Pillar 3 Disclosures

30 September 2020

Bank of Valletta

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Issued by Bank of Valletta p.l.c., 58, Triq San Żakkarija, Il-Belt Valletta, VLT 1130 – Malta

Introduction

The Basel III capital adequacy framework consists of three complementary pillars. Pillar 1 provides a framework for measuring minimum capital requirements for credit, market and operational risks. Pillar 2 establishes a system of supervisory review, aimed at improving banks' internal risk management and capital adequacy assessment in line with their risk profile. Pillar 3 is intended to enhance market discipline and requires banks to publish a range of disclosures aimed at providing further insight on the capital structure, adequacy and risk management practices.

The Pillar 3 Disclosures as at September 2020 comprises both quantitative and qualitative information required under Pillar 3. These disclosures are made in accordance with Part Eight of CRR II and the European Banking Authority's (EBA) guidelines on disclosure requirements. This quarterly report provides an updated overview of the Group's capital adequacy, risk weighted assets, leverage and liquidity, in accordance with EBA recommended guidelines on disclosure requirements - "Final Report on the Guidelines on disclosure requirements under Part Eight of Regulation No 575/2013 - EBA/GL/2016/11" which requires banks to take particular attention to the possible need for disclosing some information more frequent than annually.

This document is not subject to external audit, however the disclosures have been prepared on a basis consistent with information submitted to the regulator. The Pillar 3 disclosures have been approved by the Bank's Senior Management. The Bank is satisfied that internal verification procedures ensure that these Additional Regulatory Disclosures are presented fairly.

Section 1 – Capital Overview

The Group maintains its objective of actively managing capital in an integrated way, seeking to fulfil the regulatory requirements, guarantee solvency, and maximise profit. Through this holistic approach the Group is able to achieve long-term sustainability and identify growth opportunities that provide a sustainable risk-return performance. The Group's capital management approach aims to ensure a sufficient level of capitalisation to absorb unexpected losses from its risk.

The Group is required to meet a total SREP capital requirement (TSCR) of 11.25%, consisting of 8.00% minimum own funds requirement in line with Article 92(1) of the CRR, and a 3.25% Pillar II Requirement (P2R). In view of the current COVID-19 pandemic, on 12 March 2020 the ECB announced that as part of the extraordinary measures banks are allowed to partially use capital instruments that do not qualify as CET1 to meet the P2R. This brings forward a measure which was initially scheduled to come into effect in January 2021 as part of the revision of the Capital Requirements Directive. This implied that institutions shall meet the additional own funds requirements imposed by the ECB with own funds that satisfy the following conditions – (i) at least 75% shall be met with Tier 1 Capital; and (ii) at least 56.25% with CET1 Capital.

The Group's capital position remained comfortably above regulatory requirements with a CET1 ratio as at end of September 2020 of 19.39%, in line with the Group's risk appetite. In light of the COVID-19 pandemic, BOV Bank has followed the ECB guidance and postponed the final dividend for FY 2019, with the final payment conditional on a reassessment of the situation, taking into account the possible consequences of COVID-19. The Group is closely monitoring the situation and constantly assessing the impact of the COVID-19 pandemic. The capital plan shows that the capital ratios are expected to remain above regulatory requirements in the coming years, both under the business as usual scenario (taking into consideration the COVID-19 impact) and also under severe stressed scenarios.

Capital instruments

The Group's capital base is composed of CET1 and Tier 2 capital, as defined in Part Two of the CRR. In line with new regulations, the Group is continuously monitoring and focusing towards further strengthening its CET1 capital, which is the highest form of quality capital, thus providing the greatest level of protection against losses. The Group's capital base is primarily composed of issued common shares and retained earnings, which form part of CET1 capital – the Group's core capital. In line with the CRR, the Group's capital is subject to relative deductions. The main deductions relate to intangible assets, unrealised gains and losses and the reserve held against the depositor compensation scheme which is an added requirement in national legislation. In accordance with Section 3, Chapter 2, Title I, Part Two of CRR there were no other items requiring deductions from Own Funds. As at the end of September 2020 both the Group's significant investments and deferred taxation were below the 10% threshold as stipulated in Article 48(1) of the CRR.

The Group has three subordinated bonds in issue and these are included as part of Tier 2 Capital as they fully qualify for the provisions listed under CRR (575/2013) Part Two, Title 1, Chapter 4, and Article 63. Specifically, these instruments rank after the claim of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled. *Additional information on the main features of the capital instruments is available on our website on Page 17 of the December 2019 Financial Statement.*

	Own funds as at September 2020	**€ 000s**
	CET1 CAPITAL	
	Common Equity Tier 1 capital: instruments and reserves	
1	Capital instruments and the related share premium accounts	633,126
2	Retained earnings	317,850
3	Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards)	51,085
3a	Funds for general banking risk	5,178
6	**Common Equity Tier 1 capital before regulatory adjustments**	**1,007,240**
	Common Equity Tier 1 (CET1) capital : regulatory adjustments	
7	Additional value adjustments (negative amount)	(746)
8	Intangible assets (net of related tax liability) (negative amount)	(60,129)
	Additional deductions from CET 1 capital due to Article 3 CRR	(40,774)
28	**Total regulatory adjustments to Common equity Tier 1 (CET1)**	**(101,649)**
29	**Common Equity Tier 1 (CET1) Capital**	**905,591**
	TIER 2 capital	
51	Tier 2 (T2) capital before regulatory adjustments	**162,717**
57	Total regulatory adjustments to Tier 2 (T2)	-
58	**Tier 2 (T2) Capital**	**162,717**
59	**TOTAL CAPITAL**	**1,068,308**
	TOTAL Risk Weighted Assets	
59a	Risk weighted assets in respect of amounts subject to pre-CRR treatment and transitional treatments	
	of which deferred tax assets not deducted from CET1 capital	184,192
	of which direct holdings by the institution of the CET1 instruments of financial sector entities not included in CET1 capital	132,174
60	**TOTAL Risk Weighted Assets**	4,670,680
	Capital Ratios and buffers	
61	Common Equity Tier 1 Capital	19.39%
62	Tier 1 Capital	19.39%
63	Total Capital	22.87%
64	Institution specific buffer requirement	9.00%
65	*of which: capital conservation buffer requirement*	*2.50%*
66	*of which: countercyclical buffer requirement*	*0.00%*
67a	*of which: Other Systemically Important Institution (O-SII) buffer*	*2.00%*
68	Common Equity Tier 1 available to meet buffers	14.89%
	Amounts below the thresholds for deductions	
73	The part of the holdings of CET1 instruments of financial sector entities (as defined in Article 4(1)(27) of CRR) where the institution has a significant investment but which is below the 10 % threshold in Article 48(1) point (b) of CRR.	52,870
75	Deferred tax assets arising from temporary differences (amount below 10% threshold)	73,638

Section 2 –Overview of Pillar 1 capital requirements

The Group uses the following approaches to calculate the own funds requirements for Pillar I risks.

- The *Standardised Approach for credit risk*. Risk weights for the Treasury Portfolio are determined by taking the worst credit rating from the best two credit ratings provided by eligible External Credit Assessment Institutions (ECAIs) – Fitch, Moody's and S&P. Regulatory risk weights are used for unrated exposures and the lending portfolio.
- The *Basic Indicator Approach for operational risk*. Under this approach the Group allocates capital by taking 15% of the average gross income of the preceding three years.
- The *Standardised Approach with respect to the Group's foreign exchange risk*. The capital charge for foreign exchange risk using the Basic Method is calculated at 8% of the higher of the sum of all the net short positions and the sum of all the net long positions in each foreign currency.
- A minimum capital requirement is also determined for non-credit obligation assets (i.e. 'other assets' on the balance sheet) in line with the CRD IV 575/2013.

In accordance with Article 438(c) to (f) of the CRR, the following table provides an overview of the total RWA and the capital requirement for credit risk, split by the different exposure classes, as well as capital for operational risk, foreign exchange risk, and credit valuation adjustment risk. No capital is allocated for market risk as the Bank does not operate a trading book. The Bank has no exposure in items representing securitisation positions. Moreover, there is no capital allocated for settlement risk, commodities risk, position risk and large exposures. The exposure value is equal to the total on-balance sheet and off-balance sheet net of value adjustments and provisions and post Credit Conversion Factor (CCF). June 2020 figures for Institutions have been restated.

	EU OV1 – Overview of RWAs *EUR millions*	**30 June 2020**		**30 September 2020**	
		RWA amounts	**Minimum capital requirements**	**RWA amounts**	**Minimum capital requirements**
1	**Credit risk (excluding CCR)**	**4,101.2**	**328.1**	**4,180.2**	**334.4**
2	Of which the standardised approach	4,101.2	328.1	4,180.2	334.4
	Central government or central banks	1.0	0.1	1.0	0.1
	Regional government or local authorities	15.5	1.2	15.3	1.2
	Public sector entities	39.8	3.2	38.7	3.1
	Multilateral development banks	-	-	-	-
	International organisations	-	-	-	-
	Institutions	452.7	36.2	451.2	36.1
	Corporates	1,474.8	118.0	1,572.8	125.8
	Retail	574.2	45.9	590.7	47.3
	Secured by mortgages on immovable property	735.9	58.9	715.8	57.3
	Exposures in default	169.1	13.5	161.4	12.9
	Items associated with particular high risk	124.0	9.9	122.7	9.8
	Covered bonds	-	-	-	-
	Claims in the form of CIU	-	-	-	-
	Equity exposures	182.0	14.6	179.0	14.3
	Other items	332.2	26.6	331.5	26.5
6	**CCR**	**2.5**	**0.2**	**3.3**	**0.3**
7	Of which Mark to Market	1.4	0.1	2.7	0.2
12	Of which CVA	1.0	0.1	0.6	0.0
13	**Settlement risk**	**-**	**-**	**-**	**-**
19	**Market risk***	**2.6**	**0.2**	**19.8**	**1.6**
20	Of which the standardised approach	2.6	0.2	19.8	1.6
23	**Operational risk**	**467.5**	**37.4**	**467.5**	**37.4**
24	Of which basic indicator approach	467.5	37.4	467.5	37.4
27	**Amounts below the thresholds for deduction (subject to 250% RW)**	**332.2**	**26.6**	**331.5**	**26.5**
29	**Total**	**4,573.7**	**365.9**	**4,670.7**	**373.7**

*Own Funds allocated for Commodities Risk is equal to zero

*Own Funds allocated for Large Exposures and Position Risk is equal to zero

Section 3 – Leverage Ratio

The Leverage Ratio was introduced into the Basel III framework as a non-risk-based backstop limit, to supplement risk-based capital requirements. Its purpose is to limit the leverage effects in the balance sheet as it is a volume-based measure calculated as fully phased in Tier 1 capital divided by Total exposure in line with CRR Article 429. The latter is composed of on-balance sheet assets plus off-balance sheet exposures, such as undrawn commitments and derivatives potential future exposures, less amounts permitted to be deducted for Tier 1 capital.

As at September 2020 the actual leverage ratio remained stable at 6.97% when compared to June 2020, with a Tier 1 Capital of €905.6 million and with total leverage exposure of €12,997.3 million. The leverage ratio lies well above the 3% minimum requirement and thus no additional capital is required. The leverage ratio is monitored and reported to the BoD on a frequent basis in line with the risk appetite framework to ensure that the risk of excessive leverage is managed.

Leverage Ratio	**Sep-20**
	€ millions
On-balance sheet items (excluding derivatives and SFTs)	12,769.6
Asset amounts deducted in determining Tier 1 capital	(101.6)
Total on-balance sheet exposures (excluding derivatives and SFTs)	**12,668.0**
Replacement cost associated with all derivatives transactions	1.3
Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	5.0
Total derivatives exposures	**6.3**
Off-balance sheet exposures at gross nominal amount	2,082.9
Adjustments for conversion to credit equivalent amounts	(1,759.9)
Total Other off-balance sheet expsoures	**323.0**
Tier 1 Capital	905.6
Leverage ratio total exposure measure	**12,997.3**
Actual Leverage Ratio	**6.97%**
Statutory Minimum	**3.00%**

The following table provides a summarised reconciliation of accounting assets and leverage ratio exposures.

Summary reconciliation of accounting assets and leverage ratio exposures	**Sep-20**
	€ millions
Total assets as per published financial statements	12,770.9
Adjustments for derivatives financial instruments	*5.0*
Adjustments for off-balance sheet items	*323.0*
Other adjustments	- 101.6
Leverage ratio total exposure measure	**12,997.3**

The following table provides a summarised reconciliation of accounting assets and leverage ratio exposures.

	Table LRspl: Split-up of on balance sheet exposures (excludng derivatives, SFTs and exempted exposures)	Sep-20
		€ millions
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**12,769.6**
EU-2	Trading book exposures	-
EU-3	Banking book exposures, of which:	**12,769.6**
EU-4	Covered Bonds	-
EU-5	Exposures treated as sovereign	5,385.4
EU-6	Exposures to regional government, MDB, international organisations and PSE not treated as sovereigns	584.0
EU-7	Institutions	1,364.4
EU-8	Secured by mortgages of immovable properties	1,980.5
EU-9	Retail exposures	842.6
EU-10	Corporate	1,882.3
EU-11	Exposures in default	127.3
EU-12	Other exposures	602.9

Section 4 – Liquidity Risk

Liquidity risk is the risk that a bank is unable to meet its current or future payment obligations as they fall due, and/or to replace at reasonable cost funds when they are withdrawn, even when this occurs unexpectedly. Funding liquidity risk arises when a bank is not able to efficiently meet various cash flow and collateral needs without affecting its daily operations and/or financial position. In contrast, market liquidity risk arises when a bank is not able to easily offset or eliminate positions at the market price because of inadequate market depth and/or market disruption. The Bank has always taken the management of liquidity risk very seriously; to this end, the objective of the Bank's liquidity risk management actions is to ensure that both foreseeable and unpredicted funding commitment can be met when due and at a reasonable cost.

In accordance with paragraph 16 of the EBA 'Guidelines on LCR disclosure to complement the disclosure of liquidity risk management under Article 435 of Regulation (EU) No 575/2013', the Group is required to disclose information on other items termed as 'prone to rapid changes, which guidelines identifies the following:

(a) Total adjusted value of the Liquidity Buffer, as set out in row 21 of the LCR template in Annex II;
(b) Total adjusted value of Total Net Cash Outflows, as set out in row 22 of the LCR template in Annex II;
(c) Total adjusted value of the Liquidity Coverage Ratio (%), as set out in row 23 of the LCR template in Annex II.

These items have been disclosed in the table below:

Scope of consolidation (consolidated) Currency and units (€ million)	Total weighted value (average)				
Quarter ending on	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Number of data points used in the calculation of averages: 24	12	12	12	12	12
21 Liquidity Buffer	4,741.8	4,898.9	4,993.8	5,131.5	5,233.0
22 Total Net Cash Outflows	1,099.7	1,087.9	1,074.6	1,050.9	1,082.9
23 Liquidity Coverage Ratio (%)	435.4%	455.2%	467.4%	489.9%	485.8%

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