Market failures in the Maltese banking sector

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1. Characterisation of the market failures
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   1.3. **Size**: Start-ups and small businesses are often rejected
   1.4. **Business cycle**: Financial exclusion tends to increase during crises
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1. Characterisation of market failures (financial exclusion)

Getting a business credit in Malta is more difficult than in any other EU country, according to The World Bank’s Doing Business 2015 report
1.1. Financial exclusion in terms of *Maturity* Ratio of long-term loans

Loans to NFCs by maturity in the euro area

*New business, last 12 month average*

- Up to 5 years: 93%
- Over 5 and up to 10 years: 4%
- Over 10 years: 3%

*Source: Statistical Data Warehouse, April 2014 – March 2015*
1.1. Financial exclusion in terms of **Maturity**

Ratio of long-term loans

Share of long term loans of total loans

*(12 month average of outstanding amounts of loans to NFCs, Over 5 years maturity to total maturity)*

Source: Statistical Data Warehouse, April 2014 – March 2015
• France, Germany and Slovenia have national development banks (NDBs) included in the EU-wide stress test.

• *Kreditanstalt für Wiederaufbau* (KfW, Germany) and *Banque publique d'investissement* (BPI, France) are the two largest NDBs in the euro area. The two countries have the highest ratios of long-term loans.

• Finland, Austria and Spain have smaller but significant NDBs and also rank high in the ratio of long-term loans.

• Ireland and Greece did not have a NDB and scored lower ratios of long-term loans.

• Ireland has set up a NDB in October 2014 while Greece is planning to launch one.
1.2. Financial exclusion in terms of Sector

• Strategic sectors’ lack of funding, such as:
  - Tourism services
  - Renewable energy
  - Transport (roads, bridges, monorails, airport)
  - Telecommunications (IT, digital economy)

• Underinvestment in these strategic sectors has ripple effect across the entire Maltese economy
1.3. Financial exclusion in terms of Size

The extent of financial exclusion is higher for start-ups and small businesses.
Large companies have greater access to alternative sources of funding.

Source: Survey on the access to finance of enterprises (SAFE), April 2013 to September 2013, Question 4: “Could you please say whether you used Bank loans (new or renewal; excluding overdraft and credit lines) during the past 6 months, did not use them but have experience with them, or did not use them because this source of financing has never been relevant to your firm?”
1.4. Financial exclusion: *Business cycle*

The share of small outstanding business loans (up to €250,000) to total business loans

*Source: Central Bank of Malta, October 2003 – April 2015*

The supply of small business loans tends to decrease during an economic downturn. This development affects primarily start-ups and small businesses. Countercyclical instruments are required to stimulate the economy during a recession.
1.5. Financial exclusion: Predominance of bank financing (1)

Share of bank loans as a percentage of total debt of NFCs

(MFIs’ Loans to NFCs to Debt of NFCs, 2014Q1)

Source: Statistical Data Warehouse
1.5. Financial exclusion: Predominance of bank financing (2)

Maltese firms rely on bank financing as there are few other alternatives available. Capital markets are not a popular way to finance Maltese SMEs. Business angels, venture capital funds, mezzanine finance, and other sources of finance are scarce in Malta.

Source: SAFE Survey April to September 2013
2. Underlying reasons for the market failures
2.1. Maturity mismatch

• Maturity mismatch is a natural market failure arising from the intrinsic characteristic of commercial banks which use short-term liabilities (e.g. deposits) to fund longer-term assets (e.g. loans).

• According to Emmanuel Farhi and Jean Tirole (2009) this characteristic is so wide-spread that it requires a state intervention in some cases. They justify bail-outs on this premise.

• The financial crisis highlighted the risks of unstable funding mixes and maturity mismatches on banks’ balance sheets (ECB, Financial Stability Review, November 2014).
HHI represents the square of the market shares of all banks in total assets. It may include banks that are not entirely geared towards their domestic economies. In Malta, several banks have large asset shares but few material links with the domestic economy. The level of concentration appear much higher when only the core domestic banking segment is considered.
2.2. Market concentration - *loans*

**Loans to resident NFC's in Malta**

*Market shares, 2013*

- **80.23%**
- **19.77%**

- 2 largest banks
- 9 remaining banks

*Source: Central Bank of Malta*
2.2. Market concentration - deposits

Deposit from resident NFC's in Malta
*Market shares, 2013*

- **89.16%**  
  - 2 largest banks
- **10.84%**  
  - 17 remaining banks

*Source: Central Bank of Malta*
2.2. Market concentration - summary

Assets
• An HHI above 2,500 points indicates high concentration
• The Maltese core domestic segment has a HHI (by assets) of 3,835 points.
• The two biggest banks hold nearly 90% of the total assets of the core domestic banks.

Loans
• The Maltese credit market has a HHI (based on loan market shares) of 3,388 points. In this case, the HHI gives a more accurate picture as it's based on the loan portfolio not on assets.
• The two biggest banks provide more than 80% of the total loans to resident NFC's.

Deposits
• The Maltese deposit market has a HHI (based on deposit market shares) of 4,469 points.
• The two largest banks hold nearly 90% of total NFC deposits.
2.3. Information monopoly

- Dominant banks gather private information that is not available to other potential lenders. Hence, they acquire some degree of informational monopoly about their customers and thus market power.
- Unable to signal their quality to competing banks, creditworthy borrowers are captive of their current bank and may be forced to pay interest rates above the competitive level.
- The lack of credit registry increases the degree of information monopoly.
2.4. Lack of collateral, equity and credit history of SMEs

- The lack of collateral, equity and credit history of applicants further strengthens the impact of information monopoly. There is a strong asymmetry of information between lenders and borrowers and few possibilities to deal with adverse selection and moral hazard. Corporate leverage of NFCs is much higher in Malta than the EU average, which means lower equity.

- Resolving insolvency is more difficult in Malta than anywhere in Europe (Doing Business 2015, The World Bank). The poor efficiency of the judicial system further amplifies the potential cost of information asymmetries. This might explain the relatively high level of non-performing loans (NPLs) in Malta.
3. Quantitative assessment of the market gaps

Supply and demand analysis
3.1.1. Supply analysis – Credit gap (1)
Statistical and econometric approaches indicate a credit gap of around €600m - €800m

Projected credit gap based on models estimated over 1995-2011

- The **statistical approach** is based on fitting a linear time trend to NFC credit over the period 1995-2011. This trend is then extended over the period 2012-2014.
- The **econometric approach** involves the use of an estimated regression model for NFC credit for the period 1995-2011 to construct projections over the period 2012-2014 conditional on the developments of nominal GDP and NPLs. The econometric model predicts a gradual increase in NFC credit as the strong increase in economic activity outweighs the negative impact of the increase in NPLs.

Source: CBM, Brian Micallef, Estimating a Credit Gap for Non-Financial Corporations in Malta, WP/04/2015
3.1.1. Supply analysis – Credit gap (2)
The credit gap is projected to widen further

The credit gap is projected to widen further. Projected credit gap

The statistical approach evaluates the ‘credit gap’ by comparing the deviation of the actual credit from the trend prevailing before the crisis. The econometric approach assesses the ‘credit gap’ by measuring the difference between actual NFC credit and the level predicted on the basis of the historical relationship between the variables of the model. The two approaches show that a significant gap in NFC credit has emerged since 2012 (€600m - €800m).

Source: CBM, Brian Micallef, Estimating a Credit Gap for Non-Financial Corporations in Malta, WP/04/2015
3.1.2. Supply analysis – High lending rates (1)

Lending rates to NFCs
(new businesses, total loans, 2013 average)

Source: Statistical Data Warehouse, Central Bank of Malta
3.1.2. Supply analysis – High lending rates (2)

Lending rates to NFCs
(new businesses, up to and over €1m, 2013 average)

Source: Statistical Data Warehouse, Central Bank of Malta

Lending rates to NFCs in Malta are higher than the euro area average. Loans up to €1 million are charged an even higher rate.
3.1.2. “Cost of capital is relatively high, despite abundant liquidity” (IMF)

The funding base stability ratio (deposits other than from credit institutions relative to the sum of total deposits and total debt certificates) in Malta is better than in most of the euro area.
Maltese banks follow a traditional and prudent business model of high reliance on retail funding.
3.1.2. ...and despite adequate solvency

**Capital Adequacy Ratio of domestic banks**

*(2008-2013 average)*

Source: Statistical Data Warehouse, Central Bank of Malta

Solvency ratios of Maltese CDBs exceed regulatory requirements.
3.1.2. Despite asset quality at the average, lending rates are at the high end

While the level of NPLs in Malta is close to the best performing countries, lending rates are approaching those of stressed economies.
3.1.2. NPLs based on SSM harmonised definition: Malta is slightly below the SSM average

According to the European Banking Authority, a loan is classified as a NPE (Non-Performing Exposure) where the loan is 90 days past-due or if there is a risk of defaulted payments. The definition applies to all loans and debt securities that are on-balance-sheet.

10.8% - NPE before AQR (based on the harmonised SSM definition)
14.9% - NPE ratio following the reclassification of loans from performing to non-performing based on the credit file review

Bank average NPE$^1$ ratios before and after the AQR$^2$

(Harmonised SSM$^3$ definition as at end 2013)

$^1$NPE: Non-Performing Exposure
$^2$AQR: Asset Quality Review
$^3$SSM: Single Supervisory Mechanism
Source: European Central Bank
3.1.3. Supply analysis: Profits
Highest ROA before tax in the euro area

Total profit/loss before tax from continuing operations to total assets
(2008-2013 average)

Maltese banks are highly profitable compared to other euro area countries.

Source: Statistical Data Warehouse, Central Bank of Malta
3.1.3. Supply analysis: Profits

*Highest ROE in the euro area*

**Return on equity of domestic banks**
*(2008-2013 average)*

*Source: Statistical Data Warehouse, Central Bank of Malta*
3.1.3. Supply analysis: Profits

High intermediation margin

Intermediation margin*
(new businesses, loans up to 1m and total deposits, 2013 average)

*Intermediation margin refers to the difference between average interest rates on loans and deposits
Source: Statistical Data Warehouse, Central Bank of Malta

Intermediation margin is high due to relatively high lending rates. Deposit rates roughly in line with other countries.
3.1.4. Supply analysis – Income composition

*Net interest income*

Net interest income to total assets of domestic banks is higher in Malta than the euro area average.

**Source:** Statistical Data Warehouse, Central Bank of Malta
3.1.4. Supply analysis – Income composition

**Net interest income**

Net interest income is the main contributor to total income and profit of Maltese banks.

*Source: Statistical Data Warehouse, Central Bank of Malta*
3.1.5. Supply analysis –
*Tight credit conditions*

Following a tightening in SME credit standards in 2012, Maltese banks maintained their credit standards relatively tight in 2013 and 2014. On average the credit conditions were slightly more tightened in the euro area (by 1.76 percentage points). Credit conditions were not at the same level in 2008.

**Credit Standards of loan supply to SMEs**

(+ indicates net tightening / - indicates net easing)

*Source: Bank Lending Survey*
3.1.5. Supply analysis – 
*Tight credit conditions*

Credit terms and conditions of loan supply to SMEs in Malta

<table>
<thead>
<tr>
<th>Year</th>
<th>Collateral requirements</th>
<th>Loan covenants</th>
<th>Margin on average loans</th>
<th>Margin on riskier loans</th>
<th>Maturity</th>
<th>Non interest rate charges</th>
<th>Size of loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008*</td>
<td>Tightening</td>
<td>Keeping constant</td>
<td>Easing</td>
<td>Tightening</td>
<td>Easing</td>
<td>Tightening</td>
<td>Keeping constant</td>
</tr>
<tr>
<td>2009</td>
<td>Tightening</td>
<td>Tightening</td>
<td>Tightening</td>
<td>Tightening</td>
<td>Tightening</td>
<td>Tightening</td>
<td>Keeping constant</td>
</tr>
<tr>
<td>2010</td>
<td>Keeping constant</td>
<td>Tightening</td>
<td>Tightening</td>
<td>Tightening</td>
<td>Easing</td>
<td>Tightening</td>
<td>Keeping constant</td>
</tr>
<tr>
<td>2011</td>
<td>Easing</td>
<td>Tightening</td>
<td>Easing</td>
<td>Tightening</td>
<td>Easing</td>
<td>Tightening</td>
<td>Keeping constant</td>
</tr>
<tr>
<td>2012</td>
<td>Tightening</td>
<td>Tightening</td>
<td>Keeping constant</td>
<td>Tightening</td>
<td>Tightening</td>
<td>Easing</td>
<td>Tightening</td>
</tr>
<tr>
<td>2013</td>
<td>Tightening</td>
<td>Tightening</td>
<td>Keeping constant</td>
<td>Keeping constant</td>
<td>Easing</td>
<td>Easing</td>
<td>Keeping constant</td>
</tr>
<tr>
<td>2014</td>
<td>Keeping constant</td>
<td>Tightening</td>
<td>Easing</td>
<td>Tightening</td>
<td>Easing</td>
<td>Keeping constant</td>
<td>Keeping constant</td>
</tr>
</tbody>
</table>

*Data available only for the last 3 quarters of 2008
Source: ECB, Bank Lending Survey Statistics*

Maltese banks have strengthened their credit terms and conditions on several occasions. This occurred mainly through wider margins on riskier loans, greater collateral requirements and stricter conditions set in loan covenants. The moderate easing of terms concerned mainly maturity and margins on average loans. Maltese banks appear more risk averse.
### 3.1.5. Supply analysis – Tight credit conditions

#### Credit terms and conditions of loan supply to SMEs in Malta

<table>
<thead>
<tr>
<th>Year</th>
<th>Collateral requirements</th>
<th>Loan covenants</th>
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<th>Maturity</th>
<th>Non interest rate charges</th>
<th>Size of loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008*</td>
<td>3.31</td>
<td>0</td>
<td>-23.36</td>
<td>44.2</td>
<td>-5.04</td>
<td>46.72</td>
<td>0</td>
</tr>
<tr>
<td>2009</td>
<td>22.9</td>
<td>44.06</td>
<td>155.07</td>
<td>94.54</td>
<td>22.15</td>
<td>103.23</td>
<td>0</td>
</tr>
<tr>
<td>2010</td>
<td>0</td>
<td>19.01</td>
<td>4.52</td>
<td>11.3</td>
<td>-9.04</td>
<td>4.52</td>
<td>0</td>
</tr>
<tr>
<td>2011</td>
<td>-31.59</td>
<td>26.21</td>
<td>-51.45</td>
<td>2.48</td>
<td>-9.92</td>
<td>2.48</td>
<td>0</td>
</tr>
<tr>
<td>2012</td>
<td>39.09</td>
<td>39.09</td>
<td>0</td>
<td>2.71</td>
<td>36.38</td>
<td>-2.71</td>
<td>39.09</td>
</tr>
<tr>
<td>2013</td>
<td>2.91</td>
<td>8.73</td>
<td>0</td>
<td>0</td>
<td>-8.73</td>
<td>-2.91</td>
<td>0</td>
</tr>
<tr>
<td>2014</td>
<td>0</td>
<td>3.03</td>
<td>-18.71</td>
<td>3.03</td>
<td>-6.06</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Aggregation method: sum of quarterly diffusion indexes weighted with the share of each bank in the total loan outstanding amount of the banks in the BLS sample.

* Data available only for the last 3 quarters of 2008

Source: ECB, Bank Lending Survey Statistics

Maltese banks have strengthened their credit terms and conditions on several occasions. This occurred mainly through wider margins on riskier loans, greater collateral requirements and stricter conditions set in loan covenants. The moderate easing of terms concerned mainly maturity and margins on average loans. Maltese banks appear more risk averse.
3.1.5. Supply analysis – Inadequate collateral requirements

• Banks often require collateral to mitigate credit risk, reduce adverse selection effects and prevent moral hazard.

• The nature and level of collateral required depends on an evaluation of the level of credit risk or probability of default involved.

• Maltese banks have a standard of high collateralisation and apply a conservative valuation of the underlying securities. (Macroeconomic imbalances, Malta, European Commission, 2014)

• Some Maltese SMEs (especially startups and micro-enterprises) may be unable to provide collateral because they typically lack eligible assets.

• A supply side market failure emerges when firms are refused credit not on the basis of their project/business plan, but on the basis of their inability to provide collateral.
3.1.5. Supply analysis –
*Rigid credit risk assessment*

- The two largest banks rely on internal rating systems using complex algorithms to assess the quality of individual exposures and of the entire portfolio. These automated scoring processes determine an appropriate credit grade for SMEs loans.
- Some evidence suggests that there has been an increasing mechanisation of decision-making with the diffusion of internal rating and scoring systems.
- A survey by the Banca d’Italia (2007) found that in credit underwriting for SMEs, about 50% of large and medium sized Italian banks do not allow discretion to override the results of the internal rating systems (IRS).
- Credit rating and scoring are mostly based on quantitative factors, behavioral data and ratio analysis.
- Some qualitative factors are not sufficiently taken into consideration:
  - Market position (e.g. competitive position, number of buyers, suppliers)
  - Management quality and Leadership
  - Strategy
  - Sector
  - Business plan
The new capital and liquidity rules may have an adverse impact on lending.

- **Envisaged changes:**
  - Increased quality of capital: Eligible common equity tier 1 (CET1) largely limited to paid-in share capital and retained earnings
  - Increased quantity of capital: Minimum CET1 of 4.5% supplemented by three additional capital buffers
  - Liquidity Coverage Ratio (LCR): A safeguard for short-term liquidity
  - Net Stable Funding Ratio (NSFR): A safeguard for long-term liquidity (i.e. limiting structural maturity mismatch)
3.1.6. Supply analysis – Potential implications of Basel III rules (CRDIV/CRR) on SME credit

The new capital and liquidity rules may have an adverse impact on lending.

• Implications on SME credit
  – Domestic banks comfortably meet the new thresholds but the new rules limit manoeuvrability to extend further lending to SMEs.
  – Information: banks improve risk models, data quality and internal reporting but they typically devote fewer resources to smaller borrowers.
  – Collateral: banks demand additional security but smaller firms are less able to provide collateral and guarantees.
  – Risk-taking:
    (i) Banks shift the composition of their assets away from trading and riskier assets. So more funds become available for lending to businesses but not to smaller firms considered as riskier borrowers.
    (ii) Banks boost loan-loss provisions based on improved models which are likely to reduce rationing and increase the amount lent to smaller borrowers.
    (iii) Banks standardise small business loans for securitisation. This increases the amount that can effectively be lent to SMEs against the same amount of capital, but if standardisation extends to the actual issuance of loans, it could lead to loss of information.
    (iv) Banks reduce risk and funding costs through increased use of covenants and reduced maturities, negatively impacting small firms.
The structure of demand in Malta is different from that of the EU. The predominance of SMEs in terms of employment and value added implies the consequences of market failure in Malta are probably more harmful for the economy.
3.2.1. Demand analysis – Characteristics of applicants

Proportion of firms that applied for a loan in the previous three months
(percentage of surveyed firms)

Source: Malta Chamber of Commerce, Enterprise and Industry (MCCEI) Survey
3.2.2. Demand analysis –

*Drivers of demand*

**Real GDP**

*(Index 2008Q1=100, four quarter moving sum, chain-linked volumes)*

Source: Eurostat
3.2.2. Demand analysis – *Drivers of demand*

**Profit share of non-financial corporations (2013)**
*NFCs gross operating surplus / NFCs gross value added*

*Source: Eurostat, European Central Bank, National Statistics Office*
3.2.3. Demand analysis – Type of requested services

Are the following sources of financing relevant to your firm, that is, have you used them in the past or considered using them in the future?

Source: SAFE Survey 2014
3.2.3. Demand analysis – Characteristics of requested services

The great success of JEREMIE Malta Fund demonstrates SME demand for bank loans.

Source: SAFE Survey 2014
3.2.3. Demand analysis – Tightening was more often reported in the manufacturing and construction sectors

**Interest rates over past three months**

(Percentage)

**Other conditions on bank loans**

(percentage)

Source: MCCEI Survey
3.2.3. Demand analysis – Rejection rates appear to be higher in the construction sector

Source: MCCEI Survey
4. Appropriateness of the instruments to address the market gap
4.1.1. The proposed instruments: National Development Bank

- NDBs aim to provide additional financial instruments to viable and profitable projects that cannot get funding from the private sector.
- NDBs are also seeking to generate profits. However, as it is not their main objective, their returns tend to underperform the average return of the domestic banking system. (The World Bank, 2012).
- NDBs pursue a double bottom line strategy. They are judged on their financial performance (profit or loss) but also on their performance in terms of positive social impact.
4.1.2. The proposed instruments: *Competitive lending rates*

- NDBs aim to offer competitive lending rates to viable financially excluded projects. Some NDBs apply partially subsidized interest rates while others use risk-sharing public guarantees to lower the risk premium.
- The cost advantage gained through their low cost structure is typically passed onto borrowers.
  - Development banks benefit from lower cost of funding due to the public ownership and explicit/implicit government guarantee. As government-owned institutions, 64% of all DBs surveyed by the world bank enjoy the support of their governments who explicitly guarantee their debt and other liabilities. Given that 89% of the DBs can borrow from other financial institutions or issue debt, these guarantees allow them to borrow at a relatively lower cost and eventually transfer that lower cost to final borrowers.
4.1.3. The proposed instruments: Flexible collateral requirements

- NDBs should offer credit conditions that properly consider the particular characteristics of borrowers.
- Most NDBs rely on **Credit Guarantee Schemes (CGSs)** that alleviate high collateral requirements and diminish the risk associated with lending to SMEs.
  - CGS allow firms with insufficient collateral to access the lending market. Therefore, they can improve loan terms and facilitate access to formal credit for small firms and start-up (OECD, 2010).
  - The great success of JEREMIE Malta Fund (based on a guarantee scheme) demonstrate the demand for loans with reduced collateral obligations.
- Keeping a close contact with the borrowers through **mentoring programs** is an effective way of dealing with moral hazard risks.
4.1.4. The proposed instruments: Case-by-case credit scoring

- NDBs rely on innovative credit scoring and avoid overreliance on automatic credit scoring and rely on flexible credit assessment.
- Basel II indicate that human judgement are essential in the rating process:

  “Credit scoring models and other **mechanical procedures are permissible** as the primary or partial basis of rating assignments, and may play a role in the estimation of loss characteristics. **Sufficient human judgement** and human oversight is necessary to ensure that all relevant and material information, including that which is outside the scope of the model, is also taken into consideration, and that the model is used appropriately.”

  Basel II, Use of models, art. 417
4.1.5. The proposed instruments: 

*Credit register*

- “Implementation of the planned credit registry should help reduce financing costs and, in the medium-term, help facilitate other forms of market financing, such as securitization. This would complement the initiatives to jump start markets for risk capital”

  *(Concluding Statement of the 2014 Article IV Mission - Malta, IMF)*

- **Credit registers (CRs)** collect a wide range of data which can include borrower’s total number of current loans, repayment history and previous bankruptcies.

- CRs are a typical response to information monopoly issues. Without a transparent credit history, borrowers are unable to demonstrate their creditworthiness.

- CRs facilitates the possibilities of borrowers to seek a loan from alternative lenders.
4.1.6. The proposed instruments: 
*Review of the judicial system*

- An efficient judiciary system that deals with insolvency cases in a timely and cost-efficient manner, facilitates credit risk management by bringing down the stock of NPLs.
- An improved corporate insolvency regime facilitates the rehabilitation of viable firms and speeds up the exit of non-viable entities.
- This implies increased profitability for the banks as a result of reduced provisioning needs as well as gain of output for the real economy arising from more efficient allocation of resources.
- For instance, Latvia implemented several key improvements of its corporate insolvency regime (2009-2010):
  
  (i) accelerating court approval of debtor rehabilitation plans;
  
  (ii) reducing the threshold for initiating debt restructuring proceedings to encourage debtors to file in the early stage of their financial difficulties;
  
  (iii) decreasing the voting threshold for unsecured creditors to approve a rehabilitation plan;
  
  (iv) increasing the rehabilitation period to give financially distressed firms more time to restructure;
  
  (v) conferring priority repayment status to creditors that provide new financing.

These measures seem to yield results, as the ratio of NPLs and doubtful loans fell from 18.37% in 2010 to 6.54% in 2011 in Latvia.
4.2. How does it address the market gap?

- **Maturity**: NDBs tend to offer **long-term capital finance** to projects that generate positive externalities and hence would be underfinanced by private creditors.
- **Sector**: Development Banks (DBs) also finance **strategic sectors** that are currently underserved. (The World Bank, 2011)
- **Size**: The most common target market for DBs around the world is the **SME market** as about 60 percent of the DBs studied target SMEs. (The World Bank, 2011). A development bank can compensate for the lack of collateral of SMEs by using credit guarantee schemes.
- **Business cycle**: State-owned banks tend to be less pro-cyclical than commercial banks. They even played a **countercyclical role** during the global financial crisis. (The World Bank, 2013)
- **Predominance of bank financing**: DBs can mitigate the effect of the over reliance on **bank financing**. However non-bank financing would still need to be strengthened.
- The World Bank study (2011) found that the six most common target markets for DBs are: micro-enterprises/start-ups; small and medium sized enterprises (SMEs); international trade/globalization; housing; infrastructure; rural/agricultural sector.
4.3. How does it minimise competitions’ distortions?

- The financial services provided by a NDB, are considered as an option of last resort and cannot crowd-out the private sector.
- A NDB should serve only the markets segments where banks’ prices are above the competitive levels. It must complement (and not compete with) commercial banks.
- Authorities should support the provision of financial services only in cases of positive externalities. The financial markets are deemed inefficient when banks do not consider the full social cost/benefit of their transactions. In this context, the German government for example decided to subsidise KfW for the financing of particular types of borrowers.
- A NDB aims to finance only viable and profitable activities. For this propose, it requires efficient credit scoring and risk mitigation measures. As a result, it should maintain a relative low level of non-performing loans.
- A comparison of the NPL ratios of DBs with one of their respective banking systems shows that 39% of DBs exceeded the national average in 2009, while the other 64% of DBs was below the national average. (The World Bank, 2012). The two largest European NDBs slightly exceeded the national average: KfW IPEX-Bank GmbH: 5.15%; BPI France: 5.43%.
5. The positive results
5. The positive results

Establishing a NDB should result in the achievement of the following policy objectives:

• Increase of employment and economic growth by providing affordable credit to viable firms whose financial needs are not sufficiently served by private commercial banks

• Development of strategic sectors and nascent markets that have a spill over effect over the entire Maltese economy

• Propagation of financial innovation and introduction of new lending practices that could indirectly strengthen the efficiency of the financial sector

• Enhancing competitiveness of the private sector by reducing the cost of capital
Several EU countries have a NDB:

• Austria: Austria Wirtschaftsservice
• Bulgaria: Bulgarian Development Bank
• Croatia: Croatian Bank for Reconstruction and Development
• Czech Republic: Czech-Moravian Guarantee and Development Bank
• Estonia: Fund KredEx
• Finland: Finnvera
• France: Bpifrance (Banque Publique d'Investissement)
• Germany: KfW Bankengruppe
• Hungary: Hungarian Development Bank
• Italy: Banca MedioCredito Centrale S.p.A
• Luxembourg: Societe Nationale de Credit et d'Investissement

• Poland: Bank Gospodarstwa Krajowego
• Romania: Banca de Export Import a Romaniei EximBank
• Slovakia: Slovak Guarantee and Development Bank
• Slovenia: SID Bank
• Spain: Instituto de Crédito Oficial
• Sweden: Almi Företagspartner

Other countries just founded their NDB:

• Greece: Institution for Growth
• Ireland: Strategic Banking Corporation of Ireland
• UK: British Business Bank
• Latvia: Single Development Institution (new mandate focusing more on corporates)
Thank you