MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Circular to the Banking Sector on the Amendments to Banking Rule BR/09 'Measures Addressing Credit Risks arising from the Assessment of the Quality of Asset Portfolios of Credit Institutions Authorised under the Banking Act 1994'

The Authority would like to draw your attention to the following:

The *previous* text of Banking Rule BR/09 applicable up to 30 December 2013 derived mainly from Banking Directive BD/09 (the Directive) which was initially drafted by the Central Bank of Malta (CBM) and following the transfer of the banking supervisory function from the CBM to the Malta Financial Services Authority (MFSA), consequently implemented in late 2002 by the MFSA, then known as the MFSC (Malta Financial Services Centre). At that time, the implementation of the Directive (subsequently renamed as Banking Rule) served to bring about a much needed reclassification exercise of the lending portfolios of the main local credit institutions and increase in provisioning to cover 'Doubtful' loans. It also served to drive banks to clean their balance sheets to the extent possible of long outstanding loans and advances where the chances of recovery were practically inexistent.

Over the years however, the need was felt for the MFSA to amend this Rule, given that whilst Malta as a jurisdiction was following IFRS accounting standards, the principles espoused by BR/09 were not always in consonance with such standards, especially when it came to the provisioning process advocated through the Rule. For this purpose, a Working Group was created in mid-2011, composed of members from within the Banking Supervision Unit of the MFSA and others from the Financial Stability Division of the CBM, with the specific aim of proposing relative amendments to BR/09. It should be stated that in the meantime, in April 2012 one of the Country Specific Recommendations (CSRs) which the European Commission made with respect to Malta, required improvement in local banks' coverage ratios and increases in provisioning to cover non-performing loans (NPLs). In this context, the MFSA and the CBM agreed that these issues could also be tackled through appropriate amendments to BR/09, which were being discussed at the time.

The process of consultation was quite a comprehensive one which entailed various meetings and detailed discussions throughout the latter part of 2012 and 2013, within the Working Group, between the CBM and the MFSA, within the Joint CBM/MFSA Financial Stability Board (the JFSB) and with the industry. In fact a Consultation Document on the proposed amendments to BR/09 was issued by the MFSA at the beginning of September 2013 and all interested parties were required to provide feedback by the end of the same month. Meetings were subsequently convened with various stakeholders, including the major banks which had forwarded their comments on the draft amended Rule. The process of revision to BR/09 was formally concluded with a final draft of the Rule being endorsed during the fourth quarter of

2013 by the said JFSB for due publication by the MFSA of the Rule which would be applicable as from the 31st December 2013.

The main thrust of the amendments to BR/09, through which the authorities aimed to address the requirement of the CSR6 on provisioning and coverage ratio, (mostly the former) lies in the introduction of a new principle within the Rule whereby banks would be required to allocate an amount of capital to a reserve which is equal to 2.5 percent of a bank's NPLs less IFRS impairments and interest in suspense. Moreover, the Rule requires institutions to set up appropriate governance structures, internal control and reporting systems, in order to effect the required adjustments entailed through the new BR/09.

Given the applicability of the revised Rule as previously stated as from 31 December 2013, credit institutions have been advised in advance that the requirements of the new BR/09 should be taken into account prior to finalising their year-end financial statements for 2013.

Communications Unit
Malta Financial Services Authority
31st December 2013