

Circular on the conditions under which credit institutions are permitted to include interim or year-end profits in Common Equity Tier 1 (CET1) capital in accordance with Article 26(2) of Regulation (EU) No 575/2013

Significant supervised entities as defined in Article 2(16) of [Regulation \(EU\) No 468/2014](#)¹ (the “SSM Framework Regulation”), otherwise known as Significant Institutions (SIs), shall refer to and be bound by the requirements of the [Decision \(EU\) 2015/656 of the European Central Bank of 4 February 2015 on the conditions under which credit institutions are permitted to include interim or year-end profits in Common Equity Tier 1 capital in accordance with Article 26\(2\) of Regulation \(EU\) No 575/2013 \(ECB/2015/4\)](#). With respect to SIs, the competent authority, in terms of Article 26(2) of [Regulation \(EU\) No 575/2013](#)² (the “CRR”), is the European Central Bank (the “ECB”).

With respect to those credit institutions other than SIs (OIs), the Malta Financial Services Authority (the “Authority”) advises that pursuant to Article 26(2) of the [CRR](#), such institutions may include interim³ or year-end profits⁴ in Common Equity Tier 1 (“CET1”) capital before taking a formal decision confirming the final profit or loss of the credit institution for the year, only with the prior permission of the competent authority. Such permission shall be granted where the following two conditions are met: profits have been verified by persons independent of the credit institutions that are responsible for the auditing of the accounts of that credit institution; and the credit institution has demonstrated that any foreseeable charge or dividend, as defined in Articles 2 and 3 of [Commission Delegated Regulation \(EU\) No 241/2014](#)⁵, has been deducted from the amount of those profits.

With respect to OIs⁶ and for the purposes of this Circular, the competent authority, in terms of Article 26(2) of the [CRR](#), is the Authority. Thus, OIs shall be permitted to include interim

¹ Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation).

² Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

³ ‘interim profits’ means profits as laid down in the International Financial Reporting Standards (“IFRS”) as adopted by the European Union, computed for a reference period shorter than a full financial year, and before the OI has taken a formal decision confirming such a profit or loss of the credit institution.

⁴ ‘year-end profits’ means profits as defined in the IFRS as adopted by the European Union, computed for a reference period equal to a full financial year, and before the OI has taken a formal decision confirming such a profit or loss of the credit institution.

⁵ Commission Delegated Regulation (EU) No 241/2014 of 7 January 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions.

⁶ OIs include the list of less significant supervised entities as defined in Article 2(7) of the [SSM Framework Regulation](#) and, for the purposes of this Circular, shall also include NBG Bank Malta Limited, BAWAG Bank

or year-end profits in CET1 capital before a formal decision confirming the final profit or loss of the credit institution for the year has been taken, provided that the credit institution has met the conditions set out in this Circular.

Accordingly, this Circular lays down the conditions under which the Authority has determined to grant permission to OIs to include interim or year-end profits in CET1 capital pursuant to Article 26(2)(a) and (b) of the [CRR](#) and is without prejudice to the right of OIs to request permission from the Authority to include interim or year-end profits in CET1 capital in cases not covered by this Circular.

The conditions set out in this Circular apply from the reporting reference date of 31 December 2014 in accordance with Article 2 of [Regulation \(EU\) No 680/2014](#)⁷ and shall be met prior to the submission of the applicable reporting on own funds and own funds requirements in accordance with the reporting remittance dates laid down in Article 3 of [Regulation \(EU\) No 680/2014](#).

OIs that intend to include interim or year-end profits in CET1 capital shall send a letter addressed to the Authority that includes the documentation listed in this Circular. Following the receipt of the relevant documentation, the Authority shall notify the credit institutions concerned whether such documentation contains the information required in this Circular.

In cases where the conditions prescribed in this Circular are not met, the Authority will individually assess requests for permission to include interim or year-end profits in CET1 capital.

This Circular supersedes any previous notification in this area issued by the Authority.

Verification of the profits

In order for the Authority to consider the verification requirement under Article 26(2)(a) of the [CRR](#) as having been met, OIs are required to provide the Authority with a document signed by its external auditor (the “external auditor’s document”) that complies with the following requirements:

- a) For year-end profits, the verification shall consist either of an audit report or of a comfort letter stating that the audit has not been completed and nothing has come to the attention of the auditors that causes them to believe that the final report will include a qualified opinion;
- b) For interim profits, the verification shall consist either of an audit report or of a review report (as defined by the International Standards on Review Engagements

Malta Limited and Sparkasse Bank Malta p.l.c., as disclosed in “[The list of significant supervised entities and the list of less significant supervised institutions](#)” published by the ECB on the 30th of January 2015.

⁷ Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council.

2410 issued by the International Auditing and Assurance Standards Board) or, provided that the verification carried out by the credit institution consists of an audit report, a comfort letter along the lines set out in paragraph (a).

OIs notifying their intention to include interim or year-end profits as CET1 capital at various levels of consolidation or on an individual basis, may provide the external auditor's document at the highest level of consolidation.

Deduction from profits of any foreseeable charge or dividend

In order to demonstrate that any foreseeable charges or dividends, as defined in Articles 2 and 3 of [Commission Delegated Regulation \(EU\) No 241/2014](#), have been deducted from the amount of profits, OIs are required to:

- a) Provide a declaration that those profits have been recorded in accordance with the principles set out in the IFRS as adopted by the European Union and that the scope of prudential consolidation is not materially wider than the scope of verification referred to in the external auditor's document;
- b) Submit to the Authority a document signed by the Chairman of the Board of Directors or any other person who has been duly authorised by the credit institution's Board of Directors to sign on its behalf, detailing the main components of those interim or year-end profits, including deductions for any foreseeable charges or dividends:

Provided that where interim or year-end profits are to be included on a consolidated⁸ or sub-consolidated basis⁹, these requirements shall be satisfied by the consolidating entity¹⁰.

For the purposes of the above requirements, credit institutions shall use the model letter which can be accessed at the following link:

[http://www.mfsa.com.mt/FtpFileSystemHandler_Cs.ashx?path=/files/Announcements/Circulars/Banking/2015.04.20%20Annex%20Recognition%20of%20Interim%20Profits%20in%20CET1%20\(2\).doc](http://www.mfsa.com.mt/FtpFileSystemHandler_Cs.ashx?path=/files/Announcements/Circulars/Banking/2015.04.20%20Annex%20Recognition%20of%20Interim%20Profits%20in%20CET1%20(2).doc)

The dividends to be deducted shall be the amount formally proposed or decided by the Board of Directors. If such formal proposal or decision has not yet been taken, the dividend to be deducted shall be the highest of the following:

- a) The maximum dividend calculated in accordance with the internal dividend policy;
- b) The dividend calculated on the basis of the average pay-out ratio¹¹ over the last three years;

⁸ 'consolidated basis' has the same meaning as defined in point 48 of Article 4(1) of the [CRR](#).

⁹ 'sub-consolidated basis' has the same meaning as defined in point 49 of Article 4(1) of the [CRR](#).

¹⁰ 'consolidating entity' means the OI which shall comply with the requirements laid down in the [CRR](#) on a consolidated basis or a sub-consolidated basis, as applicable, in accordance with Articles 11 and 18 of the [CRR](#).

¹¹ 'pay-out ratio at consolidated level' means the ration between: (a) dividends, other than those paid in a form that does not reduce CET1 capital (e.g. scrip-dividends), distributed to owners of the consolidating entity; and

c) The dividend calculated on the basis of the previous year's pay-out ratio.

Any deduction of dividends based on any other approach shall not be covered by this Circular.

Should you have any queries in respect of the above, kindly contact Mr. Karol Gabarretta, Director, Banking Supervision Unit (kgabarretta@mfsa.com.mt).

Communications Unit

Malta Financial Services Authority

20th April 2015

(b) profit after tax attributable to owners of the consolidating entity. If for a given year, the ratio between (a) and (b) is negative or above 100%, the pay-out ratio shall be deemed to be 100%. If for a given year (b) is zero, the pay-out ratio shall be deemed to be 0% if (a) is zero, and 100% if (a) is above zero;

'pay-out ratio at solo level' means the ratio between: (a) dividends, other than those paid in a form that does not reduce CET1 capital (e.g. scrip-dividends), distributed to owners of the entity; and (b) profit after tax. If for a given year the ratio between (a) and (b) is negative or above 100%, the pay-out ratio shall be deemed to be 100%. If for a given year (b) is zero, the pay-out ratio shall be deemed to be 0% if (a) is zero and 100% if (a) is above zero.