

BANKING RULE BR/26

**BANKING RULE ON THE STRESS TESTING
REQUIREMENTS OF CREDIT INSTITUTIONS
LICENSED UNDER THE BANKING ACT**

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REVISIONS LOG

VERSION	DATE ISSUED	DETAILS
1.00	October 2022	Implementation of the EBA Guidelines on institutions' stress testing (EBA/GL/2018/04).

BANKING RULE ON THE STRESS TESTING REQUIREMENTS OF CREDIT INSTITUTIONS LICENSED UNDER THE BANKING ACT 1994

INTRODUCTION

1. In terms of Article 4 of the Banking Act (Cap. 371 of the Laws of Malta) (the 'Act'), the Malta Financial Services Authority (the 'Authority') as appointed under Article 3(1) of the Malta Financial Services Authority Act (Cap. 330 of the Laws of Malta) is empowered to make Banking Rules (the 'Rules') as may be required for the carrying into effect of any of the provisions of the Act. The Authority may also amend or revoke such Rules. The Rules and any amendments or revocation thereof shall be officially communicated to credit institutions and the Authority shall make copies thereof available to the public.
2. In accordance with Article 4(7) of the Act, the Authority may make, amend, or revoke Banking Rules as may be required for the purpose of implementing any guidelines, recommendations, decisions, opinions or any other instrument issued by the European Banking Authority (the 'EBA').

SCOPE AND APPLICATION

3. The Rule applies to all credit institutions licensed under the Act and credit institutions shall ensure compliance with the provisions of this Rule.
4. The scope of this Rule is to implement the [EBA Guidelines on institutions' stress testing](#) issued on 19 July 2018 (EBA/GL/2018/04) and further provide stress testing requirements that credit institutions shall abide with.
5. This Rule, however, shall not be treated as a substitute to the EBA Guidelines referred to under paragraph 4, and credit institutions shall also abide with the requirements set out in the EBA Guidelines, as well as any reviews and/or updates that may be undertaken to such Guidelines from time to time.
6. This Rule shall not substitute any other law, unless otherwise specified, by which credit institutions subject to this Rule shall abide more specifically with the applicable provisions in the Act, any other European and national legislation, and the Regulations. Particularly, the relevant provisions of the Act and the Banking Act (Supervisory Review) Regulations (S.L.371.16) shall apply to credit institutions.

DEFINITIONS

7. Unless otherwise specified in Section 2 paragraph 9 of the EBA Guidelines, terms used and defined in the Act and regulations issued thereunder shall have the same meaning in this Rule.

CREDIT INSTITUTIONS' STRESS TESTING REQUIREMENTS

8. Credit institutions shall have a stress testing programme that includes the main objectives and application, the applicable frequency and internal governance arrangements, with transparent and consistent lines of responsibility and procedures. Credit institutions shall, at least on an annual basis, assess their stress testing programmes to determine their effectiveness and robustness. The assessment shall fully reflect the changing external and internal conditions.
9. The board of directors shall approve the stress testing programme and oversee its implementation and performance, and ensure that clear responsibilities and sufficient resources, both in terms of skilled human resources and information technology systems, have been allocated for the execution of the programme. Furthermore, all elements of the stress testing programme, including its assessment, shall be appropriately documented, and regularly updated where relevant in the internal policies and procedures.
10. Stress testing shall be an integral part of the credit institution's risk management framework, including in the context of the internal capital adequacy assessment process (ICAAP) and the internal liquidity adequacy assessment process (ILAAP), and shall support business decisions and strategic planning.
11. Credit institutions shall ensure a proper data infrastructure with the capacity to capture the extensive data needs of the stress testing programme covering all material risks that the credit institution is exposed to. Such an infrastructure shall allow for flexibility and appropriate levels of quality and control. Data used in stress testing shall be consistent with regulatory reporting and the financial statements.
12. Credit institutions shall have regard to both on- and off- balance sheet assets and liabilities and shall stress test portfolios and business lines or units to identify intra- and inter-risk concentrations.
13. The stress testing programme shall be based on the principle of proportionality considering the credit institution's size and internal organisation, and the nature, scale and complexity of the activities when developing and implementing a stress testing programme. In this regard, paragraph 58 under Section 4.5 of the EBA Guidelines specifies all the criteria to be taken in account to ensure the appropriate implementation of requirements.

14. Credit institutions shall identify appropriate and robust mechanisms for translating risk factors into relevant risk parameters, such as the probability of default (PD), loss given default (LGD), write-offs and fair value haircuts. Credit institutions shall conduct sensitivity analysis, scenario analysis and reverse stress testing.
15. Credit institutions shall ensure that scenario designs are forward-looking and consider systematic and institution-specific changes in the present and foreseeable future. The severity of scenarios shall be benchmarked to EBA or ECB scenarios, taking into consideration any changes and/or enhancements carried out over time, and incorporate supervisory guidance.
16. Stress testing shall consider changes in the macroeconomic environment and shall include the analysis of the following individual risk areas, as applicable:
 - i. Credit and counterparty risks
 - ii. Securitisation
 - iii. Market risk
 - iv. Operational risk, including cyber risk and disruption in correspondent banking services
 - v. Conduct-related risk and associated litigation costs
 - vi. Liquidity risk
 - vii. Interest rate risk from non-trading activities, including risks to net interest income (NII)
 - viii. Concentration risk
 - ix. Foreign exchange lending risk
 - x. Climate risk.¹
17. Stress testing shall be used in the evaluation of the capital and liquidity plans, including management buffers, and credit institutions shall be able to identify credible management actions to address the stress tests' outputs. Furthermore, stress testing results shall be used as inputs in the process of establishing the credit institutions' risk appetite and limits.
18. Credit institutions shall use reverse stress testing as a regular risk management tool in order to improve their awareness of current and potential vulnerabilities, thereby providing added value to the credit institutions' risk management. Reverse stress testing results shall also assist with the development, assessment and calibration of the 'near default' scenarios used for recovery plan. The principle of proportionality shall apply to all aspects of reverse stress testing.

¹ Any further information on the assessment of this type of risk shall be provided in due course by the Authority.

Malta Financial Services Authority

Triq L-Imdina, Zone 1

Central Business District, Birkirkara, CBD 1010, Malta

communications@mfsa.mt

www.mfsa.mt