MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Circular

GUIDANCE ON THE COMING INTO FORCE OF THE CAPITAL CONSERVATION BUFFER

March 2015

CIRCULAR

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1. Scope

Following the publication of the MFSA Banking Rule 15 (BR/15), which amongst others transposed the CRD IV provision on the Capital Conservation Buffer, the Authority is hereby communicating its guidance on the coming into force of this capital buffer.

2. Background

The Capital Requirements Directive 2013/36/EU[1] (hereinafter referred to as 'CRD') and the Capital Requirements Regulation No. 575/2013[2] (hereinafter referred to as 'CRR') seek to safeguard the stability of the financial system through the development of a micro and macro-prudential policy framework. Both the CRD and the CRR require credit institutions and investment firms (hereinafter collectively referred to as 'institutions') to comply with various prudential requirements including the requirement to hold own funds. In particular, the CRR prescribes the characteristics for the minimum regulatory capital requirement such that institutions are required to maintain a minimum level of total capital at eight per cent (8%) of risk weighted assets (hereinafter referred to as 'RWAs'), which is made up of the following elements:

- Tier 1 capital ratio at 6% of RWAs, consisting of:
  - Common Equity Tier 1 capital at 4.5% of RWAs; and
  - Additional Tier 1 capital at 1.5% of RWAs

- Tier 2 capital at 2% of RWAs

In addition to the minimum capital requirements, institutions are, or may be, required (depending on the applicability of the buffer in question) to hold additional capital in order to conserve capital and provide additional loss-absorption capacity. These additional capital buffers include the Capital Conservation Buffer[3] (hereinafter referred to as the 'CB'), the

[1] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC; Official Journal of the European Union, L 176, 27 June 2013, p.338-436

[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; Official Journal of the European Union, L 176, 27 June 2013, p.1–337

[3] Article 129 CRD

Countercyclical Capital Buffer[4] (hereinafter referred to as 'CCB'), the Systemic Risk Buffer[5] (hereinafter referred to as 'SRB') and the Other Systemically Important Institutions Buffer[6] (hereinafter referred to as 'O-SII').

3. The Capital Conservation Buffer: Legal basis and implementation status at a European Level

Article 129 of the CRD requires institutions to maintain a CB apart from the regulatory minimum Common Equity Tier 1 requirement. This entails an additional Common Equity Tier 1 of 2.5% of total risk exposure, calculated in accordance with Article 92(3) of the CRR on an individual and consolidated basis.

Article 160 of the CRD sets a transitional period, from 1st January 2016 to 31st December 2018, during which Member States are to phase in the CB at annual intervals of 0.625% of RWAs with effect from 1st January 2016, reaching a final level of 2.5% of RWAs on 1st January 2019. Member States have the discretion to impose shorter transitional periods as well as introducing the CB prior to 2016.[7]

In the case of a breach of the CB requirement by an institution, capital distribution constraints will be imposed on the institution, limiting the amount of dividend and bonus payments. The limit becomes more restricted the further the institution erodes into the buffer. Such constraints seek to prevent the institution from additionally eroding into its capital.

Restrictions on distributions include the prohibition imposed on institutions that fail to meet the combined buffer requirement from distributing more than the Maximum Distributable Amount – calculated in accordance with Article 141 of the CRD. Where an institution fails to meet its combined buffer requirement, it shall also prepare a capital conservation plan in accordance with the provisions of Article 142(2) of the CRD and submit it for approval within 5 working days from when such shortcoming was identified. If the competent authority does not approve the conservation plan, the institution may be required to increase own funds to specified levels within specified periods or be required to implement more stringent restrictions on distributions in terms of Article 142(4) of the CRD.

Designated authorities may also increase the CB in line with Article 458 of the CRR above the micro-prudential level prescribed in the CRD. This may be done, under strict restrictions imposed by the CRR, in situations where changes in the intensity of macro-prudential or systemic risk in

[4] Article 136 CRD

[5] Article 133 CRD

[6] Article 131 CRD

[7] In terms Article 160(6) of the CRD

the financial system of a Member State are identified as having potential negative consequences to the financial system and the real economy.

4. Implementation of the CB in Malta

The MFSA, following consultation with the JFSB, shall implement the CB in line with article 160 (6) of the CRD as mentioned in section 3 above.

From a micro-prudential perspective, the MFSA shall continue to monitor the level of capital held by licensed institutions, taking into consideration these requirements and the potential additional micro or macro-prudential measures that may be activated at the domestic level or also by the European Central Bank in terms of Article 5 of the SSM Regulation 1024/2013,[8] as the competent authority for prudential supervision in terms of Article 4 of the SSM Regulation.

At the same time the MFSA reserves the right to review the current policy stance should market exigencies and developments, *inter alia*, so necessitate. This will be done after due consultation with the JFSB.

In view of possible other macro-prudential policy measures that may need to be considered for implementation by the Central Bank of Malta and/or the MFSA to ascertain financial stability, the Authority feels that at this stage it is important to consider the impact of the whole macro-prudential framework in a holistic manner. This would ultimately ensure the sustainable and orderly implementation of the overall micro and macro-prudential policy framework. Against this background, the MFSA advices credit institutions to maintain a prudent stance in order to conserve and strengthen further their capital levels.

In conclusion, the MFSA and the Central Bank of Malta will consult and inform stakeholders with regards to any prospective activation of any of the Macro-prudential measures, such as the SRB, O-SII and the CCB.

Communications Unit
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