31 December 2011 and the related share premium account which qualified as Tier one capital under the national transposition measures for point (a) of article 57 of Directive 2006/48/EC, shall qualify as Common Equity Tier 1 items, subject to the following limits (determined in accordance with article 486 (5) of the CRR):

- a. 80% during the period from 1 January 2014 to 31 December 2014;
- b. 70% during the period from 1 January 2015 to 31 December 2015;
- c. 60% during the period from 1 January 2016 to 31 December 2016;
- d. 50% during the period from 1 January 2017 to 31 December 2017;
- e. 40% during the period from 1 January 2018 to 31 December 2018;
- f. 30% during the period from 1 January 2019 to 31 December 2019;
- g. 20% during the period from 1 January 2020 to 31 December 2020;
- h. 10% during the period from 1 January 2021 to 31 December 2021.

Provided further that the proportion of perpetual non-cumulative preference shares and the related share premium account, which exceeds the above percentages, shall be considered as Tier 2 capital.

<u>Licence Holder Category</u>		<u>Initial Capital</u> <u>EURO</u>
Category 2 MiFID Firms	Licence Holders authorised to provide any Investment Service and to hold or control Clients' Money or Customers' Assets, but not to operate a multilateral trading facility or deal for their own account or	125,000

<u>Licence Holder Category</u>		<u>Initial Capital</u> <u>EURO</u>
	underwrite or place instruments on a firm commitment basis.	
Category 3	Licence Holders authorised to provide any Investment Service and to hold and control Clients' Money or Customers' Assets.	730,000
Category 4a	Licence Holders authorised to act as trustees or custodians of all types of Collective Investment Schemes.	730,000

1.3.2 Risks associated with non-trading book business

This category is made up of two components:

- i. The credit/ counterparty risk component:
The possibility of a loss occurring due to:
 - a. the failure of a debtor of a Licence Holder to meet its contractual debt obligations; or
 - b. the loss in value of any other asset (excluding derivatives which are exclusively dealt with in the sections on trading book business and commodities instruments – risk component) which forms part of the Licence Holder's balance sheet except for: (a) intangible assets including goodwill; (b) cash in hand and at bank; (c) those financial instruments which fall within the category of trading book business; and (d) commodity positions.
- ii. Free deliveries:
Free Deliveries caters for the risk that the Licence Holder has either: (a) paid for securities, foreign currencies or commodities before receiving them; or (b) has delivered securities, foreign currencies or commodities before receiving payment for them; or (c) in the case of cross-border transactions, one day or more has elapsed since it made that payment or delivery.

1.3.3 Risks associated with trading book business

This category is made up of two risk components:

i. The position risk component:

The risk of losses, arising from movements in market prices, in on and off balance sheet investments in financial instruments which qualify as trading book business.

ii. The counterparty credit risk component:

'Counterparty Credit Risk' or 'CCR' means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

1.3.4 Commodities Instruments - Risk Component

Commodities Risk is the risk component required to cover the Licence Holder's risk of holding or taking positions in commodities such as physical products which are and can be traded in the secondary market including commodity derivatives.

1.3.5 Large Exposures Risk Component – (applicable only to Category 3 Licence Holders)

The purpose of the large exposure requirement is to ensure that a firm manages its exposure to counterparties within appropriate limits set in relation to its capital resources requirements.

1.3.6 Foreign Exchange Risk Component

Foreign Exchange Risk is the risk that an asset or liability denominated in a currency other than the reporting currency may be adversely affected by a change in the value of the foreign currency.

1.3.7 Operational Risk Component – (applicable only to Category 3 Licence Holders)

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk.

1.3.8 Settlement risk component

Settlement risk is the risk that the Licence Holder's cash against documents transactions in financial instruments are unsettled after their due delivery dates.

1.3.9 Credit valuation adjustment risk

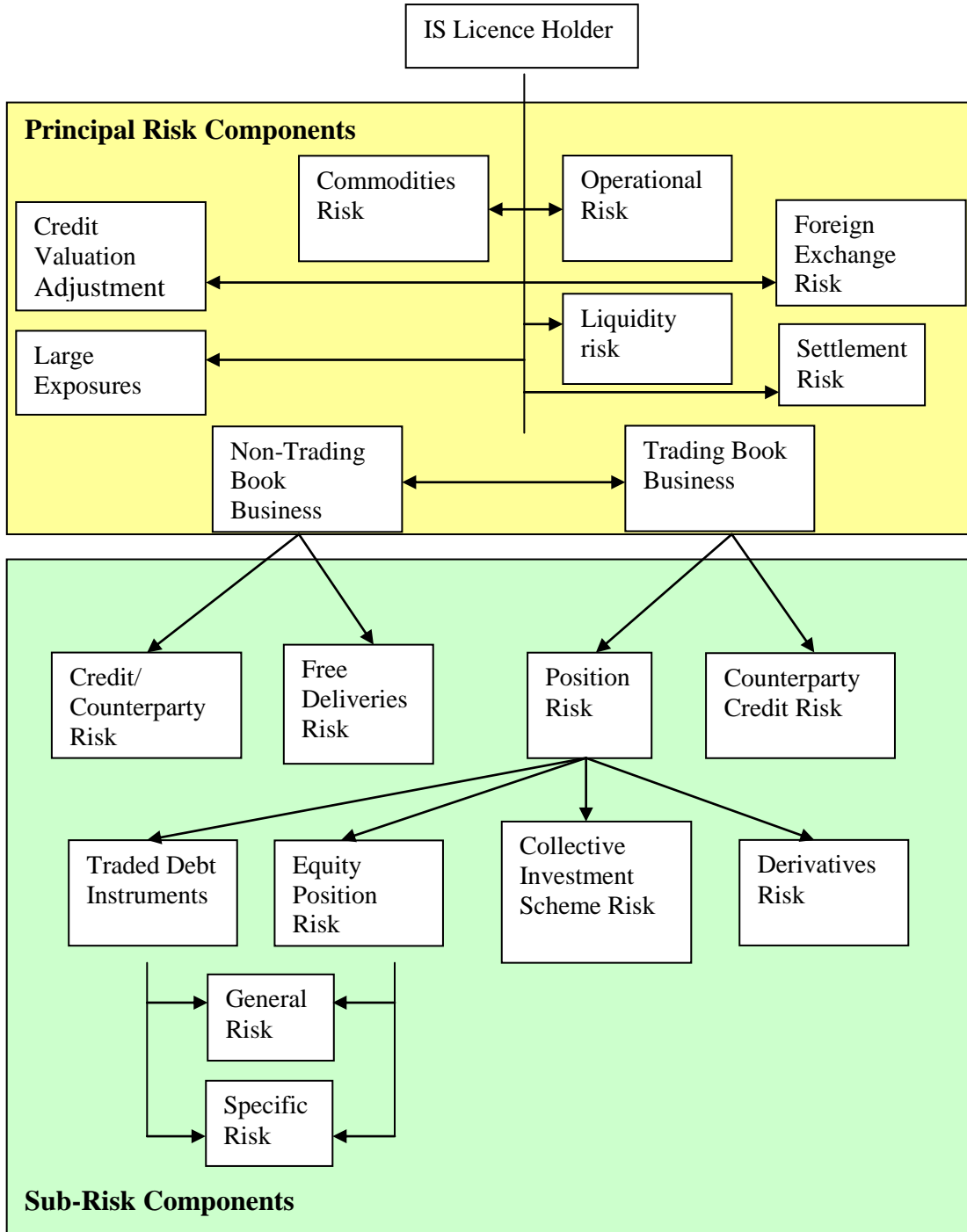
'Credit valuation adjustment' or 'CVA' means an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. That adjustment

reflects the current market value of the credit risk of the counterparty to the Licence Holder, but does not reflect the current market value of the credit risk of the Licence Holder to the counterparty.

1.3.10 Liquidity risk

The risk that the Licence Holder cannot meet its financial obligations, such as payments and collateral needs, as they fall due in the short term and medium term, either at all or without incurring unacceptable losses.

Table outlining the various risk components



2.0 *Trading Book*

2.1 The trading book of a Licence Holder shall consist of all positions in financial instruments and commodities held either with trading intent or in order to hedge positions held with trading intent and which are either free of any restrictive covenants on their tradability or are able to be hedged.

Provided that where the following requirements in accordance with article 94 of the CRR are met, trading book positions may be accounted for as non-trading book positions:

- a. the trading book business of the Licence Holder does not normally exceed 5 % of the total assets; and
- b. their trading-book positions do not normally exceed EURO 15 Million; and
- c. the trading book business of the Licence Holder never exceeds 6% of total assets (being the combined off and on balance sheet business) and total trading book positions never exceed EUR 20 million.

In order to calculate the proportion that trading book business bears to total business for the purposes of points (a) and (c) above, the Licence Holders shall apply the following:

- (i) **debt instruments** shall be valued at their market prices or their nominal values, **equities** at their market prices and **derivatives** according to the nominal or market values of the instruments underlying them.
- (ii) the absolute value of long positions shall be combined with the absolute value of short positions.

If a Licence Holder subject to the exemption from the trading book requirement, fails to meet the condition in paragraph (c) above, the Licence Holder is required to notify the MFSA immediately. If following assessment, the MFSA determines and notifies the Licence Holder that the requirement in paragraphs (a) and (b) are not met, the Licence Holder shall meet the requirements outlined in para. 2.1 from the next reporting date.

2.2 In complying with para. 2.1 above, a Licence Holder shall abide by the following conditions:

2.2.1 *Positions held with trading intent*

Positions held with trading intent have the same meaning as in point (85) of paragraph (1) of article 4 of the CRR and comprise any of the following:

- a. proprietary positions and positions arising from client servicing and market making;
- b. positions intended to be resold short term;
- c. positions intended to benefit from actual or expected short term price differences between buying and selling prices or from other price or interest rate variations.

2.2.2 *Trading intent*

Trading intent shall be evidenced on the basis of the strategies, policies and procedures set up by the Licence Holder to manage the position or portfolio in accordance with article 103 of the CRR. These shall include the following:

- a. The Licence Holder shall have in place a clear documented trading strategy for the position/instrument or portfolios. Such strategy shall be approved by senior management, and shall include the expected holding period;
- b. The Licence Holder shall have in place clearly defined policies and procedures for the active management of positions, which shall include the following:
 - i. positions entered into on a trading desk;
 - ii. position limits are set and monitored for appropriateness;
 - iii. autonomy for dealers to enter into/manage the position within agreed limits and according to the approved strategy;
 - iv. positions are reported to senior management as an integral part of the Licence Holder's risk management process; and
 - v. positions are actively monitored with reference to market information sources and an assessment made of the marketability or hedge-ability of the position or its competent risks, including the assessment, the quality and availability of market inputs to the valuation process, level of market turnover, sizes of positions traded in the market;
 - vi. active anti fraud procedures and controls; and
- c. The Licence Holder shall have in place a clearly defined policy and procedures to monitor the positions against the Licence Holder's trading strategy including the monitoring of turnover and positions for which the originally intended holding period has been exceeded.

2.2.3 Systems and controls

All trading book positions shall be subject to the standards for prudent valuation specified in article 105 of the CRR. Licence Holders shall in particular ensure that the prudent valuation of their trading book positions achieves an appropriate degree of certainty having regard to the dynamic nature of trading book positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of trading book positions. In this regard, Licence Holders should refer to the [Draft Regulatory Technical Standards on Prudent Valuation](#) for the different approaches that can be applied in order to achieve an appropriate degree of certainty in accordance with article 105 of the CRR.

Licence Holders shall establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates and shall include:

a. Documented policies and procedures for the process of valuation.

These should include clearly defined responsibilities of the various areas involved in the determination of the valuations, sources of market information and review of their appropriateness, guidelines for the use of unobservable inputs reflecting the Licence Holders' assumptions of what market participants would use in pricing the position, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures; and reporting lines for the department accountable for the valuation process that are clear and independent of the front office. The reporting line shall ultimately be to the management body.

b. Prudent valuation methods as follows:

- i. Licence Holders shall mark their positions to market whenever possible, including when applying trading book capital treatment. The term 'marking to market' is defined in point (68) of paragraph (1) of article 4 as the valuation of positions at readily available close out prices that are sourced independently, including exchange prices, screen prices, or quotes from several independent reputable brokers;
- ii. When marking to market, the more prudent side of bid/offer shall be used unless the Licence Holder can close out at mid market. Where Licence Holders make use of this derogation, they shall inform the MFSA every six months of the positions concerned and furnish evidence that they can close out at mid-market;
- iii. Where marking to market is not possible, Licence Holders shall conservatively mark to model their positions/portfolios, including when calculating the position risk component. The term 'marking to

model' is defined as any valuation which has to be benchmarked, extrapolated or otherwise calculated from one or more market inputs;

- iv. The following requirements must be complied with when marking to model:
- senior management shall be aware of the elements of the trading book or of other fair-valued positions which are subject to mark to model and shall understand the materiality of the uncertainty thereby created in the reporting of the risk/performance of the business;
 - market inputs shall be sourced, where possible, in line with market prices, and the appropriateness of the market inputs of the particular position being valued and the parameters of the model shall be assessed on a frequent basis;
 - where available, valuation methodologies which are accepted market practice for particular financial instruments or commodities shall be used;
 - where the model is developed by the Licence Holder itself, it shall be based on appropriate assumptions, which have been assessed and challenged by suitably qualified parties independent of the development process;
 - there shall be formal change control procedures in place and a secure copy of the model shall be held and periodically used to check valuations;
 - the person/s responsible for risk management shall be aware of the weaknesses of the models used and how best to reflect those in the valuation output; and
 - the Licence Holder's models shall be subject to periodic review to determine the accuracy of its performance, which shall include assessing the continued appropriateness of assumptions, analysis of profit and loss versus risk factors, and comparison of actual close out values to model outputs.

The model shall be developed or approved independently of the trading desk and shall be independently tested, including validation of the mathematics, assumptions and software implementation.

Independent price verification should be performed in addition to daily marking to market or marking to model. This is the process by which market prices or marking to model inputs are regularly verified for accuracy and independence. Verification of market prices and model inputs should be performed by a person or department independent from persons or departments that benefit from the trading book, at least monthly (or, depending on the nature of the market/ trading activity, more frequently). Where independent pricing sources are not available or pricing sources are more subjective, prudent measures such as valuation adjustments may be appropriate.

- c. *Procedures for considering valuation adjustments* which make provision for (i) unearned credit spreads; (ii) close-out costs; (iii) operational risks; (iv) market price uncertainty; (v) early termination; (vi) investing and funding costs; (vii) future administrative costs and (viii) where relevant, model risk.
- d. *Standards for less liquid positions as follows:*
- i. Less liquid positions could arise from both market events and institution-related situations e.g. concentrated positions and/or positions for which the originally intended holding period has been exceeded.
 - ii. Licence Holders shall establish and maintain procedures for calculating an adjustment to the current valuation of any less liquid positions. Such adjustments shall where necessary be in addition to any changes to the value of the position required for financial reporting purposes and shall be designed to reflect the illiquidity of the position. Under these procedures, Licence Holders shall consider several factors when determining whether a valuation adjustment is necessary for less liquid positions. These factors include the amount of time it would take to hedge out the position/risks within the position, the volatility and average of bid/offer spreads, the availability of market quotes (number and identity of market makers) and the volatility and average of trading volumes including trading volumes during periods of market stress, market concentrations, the ageing of positions, the extent to which valuation relies on marking-to-model, and the impact of other model risks.
 - iii. When using third party valuations or marking to model, Licence Holders shall consider whether to apply a valuation adjustment. In addition, Licence Holders shall consider the need for establishing adjustments for less liquid positions and on an ongoing basis review their continued suitability. Licence Holders shall also explicitly

assess the need for valuation adjustments relating to the uncertainty of parameter inputs used by models.

- iv. With regard to complex products including securitisation exposures and nth-to-default credit derivatives, Licence Holders shall explicitly assess the need for valuation adjustments to reflect the model risk associated with using a possibly incorrect valuation methodology and the model risk associated with using unobservable (and possibly incorrect) calibration parameters in the valuation model.

e. *Policies and procedures covering inclusion in the trading book* as follows:

- i. Licence Holders shall have in place clearly defined policies and procedures for determining which position to include in the trading book for the purposes of calculating their capital requirements, in accordance with the requirements set out in article 102 of the CRR and the definition of trading book in accordance with point (86) of paragraph (1) of article 4, taking into account the Licence Holder's risk management capabilities and practices. Compliance with these policies and procedures shall be fully documented and for those Licence Holders having an internal audit function, they shall subject these policies and procedures to periodic internal audit.
- ii. Licence Holders shall have in place clearly defined policies and procedures for the overall management of the trading book. As a minimum these policies and procedures shall address:
 - the activities the Licence Holder considers to be trading and as constituting part of the trading book for capital requirement purposes;
 - the extent to which a position can be marked-to-market daily by reference to an active, liquid two-way market;
 - for positions that are marked-to-model, the extent to which the Licence Holder can: (i) identify all material risks of the position; (ii) hedge all material risks of the position with instruments for which an active, liquid two-way market exists; and (iii) derive reliable estimates for the key assumptions and parameters used in the model;
 - the extent to which the Licence Holder can, and is required to, generate valuations for the position that can be validated externally in a consistent manner;

- the extent to which legal restrictions or other operational requirements would impede the Licence Holder's ability to effect a liquidation or hedge of the position in the short term;
- the extent to which the Licence Holder can, and is required to, actively manage the risks of positions within its trading operation; and
- the extent to which the Licence Holder may transfer risk or positions between the non-trading and trading books and the criteria for such transfers.

2.2.4 Internal Hedging

When including internal hedging in the calculation of the position risk component, Licence Holders shall comply with the requirements of articles 103 to 106 of the CRR, which include the following:

- a. An internal hedge is a position that materially offsets the component risk elements between a trading book and a non-trading book position or sets of positions. Positions arising from internal hedges may be included in the calculation of the position risk component, provided that they are held with trading intent and that the general criteria on trading intent and prudent valuation specified in paras. 2.2.1 to 2.2.3 are met. In particular:
 - internal hedges shall not be primarily intended to avoid or reduce capital requirements;
 - internal hedges shall be properly documented and subject to particular internal approval and audit procedures
 - the internal transaction shall be dealt with at market conditions;
 - the market risk that is generated by the internal hedge shall be dynamically managed in the trading book within the authorised limits;
 - internal transactions shall be carefully monitored; and
 - monitoring must be ensured by adequate procedures.
- b. The treatment referred to in point (a) applies without prejudice to the requirements applicable to the hedged position in the non-trading book.

By way of derogation from points (a) and (b), when the Licence Holder hedges its non-trading book credit risk exposure or counterparty risk exposure using a credit derivative booked in its trading book (using an internal hedge), the non-trading book exposure or counterparty risk exposure shall not be deemed to be hedged for the purposes of calculating the risk components unless the Licence Holder purchases from an eligible third party protection provider a corresponding credit derivative meeting the requirements for unfunded credit protection in the non-trading book. Without prejudice to point (h) of article 299 (2) of the CRR, where such third party protection is purchased and recognised as a hedge of a non-trading book exposure for the purposes of calculating capital requirements, neither the internal nor the external credit derivative hedge shall be included in the trading book for the purposes of calculating capital requirements.

3.0 *The automated COREP Return*

3.1 *Introduction*

- a. This Manual provides detailed instructions on how to fill in the automated COREP Return. It then provides an explanation of how Licence Holders are to complete a number of worksheets in the Return namely:

Section 1 – Standard Templates	Section 2 – COREP Templates	Section 3 – Fixed Overhead Template
Input Sheet	Capital Adequacy	Fixed Overhead Requirement
Income Statement	Credit Risk	
Balance Sheet Statement	Operational Risk	
Validation Check	Market Risk	
Financial Details	Large Exposures	
Representations	Leverage	

3.2 *Instructions for using the automated COREP Return*

- a. This Manual also provides guidance for Licence Holders when compiling the automated Interim COREP Return (“ICR”), the automated Annual COREP Return (“ACR”), and the automated Annual Audited COREP Return (“AACR”).
- b. The Return is compiled via an MS Excel File. The file has been optimised to work on Microsoft Excel 2010. Some functions may not work if converted for use with other software or later version of Excel. This MS Excel file must be saved in the following format: Microsoft Excel Macro-Enabled Worksheet (.xlsm).
- c. To select a worksheet, go to “INDEX” sheet and click on the icon next to the required sheet.

- d. The worksheets are password protected.
- e. In instances where the cells are linked, only the values need to be inputted once.
- f. Subtotals are calculated automatically.
- g. A number of worksheets require manual intervention. The user will be prompted to execute a function or to input a value. Any computer prompted instructions are to be followed carefully.
- h. Licence Holders are to provide additional details where required. This is required at the bottom of the “Income Statement and Balance Sheet Statement” sheets. It is preferable that entries do not exceed the space provided for this purpose.
- i. The compilation of the automated COREP Return should start from the first worksheet (that is, the “COVER SHEET”). Details are to be inserted (as and where appropriate) starting from top and moving to the end of each worksheet.
- j. The following is an outline of all the applicable sheets:

Sheet	Sheet title	Applicable to
Input Sheet	Input Sheet	Category 2/3
Income Statement	Income Statement	Category 2/3
Balance Sheet Statement	Balance Sheet Statement	Category 2/3
Validation Check	Validation Check	Category 2/3
Financial Details	Financial Details	Category 2/3
Representations	Representations	Category 2/3
CA 1	Own Funds	Category 2/3
CA 2	Own Funds Requirement	Category 2/3
CA 3	Capital Ratios	Category 2/3
CA 4	Memorandum Items	Category 2/3
CA 5	Transitional Provisions	Category 2/3
CR SA	Credit and Counterparty Credit Risk and Free Deliveries: Standardised Approach To Capital Requirements	Category 3
CR GB	Geographical Breakdown	Category 3
CR SETT	Settlement/Delivery Risk	Category 3
Operational Risk	Operational Risk	Category 3
MKR SA TDI	Market Risk: Standardised Approach for Position Risks in	Category 3

	Traded Debt Instruments	
MKR SA EQU	Market Risk: Standardised Approach for Position Risk in Equities	Category 3
MKR SA FX Working	MKR SA Foreign Exchange Risk Working	Category 2/3
MKR SA FX	Market Risk: Standardised Approaches for Foreign Exchange Risk	Category 3
MKR SA COM	Market Risk: Standardised Approaches for Commodities	Category 3
MKR IM	Market Risk Internal Models	Category 3
CVA	Credit Value Adjustment Risk	Category 3
LE	Large Exposures	Category 3
Leverage	Leverage	Category 3
Fixed Overhead	Fixed Overhead Requirement	Category 2

- k. Users should not key in “0” or “-” whenever a value is nil but should leave the cell empty.
- l. Returns should be submitted by their due date in electronic format by use of the FRE/D Interface accessed through the following link: <http://fredisu.mfsa.com.mt/>. Licence Holders will be provided with a username and password to log into the FRE/D system. The FRE/D Financial Institution Representative Instructions are available on the MFSA website. The Authority does not bear any liability which may result from unauthorised access to returns submitted in electronic format.
- m. The automated COREP Return is to be signed by means of a Digital Certificate. To obtain a personal Digital Certificate one should register for an e-ID issued by the Government of Malta Certification Authority by following the procedures as established on the myGov.mt web portal: [https://mygov.mt/portal/\(laa4cwrit3rekrecwx1fl3jb\)/webforms/howdoigetaccesstomygov.aspx#Register](https://mygov.mt/portal/(laa4cwrit3rekrecwx1fl3jb)/webforms/howdoigetaccesstomygov.aspx#Register)

3.3 The Cover Sheet

- a. All cells in items 1 to 11 which are highlighted in blue are to be completed.
- b. Item 1: Select document type – either Annual or Interim COREP Return – from the drop down list depending on the period for which the return is being compiled.

1.0	Document Type:	
	ANNUAL COREP RETURN INTERIM COREP RETURN	↓
2.0	Name of Licence Holder	

Select Document type – either Interim COREP Return or Annual COREP Return

- c. Returns are to be prepared in the currency in which the Audited Annual Financial Returns are compiled. The reporting currency of the accounts should be inserted in ISO Code.
- d. Irrespective of the reporting currency, the relevant Middle Exchange Rate converting EUR to the reporting currency is to be inserted in Item 9.
- e. Upon satisfactory completion of items 1 – 11, click on the button which leads directly to the “Index Sheet”

8.0	Number of months covered by reporting period	
9.0	Currency in which accounts are reported	
10.0	Exchange rate as at end of reporting period converting the reporting currency to EURO	
11.0	Accounting Framework	

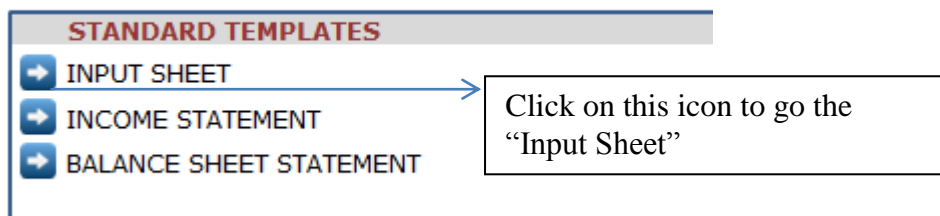
When this sheet is completed click here to go to Index page

3.4 The Index sheet

- a. The Index sheet is mainly divided into three sections as follows:
SECTION 1 – STANDARD TEMPLATES
SECTION 2 – COREP TEMPLATES
SECTION 3 – FIXED OVERHEAD TEMPLATE
- b. In order to access a specific sheet, the relative icon to the left of the sheet’s title must be selected.
- c. Sheets filled in either manually or by way of automation will be marked in **(RED, BOLD & UNDERLINED)** in the “INDEX SHEET”.

3.5 The Input Sheet

SECTION 1 - STANDARD TEMPLATES



- a. Click on the icon on the left of the sheet's "title" to access the "INPUT SHEET"
- b. The input sheet has a similar structure to a Trial Balance. All amounts on the credit (mainly items of income and liabilities) are to have a negative figure, by inserting a 'sign' before the figure. On the other hand, all amounts on the debit (mainly assets and expense) should be indicated as positive. If a negative amount is filled in a cell representing an asset, the program will prompt the Licence Holder to insert a positive amount. In general, the Licence Holder will not be allowed to insert a negative amount in a cell representing an asset or an expense. Similarly such Licence Holder will not be allowed to insert a positive amount in a cell representing an item of income or a liability. For convenience, some cells have an automated pop-up window explaining what must be inserted.
- c. The "INPUT SHEET" is mainly divided into six sections as follows:
 - i. Income
 - ii. Expenditure
 - iii. Assets
 - iv. Liabilities
 - v. Capital & Reserves
 - vi. Other

Steps to be followed for the completion of certain items in the Input Sheet:

a. *Other Comprehensive Income*

If the Licence Holder is required to report an amount in "Fair value movements on Intangible assets" or "Gain/Loss on revaluation of property", then Item "a" or "c" in "Statement of Other Comprehensive Income" section must be filled in. Once the input cell has been filled in, a pop-up will appear, prompting the Licence Holder to qualify the item as a "P/L" or "OCI" item.

b. *Assets*

- i. If the Licence Holder requires reporting an amount in “Goodwill” then item (a) i) in the “Assets” section must be filled in. Once the input cell has been filled in, a pop-up will appear, prompting the Licence Holder to qualify the item as a “Goodwill item accounted for as intangible asset” or “Goodwill item included in the valuation of significant investments”. The amount will feature in the CA1 Template according to the selected category.
- ii. If the Licence holder needs to report any “Amounts due from Group Companies” and/or “Amounts due from other connected persons”, the credit quality step of the central government in which the amount is due from must be specified. These items are considered as exposures to corporates which are unrated and thus shall be assigned the risk weight of exposures to the central government of the jurisdiction in which the corporate is established. A credit assessment of 1 to 5 and an unrated credit assessment will risk weight the amount at 100%, while a credit assessment of 6 will risk weight the amount at 150%.
- iii. “Trade Receivables” and “Other Receivables” must be classified according to the Exposure Type. The three exposure types available are “Exposures to Institutions”; “Exposures to Corporates”; and “Other Exposures”. If the reporting amount is classified as an “Exposures to Corporates”, these items are considered as unrated and thus shall be assigned the risk weight of exposures to the central government of the jurisdiction in which the corporate is established. A credit assessment of 1 to 5 and an unrated credit assessment will risk weight the amount at 100%, while a credit assessment of 6 will risk weight the amount at 150%.

c. *Liabilities*

If the Licence Holder needs to report any “Subordinated Loan as at 31/12/2013” and/or any “Subordinated Loan as from 01/01/2014”, the issue date and maturity date must be specified in the adjacent cells.

d. *Other*

- i. If the Licence Holder holds “assets/ liabilities denominated in a currency other than the reporting currency” then item “a” in Section 6 of the INPUT SHEET must be answered “Yes”. If the answer to the Question is “Yes” a pop-up will appear indicating “Please input the relevant exposure in MKR SA FX Working Sheet”. The MKR SA FX Working Sheet can be accessed through the Index Sheet.

- ii. If the Licence Holder holds “Investments in Own CET 1, AT1 or T2 Instruments” then item “d” in Section 6 of the INPUT SHEET must be answered “Yes”. If the answer to the Question is “Yes” a pop-up will appear prompting the Licence Holder to input the “Capital Type”, “Holding Type” and “Amount”. The amount will feature in the CA1 Template according to the selected “Capital Type”.
- iii. If the Licence Holder holds “Instruments of financial sector entities where the institution has a significant investment” and/or “exposures to any Securitisation Positions”, then item “e” and/or “o” of Section 6 of the INPUT SHEET is answered “Yes”. If the answer to the question is “Yes” a pop-up will appear indicating “Please Inform MFSA”. The MFSA will then guide the Licence Holder accordingly.
- iv. If the Licence Holder holds “Instruments of financial sector entities where the institution does not have a significant investment”, the amount must be specified in Item “f” of Section 6 of the INPUT SHEET. A pop-up will immediately appear prompting the Licence Holder to input the “Capital Type”. The amount will feature in the “CA1” Template according to the selected “Capital Type”.
- v. If the Licence Holder is “involved in any Credit Risk Mitigation Techniques” and/or is “subject to any Off-balance sheet exposures” then Question “l” and/or “m” in Section 6 of the INPUT SHEET must be answered “Yes”. If the answer to the Question is “Yes” a pop-up will appear indicating “Please Inform MFSA”. The MFSA will then guide the Licence Holder accordingly.
- vi. If the Licence Holder holds “exposures secured by mortgages on immovable property” then Question “n” in Section 6 of the INPUT SHEET must be answered “Yes”. If the answer to the Question is “Yes” a pop-up will appear indicating “Please input the relevant exposure in CR SA - Secured by Mortgages on Immovable Property”.

3.6 *The Income Statement*

- a. This sheet is fully automated except for Item 8.0.
- b. The space provided in item 8.0 (“Details of ‘Other ISA related revenue’ and/or Any other details or comments” is to be used to explain Item 5.0 (“Other ISA related revenue”).

3.7 *The Balance Sheet Statement*

- a. This sheet is fully automated except for item 8.0.
- b. The space provided in Item 8.0 (“Details of 'Amounts due to/ from other connected persons' and/or **'Amounts due to/ from group Companies' and/or Any other details or comments :’”) should provide explanations to Item 2.0 (f) (“Amounts due from group companies**”) and item 2.0 (g) (“Amounts due from other connected persons*”).

3.8 *COREP Structure*

- a. Overall the framework consists of 6 set of templates: **[i]** Capital Adequacy; **[ii]** Credit Risk; **[iii]** Operational Risk; **[iv]** Market Risk; **[v]** Large Exposures Risk; and **[vi]** Leverage.

A description of these templates is provided in the following sections.

- b. Category 3 Licence Holders are required to complete all the COREP Templates that are included within the automated COREP Return, as long as these are applicable to them, depending on the type of investment services activities that they provide. In addition, certain reporting templates are only required to be completed if they exceed the reporting thresholds on two consecutive reporting reference dates. Licence Holders should refer to Article 4 of EBA Final draft Implementing Technical Standard on supervisory reporting for the purpose of complying with the entry and exit criteria for reporting thresholds.
- c. Category 2 Licence Holders are only required to complete the Capital Adequacy Templates. Given that these templates contain certain information which require the calculation of the risk components and the fixed overhead requirement, Category 2 Licence Holders are required to complete the following sheets in addition to the Capital Adequacy Templates: **[i]** Input Sheet; **[ii]** Income Statement; **[iii]** Balance Sheet Statement; **[iv]** Financial Details; **[v]** Representations; **[vi]** the MKR SA FX Working (Foreign Exchange Working) Sheet; and **[vii]** Fixed Overhead Requirement. This will ensure the automatic calculation of the risk components and the fixed overhead calculation in the Capital Adequacy Templates.

3.9 *The Capital Adequacy – (CA) Templates*

- a. These templates mainly contain summary information about the own funds (numerator) and the own funds requirement (denominator) of the Licence

Holder, resulting in the calculation of the capital adequacy ratio. They are divided into five sub-templates:

- b. **The CA 1 Template** provides details about the Licence Holder's Common Equity Tier 1 Capital (CET 1), Additional Tier 1 Capital and Tier 2 Capital. This sheet is partly automated via the "INPUT SHEET". Where applicable, cells marked in blue are to be filled in.
- c. **The CA 2 Template** establishes the Licence Holder's capital requirement based on risk-weighted credit and counterparty credit risk component, the market risk component, the operational risk component, the credit valuation adjustment (over-the-counter) derivative instrument risk component and where applicable the large exposures risk and the Fixed Overhead Requirement.
- d. **The CA 3 Template** calculates the Licence Holder's CET1 capital ratio, the Tier 1 capital ratio and the total capital ratio.
- e. **The CA 4 Template** contains memorandum items such as [a] deferred tax assets; [b] thresholds for CET 1 deductions; [c] investments in the capital of financial sector entities where the institution does not have a significant investment; [d] investments in the capital of financial sector entities where the institution has a significant investment; [e] Pillar II requirements; and [f] additional information for investment firms and for the calculation of the reporting thresholds.
- f. **The CA 5 Template is structured as follows:**
 - i. **The CA 5.1 (Transitional Provisions) Template** includes items which are covered under the transitional provisions, hence will be phased out in due course.
 - ii. **The CA 5.2 (Grandfathered Instruments) Template** provides further details on the calculation of grandfathered instruments which do not constitute state aid.
- g. Any amount that increases the own funds or the own funds requirement will be reported as a positive figure. On the contrary, any amount that reduces the total own funds or the own funds requirement will be reported as a negative figure. Where there is a negative sign (-) preceding the label of an item, no positive figure is expected to be reported for that item.

A detailed account of the information to be inputted in every row of the CA Templates is available from [Annex II to Draft ITS on Supervisory Reporting](#).

3.10 *The Credit and Counterparty Credit Risk and Free Deliveries: Standardised Approach for Own funds Requirements (CR SA Templates)*

- a. The CR SA templates provide the necessary information on the calculation of the credit risk component according to the Standardised Approach. In particular, they provide detailed information on:
 - i. the classification of the exposure values according to the different exposure types, risk weights and exposure classes; and
 - ii. the amount and type of credit risk mitigation techniques used by the Licence Holder in accordance with Part Three, Title II, Chapter 4 of the CRR.
- b. Each exposure shall be assigned to one of the 16 exposure classes listed below in order to calculate the own funds requirements via the “INPUT SHEET”
 - i. Exposures to central governments or central banks;
 - ii. Exposures to regional governments or local authorities;
 - iii. Exposures to public sector entities;
 - iv. Exposures to multilateral development banks;
 - v. Exposures to international organisations;
 - vi. Exposures to institutions;
 - vii. Exposures to corporates;
 - viii. Retail exposures;
 - ix. Exposures secured by mortgages on immovable property;
 - x. Exposures in default;
 - xi. Exposures associated with particularly high risk;
 - xii. Exposures in the form of covered bonds;
 - xiii. Exposures to institutions and corporates with a short-term credit assessment;
 - xiv. Exposures in the form of units or shares in collective investment undertakings (CIUs);
 - xv. Equity exposures; and
 - xvi. Other items.
- c. Once the exposure has been categorised under one of the exposure classes referred to above, a description of that exposure must be inserted.
- d. Immediately after a description of the exposure has been inserted, a number of cells will turn ‘red’. These ‘red’ cells are required to be filled in.

- e. The Licence Holder must input the ‘balance sheet value’ and the ‘market value’ of the exposure in the adjacent columns.
- f. The Licence Holder must qualify the asset as a non-trading book business asset exposure by choosing “No” from the drop down list which is available in the column titled ‘Held with trading intent?’.
- g. A number of these exposure classes apply the Credit Quality Steps Approach (‘CQSA’). In terms of CQSA, the individual risk weighting of non-trading book asset exposures is to be assigned a risk weighting depending on their credit quality assessment rating.

Steps to use the CQSA:

- i. Check whether the relevant non-trading book business asset exposure is rated by one of the following rating agencies: Fitch Rating, Moody’s, and Standard and Poor’s;
- ii. Obtain from the rating agency, the rating of the relevant non-trading book business asset exposure;
- iii. Apply the following mapping table to categorise the non-trading book business asset exposure in one of the credit quality steps:

Credit Quality Step	Fitch’s assessment	Moody’s assessment	S&P assessment
1	AAA to AA-	Aaa to Aa3	AAA to AA-
2	A+ to A-	A1 to A3	A+ to A-
3	BBB+ to BBB-	Baa1 to Baa3	BBB+ to BBB-
4	BB+ to BB-	Ba1 to Ba3	BB+ to BB-
5	B+ to B-	B1 to B3	B+ to B-
6	CCC+ and below	Caal and below	CCC+ and below

- h. Where the risk weighting of the exposure is determined through the CQSA, depending on the category of exposure, the Licence Holder must choose the applicable option from the drop down list which is available in the column titled 'Credit Quality Assessment'.
- i. Certain exposures may be classified as 'Unrated' when determining the CQSA. When this classification is chosen, another adjacent cell turns red, prompting input. These exposures include:
 - i. Exposures to Regional Governments or Local Authorities (treated as Institutions);
 - ii. Exposures to Public Sector Entities;
 - iii. Exposures to Multilateral Development Banks; and
 - iv. Exposures in the form of Covered Bonds.
- j. The information of each exposure class is reported in separate templates. The information in the 'CR SA template' is gathered individually for each of the exposure classes as defined for the standardised approach by means of the "INPUT SHEET".
- k. The "CR SA TOTAL" template is automatically completed via the individual CR SA exposure classes.
- l. If the Licence Holder needs to report the counterparty credit risk of derivative instruments, the exposure value is to be inputted in Row 110, Column 010 of the relevant CR SA Template.

3.11 The Credit Risk Geographical Breakdown (CR GB) Template

- a. Licence Holders are only required to complete this template where the 'non-domestic' credit risk exposures in all 'non-domestic' countries in all exposure classes, as reported in row 850 of template 'CA4', are equal to or higher than 10% of the total domestic and non-domestic original credit risk exposures as reported in row 860 of the same template. For this purpose, exposures shall be deemed to be domestic where they are exposures to counterparties located in the Member State where the institution is located. This requirement is only applicable to Category 3 Licence Holders pursuant to article 5 of the [Draft ITS on Supervisory Reporting](#). Licence Holders should refer to article 4 of the [Draft ITS on Supervisory Reporting](#) for the purpose of complying with the entry and exit criteria relating to the reporting thresholds.
- b. *Steps to be followed in the Input Sheet of the Return:*

If the Licence Holder holds “any non-domestic original exposures in all 'non domestic' countries” then the amount must be filled in Section 6(g) of the INPUT SHEET. The 10% threshold described above will automatically be computed. If the threshold is reached, a pop-up will appear indicating “Kindly fill in the CR GB Template in accordance with the Entry & Exit criteria of article 4 of the ITS on Supervisory Reporting”.

Licence Holders which are required to report the geographical distribution of exposures by country, should report the relevant data by accessing the CR GB Template. A separate CR GB Template must be filled in for every country of residence of the obligor. The automated COREP Return caters for 3 countries.

- c. **A detailed account of what information needs to be inputted in every column of the CR GB Template is available from [Annex II to Draft ITS on Supervisory Reporting](#).**

3.12 *The Settlement/Delivery Risk (CR SETT) Template*

- a. This template requests information on both the trading and non-trading book transactions which are not settled after their due delivery dates, for the purpose of calculating the settlement risk component.
- b. Licence Holders report in the “CR SETT” template information on the settlement/delivery risk in connection with debt instruments, equities, foreign currencies and commodities held in their trading or non-trading book.
- c. Licence Holders should note that own funds requirements for free deliveries are not within the scope of the CR SETT template; the latter shall be reported in the credit risk templates (CR SA template).
- d. *Steps to be followed in the Input Sheet of the Return:*
 - i. Identify those financial instruments which have been delivered by the Licence Holder but for which payment is still due after delivery date;
 - ii. Identify the cash amounts which have been settled by the Licence Holder in respect of undelivered financial instruments;
 - iii. Determine whether the instruments qualify as a trading book position or a non-trading book position;

- iv. Categorise in section 3 (g) (i) of the “**Input Sheet**” the unsettled securities transactions, identified in (i) and (ii) above, under one of the available headings:

g) i) unsettled securities transactions - cash against documents		of which Trading Book	Of which Non Trading Book	Market value of Trading Book Position	Market value of Non Trading Book Position
0 - 4 working days					
5 - 15 working days					
16 - 30 working days					
31 - 45 working days					
46 or more working days					

- v. Enter the balance sheet value of the amount due to the Licence Holder in column (D). If the instrument is qualified as trading book business input the value in column (F), if the instrument is qualified as non-trading book business input the value in column (G). In the adjacent columns include the current market value, depending whether the instrument qualifies as trading book or non-trading book business.

3.13 The Operational Risk (OPR) Template

- a. This template provides information on the calculation of the operational risk component for Operational Risk under the Basic Indicator Approach (BIA), the Standardised Approach (TSA), the Alternative Standardised Approach (ASA) and the Advanced Measurement Approaches (AMA).

N.B. These instructions cater for the Basic Indicator Approach, as all Licence Holders currently use this method to calculate the operational risk component.

- b. Licence Holders using the BIA shall calculate their operational risk component, based on the information at financial year end. When audited figures are not available, the Licence Holder may use business estimates. If audited figures are available the Licence Holder should report these figures, which will then remain unchanged.
- c. Under the BIA, the operational risk component is equal to 15% of the average over three years of the relevant indicator. Licence Holders shall include each element of the relevant indicator in the sum with its positive or negative sign.

This working needs to be inputted within the “Operational Risk Working” sheet which feeds in the “OPR Template”. The “OPR TEMPLATE” is fully automated.

	YEAR-3	YEAR-2	LAST YEAR
Interest Receivable & Similar Income			
Interest Payable & Similar charges			
Income from shares & Other variable/fixed yield securities			
Commissions/fees receivable			
Commissions/fees payable			
Net profit or net loss on financial operations			
Other operating income			

3.14 *The Market Risk: Standardised Approach for Position Risks in Traded Debt Instruments (MKR SA TDI) Template*

- a. This template calculates the position risk component on traded debt instruments under the standardised approach.
- b. The template is to be filled out separately for the “Total”, plus a static, pre-defined list of the following currencies: all European Union currencies and USD, CHF, JPY, RUB, TRY, RSD, ALL, UAH, MKD, EGP, NOK, ISK and one residual dimension for all other currencies.
- c. *Steps to be followed in the Input Sheet of the Return:*
 - i. Identify those financial instruments which fall within the traded debt instruments category and which qualify as trading book business asset exposures;
 - ii. Input a description in section 3(f) of the relevant trading book business asset exposure;
 - iii. Immediately after a description of the exposure has been inputted, a number of cells will turn ‘red’. These ‘red’ cells are required to be filled in;
 - iv. Input the ‘balance sheet value’ and the ‘market value’ of the trading book business asset exposure in the adjacent columns;
 - v. Qualify the asset as a trading book business asset exposure by choosing ‘YES’ from the drop down list which is available in the column titled ‘Held with trading intent’;
 - vi. In the case of financial instruments which can be classified as either ‘Debt’ or ‘Equity’ instruments, qualify the asset as a ‘Debt’ instrument by choosing ‘Debt’ from the drop down list which is available in the column titled ‘Type of Instrument’;

- vii. Choose the currency the instrument is being traded in from the drop down list which is available in the column titled 'Currency';
- viii. Input the number of months to maturity in the adjacent column;
- ix. Where the risk weighting of the trading book business asset exposure is determined through the CQSA, depending on the category of asset, choose the applicable option from the drop down list which is available in the column titled 'Credit Quality Assessment';
- x. Input the coupon rate in the final column;
- xi. The return will automatically compute both the specific risk and the general risk component for traded instruments in the currency sheet respectively.

3.15 *The Market Risk: Standardised Approach for Position Risks in Equities (MKR SA EQU) Templates*

- a. These templates request information on the positions and the corresponding own funds requirements for position risk in equities held in the trading book and treated under the standardised approach.

The templates have to be filled out separately for the "Total", plus a static, pre-defined list of following markets: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Liechtenstein, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom, Albania, Japan, Former Yugoslav Republic of Macedonia, Russian Federation, Serbia, Switzerland, Turkey, Ukraine, USA plus one residual template for all other markets.

- b. *Steps to be followed in the Input Sheet of the Return:*
 - i. Identify those financial instruments which fall within the equity instruments category and which qualify as trading book business asset exposures;
 - ii. Input a description in section 3 (f) of the relevant trading book business asset exposure;
 - iii. Immediately after a description of the exposure has been entered, a number of cells will turn 'red'. These 'red' cells are required to be filled in;
 - iv. Input the 'balance sheet value' and the 'market value' of the trading book business asset exposure in the adjacent columns;

- v. Qualify the asset as a trading book business asset exposure by choosing 'YES' from the drop down list which is available in the column titled 'Held with trading intent';
- vi. A number of instruments can be either 'Debt' or 'Equity' Instruments. Qualify the asset as an 'Equity' instrument by choosing 'Equity' from the drop down list which is available in the column titled 'Type of Instrument';
- vii. Choose the type of Market that the equity instrument is being traded in from the drop down list which is available in the column titled 'Market';
- viii. The Return will automatically compute both the specific and general risk for equity instruments in the market sheets respectively.

3.16 *The Market Risk: Standardised Approaches for Foreign Exchange Risk (MKR SA FX) Template*

- a. This template requests information on the positions in each currency (reporting currency included). Gold is also treated as a foreign currency.
- b. *Steps to be followed in the Return:*

All positions, both short and long, have to be converted in the reporting currency, before being reported in the "MKR SA FX WORKING". The amounts inputted in the "MKR SA FX WORKING" sheet are in turn fed into the "MKR SA FX Template". The "MKR SA FX Template" is fully automated. All values both short and long have to be inputted in positive figures.

- i. The "MKR SA FX WORKING" sheet facilitates the calculation of the net long and net short positions for each currency, by deducting the total of short positions from the total of long positions.
- ii. Identify those foreign exchange positions which fall either within the long currency position or the short currency position in the "MKR SA FX WORKING" sheet.
- iii. Input the relevant amount in the applicable "Category", according to the "Currency" the position is held in.
- iv. All calculations are fully automated and linked to the COREP "MKR SA FX" Template.

3.17 *The Market Risk: Standardised Approach for Commodities (MKR SA COM) Template*

As Licence Holders rarely invest in commodities or commodity derivatives, the MFSA has not automated the MKR SA COM template. Licence holders which invest in commodities or commodity derivatives should refer to [Annex II to Draft ITS on Supervisory Reporting](#) to complete the MKR SA COM Template.

3.18 *The Market Risk Internal Risk Models (MKR IM) Template*

Licence Holders which have the Authority's permission to implement an internal risk measurement model are advised to refer to [Annex II to Draft ITS on Supervisory Reporting](#) to complete the MKR IM Template.

3.19 *The Credit Valuation Adjustment (CVA) Risk Template*

Licence Holders that provide investment services in relation to OTC derivatives (except for credit derivatives recognised to reduce risk-weighted exposure amounts for credit risk) are required to calculate the CVA risk. Licence holders should refer to [Annex II to Draft ITS on Supervisory Reporting](#) to complete the CVA Template.

3.20 *The Large Exposures (LE) Templates*

a. *LE Limits Template*

The Large Exposure Limits are fully automated in the LE Limits Template and are reported as follows:

- i. The large exposures limit for non institutions is equivalent to 25% of the Licence Holder's eligible capital.
- ii. The large exposure limit for institutions is the higher of 25% of the Licence Holder's eligible capital or EUR 150 million.

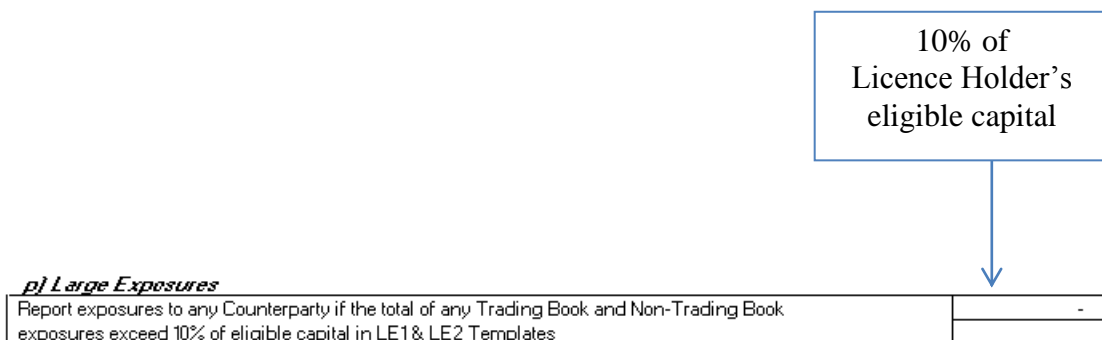
The term 'eligible capital' is defined in article 4(71) of the CRR and is reported in the CA4 Template, Row 220.

b. *Large Exposures in the Non-Trading and Trading Book (The LE Templates)*

- i. Every large exposure which falls within the definition of article 392 of the CRR, including large exposures that need not be considered for the

large exposures limits (explained in 3.20a above), should be reported to the MFSA.

- ii. Section 6(p) of the Input Sheet reports every large exposure which exceeds 10% of the Licence Holder's eligible capital. If the exposure exceeds 10% of the Licence Holder's eligible capital, then the LE1 and LE2 templates need to be filled in accordingly.



3.21 The Fixed Overhead Requirement

- a. The fixed overhead requirement is calculated by taking at least one quarter of the preceding year's fixed overheads as follows:
 - i. Deducting the items of previous year's expenditure outlined in point (iv) below from the previous year's total expenditure to obtain the relevant fixed expenditure figure;
 - ii. Taking one quarter of the annual relevant fixed expenditure;
 - iii. Multiplying the figure obtained in point (ii) by 12.5;
 - iv. The following items of the expenditure are to be deducted from the total expenditure reported in the previous year's Income Statement:
 - a. fully discretionary staff bonuses;
 - b. employees', directors' and partners' shares in profits, to the extent that they are fully discretionary;
 - c. other appropriations of profits and other variable remuneration, to the extent that they are fully discretionary;
 - d. shared commissions and fees payable, which are directly related to commission and fees receivable, which are included within total revenue, and where the payment of the commission

- and fees payable is contingent upon the actual receipt of the commission and fees receivable;
- e. fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing registering or clearing transactions;
 - f. fees to tied agents;
 - g. interest paid to customers on clients' money;
 - h. non-recurring expenses from non-ordinary activities.
- b. Input the items of expenditure in the fixed overhead requirement working;
- c. If the Licence Holder “makes use of tied agents”, then Question “6” in the “Fixed Overhead Requirement Working” must be answered “Yes”. If the answer to the Question is “Yes”, a pop-up will appear indicating “Input 35% of all the fees related to tied agents”. The relevant amount must be inputted in the corresponding cell;
- d. The return will automatically calculate the fixed overhead requirement and link the value to the CA 2 Template.

Licence Holders are to note that the calculation of the Fixed Overhead Requirement has been based on the methodology laid down on [EBA's FINAL draft regulatory technical standards on fixed overheads](#).

3.22 Financial Details

Where applicable, all the cells marked in blue are to be inputted.

- a. Some cells enable the user to select a reply from a drop down menu.
- b. The Licence Holder should only mark as “Yes” questions 1, 4 and 6 of this Sheet if the particular investment services activities are allowed by its investment services licence granted in terms of the Investment Services Act, 1994.
- c. Where the Return is being compiled as an Audited Annual Financial Return and where applicable, the total amount in the equivalent local currency of the number of clients’ assets held under nominee and the number of clients (beneficial owners) provided with discretionary portfolio management and/or fund management services is to be inputted in items 2 and 3 respectively.

- d. The Licence Holder may add further details/comments in item 7 of this sheet.

3.23 Representations

- a. Items 1 to 3 of this sheet must be filled in by the Licence Holder.
- b. Where the Return is being compiled as an Audited Annual Financial Return, the Licence Holder is required to input in Item 4 the: (i) names of shareholders / members possessing qualifying holdings; and (ii) the respective size of their holdings.
- c. The Licence Holder should also indicate whether any complaints were received during the reporting period in Item 5. If in the affirmative, the Licence Holder is to include: (i) the number of complaints received and (ii) those which are still pending at the end of the reporting period.
- d. Any breaches to the Investment Services Act, 1994 and/or to the standard licence conditions, are to be filled in Item 6.
- e. The date when the Licence Holder approved the Return is to be inputted in item 7.
- f. In cases where the Licence Holder is a sole trader, only the owner is required to electronically sign the Return. Otherwise the Return is to be electronically signed by two Directors or other authorised signatories. When the Return is electronically signed by the latter, the Licence Holder should provide a certified true copy of the Board of Directors' Resolution authorising the individual to sign the Return on behalf of the Directors.
- g. Where the Return is being compiled as an Audited Annual Financial Return, items 8 and 9 of the Return are to be completed. Furthermore, it must also be electronically signed by the auditor of the Licence Holder.

3.24 Validation Sheet

Prior to submitting the automated COREP Return to the MFSA, the Licence Holder must ensure that all Validations are marked "OK". Where the validation is marked "ERROR", the Licence Holder should check and correct the relevant sheet accordingly.

4.0 *The various elements which make up the calculation of the Own Funds, the Risk Components and the Fixed Overheads Requirement*

4.1 Own Funds

Own Funds means the sum of Tier 1 capital and Tier 2 capital.

4.1.1 Tier 1 capital

Tier 1 capital consists of the sum of the Common Equity Tier 1 capital and Additional Tier 1 capital.

4.1.1.1 *Common Equity Tier 1 capital*

Common Equity Tier 1 capital is made up of Common Equity Tier 1 items (as defined in article 26 of the CRR), after applying the prudential filters (laid down in articles 32 to 35 of the CRR) and the deductions from Common Equity Tier 1 items (articles 36 to 49 of the CRR).

(A) *Common Equity Tier 1 items:*

- i. Capital instruments provided that the conditions laid down in article 28 of the CRR or, where applicable, article 29 of the CRR are met.
- ii. Share premium account as defined in point (124) of article 4 (1) of the CRR.

Any amount received in excess of the nominal value of any capital instruments referred to in point (i).

- iii. Retained earnings as defined in point (123) of article 4 (1) of the CRR.

For the purposes of this point, Licence Holders shall include interim or year-end profits before a formal decision has been taken only if these profits have been verified by persons responsible for the auditing of the accounts (i.e. external auditors) and if it is proved to the satisfaction of the Authority that the amount thereof has been evaluated in accordance with International Financial Reporting Standards as adopted by the European Union.

Interim or year-end profits shall be included after deduction of any foreseeable charge, tax or dividend. Licence Holders should refer to the [Regulatory Technical Standards on Own Funds](#) for the meaning of foreseeable when determining whether any foreseeable charge or dividend has been deducted.

- iv. Accumulated other comprehensive income as defined in point (100) of article 4 (1) of the CRR.
- v. Other reserves as defined in point (117) of article 4 (1) of the CRR.

vi. Minority Interests (applicable for the scope of consolidation)

The amount of Common Equity Tier 1 capital of a subsidiary of a Licence Holder that is attributable to natural or legal persons other than those included in the prudential scope of consolidation of the Licence Holder.

The amount of minority interests to be included in consolidated Common Equity Tier 1 capital should be calculated in accordance with articles 81 and 84 of the CRR.

For the purposes of article 480 (3) of the CRR, the multiple of the percentage of minority interests allowed under article 84 (1) (b) of the CRR shall be as follows, during the period 1 January 2014 to 31 December 2017:

- a. 1 in the period from 1 January 2014 to 31 December 2014;
- b. 1 in the period from 1 January 2015 to 31 December 2015;
- c. 1 in the period from 1 January 2016 to 31 December 2016;
- d. 1 in the period from 1 January 2017 to 31 December 2017.

Provided that for the period 1 January 2014 to 31 December 2021, perpetual non-cumulative preference shares issued on or prior to 31 December 2011 and the related share premium account which qualified as Tier one capital under the national transposition measures for point (a) of article 57 of Directive 2006/48/EC, shall qualify as Common Equity Tier 1 items, subject to the following limits (determined in accordance with article 486 (5) of the CRR):

- a. 80% during the period from 1 January 2014 to 31 December 2014;
- b. 70% during the period from 1 January 2015 to 31 December 2015;
- c. 60% during the period from 1 January 2016 to 31 December 2016;
- d. 50% during the period from 1 January 2017 to 31 December 2017;
- e. 40% during the period from 1 January 2018 to 31 December 2018;
- f. 30% during the period from 1 January 2019 to 31 December 2019;
- g. 20% during the period from 1 January 2020 to 31 December 2020;
- h. 10% during the period from 1 January 2021 to 31 December 2021.

Provided further that the proportion of perpetual non-cumulative preference shares and the related share premium account, which exceeds the above percentages, shall be considered as Tier 2 capital.

(B) Prudential filters:

i. Securitised assets.

Any increase in equity resulting from securitised assets should be deducted from Common Equity Tier 1 capital in accordance with article 32 of the CRR.

ii. Cash flow hedge reserve.

The amount to be reported should be added to Common Equity Tier 1 capital if the cash flow hedges result in a loss (i.e. if it reduces accounting equity), and vice versa.

iii. Cumulative gains and losses due to changes in own credit risk on fair valued liabilities.

The amount to be reported should be added to Common Equity Tier 1 capital if there is a loss due to changes in the Licence Holder's own credit risk (i.e. if it reduces accounting equity), and vice versa.

iv. Fair value gains and losses arising from the Licence Holder's own credit risk related to derivative liabilities.

The amount to be reported should be added to Common Equity Tier 1 capital if there is a loss due to changes in the Licence Holder's own credit risk (i.e. if it reduces accounting equity), and vice versa.

Licence Holders should refer to [EBA Final draft Regulatory Technical Standards](#) to determine what constitutes close correspondence between the value of the bonds and the value of the assets relating to the Licence Holder's own credit risk, referred to in paragraph 3 (c) of article 33 of the CRR.

v. Additional value adjustments.

Adjustments to all the assets measured at fair value due to stricter standards for prudent valuation set in article 105 of CRR should be deducted from Common Equity Tier 1 capital.

In terms of article 35 of the CRR, Licence Holders shall not make adjustments to remove from their own funds unrealised gains or losses on their assets or liabilities measured at fair value.

(C) Deductions from Common Equity Tier 1 items:

- i. Losses for the current financial year.
- ii. Intangible assets as defined in point (115) of article 4 (1) of the CRR, which are calculated in accordance with article 37 of the CRR.
- iii. Deferred tax assets that rely on future profitability as defined in point (107) of article 4 (1) of the CRR, determined in accordance with article 38 of the CRR, taking into account the threshold exemptions set out in article 48 of the CRR.
- iv. IRB shortfall of credit risk adjustments to expected losses laid down in articles 158 and 159 of the CRR.

Applicable only for Licence Holders availing of the internal ratings based approaches in the calculation of credit risk. These approaches are explained in section 4.2.1.1 (A).

- v. Defined benefit pension fund assets within the meaning of point (109) of article 4 (1) of the CRR, as reported in the Licence Holder's balance sheet and calculated in accordance with article 41 of the CRR.
- vi. Direct, indirect and synthetic holdings of the Licence Holder's own Common Equity Tier 1 capital instruments, determined in accordance with article 42 of the CRR.

For the purposes of this point and points (vii) and (viii), Licence Holders should refer to point (114) of article 4 (1) of the CRR for the meaning of the term 'indirect holding' and to point (126) of article 4 (1) of the CRR for the meaning of the term 'synthetic holding'.

- vii. Reciprocal cross holdings in Common Equity Tier 1 capital instruments within the meaning of point (122) of article 4 (1) of the CRR and calculated in accordance with article 44 of the CRR.
- viii. Direct, indirect and synthetic holdings by the Licence Holder of Common Equity Tier 1 capital instruments of financial sector entities where the Licence Holder does not have a significant investment.
- ix. Direct, indirect and synthetic holdings by the Licence Holder of Common Equity Tier 1 capital instruments of financial sector entities where the Licence Holder has a significant investment.

For the purpose of this deduction and the previous point (point vii), Licence Holders are required to refer to: **[i]** article 43 of the CRR to determine the conditions which contribute to a significant investment; and **[ii]** articles 44 to 49 of

the CRR for the calculation methodology of direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of financial sector entities.

- x. Excess of deduction from Additional Tier 1 items pursuant to article 56 of the CRR over Additional Tier 1 capital.
- xi. Qualifying holdings outside the financial sector, which can alternatively be subject to 1 250% risk weight.
- xii. Securitisation positions, in accordance with article 243 (1) (b), article 244 (1) (b) and article 258 of the CRR, which can alternatively be subject to 1 250% risk weight.
- xiii. Free deliveries, in accordance with article 379 (3) of the CRR, which can alternatively be subject to 1 250% risk weight.
- xiv. Positions in a basket for which the Licence Holder cannot determine the risk weight under the IRB approach, in accordance with article 153 (8) of the CRR, and can alternatively be subject to 1 250% risk weight.
- xv. Equity exposures under an internal models approach, in accordance with article 155 (4) of the CRR, which can alternatively be subject to 1 250% risk weight.
- xvi. Any tax charge relating to Common Equity Tier 1 items foreseeable at the moment of its calculation, except where the Licence Holder suitably adjusts the amount of Common Equity Tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to cover risks or losses.

For the purpose of applying the above deductions from Common Equity Tier 1 items, Licence Holders should, in addition to articles 36 to 49 of the CRR, also make reference to the [Regulatory Technical Standards on Own Funds](#).

4.1.1.2 Additional Tier 1 capital

Additional Tier 1 capital is made up of Additional Tier 1 items (as defined in article 51 of the CRR), after applying the deductions from Additional Tier 1 items (laid down in articles 56 to 60 of the CRR) and the application of article 79 of the CRR.

(A) Additional Tier 1 items:

- i. Capital instruments where the conditions laid down in articles 52 (1), 53 and 54 of the CRR are met.

- ii. Share premium account as defined in point (124) of article 4 (1) of the CRR.

Any amount received in excess of the nominal value of any capital instruments referred to in point (i).

For the purpose of point (i) above, Licence Holders should make reference to the [Regulatory Technical Standards on Own Funds](#) in order to determine the appropriate classification of capital instruments.

- iii. Instruments issued by subsidiaries that are given recognition in Additional Tier 1 capital (applicable for the scope of consolidation).

The sum of all the amounts of qualifying Tier 1 capital of subsidiaries that is included in consolidated Additional Tier 1 capital, calculated in accordance with articles 82, 85 and 86 of the CRR.

(B) Deductions from Additional Tier 1 items:

- i. Direct, indirect and synthetic holdings of the Licence Holder's own Additional Tier 1 capital instruments calculated in accordance with article 57 of the CRR.
- ii. Reciprocal cross holdings in Additional Tier 1 capital instruments within the meaning of point (122) of article 4 (1) of the CRR determined in accordance with article 58 of the CRR.
- iii. Direct, indirect and synthetic holdings by the Licence Holder of Additional Tier 1 capital instruments of financial sector entities where the Licence Holder does not have a significant investment, determined in accordance with article 60 of the CRR.
- iv. Direct, indirect and synthetic holdings by the Licence Holder of Additional Tier 1 capital instruments of financial sector entities where the Licence Holder has a significant investment.

For the purpose of this deduction and the previous point (point iii), Licence Holders are required to refer to articles 58 and 59 of the CRR for the calculation methodology of direct, indirect and synthetic holdings of Additional Tier 1 instruments of financial sector entities.

- v. Excess of deduction from Tier 2 items pursuant to article 66 of the CRR over Tier 2 capital.

- vi. Any tax charge relating to Additional Tier 1 items foreseeable at the moment of its calculation, except where the Licence Holder suitably adjusts the amount of Additional Tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to cover risks or losses.

For the purpose of applying the above deductions from Additional Tier 1 items, Licence Holders should, in addition to articles 56 to 60 of the CRR, also make reference to the [Regulatory Technical Standards on Own Funds](#).

4.1.2 *Tier 2 capital*

Tier 2 capital consists of instruments that combine the features of debt and equity wherein they are structured like debt but exhibit some of the loss absorption and funding flexibility forms of equity.

Tier 2 capital is made up of Tier 2 items (as defined in article 62 of the CRR), after applying the deductions from Tier 2 items (laid down in articles 66 to 70 of the CRR) and the application of article 79 of the CRR.

(A) *Tier 2 items:*

- i. Capital instruments and subordinated loans where the conditions laid down in article 63 of the CRR are met.

The extent to which capital instruments and subordinated loans qualify as Tier 2 items during the final five years of maturity of the instruments should be calculated in accordance with article 64 of the CRR.

The subordinated loans must be approved by the MFSA and must be in the form set out in Annex I.

- ii. Share premium account as defined in point (124) of article 4 (1) of the CRR.

Any amount received in excess of the nominal value of any capital instruments referred to in point (i).

- iii. Standardised Approach General credit risk adjustments, calculated in accordance with article 62 (c) of the CRR.

Applicable only for Licence Holders availing of the standardised approach in the calculation of credit risk. This approach is explained in section 4.2.1.1 (A).

- iv. IRB Excess of provisions over expected losses eligible, calculated in accordance with articles 158 and 159 of the CRR.

Applicable only for Licence Holders availing of the internal ratings based approaches in the calculation of credit risk. These approaches are explained in section 4.2.1.1 (A).

- v. Instruments issued by subsidiaries that are given recognition in Tier 2 capital (applicable for the scope of consolidation).

The sum of all the amounts of qualifying own funds of subsidiaries that is included in consolidated Tier 2 capital, calculated in accordance with articles 82, 87 and 88 of the CRR.

(B) *Deductions from Tier 2 items:*

- i. Direct, indirect and synthetic holdings of the Licence Holder's own Tier 2 capital instruments calculated in accordance with article 67 of the CRR.
- ii. Reciprocal cross holdings in Tier 2 capital instruments within the meaning of point (122) of article 4 (1) of the CRR determined in accordance with article 68 of the CRR.
- iii. Direct, indirect and synthetic holdings by the Licence Holder of Tier 2 capital instruments of financial sector entities where the Licence Holder does not have a significant investment, determined in accordance with article 70 of the CRR.
- iv. Direct, indirect and synthetic holdings by the Licence Holder of Tier 2 capital instruments of financial sector entities where the Licence Holder has a significant investment.

For the purpose of this deduction and the previous point (point iii), Licence Holders are required to refer to articles 68 and 69 of the CRR for the calculation methodology of direct, indirect and synthetic holdings of Tier 2 instruments of financial sector entities.

4.1.3 Transitional provisions on unrealised losses measured at fair value

By way of derogation from article 35 of the CRR, during the period from 1 January 2014 to 31 December 2017, Licence Holders shall include in the calculation of their Common Equity Tier 1 items the following applicable percentages of unrealised losses related to assets or liabilities measured at fair value, and reported on the balance sheet, excluding those referred to in article 33 and all other unrealised losses reported as part of the profit and loss account, in terms of article 467 (2) of the CRR:

- a. 100% for the period from 1 January 2014 to 31 December 2014;
- b. 100% for the period from 1 January 2015 to 31 December 2015;
- c. 100% for the period from 1 January 2016 to 31 December 2016;
- d. 100% for the period from 1 January 2017 to 31 December 2017.

4.1.4 Transitional provisions on unrealised gains measured at fair value

By way of derogation from article 35 of the CRR, during the period from 1 January 2014 to 31 December 2017, Licence Holders shall remove from their Common Equity Tier 1 items the following applicable percentages of unrealised gains related to assets or liabilities measured at fair value, and reported on the balance sheet, excluding those referred to in article 33 and all other unrealised gains with the exception of those related to investment properties reported as part of the profit and loss account, in terms of article 468 (2) of the CRR:

- a. 100% for the period from 1 January 2014 to 31 December 2014;
- b. 60% for the period from 1 January 2015 to 31 December 2015;
- c. 40% for the period from 1 January 2016 to 31 December 2016;
- d. 20% for the period from 1 January 2017 to 31 December 2017.

The resulting residual amount shall not be removed from Common Equity Tier 1 items.

4.1.5 Transitional provisions on unrealised gains measured at fair value from derivative liabilities on own credit risk

By way of derogation from article 33 (1) (c), during the period from 1 January 2013 to 31 December 2017, Licence Holders shall not include in their own funds the following applicable percentage of the fair value gains and losses from derivative liabilities arising from changes in the own credit standing of the Licence Holder, determined in accordance with article 478:

- a. 100% for the period from 1 January 2014 to 31 December 2014;
- b. 100% for the period from 1 January 2015 to 31 December 2015;
- c. 100% for the period from 1 January 2016 to 31 December 2016;
- d. 100% for the period from 1 January 2017 to 31 December 2017.

4.1.6 Transitional provisions on deductions from Common Equity Tier 1 items

In terms of article 478 (3) of the CRR, the Authority sets out the following percentages for the deductions, which are applicable during the period 1 January 2014 to 31 December 2017:

CRR article	Transitional Prvosition	This Appendix	From Jan 2014	From Jan 2015	From Jan 2016	From Jan 2017
469 (1) (a)	Losses for the current financial year (article 36 (1) (a))	Section 4.1.1.1 (C) (i)	100%	100%	100%	100%
469 (1) (a)	Intangible assets (article 36 (1) (b))	Section 4.1.1.1 (C) (ii)	100%	100%	100%	100%
469 (1) (a)	IRB shortfall of credit risk adjustments to expected losses (article 36 (1) (d))	Section 4.1.1.1 (C) (iv)	100%	100%	100%	100%
469 (1) (a)	Defined benefit pension fund assets (article 36 (1) (e))	Section 4.1.1.1 (C) (v)	100%	100%	100%	100%
469 (1) (a)	Holdings of the Licence Holder's own CET 1 capital instruments (article 36 (1) (f)	Section 4.1.1.1 (C) (vi)	100%	100%	100%	100%
469 (1) (a)	Reciprocal cross holdings (article 36 (1) (g)	Section 4.1.1.1 (C) (vii)	100%	100%	100%	100%
469 (1) (a)	Non-significant holdings (article 36 (1) (h)	Section 4.1.1.1 (C) (viii)	100%	100%	100%	100%

469 (1) (c)	Deferred tax assets (article 36 (1) (c))	Section 4.1.1.1 (C) (iii)	100%	100%	100%	100%
469 (1) (c)	Significant holdings (article 36 (1) (i)	Section 4.1.1.1 (C) (ix)	100%	100%	100%	100%

For the purposes of the calculation of **deferred tax assets** in terms of article 469 (1) (c), Licence Holders shall take into the provisions of article 470 of the CRR, i.e.

- a. By way of derogation from article 48 (1) of the CRR, during the period from 1 January 2014 to 31 December 2017, Licence Holders shall not deduct (deferred tax assets that are dependent on future profitability and arise from temporary differences and in aggregate are equal to or less than 10% of relevant Common Equity Tier 1 items), which in aggregate are equal to or less than 15% of relevant Common Equity Tier 1 items;
- b. For the purposes of paragraph (a) above, relevant Common Equity Tier 1 items shall comprise the Common Equity Tier 1 items of the Licence Holder calculated after applying the provisions of article 32 to 35 and making the deductions pursuant to points (a) to (h), k(ii) to (v) and (l) of article 36 (1), excluding deferred tax assets that rely on future profitability and arise from temporary differences;
- c. By way of derogation from article 48 (4) of the CRR, the items exempt from deduction pursuant to paragraph (a) above shall be risk weighted at 250%.

For **deferred tax assets that existed prior to 1 January 2014**, the Authority sets out the following applicable percentages for the purpose of deduction from Common Equity Tier 1 items in terms of article 469 (1) (c) of the CRR:

- e. 100% for the period from 1 January 2014 to 31 December 2014;
- f. 100% for the period from 1 January 2015 to 31 December 2015;
- g. 100% for the period from 1 January 2016 to 31 December 2016;
- h. 100% for the period from 1 January 2017 to 31 December 2017;
- i. 100% for the period from 1 January 2018 to 31 December 2018;
- j. 100% for the period from 1 January 2019 to 31 December 2019;

- k. 100% for the period from 1 January 2020 to 31 December 2020;
- l. 100% for the period from 1 January 2021 to 31 December 2021;
- m. 100% for the period from 1 January 2022 to 31 December 2022;
- n. 100% for the period from 1 January 2023 to 31 December 2023;

For the residual amount of the deferred tax assets referred to in point (c) of article 36 (1), the Licence Holder shall apply the requirement laid down in article 472 (5) during the period 1 January 2014 to 31 December 2017 i.e. the residual amount shall not be deducted and shall be subject to a risk weight of 0%.

In terms of article 469 (2) of the CRR, Licence Holders shall determine the portion of the total residual amount of deferred tax assets that is subject to article 472 (5), by dividing the amount specified in point (a) of this paragraph by the amount specified in point (b) of this paragraph:

- a. The amount of deferred tax assets that are dependent on future profitability and arise from temporary differences, which in aggregate are equal to or less than 10% of the relevant Common Equity Tier 1 items of the Licence Holder;
- b. The sum of the following:
 - i. The amount of deferred tax assets that are dependent on future profitability and arise from temporary differences, which in aggregate are equal to or less than 10% of the relevant Common Equity Tier 1 items of the Licence Holder;
 - ii. the amount of direct, indirect and synthetic holdings by the Licence Holder of the Common Equity Tier 1 instruments of financial sector entities where the Licence Holder has a significant investment, that in aggregate are equal to or less than 10% of relevant Common Equity Tier 1 items of the Licence Holder.

For the purposes of the calculation of **significant holdings** in terms of article 469 (1) (c), Licence Holders shall take into the provisions of article 470 of the CRR, i.e.

- a. By way of derogation from article 48 (1) of the CRR, during the period from 1 January 2014 to 31 December 2017, Licence Holders shall not deduct (the applicable amount of direct, indirect and synthetic holdings by the Licence Holder of the Common Equity Tier 1 instruments of financial sector entities where the Licence Holder has a significant investment, that in aggregate are

equal to or less than 10% of relevant Common Equity Tier 1 items), which in aggregate are equal to or less than 15% of relevant Common Equity Tier 1 items;

- b. For the purposes of paragraph (a) above, relevant Common Equity Tier 1 items shall comprise the Common Equity Tier 1 items of the Licence Holder calculated after applying the provisions of article 32 to 35 and making the deductions pursuant to points (a) to (h), k(ii) to (v) and (l) of article 36 (1), excluding deferred tax assets that rely on future profitability and arise from temporary differences;
- c. By way of derogation from article 48(4) of the CRR, the items exempt from deduction pursuant to paragraph (a) above shall be risk weighted at 250%. These items shall also be subject to the requirements of Title IV of Part Three of the CRR, as applicable.

For the residual amount of significant holdings referred to in point (i) of article 36 (1), the Licence Holder shall apply the requirement laid down in article 472 (11) during the period 1 January 2014 to 31 December 2017, i.e.

- a. The amounts required to be deducted that relate to direct holdings are deducted half from Tier 1 items and half from Tier 2 items;
- b. The amounts that relate to indirect and synthetic holdings are not deducted and are subject to risk weights in accordance with Chapter 2 or 3 of Title II of Part Three and to the requirements laid down in Title IV of Part Three, as applicable.

In terms of article 469 (3) of the CRR, Licence Holders shall determine the portion of the total residual amount of significant holdings that is subject to article 472 (11), by dividing the amount specified in point (a) of this paragraph by the amount specified in point (b) of this paragraph:

- a. The amount of direct and indirect holdings of the Common Equity Tier 1 instruments of financial sector entities where the Licence Holder has a significant investment, that in aggregate are equal to or less than 10% of relevant Common Equity Tier 1 items of the Licence Holder.
- b. The sum of the following:
 - i. The amount of deferred tax assets that are dependent on future profitability and arise from temporary differences, which in aggregate are equal to or less than 10% of the relevant Common Equity Tier 1 items of the Licence Holder;

- ii. The amount of direct, indirect and synthetic holdings by the Licence Holder of the Common Equity Tier 1 instruments of financial sector entities where the Licence Holder has a significant investment, that in aggregate are equal to or less than 10% of relevant Common Equity Tier 1 items of the Licence Holder.

4.1.7 Transitional provisions on deductions from Additional Tier 1 items

For the purposes of article 474 (a) of the CRR, the Authority sets out the following percentages for all the deductions from Additional Tier 1 items, required pursuant to article 56 (b) – (d) of the CRR, which are applicable during the period 1 January 2014 to 31 December 2017:

- a. 100% for the period from 1 January 2014 to 31 December 2014;
- b. 100% for the period from 1 January 2015 to 31 December 2015;
- c. 100% for the period from 1 January 2016 to 31 December 2016;
- d. 100% for the period from 1 January 2017 to 31 December 2017.

For the residual amount required to be deducted pursuant to point (a) of article 56 of the CRR, Licence Holders shall apply the requirements laid down in article 475 (2) of the CRR, during the period 1 January 2014 to 31 December 2017, i.e.

- a. Direct holdings of own Additional Tier 1 instruments are deducted at book value from Tier 1 items;
- b. Indirect and synthetic holdings of own Additional Tier 1 instruments, including own Additional Tier 1 instruments that a Licence Holder could be obliged to purchase by virtue of an existing or contingent contractual obligation are not deducted and are risk weighted in accordance with Chapter 2 or 3 of Title II of Part Three and subject to the requirements of Title IV of Part Three, as applicable.

4.1.8 Transitional provisions on deductions from Tier 2 items

For the purposes of article 476 (a) of the CRR, the Authority sets out the following percentages for all the deductions from Tier 2 items, required pursuant to article 66 (b) – (d) of the CRR, which are applicable during the period 1 January 2014 to 31 December 2017:

- a. 100% for the period from 1 January 2014 to 31 December 2014;
- b. 100% for the period from 1 January 2015 to 31 December 2015;

- c. 100% for the period from 1 January 2016 to 31 December 2016;
- d. 100% for the period from 1 January 2017 to 31 December 2017.

For the residual amount required to be deducted pursuant to point (a) of article 66 of the CRR, Licence Holders shall apply the requirements laid down in article 477 (2) of the CRR, during the period 1 January 2014 to 31 December 2017, i.e.

- c. Direct holdings of own Tier 2 instruments are deducted at book value from Tier 2 items;
- d. Indirect and synthetic holdings of own Tier 2 instruments, including own Tier 2 instruments that a Licence Holder could be obliged to purchase by virtue of an existing or contingent contractual obligation are not deducted and are risk weighted in accordance with Chapter 2 or 3 of Title II of Part Three and subject to the requirements of Title IV of Part Three, as applicable.

4.1.9 Transitional provisions on additional filters and deductions

For the purposes of article 481 (5) of the CRR:

- i. The Authority is not considering to apply additional filters and deductions to the own funds of Licence Holders in terms of article 481 (1) of the CRR. The following percentages shall therefore apply during the period 1 January 2014 to 31 December 2017:
 - e. 0% for the period from 1 January 2014 to 31 December 2014;
 - f. 0% for the period from 1 January 2015 to 31 December 2015;
 - g. 0% for the period from 1 January 2016 to 31 December 2016;
 - h. 0% for the period from 1 January 2017 to 31 December 2017;
- ii. As the requirements of article 481 (2) of the CRR are not generally applied by Licence Holders, the Authority determines that the applicable percentage of 0% is appropriate for the period 1 January 2014 to 31 December 2014.

4.2 Risk Components

4.2.1 Non Trading Book Business Risk Component:

This category is made up of two components: (i) the credit/counterparty risk component; and (ii) free deliveries.

4.2.1.1 Credit/Counterparty Risk Component

Being the possibility of a loss occurring due to:

- i. the failure of a debtor of a Licence Holder to meet its contractual debt obligations; or
- ii. the loss in value of any other asset (excluding derivatives which are exclusively dealt with in the sections on trading book business and commodities instruments – risk component) which forms part of the Licence Holder's balance sheet except for: (a) intangible assets including goodwill; (b) cash in hand and at bank; (c) those financial instruments which fall within the category of trading book business; and (d) commodity positions.

(A) Measuring the Credit/Counterparty Risk

The credit/ counterparty risk can be measured through any one of the following two methods: (i) the Standardised Approach; and (ii) the Internal Ratings Based Approach (IRB), as referred to in Part Three, Title II of the CRR.

The Standardised Approach calculates the credit risk component by applying a broad category of risk weights to non-trading book business asset exposures.

The IRB approach is based on the Licence Holder's assessments of the risks to which it is exposed. It is strongly recommended that Licence Holders which are significant in terms of their size, internal organisation and the nature, scale and complexity of their activities develop an internal credit risk assessment capacity and increase the use of the IRB approach for the purposes of calculating the credit/counterparty risk component, where their exposures are material in absolute terms and where they have at the same time a large number of material counterparties. This is without prejudice to the fulfilment of criteria laid down in Part Three, Title II, Chapter 3, Section 1 of the CRR.

Licence Holders are advised to seek the MFSA's guidance prior to adopting the IRB approach, which method is to be approved by the MFSA. Licence Holders which have obtained the Authority's approval to use the IRB approach must report annually to the MFSA:

- i. the results of the calculations of their internal approaches for their exposures that are included in the benchmark portfolios; and
- ii. an explanation of the methodologies used to produce those calculations in (i) above.

Licence Holders must submit the results referred to in (i) above, in line with the template developed by EBA in accordance with article 78 (8) of CRD IV to the MFSA and to EBA.

Where the MFSA has chosen to develop specific portfolios in accordance with article 78 (2) of CRD IV, the Licence Holder must report the results of the calculations separately from the results of the calculations for EBA portfolios.

(B) Credit/ Counterparty Risk applying the Standardised Approach

The computation of the credit/counterparty risk component using the standardised approach is calculated as follows:

- i. identify the exposure value of the asset item in accordance with article 111 of the CRR;
- ii. assign each exposure to one of the exposure classes referred to in Section 3.10 (b);
- iii. calculate the risk weighted exposure amounts by multiplying the exposure value by an applicable risk weight specified or determined in accordance with Part Three, Title II, Chapter 2, Section 2 of the CRR, or the transitional provisions set out in Part Ten of the CRR, as applicable;
- iv. add the total risk weighted exposure amounts; and
- v. the credit/counterparty risk capital component is 8% of the total risk weighted exposure amounts.

For the purposes of compiling the credit risk calculation, Licence Holders should refer to Section 3.10.

4.2.1.2 Free Deliveries

For the purpose of these Rules, free deliveries transactions shall mean non delivery versus payment transactions in financial instruments.

Free Deliveries caters for the risk that the Licence Holder has either: (a) paid for securities, foreign currencies or commodities before receiving them or has delivered securities, foreign currencies or commodities before receiving payment for them; (b) in the case of cross-border transactions, one day or more has elapsed since the Licence Holder made that payment or delivery.

(A) Measuring Free Deliveries

The applicable free deliveries risk factor is calculated in accordance with article 379 of the CRR as follows:

Multiply the market value of the financial instrument by the applicable discount factor as detailed in the following table:

Period	Risk Discount Factor
Up to first contractual payment/ delivery leg	0%
From first contractual payment/ delivery leg up to four days after second contractual payment/ delivery leg	Treat as an exposure risk weighted at 100% if positive exposure is not material
From five business days post second contractual payment/ delivery leg until extinction of transaction	Treat as an exposure risk weighted at 1 250%

4.2.2 Trading Book Business Risk Components:

This category is made up of two risk components: (i) the position risk component; and (ii) the counterparty credit risk component.

4.2.2.1 Position Risk

The risk of losses in on and off balance sheet investments in financial instruments, which qualify as trading book business, arising from the movement in market prices. For the purpose of the calculation of position risk, financial instruments are categorised under one of the following titles: (i) Traded Debt Instruments; (ii) Traded Equities; (iii) Collective Investment Schemes; and (iv) Derivatives.

The position risk component can be measured through the Licence Holder's own internal risk-management model. Licence Holders are advised to seek the MFSA's guidance prior to adopting this internal risk-management model in terms of Part Three, Title IV, Chapter 5 of the CRR, which model is to be approved by the MFSA.

It is strongly recommended that Licence Holders which are significant in terms of their size, internal organisation and the nature, scale and complexity of their investment services activities develop an internal specific risk assessment capacity and increase the use of internal models for calculating the specific risk component of traded 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 hold a large number of material positions in traded debt instruments of different issuers. This shall be without prejudice to the fulfilment of the criteria laid down in Part Three, Title IV, Chapter 5, Sections 1 to 5, of the CRR.

Licence Holders are requested to refer to the [Draft Regulatory Technical Standards on the Definition of Materiality Thresholds for Specific Risk in the Trading Book](#) for: (i) the definition of ‘exposures to specific risk which are material in absolute terms’; and (ii) the definition of ‘large number of material positions in traded debt instruments of different issuers’.

Licence Holders which have obtained the Authority’s approval to use their own internal risk-management model to calculate the position risk component must report annually to the MFSA:

- i. the results of the calculations of their internal approaches for their positions that are included in the benchmark portfolios; and
- ii. an explanation of the methodologies used to produce those calculations in (i) above.

Licence Holders must submit the results referred to in (i) above, in line with the template developed by EBA in accordance with article 78 (8) of CRD IV to the MFSA and to EBA.

Where the MFSA has chosen to develop specific portfolios in accordance with article 78 (2) of CRD IV, the Licence Holder must report the results of the calculations separately from the results of the calculations for EBA portfolios.

(A) Measuring the Position Risk Component

The methodology for measuring the position risk component varies depending on the type of financial instrument. The following explains briefly the manner in which the position risk component is calculated in the CRR.

(B) Traded Debt Instruments / Traded Equities

The calculation of the position risk component for Traded Debt Instruments and Traded Equities is based on two factors being:

- i. the specific risk factor which is the risk of a price change in the instrument concerned due to factors related to its Issuer; and
- ii. the general risk factor being the risk of a price change in the instrument due in the case of a traded debt instrument to a change in the level of interest

rates or in the case of equity to a broad equity-market movement unrelated to any specific attributes of individual securities.

Licence Holders should refer to articles 334 to 340 in the CRR for the purpose of calculating the position risk component of traded debt instruments and to articles 341 to 344 for the calculation of the position risk component of traded equities.

Where the Licence Holder has positions in stock indices, it shall also refer to the [Draft Implementing Technical Standards for the purposes of calculating the position risk component of traded equities under article 344 of the CRR](#).

For the purposes of calculating the position risk component: Standardised Approach for Position Risks in Traded Debt Instruments and Equities, Licence Holders should refer to Section 3.14 and Section 3.15 of this Appendix respectively.

(C) Collective Investment Schemes: Specific and General Risk

The specific and general risk factor of the position risk component in the case of collective investment schemes is combined. In this case, the position risk component is the equivalent of the market value of the units in the collective investment scheme multiplied by the applicable position risk weighting of 32%.

Licence Holders should refer to articles 348 to 350 of the CRR for the detailed calculation of the collective investment schemes risk component. For reporting purposes, these positions shall be reported in the MKR SA EQU template.

(D) Derivatives

The position risk component for financial derivative instruments is set out in Part Three, Title IV of the CRR.

As it is generally the exception that Licence Holders invest in derivatives, Licence Holders who provide investment services in relation to financial derivative instruments should contact the MFSA for guidance as to how the derivatives related position risk component should be catered for in the automated COREP Return.

4.2.2.2 Counterparty Credit Risk Component

In terms of article 272 of the CRR, counterparty credit risk means the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

Licence Holders should refer to Chapter 6 of Title II of Part Three of the CRR for the calculation of the counterparty credit risk component in relation to derivative instruments listed in Annex II to the CRR.

N.B. The calculation of the counterparty credit risk component shall be reported in the CR SA Template. This notwithstanding, it relates to exposure arising from trading book activities.

For the purposes of calculating the Counterparty Credit Risk Component, Licence Holders should refer to Section 3.10 (l) of this Appendix.

4.2.3 Commodities Instruments - Risk Component

Commodities Risk is the risk component required to cover the Licence Holder's risk of holding or taking positions in commodities such as physical products which are and can be traded in the secondary market including commodity derivatives.

Some traditional examples of commodities include grains, gold, beef, oil and natural gas. More recently, the definition has been expanded to include: (a) financial products such as foreign currencies and indices, and (b) cell phone minutes and bandwidth.

The commodities risk component can be measured through the Licence Holder's own internal risk-management model. It is strongly recommended that MFSA's guidance is sought prior to adopting this internal risk-management model in terms of Part Three, Title IV, Chapter 5 of the CRR, which model is to be approved by the MFSA.

Licence Holders which have obtained the Authority's approval to use their own internal risk-management model to calculate the commodities risk component must report annually to the MFSA:

- i. the results of the calculations of their internal approaches for their exposures or positions that are included in the benchmark portfolios; and
- ii. an explanation of the methodologies used to produce those calculations in (i) above.

Licence Holders must submit the results referred to in (i) above, in line with the template developed by EBA in accordance with article 78 (8) of CRD IV to the MFSA and to EBA.

Where the MFSA has chosen to develop specific portfolios in accordance with article 78 (2) of CRD IV, the Licence Holder must report the results of the calculations separately from the results of the calculations for EBA portfolios.

(A) Measuring the Commodities Instruments - Risk Component:

Licence Holders shall calculate the commodities instruments – risk component with one of the methods laid down in Part Three, Title IV, Chapter 4 of the CRR: (i)

Maturity Ladder Approach (as referred to in article 359 of the CRR); (ii) Extended Maturity Ladder Approach (as referred to in article 361 of the CRR); or (iii) Simplified Approach (as referred to in article 360 of the CRR).

(B) *A Licence Holder's commodities instruments - risk component calculation shall include the following items, referred to in Table 2 of article 361 of the CRR:*

- i. precious metals (excluding gold);
- ii. base metals;
- iii. agricultural products (softs);
- iv. other, including energy products such as oil and gas.

(C) *Commodities Instruments – Risk Component - the Return*

For the purposes of calculating the market risk: Standardised Approach for Commodities, Licence Holders should refer to Section 3.17 of this Appendix.

4.2.4 Large Exposures Risk Component – (applicable only to Category 3 Licence Holders)

The purpose of the large exposures requirement is to ensure that a firm manages its exposure to counterparties within appropriate limits set in relation to its capital resources requirements. A large exposure may be in the form of a loan to a single borrower, or it may arise across many transactions involving different types of financial instruments with several counterparties.

A large exposure means the exposure to: (a) an individual client; or (b) a group of connected clients, where its value is equal to or exceeds 10% of the Licence Holder's Eligible Capital (both terms are defined in point (A) below).

In terms of article 4 (71) of the CRR, Eligible Capital means the sum of the following:

- i. Tier 1 capital as referred to in article 25 of the CRR;
- ii. Tier 2 capital as referred to in article 71 of the CRR that is equal to or less than one third of Tier 2 capital.

For the purposes of this Section, the term ‘exposure’ shall have the same meaning as referred to in article 389 of the CRR, and the calculation of the exposure value shall be made in accordance with article 390 of the CRR.

The following items will not be included in the measurement of a large exposure, as set out in article 390 (6) of the CRR:

- i. Claims arising in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the two working days following payment;
- ii. Claims arising in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during five working days following payment or delivery of the securities, whichever the earlier;
- iii. Claims arising in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking or financial instruments clearing, settlement and custody services to clients, delayed receipts in funding and other exposures arising from client activity which do not last longer than the following business day;
- iv. Claims arising in the case of the provision of money transmission including the execution of payment services, clearing and settlement in any currency and correspondent banking, intra-day exposures to institutions providing those services;
- v. Exposures deducted from own funds in accordance with article 36, 56 and 66 of the CRR.

Licence Holders which have exposures to clients in respect of transactions with underlying assets under article 390 (8) of the CRR should refer to the [Final Draft Regulatory Technical Standards for the methodology used to determine the overall exposure to a client or group of connected clients](#).

Condition regarding Individual Large Exposures

Licence Holders are to adopt policies within which exposures (after taking into account the effect of the credit risk mitigation in accordance with articles 399 to 403 of the CRR) to any class of the above-mentioned categories of counterparties do not exceed 25% of their Eligible Capital.

Where that individual client is either a credit institution or an investment firm or where a group of connected clients includes one or more credit institutions or investment firms, that value shall not exceed 25% of the Licence Holder’s Eligible

Capital or €150 million, whichever is the higher, provided that the sum of exposure values, after taking into account the effect of the credit risk mitigation, in accordance with articles 399 to 403 of the CRR, to all connected clients that are not credit institutions or investment firms, does not exceed 25% of the Licence Holder's Eligible Capital.

Where the amount of €150 million is higher than 25% of the Licence Holder's Eligible Capital, the value of the exposure, after taking into account the effect of credit risk mitigation, in accordance with articles 399 to 403 of the CRR, shall not exceed a reasonable limit in terms of the Licence Holder's Eligible Capital. That limit shall be determined by Licence Holder, in accordance with the policies and procedures to address and control concentration risk referred to in Appendix 10, and shall not be higher than 100% of the Licence Holder's Eligible Capital.

Notwithstanding the above, the Authority retains the right to set a lower limit than the €150 million referred to in the preceding paragraph.

As stipulated in article 395 (3) of the CRR, the Licence Holder shall at all times comply with the above-mentioned limit. This limit may be exceeded for the exposures on the Licence Holder's trading book if all the conditions in article 395 (5) of the CRR are met. In this regard, the Licence Holder shall be required to hold an additional own funds requirement (i.e. the Large Exposures Risk Component) on the excess in respect of this limit, which shall be calculated in accordance with articles 397 and 398 of the CRR.

Should the Licence Holder find that for reasons beyond its control it has incurred an exposure to an individual client or a group of connected clients, (e.g. following merger, amalgamation or buy-out), which results in it exceeding any of the above-mentioned limits, it should report the matter without delay to the Authority. The Authority will discuss the circumstances of any such exposures and where the situation warrants it, it may allow the Licence Holder a limited period of time in which to comply with the limits.

Where the amount of €150 million referred to above is applicable, the Authority may allow on a case-by-case and strictly on an exceptional basis, the 100% limit in terms of the Licence Holder's Eligible Capital, to be exceeded.

These provisions are in accordance with article 396 of the CRR.

(A) Types of Clients

Individual Clients

An individual client may be either a natural or a legal person. Examples of individual clients include:

- i. the client which includes governments, local authorities, public sector entities, individual trusts, corporations, unincorporated businesses and non-profit making bodies and individual clients;
- ii. where the Licence Holder is providing a guarantee, the person guaranteed;
- iii. for a derivatives contract, the person with whom the contract was made; and
- iv. the company in which a Licence Holder acquires shares which are traded on a regulated market either as principal or on behalf of clients.

Groups of Connected clients

A group of connected clients is defined in article 4 (39) of the CRR and it means any of the following:

- i. two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; or
- ii. two or more natural or legal persons between whom there is no relationship of control as described in point (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would also be likely to encounter funding or repayment difficulties.

Examples of relationships between individual counterparties which might be considered to constitute a single risk for the purposes of the definition of group of connected clients include: schemes in the same group; companies whose ultimate owner (whether wholly or significantly) is the same individual or individuals, and which do not have a formal group structure; companies having common directors or management; and counterparties linked by cross guarantees.

For the purposes of compiling the Large Exposure calculation, Licence Holders should refer to Section 3.20 of this Appendix.

(B) Large Exposures - Exempt Exposures

The following exposures are to be fully exempt from the calculation of the large exposure calculation, in accordance with article 400 (1) and article 493 (3) of the CRR:

Exempt Exposures

<p>(a) asset items constituting claims on central governments, central banks or public sector entities which, unsecured, would be assigned a 0 % risk weight under the Credit/Counterparty Risk Calculation;</p>
<p>(b) asset items constituting claims on international organisations or multilateral development banks which, unsecured, would be assigned a 0 % risk weight under the Credit/Counterparty Risk Calculation;</p>
<p>(c) asset items constituting claims carrying the explicit guarantees of central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity providing the guarantee would be assigned a 0 % risk weight under the Credit/Counterparty Risk Calculation;</p>
<p>(d) other exposures attributable to, or guaranteed by, central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity to which the exposure is attributable or by which it is guaranteed would be assigned a 0 % risk weight under the Credit/Counterparty Risk Calculation;</p>
<p>(e) asset items constituting claims on regional governments or local authorities of Member States where those claims would be assigned a 0 % risk weight under Part Three, Title II, Chapter 2 and other exposures to or guaranteed by those regional governments or local authorities, claims on which would be assigned a 0 % risk weight under Credit/Counterparty Risk Calculation;</p>
<p>(f) exposures to counterparties referred to in Article 113(6) or (7) of the CRR if they would be assigned a 0 % risk weight under Credit/Counterparty Risk Calculation. Exposures that do not meet those criteria, whether or not exempted from Article 395(1) of the CRR shall be treated as exposures to a third party;</p>
<p>(g) asset items and other exposures secured by collateral in the form of cash deposits placed with the lending institution or with an institution which is the parent undertaking or a subsidiary of the lending institution;</p>
<p>(h) asset items and other exposures secured by collateral in the form of certificates of deposit issued by the lending institution or by an institution which is the parent undertaking or a subsidiary of the lending institution and lodged with either of them;</p>
<p>(i) exposures arising from undrawn credit facilities that are classified as low-risk off-balance sheet items in Annex I and provided that an agreement has been concluded with the client or group of connected clients under which the facility may be drawn only if it has been ascertained that it will not cause the limit applicable under Article 395(1) of the CRR to be exceeded;</p>
<p>(j) trade exposures to central counterparties and default fund contributions to central counterparties;</p>
<p>(k) covered bonds falling within Article 129(1), (3) and (6) of the CRR</p>

<p>(l) asset items constituting claims on regional governments or local authorities of Member States where those claims would be assigned a 20 % risk weight under Part Three, Title II, Chapter 2 and other exposures to or guaranteed by those regional governments or local authorities, claims on which would be assigned a 20% risk weight under Part Three, Title II, Chapter 2 of the CRR.</p>
<p>(m) exposures, including participations or other kinds of holdings, incurred by an institution to its parent undertaking, to other subsidiaries of that parent undertaking or to its own subsidiaries, in so far as those undertakings are covered by the supervision on a consolidated basis to which the institution itself is subject, in accordance with the CRR, Directive 2002/87/EC or with equivalent standards in force in a third country. Exposures that do not meet those criteria, whether or not exempted from Article 395(1) of the CRR, shall be treated as exposures to a third party;</p>
<p>(n) asset items constituting claims on and other exposures to institutions, provided that those exposures do not constitute such institutions' own funds, do not last longer than the following business day and are not denominated in a major trading currency;</p>
<p>(o) asset items constituting claims on central banks in the form of required minimum reserves held at those central banks which are denominated in their national currencies;</p>
<p>(p) asset items constituting claims on central governments in the form of statutory liquidity requirements held in government securities which are denominated and funded in their national currencies provided that, at the discretion of the competent authority, the credit assessment of those central governments assigned by a nominated ECAI is investment grade;</p>
<p>(q) assets items constituting claims on and other exposures to recognised exchanges.</p>

(C) General

Licence Holders shall ensure that they comply with the provisions of Part Four of the CRR for the purposes of monitoring their large exposures and for calculating the large exposures risk component with respect to their trading book business.

Provided that for a transitional period until the entry into force of any legal act following the European Commission's review of article 400 (2) of the CRR in accordance with article 507 of the CRR, but not after 31 December 2028, the exposures referred to in Section B (k) to (q) above shall be considered fully exempt from the calculation of the large exposures risk component.

4.2.5 Foreign Exchange Risk Component

Foreign Exchange Risk is the risk that an asset or liability denominated in a currency other than the reporting currency may be adversely affected by a change in the value of the foreign currency.

(A) *To calculate its foreign exchange risk component which will form part of the applicable capital resources requirement, a Licence Holder shall identify the foreign currencies to which it is exposed and then calculate the open currency position by:*

- i. calculating the net (long/short) open currency position in each foreign currency to which the Licence Holder is exposed;
- ii. converting each net open position into its base currency equivalent at current spot rates;
- iii. summing all short net positions and summing all long net positions and selecting the larger sum; and
- iv. multiplying the sum of the net open currency position in base currency equivalent by 8%, subject that it exceeds 2% of its total own funds.

(B) *A Licence Holder's foreign exchange risk component calculation shall include the following items regardless whether they are trading book business positions or non-trading book business positions or commodity positions:*

- i. all financial instruments which are denominated in a foreign currency;
- ii. all spot positions in foreign currency (including accrued interest); and
- iii. other assets/liabilities including gold positions.

In addition to the above, the Licence Holder shall also refer to Part Three, Title IV, Chapter 3 of the CRR for the purposes of calculating the foreign exchange risk component under the Standardised Approach.

Where the Licence Holder has positions in closely correlated currencies, it shall also refer to the [Draft Implementing Technical Standards for the purposes of calculating the foreign exchange risk component under article 354 of the CRR](#).

The foreign exchange risk component can also be measured through the Licence Holder's own internal risk-management model. It is strongly recommended that MFSA's guidance is sought prior to adopting this internal risk-management model in terms of Part Three, Title IV, Chapter 5 of the CRR, which model is to be approved by the MFSA.

Licence Holders which have obtained the Authority's approval to use their own internal risk-management model to calculate the foreign exchange risk component must report annually to the MFSA:

- i. the results of the calculations of their internal approaches for their exposures or positions that are included in the benchmark portfolios; and
- ii. an explanation of the methodologies used to produce those calculations in (i) above.

Licence Holders must submit the results referred to in (i) above, in line with the template developed by EBA in accordance with article 78 (8) of CRD IV to the MFSA and to EBA.

Where the MFSA has chosen to develop specific portfolios in accordance with article 78 (2) of CRD IV, the Licence Holder must report the results of the calculations separately from the results of the calculations for EBA portfolios.

Licence Holders which would like to undertake transactions in derivatives should contact the MFSA for guidance as to how the derivatives related foreign exchange risk component should be calculated and catered for in the Return.

For the purposes of compiling the Market Risk: Standardised Approach for Foreign Exchange Risk, Licence Holders should refer to Section 3.16 of this Appendix.

4.2.6 Operational Risk Capital Requirement (applicable only to Category 3 Licence Holders)

Operational Risk means the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk.

The operational risk capital requirement ("ORCR") for a Licence Holder is an amount calculated in accordance with one of the following methods, as outlined in Part Three, Title III of the CRR:

- i. The Basic Indicator Approach ('BIA') as set out in Chapter 2 of Title III, Part Three of the CRR;
- ii. The Standardised Measurement Approach ('SMA') as laid down in Chapter 3 of Title III, Part Three of the CRR; and
- iii. The Advanced Measurement Approach ('AMA') as outlined in Chapter 4 of Title III, Part Three of the CRR.

For the purposes of compiling the Operational Risk Calculation, Licence Holders should refer to Section 3.13 of this Appendix.

4.2.7 Settlement/delivery Risk – Cash Against Documents

For the purpose of these rules, cash against documents transactions shall mean transactions where the purchaser takes ownership of the financial instrument the moment cash is handed over to the seller (delivery versus payment).

Settlement risk is the risk that the Licence Holder’s cash against documents transactions in financial instruments are unsettled after their due delivery dates.

(A) Measuring the Settlement Risk Component

The Settlement Risk Component is the equivalent of the difference between the agreed settlement price for the debt instrument, equity, foreign currency or commodity in question and its current market value, where the difference could involve a loss for the Licence Holder, multiplied by the relevant risk weight. The applicable risk weights are outlined in the following table:

Number of working days after the due settlement date	Risk Weight
5-15	8%
16 - 30	50%
31 – 45	75%
46 or more	100%

The Licence Holder shall calculate the settlement risk component in accordance with Part Three, Title V of the CRR, with the exception of article 379 of the CRR (which relates to the free deliveries risk component).

For the purposes of calculating the Settlement/Delivery Risk component, Licence Holders should refer to Section 3.12 of this Appendix.

4.2.8 Credit Valuation Adjustment – Risk Component

Licence Holders that provide investment services in relation to over-the-counter (OTC) derivatives (except for credit derivatives recognised to reduce risk-weighted exposure amounts for credit risk) shall be required to hold own funds for credit

valuation adjustment risk (CVA). The CVA risk component shall be calculated in accordance with Part Three, Title VI of the CRR.

The term ‘CVA’ is defined in article 381 of the CRR as an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. That adjustment reflects the current market value of the credit risk of the counterparty to the Licence Holder, but does not reflect the current market value of the credit risk of the Licence Holder to the counterparty.

Certain transactions are exempt from the calculation of the CVA risk component. Licence Holders are requested to refer to article 382 of the CRR to determine which transactions are excluded from the scope of this calculation.

Provided that in respect of those transactions referred to in article 89 of Regulation (EU) No 648/2012 (EMIR) and entered into with a pension scheme arrangement as defined in article 2 of that Regulation, Licence Holders shall not calculate the CVA risk component, as provided for in article 382 (4) (c) of the CRR.

The CVA risk component can be measured through any one of the following three methods: (i) the Advanced method; (ii) the Standardised method; and (iii) the Alternative method.

The Advanced method allows Licence Holders to measure the CVA risk through the internal market risk model, as referred to in article 383 of the CRR and [the Draft Regulatory Technical Standards in relation to CVA risk](#).

The Standardised method should be used by Licence Holders which do not have the Authority’s approval to calculate the specific risk of traded debt instruments using their own internal risk management model in accordance with point (d) of article 363 (1) of the CRR. Licence Holders are requested to refer to article 384 of the CRR to calculate the CVA risk component.

The Alternative method [article 385 of the CRR] applies a multiplication factor of 10 to the resulting risk-weighted exposure amounts for counterparty credit risk under the Original Exposure Method as laid down in article 275 of the CRR in relation to instruments referred to in article 382 of the CRR, instead of calculating the CVA risk component.

For the purposes of calculating the Credit Valuation Adjustment – Risk Component, Licence Holders should refer to Section 3.19 of this Appendix.

4.3 Fixed overhead requirement

The fixed overhead requirement is calculated by holding eligible capital of at least one quarter of the fixed overheads of the preceding year, in accordance with article 97 of the CRR.

If the Licence Holder has not completed business for one year, starting from the day it starts trading, the Licence Holder shall hold eligible capital of at least one quarter of the fixed overheads projected in its business plan, except where the Authority requires the business plan to be adjusted. In this case, the Licence Holder should refer to article 34c of the [FINAL draft Regulatory Technical Standards on Fixed Overheads](#) to determine how to arrive at the projected fixed overheads.

The Authority may require the Licence Holder to adjust the fixed overhead requirement, where there is a material change in the business of the Licence Holder since the preceding year.

For the purposes of these rules:

- i. eligible capital means the sum of the following:
 - a. Tier 1 capital;
 - b. Tier 2 capital that is equal to or less than one third of Tier 1 capital.
 - ii. the term *material change* shall have the same meaning as determined in article 34b of the [FINAL draft Regulatory Technical Standards on Fixed Overheads](#).
- (A) *The following items of expenditure are to be deducted from the total expenditure reported in their most recent audited annual financial statements:*
- i. fully discretionary staff bonuses;
 - ii. employees', directors' and partners' shares in profits, to the extent that they are fully discretionary;
 - iii. other appropriation of profits, to the extent that they are fully discretionary;
 - iv. shared commissions and fees payable which are directly related to commission and fees receivable, which are included within total revenue, and where the payment of the commission and fees payable is contingent upon the actual receipt of the commission and fees receivable;
 - v. fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registered or clearing transactions;
 - vi. fees to tied agents;

- vii. interest paid to customers on clients' money;
- viii. extraordinary non-recurring expenses.

Where the Licence Holder makes use of tied agents, the Licence Holder shall add 35% of the costs related to the tied agent to its fixed overheads.

(B) Fixed Overhead Requirement – The Return

Input the items of expenditure in Sheet 5 of Appendix 2A or Appendix 2B, as applicable.

For the purposes of calculating the fixed overhead requirement, Licence Holders should refer to Section 3.21 of this Appendix.

4.4 Exemption from Part Six of the CRR on a solo (as opposed to consolidated) basis

Category 2 Licence Holders are not subject to the rules relating to the liquidity risk component set out in Part Six of the CRR.

For the purpose of article 6(4) of the CRR, a Category 3 Licence Holder, which is not significant in terms of the nature, scale and complexity of its investment services activities, is exempt from compliance with the obligations in Part Six of the CRR (Liquidity) on a solo basis.

For the purposes of determining whether a Category 3 Licence Holder is to be considered significant, the Authority shall apply SLCs 1.55 to 1.58 inclusive of Part BI.