

INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS

PART B: STANDARD LICENCE CONDITIONS

Appendix 1A

Financial Resources Requirements and Guidance on the compilation of the Financial Return for Category 1, Category 2 (which qualify as Fund Managers) and Category 4b Investment Services Licence Holders

This Appendix:

- a. details the financial resources requirement;
- b. defines the various elements which make up the calculation of the Own Funds and the fixed overheads requirement; and
- c. explains the manner in which the automated financial return which Licence Holders are required to submit to the Authority in terms of the Investment Services Rules, should be completed.

1.0 The Financial Resources Requirement

- 1.1 In terms of SLC 7.01 of Part BI, SLC 5.01 of Part BII, SLC 6.01 of Part BIII and SLC 2.01 of Part BIV of these Investment Services Rules, Licence Holders are required at all times to maintain own funds which are equal to or in excess of their capital resources requirement. This shall constitute the Licence Holder's Financial Resources Requirement.

The Capital Resources Requirement

- 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 1a, 1b, and Category 4b

The Capital Resources Requirement shall be the higher of (i) and (ii) below:

- i. Initial Capital
- ii. The fixed overheads requirement.

B. Category 2 which qualify as Fund Managers

For the purposes of these Rules, a **'Fund Manager'** is categorised as either a **'UCITS Fund Manager'** or a **'Non-UCITS Fund Manager'**.

A **'UCITS Fund Manager'** refers to a Licence Holder which qualifies as a **'Maltese Management Company'** pursuant to the Investment Services Act (UCITS Management Company Passport) Regulations, 2011 and Part BII of these Rules.

A **'Non-UCITS Fund Manager'** refers to a Licence Holder which is authorised to provide management services for Non-UCTIS schemes in terms of the Investment Services Act.

The Capital Resources Requirement applicable to Fund Managers shall be the higher of (i) and (ii) below:

- i. The sum of the following:
 - a. Initial Capital of EUR 125,000;

- b. An additional amount of Own Funds equivalent to 0.02% of the amount by which the value of the portfolios under management exceed EUR 250,000,000.

The summation of (a) and (b) above shall not exceed EUR 10,000,000.

Provided that the Fund Manager may be exempted from providing up to 50% of the additional amount of Own Funds referred to in (b) above, if it benefits from an approved guarantee of the same amount given by a credit institution or insurance undertaking. The credit institution or insurance undertaking must have its registered office in a Member State or in a third country that it is subject to prudential rules considered by the MFSA as equivalent to those laid down in EU Law.

Fund Managers wishing to avail themselves of this exemption should make an application to the MFSA.

- ii. The fixed overheads requirement.

For the purpose of the above calculation, the following portfolios shall be deemed to be the portfolios of the Fund Manager:

- a. unit trusts/ common funds managed by the Fund Manager including portfolios for which it has delegated the management function but excluding portfolios that it is managing under delegation;
- b. investment companies for which the Fund Manager is the designated management company;
- c. other collective investment schemes managed by the Fund Manager including portfolios for which it has delegated the management function but excluding portfolios that it is managing under delegation.

The Fund Manager shall be considered as managing portfolios under delegation in those cases where it does not have a direct relationship with the UCITS or Non-UCITS schemes due to its role as a Sub-Manager of the designated UCITS or Non-UCITS Fund Manager.

General Outline of the Initial Capital

- 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 various categories of 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.

<u>Licence Holder Category</u>		<u>Initial Capital</u> <u>EURO</u>
Category 1 (A)	<p>Licence Holders authorised to receive and transmit orders in relation to one or more instruments and/or to provide investment advice, and/or to place instruments without a firm commitment basis but not to hold or control Clients’ Money or Customers’ Assets.</p> <p>Provided that where Category 1 (A) Licence Holders are also registered under the Insurance Mediation Directive, the initial capital requirement shall be reduced to EUR 25,000.</p>	50,000
Category 1 (B)	Licence Holders authorised to receive and transmit orders, and/or to provide investment advice in relation to one or more instruments, and/or to place instruments without a firm commitment basis solely for professional clients and, or eligible counterparties but not to hold or control Clients’ Money or Customers’	20,000 With PII
		50,000

<u>Licence Holder Category</u>		<u>Initial Capital</u> <u>EURO</u>
	<p>Assets.</p> <p>Provided that where Category 1 (B) Licence Holders are also registered under the Insurance Mediation Directive, the initial capital requirement shall be EUR 25,000.</p>	Without PII
Category 2 Fund Managers	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 underwrite or place instruments on a firm commitment basis.	125,000
Category 4b	<p>Licence Holders authorised to act:</p> <p>(a) as custodians of AIFs which have no redemption rights exercisable during the five year period from the date of initial investment and which generally do not invest in assets that must be held in custody in terms of the Investment Services Rules.</p> <p>(b) as custodians to AIFs marketed in Malta in terms of regulation 7 of the Investment Services Act (Alternative Investment Fund Manager) (Third Country) Regulations.</p>	125,000

2.0 *The automated Financial Return*

This section of the Appendix provides detailed instructions on how to use the automated Financial Return. It then provides an explanation of how Licence Holders are to complete a number of worksheets in the Return, namely:

	Appendix 2A – Category 1 & Category 4b Licence Holders	Appendix 2B – Fund Managers
i. Cover Sheet		
ii. the Input Sheet	Sheet 1	Sheet 1
iii. the Income Statement	Sheet 2	Sheet 2
iv. the Balance Sheet	Sheet 3	Sheet 3
v. Representations	Sheet 7	Sheet 7
vi. CBM BOP Return	CBM BOP RETURN	CBM BOP RETURN
vii. Validation Sheet		

Detailed explanations of the:

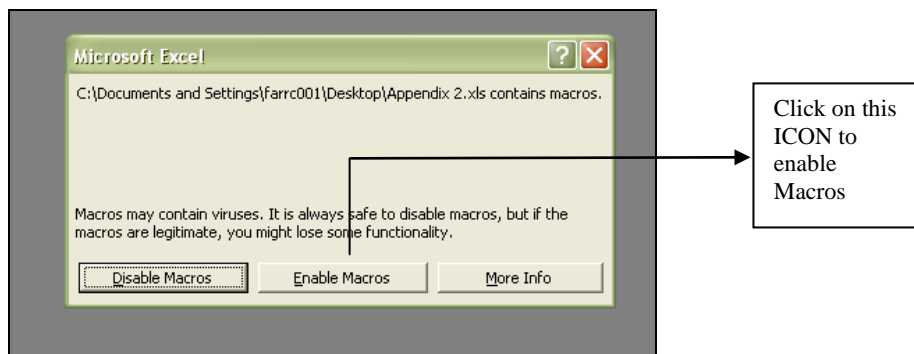
	Appendix 2A – Licence Holders (excluding Fund Managers)	Appendix 2B – Fund Managers
i. Own Funds	Sheet 4	Sheet 4
ii. the Fixed Overhead Requirement	Sheet 5	Sheet 5
iii. the Financial Resources Requirement	Sheet 6	Sheet 6

are provided in section 4.0 of this Appendix.

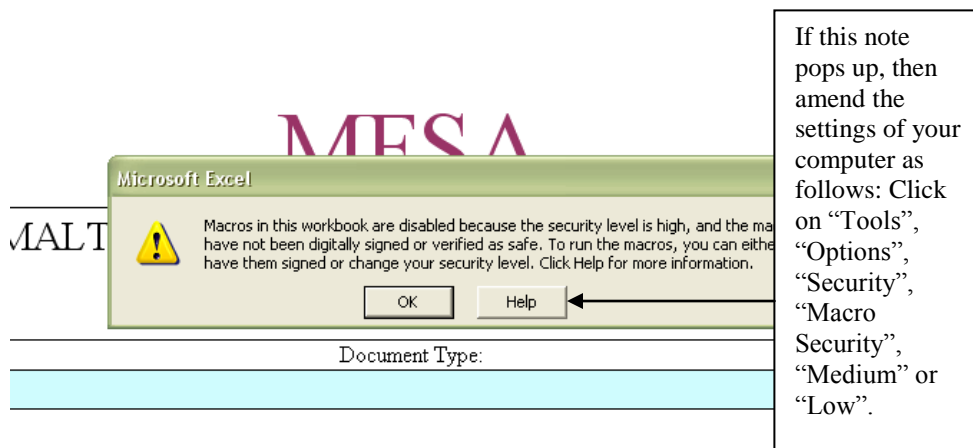
2.1 Instructions for using the automated Financial Return

- a. This section of the Appendix provides guidance for Investment Services Licence Holders when compiling the automated Interim Financial Return (“IFR”), the automated Annual Financial Return (“AFR”) and the automated Annual Audited Financial Return (“AAFR”). Unless otherwise specified, the term “Return” and the Rules of the Appendix refer to the IFR, AFR and AAFR.
- b. The Return is compiled via an Ms Excel file. This file has been optimised for use on Microsoft Excel 2010. Some functions may not work if converted for use with other software or later versions of Excel. This Ms Excel file must be saved in the following format: Microsoft Excel Macro-Enabled Worksheet (.xlsm).

When opening the Excel Spreadsheet a window may open up giving the option to enable the macros, in which case click on the button “Enable Macros” prior to proceeding with the compilation of the Return.



If a further pop-up window appears on screen, as shown in the figure below, kindly amend the program's settings as described on the next page.



- c. To select a worksheet, go to the "CONTENTS" sheet and click on the button next to the required sheet.
- d. The worksheets are password protected. With the exception of cells highlighted in blue, all cells in this program are locked and only these cells allow the inputting, deleting and amending of values.
- 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 may require manual intervention by being 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, such as additional details required in “SHEETS 2 and 3”. It is preferable that entries should not exceed the space provided for this purpose.
- i. The compilation of the automated Return should start from the first worksheet (that is, the “COVER SHEET”). Details should be inserted (as and where appropriate) starting from the top and moving to the end of each worksheet.
- j. Users should not key in “0” or “-” whenever a value is nil but should leave the cell empty.
- k. **Returns should be submitted by their due date in both hardcopy (signed) and electronic format (by e-mail). The Authority does not accept any liability for unauthorised access to returns submitted in electronic format.**

2.2 Cover Sheet

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

The image shows a screenshot of a form with two rows. Row 1.0 is labeled 'Document Type:' and has a dropdown menu open showing two options: 'ANNUAL FINANCIAL RETURN' and 'INTERIM FINANCIAL RETURN'. Row 2.0 is labeled 'Name of Licence Holder' and has a blue highlighted input field. A blue arrow points from the dropdown menu to a callout box on the right. The callout box contains the text: 'Select Document type – either Interim Financial Return or Annual Financial Return'.

- c. Returns are to be prepared in the currency in which the Audited Annual Financial Statements are compiled. The Reporting Currency of the accounts should be inserted in ISO Code in Item 8.
- 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 –10, click on the button “Contents Page” at the bottom of this sheet to go to the “Contents 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 “Contents
Sheet”

2.3 Input Sheet – Sheet 1

CONTENTS			
Sheet 1	AFR 1	Sheet 1	INPUT SHEET
Sheet 2	AFR 2	Sheet 2	PROFIT & LOSS ACCOUNT

Click on this icon
to go to the
“INPUT SHEET”

- a. Click on the button “SHEET 1” in the ‘Contents Sheet’ to go to 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 the amounts on the debit (mainly assets and expenses) 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

- d. Under the “Income and Expenditure” sections, the revenue/ expenses earned/ incurred by the Licence Holder during the reporting period are to be included.

(N.B.) Besides providing for taxation in the Annual Income statement included in the AFR, Licence Holders are also required to provide for taxation in the Interim (monthly, quarterly or half-yearly – as applicable) Income statement in the IFR.

- e. Allowable Commissions and Fees, Item 2(a) in the “Revenue” section relates to commissions and fees payable, provided they are directly attributable to commissions and fees receivable which are included in total revenue.
- f. In terms of IAS 1(88), an entity shall recognise all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise. Some IFRSs require or permit some components to be excluded from profit or loss and instead to be included in other comprehensive income. The components of other comprehensive income include: [i] changes in revaluation surplus (IAS 16 and IAS 38); [ii] gains and losses on re-measuring available-for-sale financials assets (IAS 39); and [iii] the amount of income tax relating to each item included in other comprehensive income.
- g. Exceptional Expenditure, Item 2(c) (i) in the “Expenditure” section are items of expenditure for which the MFSA’s no-objection should be sought prior to their inclusion in the Return.
- h. Under the “Assets” section, financial instruments, both long and short positions, held on the Licence Holder’s (item 3(f)) balance sheet are to be categorised under one of the available headings. The long or short position in a particular investment is the net of any long or short positions held in that same investment. It is important that financial instruments are inserted under their appropriate heading. Licence Holders should only include the balance sheet value of these financial instruments under item 3 (f).
- i. Collective investment schemes, Item 3(g) (iii), are any amounts receivable by the Licence Holder from transactions in collective investment schemes.
- j. Group creditors - due within 1 year, Item 4(c) and Group creditors - due after more than 1 year, Item 4(g). These represent amounts receivable from group companies and/ or connected persons. The relevant definition of “Group” for this purpose is that defined in the Companies Act, 1995.
- k. Secured Liabilities, Item 6(a). Under item (i), the Licence Holder must include the total secured liabilities which are due within 1 year. On the other hand, under item (ii) the Licence Holder must insert that part of the amount inserted in (i) which is secured by a charge on land and buildings. Under item (iii), the Licence Holder must include the total secured liabilities which are due after more than 1 year.

Similarly, under item (iv) the Licence Holder must insert that part of the amount inserted in (iii) which is secured by a charge on land and buildings.

1. The Licence Holder is to input the relevant figures for items 6(b), 6(c), 6(d), 6(e), 6(f) and 6(g) if these are applicable.
- m. The Fund Manager must include the total value of the portfolios under management under Item 6 (h) of Appendix 2B of the automated Financial Return. The portfolios of the Fund Manager are deemed to be the portfolios referred to in Section 1.2 (B) of this Appendix. The value of any other Assets under Management which are held by the Fund Manager should be included under Item 6 (i) of Appendix 2B of the automated Financial Return.

2.4 *Income Statement – Sheet 2*

- 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”).

2.5 *Balance Sheet – Sheet 3*

- 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 include explanations to the following Items:
 - i. Item 2.0(f) (“*Amounts due from Group Companies*”)
 - ii. Item 2.0(g) (“*Amounts due from other connected persons*”)
 - iii. Item 5.0(b) (“*Amounts due to Group Companies – within 1 year*”)
 - iv. Item 5.0(c) (“*Amounts due to other connected persons – within 1 year*”)
 - v. Item 6.0(c) (“*Amounts due to Group Companies – after more than 1 year*”)
 - vi. Item 6.0(d) (“*Amounts due to other connected persons – after more than 1 year*”)

2.6 *Sheet 7 – Representations*

- a. Items 1 – 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 the: (i) names of shareholders / members possessing qualifying holdings and (ii) the respective size of their holdings. A

qualifying shareholder is defined as a holder of a direct or indirect holding in a body corporate which represents ten per cent or more of the share capital issued by such body, or of the voting rights attaching to such share capital or which makes it possible to exercise a significant influence over the management of the body corporate.

- 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, Regulations issued thereunder 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 sign the Return. Otherwise the Return is to be signed by two Directors or other authorised signatories. When the Return is 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 signed by the auditor of the Licence Holder.

2.7 *Validation Sheet*

Prior to submitting the 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.

3.0 *The various elements which make up the calculation of the Own Funds and the Fixed Overheads Requirement*

3.1 *Own Funds*

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

3.1.1 *Tier 1 capital*

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

3.1.1.1 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.

(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.

- 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.

(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. 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.
- v. 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’.

- vi. 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.
- vii. 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.
- 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 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.

- ix. Excess of deduction from Additional Tier 1 items pursuant to article 56 of the CRR over Additional Tier 1 capital.
- x. Qualifying holdings outside the financial sector.
- xi. 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 39, 41 to 49 of the CRR, also make reference to the [Regulatory Technical Standards on Own Funds](#).

3.1.1.2 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.

(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](#).

3.1.2 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).

(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.

3.1.3 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.

3.1.4 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.

3.1.5 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.

3.1.6 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 Prvosiion	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 3.1.1.1 (C) (i)	100%	100%	100%	100%
469 (1) (a)	Intangible assets (article 36 (1) (b))	Section 3.1.1.1 (C) (ii)	100%	100%	100%	100%
469 (1) (a)	Defined benefit pension fund assets (article 36 (1) (e))	Section 3.1.1.1 (C) (iv)	100%	100%	100%	100%
469 (1) (a)	Holdings of the Licence Holder's own CET 1 capital	Section 3.1.1.1 (C) (v)	100%	100%	100%	100%

	instruments (article 36 (1) (f))					
469 (1) (a)	Reciprocal cross holdings (article 36 (1) (g))	Section 3.1.1.1 (C) (vi)	100%	100%	100%	100%
469 (1) (a)	Non- significant holdings (article 36 (1) (h))	Section 3.1.1.1 (C) (vii)	100%	100%	100%	100%
469 (1) (c)	Deferred tax assets (article 36 (1) (c))	Section 3.1.1.1 (C) (iii)	100%	100%	100%	100%
469 (1) (c)	Deferred tax assets that existed prior to 1 January 2014 (article 36 (1) (c))	Section 3.1.1.1 (C) (iii)	100%	100%	100%	100%
469 (1) (c)	Significant holdings (article 36 (1) (i))	Section 3.1.1.1 (C) (viii)	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.

3.1.7 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.

3.1.8 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.

3.1.9 Transitional provisions on additional filters and deductions

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

- a. The Authority does not intend 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:
 - d. 0% for the period from 1 January 2014 to 31 December 2014;
 - e. 0% for the period from 1 January 2015 to 31 December 2015;
 - f. 0% for the period from 1 January 2016 to 31 December 2016;
 - g. 0% for the period from 1 January 2017 to 31 December 2017;
- b. 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.

3.1.10 The Return

Sheet 4 – (Own Funds) of the Return, which calculates the Licence Holder's own funds is partially automated and may in certain cases require manual intervention.

3.2 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.

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 defined 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 and other variable remuneration, 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. non-recurring expenses from non-ordinary activities.

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

(B) *Fixed Overhead Requirement – The Return*

Input the items of expenditure in Sheet 5 of the Financial Return, as applicable. The Return will automatically calculate the fixed overhead requirement.

For the purposes of calculating the fixed overhead requirement, Licence Holders should also refer to article 97 of the CRR and the [Final draft Regulatory Technical Standards on Fixed Overheads](#).