



BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

CENTRAL BANK OF MALTA

DIRECTIVE No 16

**FEEDBACK STATEMENT ON THE
REGULATION ON BORROWER-BASED
MEASURES**

March 2019

1. Introduction

On 1 October 2018, the Central Bank of Malta (hereinafter referred to as ‘the Bank’), launched a public consultation on the proposed Directive on Borrower-Based Measures under the Central Bank of Malta Act (Cap. 204). The consultation period ended on 24 October 2018 where interested parties were invited to submit their written feedback. This document outlines the objective of the Directive, the scope of application, followed by the feedback received from the respondents and the views expressed by the Bank and the Malta Financial Services Authority (hereinafter referred to as the MFSA). The Annex attached to the Feedback Statement incorporates amendments in the Directive taken on board by the Authorities following the public consultation.

2. Objective of the Directive

Following a recommendation of the Joint Financial Stability Board (JFSB), the Bank is hereby issuing a Directive on Borrower-Based Measures applicable to all lenders engaged in domestic residential real estate (RRE) lending. The objective of the Directive is to strengthen the resilience of lenders and borrowers against the potential build-up of vulnerabilities which could result in financial losses both to lenders and borrowers stemming from potential unfavourable economic developments.

3. Scope and Application

The Directive will apply to all lenders granting domestic RRE loans and will apply to both resident and non-resident borrowers entering into new RRE loans secured by RRE. The limits imposed in this Directive will act as a minimum standard. Therefore, lenders may adopt their existing internal credit risk assessment policies provided that these are not in breach of the Directive.

4. Feedback received from Respondents and Authorities’ Response

Written feedback was received from the Malta Bankers’ Association (MBA), credit institutions and Advisory Service firms. Following the public consultation, the Bank analysed and gave due consideration to all comments received. The Bank, jointly with the MFSA, held a meeting with the respondents on 8 February 2019 to discuss their written feedback to the proposed Directive on Borrower-Based Measures. The Authorities also discussed the proposed Directive with IMF and ECB experts. The feedback received by the respondents and the views expressed by the authorities are being presented in tabular form as follows.

<u>Published Draft Directive for Consultation</u>	<u>Respondents' Feedback</u>	<u>Authorities' Response/Revised Text</u>
<p>'6. f) <i>Category I Borrowers</i> – comprises first-time buyers (FTBs) and non-FTBs purchasing their primary residence;'</p>	<p>Clarification on the definition of Category I Borrowers was requested.</p>	<p>The definition of <i>Category I Borrowers</i> has been adjusted as follows:</p> <p>'6. f) <i>Category I Borrowers</i> means first-time buyers (FTBs) and non-FTBs purchasing their primary residence as defined in Paragraph 6(x), not having outstanding RRE loans upon the signing of the deed, and includes borrowers who already own or have owned a primary residence, and at the origination of the mortgage loan such primary residence has either already been sold or a promise of sale agreement (<i>'konvenju'</i>) has been entered into or there are pending proceedings before the Civil Court (Family Section) which hinder the sale of the primary residence.'</p>
<p>Insertion of new definition of <i>'Debt'</i>.</p>	<p>Respondents queried whether debt refers to the committed or drawn balance.</p>	<p>A new definition of the term <i>'Debt'</i> has been inserted:</p> <p>'6. j) <i>'Debt'</i> means the total committed secured and unsecured borrowing by a natural and/or legal person/s;'</p>
<p>'6. l) <i>'Gross Income'</i> means the total monetary income received by the household over a specified income reference period, before deduction of income tax, regular taxes on wealth, employees' or self-employed social security contribution and any recurrent sources of income. For joint loan accounts, income should include the joint gross income, unless the bank decides otherwise at loan</p>	<p>Respondents requested feedback on the following:</p> <ul style="list-style-type: none"> i. whether the term <i>'gross income'</i> encompasses variable income, overtime and performance bonuses (in cases where applicable); 	<p>On the basis of the feedback received, the definition of the term <i>'Gross Income'</i> has been revised and split into four parts as follows:</p> <p>'6. n) <i>'Gross Income'</i> means the total annual monetary income received by the borrower/s, which is stable and recurrent, including actual rental income before deduction of income tax,</p>

<p>evaluation stage. For BTL loans, rental income derived from the mortgage-backed property shall not be considered as gross income for the purpose of this Directive;’</p>	<ul style="list-style-type: none"> ii. reference to the ‘<i>the total monetary income received by the household</i>’ should be replaced by the ‘<i>the total monetary income received by the borrower</i>’; iii. whether projections of income often made by banks in cases of self-employed persons ought to fall within the scope of this term; iv. for BTL loans, rental income which is actual and backed by supporting documentation should be taken into consideration after the appropriate haircuts are applied; v. proposal that each bank should have the discretion to determine according to its policies, what should be considered as ‘<i>gross income</i>’ for each individual case. 	<p>regular taxes on wealth, social security contribution, including the gross income for joint loan accounts, the gross income for BTL loans and the gross income for corporates;</p> <p>6. o) ‘<i>Gross Income for Joint Loan Accounts</i>’ means income which includes the joint gross income, unless the lender decides otherwise at the loan evaluation stage;</p> <p>6. p) ‘<i>Gross Income for BTL loans</i>’ means the prospective rental income to be derived from the mortgage-backed property supported by adequate and sufficient supporting documentation, provided that such rental income shall be subject to haircuts in accordance with the internal policy of the lender;</p> <p>6. q) ‘<i>Gross Income for Corporates</i>’ means income that is calculated on the basis of Earnings before Interest, Taxes, Depreciation and Amortisation (EBITDA);’</p> <p>As specified in the Directive, the Debt Service to Income Ratio at Origination (DSTI-O) is set at origination. Therefore, only the income at the time of loan origination is considered in the case of self-employed persons. Any projections of income should be excluded.</p> <p>It is imperative that the definition of gross income is aligned to ensure one common interpretation level by the lenders.</p>
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<p>‘6. q) <i>‘Non-First Time Buyers purchasing their Primary Residence’</i> – means a borrower who already owns or owned a primary residence and intends to sell or sold his/her primary residence;</p>	<p>A clarification on the term <i>‘intends to sell’</i> was requested.</p>	<p>This definition has been dropped and instead incorporated in the definition for <i>‘Category I Borrowers’</i>. The signed promise of sale agreement (<i>‘konvenju’</i>) should serve as the basis for the definition of <i>‘intends to sell’</i>.</p>
<p>‘6. v) <i>‘Speed Limit’</i> – restricts the share of new RRE lending at LTV-O over the thresholds stipulated in this Directive;’</p>	<p>Respondents queried whether loan commitments not yet drawn are to be taken into consideration when reporting, in so far as speed limits are concerned.</p>	<p>For clarification purposes the definition of the term <i>‘Speed Limit’</i> has been adjusted slightly by including reference that it should be applied on the volume of loans, as follows:</p> <p>‘6. aa) <i>‘Speed Limit’</i> means the restriction of the volume (in terms of number of loans) of new RRE lending at LTV-O over the thresholds stipulated in this Directive;’</p>
<p>‘10. A credit institution shall ensure that the total volume of RRE loans provided to Category I Borrowers with an LTV-O beyond the 90 per cent threshold does not exceed 10 per cent of the total volume of RRE loans provided to Category I Borrowers in a given quarter;</p> <p>11. A credit institution shall ensure that the total volume of RRE loans advanced for Category II Borrowers with an LTV-O beyond that set in paragraph 9 shall not exceed 20 per cent of the total volume of RRE loans provided in a given quarter;’</p>	<p>Respondents stated that the <i>‘speed limit’</i> is too prescriptive if imposed on a quarterly basis. To this end, respondents proposed that such speed limit is imposed on an annual basis.</p>	<p>The speed limit is being extended from a quarterly to a semi-annual basis. This would give lenders more room to manoeuvre to abide by the <i>‘speed limit’</i> and any deviations could be compensated in the second half of the year. Accordingly, paragraphs 8 and 9 of the Directive have been adjusted, as follows:</p> <p>‘8. A lender shall ensure that the LTV-O ratio of an RRE for Category I Borrowers shall not exceed the 90 per cent LTV-O.</p> <p>Provided that, the total volume of RRE loans granted to Category I Borrowers with an LTV-O beyond the 90 per cent threshold, does not exceed 10 per cent of the total volume of RRE loans granted to Category I Borrowers on a semi-annual basis.</p>

		<p>9. A lender shall ensure that the LTV-O ratio of an RRE loan for Category II Borrowers shall not exceed 85 per cent in the first year of the coming into force of this Directive and 75 per cent in the years thereafter.</p> <p>Provided that, the total volume of RRE loans granted to Category II Borrowers with an LTV-O beyond that set in this paragraph shall not exceed 20 per cent of the total volume of RRE loans provided on a semi-annual basis.’</p>
<p>‘15. A credit institution shall assess the borrowers’ ability to service the RRE loan by applying a stressed DSTI-O of 40% limit, subject to an interest rate shock of 150 basis points for both Category I and Category II Borrowers. The stressed DSTI-O shall be calculated as follows:</p> $\text{DSTI-O}_{\text{stressed}} = \frac{(\text{Annual total debt service} \Delta r_{\text{stressed}})}{\text{Gross Income}}$ $\Delta r_{\text{stressed}} = +150 \text{ bp}$	<p>Respondents asked for a clarification as to whether the interest rate shock of 150 basis points will be ‘hardcoded’.</p>	<p>The interest rate shock is not hardcoded and may be reviewed from time to time to reflect changes in the market conditions and the existing monetary policy stance. The following provision has been included in the Directive to clarify this point:-</p> <p>‘13. A lender shall assess the ability of the borrower to service the RRE loan by applying a stressed DSTI-O of 40 per cent limit, subject to an interest rate shock of 150 basis points for both Category I and Category II Borrowers.</p> <p>The interest rate shock shall be reviewed subject to market conditions.</p> <p>The stressed DSTI-O shall be calculated as follows:</p>

		$DSTI-O_{stressed} = \frac{(\text{Annual total debt service} \Delta r_{stressed})}{\text{Gross Income}}$ $\Delta r_{stressed} = +150 \text{ bp}$
<p>‘8. A credit institution shall ensure that the LTV-O for Category I Borrowers shall not exceed the 90 per cent LTV-O;</p> <p>9. A credit institution shall ensure that the LTV-O ratio of an RRE loan for Category II Borrowers shall not exceed 85 per cent in the first year of the coming into force of this Directive and 75 percent in the years thereafter;’</p>	<p>Respondents proposed the following categories of borrowers:</p> <ul style="list-style-type: none"> • Category 1 for first time buyers - 90% LTV-O; • Category 2 for persons purchasing their second property – 85% LTV-O; • Category 3 for persons purchasing their third and subsequent properties and BTL loans – 75% LTV-O. 	<p>The categories will remain unchanged but the definition of ‘<i>Category I Borrowers</i>’ under paragraph 6(f) has been expanded by including also borrowers who are purchasing their primary residence in addition to pre-existing property, provided that they do not have any outstanding RRE loans. Furthermore, borrowers who have pending proceedings before the Civil Court (Family Section) which is hindering the sale of the primary residence are also classified under this Category of borrowers.</p>
<p>‘17. The maturity term at origination of an RRE loan provided for Category I Borrowers shall not exceed the horizon of 40 years or the official retirement age, whichever occurs first;</p> <p>18. The maturity term of an RRE loan provided for Category II Borrowers shall not exceed the horizon of 20 years or the official retirement age, whichever occurs first;’</p>	<p>In the light of the amendments proposed under paragraphs 8 and 9 to widen the applicable categories to 3, respondents proposed the following applicable maturity terms:</p> <ul style="list-style-type: none"> • Category 1 – 40 years; • Category 2 – 40 years; • Category 3 – 25 years. 	<p>The categories will remain unchanged but the maturity term for Category II borrowers has been extended from 20 years to 25 years. Accordingly, paragraph 16 of the Directive has been adjusted, as follows:</p> <p>‘16. The maturity term at origination of an RRE loan granted to Category II Borrowers shall not exceed the horizon of 25 years or the official retirement age, whichever occurs first.’</p>
<p>‘20. Credit institutions shall be required to assess their compliance with the Directive through an annual external audited self-assessment on the adherence to these measures. This without</p>	<p>Respondents proposed that in order to mitigate the costs due to the implementation of the measures, the annual audit exercise would be</p>	<p>In order to lessen the burden on lenders, the process of compliance with the Directive has been adjusted as follows:</p>

<p>prejudice to on-site and off-site supervision by the MFSA. The audited self-assessment is to be forwarded to the Bank;’</p>	<p>undertaken by banks’ internal audit departments rather than through external auditors.</p>	<p>‘18. Compliance with this Directive shall be verified annually by the internal auditor of the reporting lender and by an external auditor at the end of the financial year of the third year of application of the Directive and every third year, thereafter. This without prejudice to on-site and off-site inspection by the MFSA and that the Bank may request a report by the external auditor subject to its discretion to carry out its functions under the Act and under any other applicable legislation. The external and internal audit assessment is to be forwarded to the Bank and the MFSA.’</p>
<p>‘22. This Regulation shall enter into force upon publication.’</p>	<p>Respondents commented that the implementation of the Directive necessitate significant changes to banks’ IT set-ups in order to extract the information required for compliance with the provisions of the Directive. A six (6) month transitional period which would permit banks to carry out the necessary changes to their IT infrastructure was requested by the respondents.</p>	<p>A transitional period will be provided to allow banks to apply any changes to their IT set-ups. Accordingly, paragraph 20 has been amended, as follows: ‘20. This Directive shall enter into force on 1 July 2019.’</p>
<p>‘6. d) <i>‘Buy-to-Let (BTL) Housing’</i> means any RRE directly owned by a natural and/or a legal person/s primarily for letting to tenants;</p> <p>6. e) <i>‘Buy-to-Let (BTL) Loan’</i> means the sum of all loans or loan tranches secured by the borrower/s on the BTL housing at the moment of</p>	<p>Respondents proposed that BTL Housing/Loans should be divided into two components as follows:</p> <ol style="list-style-type: none"> 1. Individuals taking out a loan for BTL housing as well as for corporates taking out BTL loans 	<p>The objective of the Directive is to continue strengthening the resilience of lenders and borrowers against the potential build-up of vulnerabilities stemming from changing economic conditions. Lenders are still exposed to the same type of residential real estate risks regardless of the fact that the loan was taken up by an individual or</p>

<p>loan origination;’</p>	<p>when letting is not their main line of business and;</p> <p>2. Corporates who specialise in building up a portfolio of BTL properties. The latter should be excluded from the scope of the Directive since loans to such entities are considered as commercial loans.</p>	<p>a corporate.</p> <p>No distinction should be made among corporate types in terms of ‘<i>letting not their main line of business</i>’ vs ‘<i>specialising in BTL</i>’.</p> <p>Both individuals and corporates should have the same policy measures. Accordingly, the definition of the term ‘<i>Borrower</i>’ in paragraph 6(c) has been adjusted as follows:</p> <p>‘6. c) ‘<i>Borrower</i>’ means a natural and/or a legal person/s, who is granted an RRE loan and is receiving financing from the lender;’</p>
<p>‘6. k) ‘<i>Debt Service to Income Ratio at Origination</i>’ (DSTI-O) – means the annual total debt service relative to the borrower’s total annual gross income at the moment of loan origination;’</p>	<p>Respondents asked for a clarification on what is meant by the term ‘<i>annual total debt service</i>’ and whether alimony payments should be included.</p> <p>Respondents also proposed that each bank can follow its own policies as to what is meant by ‘<i>annual total debt service</i>’.</p>	<p>Paragraph 6 (a) of the Directive provides adequate definition of the annual total debt service. The definitions in the Directive will serve as minimum requirement but banks have the discretion to implement tighter provisions such as the inclusion of alimony payments across the board or on a case-by-case basis. For clarification purposes, a new definition of the term ‘<i>Debt</i>’ is included under paragraph 6(i), as follows:</p> <p>‘6. i) ‘<i>Debt</i>’ means the total committed secured and unsecured borrowing by a natural and/or legal person/s;’</p> <p>Definitions in the Directive should be harmonised among banks to ensure level playing field and close the possibility of different interpretations by the banks.</p>

<p>‘6. w) <i>‘Residential Real Estate’</i> – means any immovable property located in the domestic territory, available for RRE purposes, acquired, built or renovated by a private individual and that is not qualified as a CRE property;’</p>	<p>The proposed directive defines Residential Real Estate (RRE) as being <i>‘any immovable property located in the domestic territory, available for RRE purposes, acquired, built or renovated by a private individual and that is not qualified as a CRE property’</i>.</p> <p>Respondents proposed that the words <i>‘domestic territory’</i> are used whenever a definition includes Residential Real Estate (e.g. the definition Second Real Residential Estate does not include the words <i>‘domestic territory’</i>) as this would give way to a wide interpretation of the definition of RRE and as to its applicability.</p> <p>Respondents proposed that the term <i>‘domestic territory’</i> should be included in the following definitions:</p> <ul style="list-style-type: none"> i. Buy-to-Let (BTL) Housing; ii. Buy-to-Let (BTL) Loan, and iii. Commercial Real Estate (CRE). 	<p>The definition of <i>‘Residential Real Estate’</i> already makes reference to immovable property located in the domestic territory.</p> <p>The definition of <i>‘Residential Real Estate Loan’</i> makes reference to RRE which is explained further in paragraph 6(y), as follows:</p> <p>‘6. y) <i>‘Residential Real Estate Loan’</i> means a loan to a natural and/or legal person/s secured by RRE collateral;’</p>
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<p>‘7. Loans of Category I Borrowers with a collateral market value below EUR175,000 (excluding haircuts) are exempted from the LTV-O and DSTI-O limits specified in this Directive. Credit institutions shall still apply prudent lending policies in terms of the MFSA Notice on the Management of Credit Risk by Credit Institutions authorised under the Banking Act 1994 (BN/01/2002) in relation to loans of Category I Borrowers with collateral market value falling below EUR175,000 (excluding haircuts).’</p>	<p>Respondents proposed that the ceiling applicable for exemption from the LTV-O and DSTI-O limits specified in the draft Directive be increased to EUR250,000.</p>	<p>The proposed threshold by the respondents would dilute the impact of the borrower-based measures. However, the proposed threshold may be revised at the Authorities’ discretion.</p>
<p>‘10. A credit institution shall ensure that the total volume of RRE loans provided to Category I Borrowers with an LTV-O beyond the 90 per cent threshold does not exceed 10 per cent of the total volume of RRE loans provided to Category I Borrowers in a given quarter;</p> <p>11. A credit institution shall ensure that the total volume of RRE loans advanced for Category II Borrowers with an LTV-O beyond that set in paragraph 9 shall not exceed 20 per cent of the total volume of RRE loans provided in a given quarter;’</p>	<p>Respondents proposed the following:</p> <ul style="list-style-type: none"> i. A ‘<i>cure</i>’ period should be introduced so that if there are minor diversions, they can be remedied over the subsequent period; ii. The ‘<i>speed limit</i>’ should also be applied for the DSTI-O and maturity; iii. The speed limit ought to be set at 20% for all categories. 	<p>For each proposal, the Authorities’ views are expressed below:</p> <ul style="list-style-type: none"> i. The extension of the speed limit from a quarterly to a semi-annual basis provides adequate time for a lender to compensate for any divergences in a particular quarter; ii. The DSTI-O on a gross income basis is less restrictive than the DSTI-O on disposable income; iii. On the basis of internal studies conducted by the CBM, the speed limit of 10% to Category I Borrowers is deemed as sufficient.

<p>‘14. No additional collateral (financial and non-financial) besides that backing the RRE loan should be taken into account when calculating the LTV-O, except when exercising the speed limit;’</p>	<p>Respondents proposed that additional collateral ought to count for the calculation of the LTV-O.</p>	<p>The LTV-O definition as set in the Directive is in line with the ESRB definition of the ESRB Recommendation on Closing Real-Estate Data Gaps, which makes no reference to additional collateral.</p> <p>However, paragraph 14 (new paragraph 12) has been clarified further by including reference to both financial and non-financial collateral which should be utilized when exercising the speed limit.</p>
<p>‘15. A credit institution shall assess the borrowers’ ability to service the RRE loan by applying a stressed DSTI-O of 40% limit, subject to an interest rate shock of 150 basis points for both Category I and Category II Borrowers. The stressed DSTI-O shall be calculated as follows:</p> $\text{DSTI-O}_{\text{stressed}} = \frac{(\text{Annual total debt service} \Delta r_{\text{stressed}})}{\text{Gross Income}}$ $\Delta r_{\text{stressed}} = +150 \text{ bp}$	<p>Respondents proposed that the DSTI-O limit should vary depending on income brackets in such a way that the higher the income, the higher the limit.</p> <p>Clarification was requested as to whether the stressed rate (<i>interest rate shock</i>) is to be applied to the new loan only or on all prevailing loans, irrespective of the loan term involved.</p>	<p>The 40% stressed DSTI-O should apply to all income brackets as this level is deemed to be the maximum level or ceiling to which any individual borrower can extend himself/herself. Bank may still exercise their discretion to apply a lower stressed DSTI for higher risk borrowers.</p> <p>The stressed DSTI affordability test should be applied on all prevailing loans.</p>
<p>‘6. k) ‘<i>First-time Buyer</i>’ – means a borrower who acquired his/her first immovable RRE property;’</p>	<p>Respondents requested further clarification of the term ‘<i>First-time buyer</i>’ in view of a number of scenarios. These scenarios included the following:</p> <p><u>Scenario 1:</u> A customer who has a residence in</p>	<p><u>Scenario 1:</u> Based on the recent amendments to paragraph 6(f), if the secondary residence is for primary residence purposes and the customer who has already a property in his name has no outstanding RRE loans, then the RRE loan would be classified under Category I. However, if the purchase of the secondary residence is not for primary residence</p>

	<p>his/her name (with or without loan) but then seeks to obtain a loan in order to purchase a secondary residence jointly with another person who is a first time buyer;</p> <p><u>Scenario 2:</u> A customer who has a primary residence with no loans attached to it but then seeks to obtain a loan in order to purchase a summer residence;</p> <p><u>Scenario 3:</u> A customer who wants to move to another property to be his/her primary residence but retaining his/her first property as a secondary/summer residence.</p>	<p>purposes, then in this case, the RRE loan would be classified under Category II;</p> <p><u>Scenario 2:</u> This borrower is classified under Category II as the property purchased is a summer residence and it classifies under Category II;</p> <p><u>Scenario 3:</u> The definition of Category I borrowers has been amended as per paragraph 6 (f). If the borrower who is purchasing his primary residence has no outstanding RRE loans upon the signing of deed, the borrower would classify under Category I Borrowers. If, however, the borrower has an outstanding RRE loan and is obtaining another loan for the purchase of the primary residence and did not sell or did not provide any intention to sell his first property by entering into a signed promise of sale agreement, then the RRE loan would classify under Category II.</p>
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<u>Feedback by Respondents</u>	<u>Feedback by Authorities</u>
<p>Respondents proposed that the Directive does not apply to house loans granted by banks to their employees (staff loans).</p>	<p>Staff loans fall under the scope of the Directive. Lenders may consider granting staff benefits by applying lower interest rate/fees. This will manifest itself indirectly by a lower DSTI-O in which case lenders can extend a higher loan amount.</p>
<p>Respondents enquired whether credit institutions would still have an element of discretion in so far as the maturity of the loan is concerned.</p> <p>For example, would the banks be able to extend the term of the loan to the age of 70 but still within the maximum term of 40 years for a certain category of clients such as professionals?</p>	<p>The maturity limits are being harmonised for loans covered by the Directive. Thus, credit institutions may only set a lower maturity term than those stipulated in the Directive.</p>
<p>Would taking out a loan for the purchase of, for example furniture secured by a hypothec on the mortgaged property with a 90% LTV-O 'eat' into the speed limit?</p>	<p>The 90% LTV-O includes the purchasing of any furnishings which are secured by the same property. As specified in paragraph 6(t) of the Directive, the LTV-O includes the sum of all loans or loans tranches secured by the borrower on the immovable property. Furthermore, the speed limit is set on a volume basis.</p>
<p>Is a loan for the purchase of a garage situated close to a (primary) residence and used by the client for his/her own purposes, considered also as Category I?</p>	<p>The purchase of a garage on its own does not fall under the scope of the Directive.</p>
<p>There may be cases where a customer who had in the past taken out a house loan but has paid off his/her dues and are currently unencumbered and now seek to apply for a new house loan. Would this borrower be classified as a Category I borrower?</p>	<p>Based on the recent amendments to paragraph 6(f), if the new residence is for primary residence purposes, then the RRE loan would be classified under Category I. However, if the purchase of the secondary residence is not for primary residence purposes, in this case, the RRE loan would be classified under Category II.</p>

5. Conclusion and Way Forward

After taking into consideration the feedback received from the industry, the amended Directive was forwarded for approval to the JFSB and will become effective and binding on 1 July 2019. The Directive will be published on the Bank's website on 29 March 2019, together with this Feedback Statement.

Unchanged Text
Amended Text
New Insertions

Annex 1 – Amendments to the Directive following the Public Consultation

<u>Published Draft Directive for Consultation</u>	<u>Revised Text following Public Consultation</u>
<p>Introduction</p> <p>1. In terms of Article 17A of the Central Bank of Malta Act (Cap. 204) (hereinafter referred to as ‘the Act’), the Central Bank of Malta (hereinafter referred to as ‘the Bank’) is empowered to issue directives in order to develop macroprudential tools and implement macroprudential policy;</p>	<p>Introduction</p> <p>1. In terms of Article 17A of the Central Bank of Malta Act (<i>Cap. 204 of the Laws of Malta</i>) (hereinafter referred to as ‘the Act’), the Central Bank of Malta (hereinafter referred to as ‘the Bank’) is empowered to issue directives in order to develop macroprudential tools and implement macroprudential policy.</p>
<p>Objective of the Directive</p> <p>2. In accordance with Directive 11, the objective of macroprudential policy shall be to contribute to the safeguard of the stability of the financial system as a whole, primarily by strengthening the resilience of the financial system and decreasing the build-up of systemic risk, thereby ensuring a sustainable contribution of the financial sector to economic growth;</p> <p>3. The objective of the Directive is to strengthen the resilience of banks and borrowers against the potential build-up of vulnerabilities which could result in financial losses to both banks and borrowers stemming from potential unfavourable economic developments;</p>	<p>Objective of the Directive</p> <p>2. In accordance with Directive No 11, the objective of macroprudential policy shall be to contribute to the safeguard of the stability of the financial system as a whole, primarily by strengthening the resilience of the financial system and decreasing the build-up of systemic risk, thereby ensuring a sustainable contribution of the financial sector to economic growth.</p> <p>3. The objective of the Directive is to strengthen the resilience of banks lenders and borrowers against the potential build-up of vulnerabilities which could result in financial losses to both banks-lenders and borrowers stemming from potential unfavourable economic developments.;</p>
<p>New paragraph 3 (a)</p>	<p>3a. The limits imposed in this Directive shall act as a minimum standard. Lenders may adopt their existing internal credit risk assessment policies subject that these are not in breach of the Directive.</p>
<p>Scope and Application</p> <p>4. The Directive shall apply to all credit institutions authorised under the Banking Act 1994 (Cap. 371 of the Laws of Malta) on a solo basis;</p> <p>5. The Directive shall target both resident and non-resident borrowers entering into new residential real estate (RRE) loans secured by RRE;</p>	<p>Scope and Application</p> <p>4. The Directive shall apply to- all lenders granting domestic residential real estate (RRE) loans-credit institutions authorised under the Banking Act 1994 (Cap. 371 of the Laws of Malta) on a solo basis.;</p> <p>5. The Directive shall target-apply to both resident and non-resident borrowers entering into new residential real estate (RRE) loans secured by RRE.;</p>

Definitions	Definitions
<p>6. The following definitions shall apply for the purposes of this Directive:</p> <p>a) ‘Annual Repayment’ – includes the combined interest and principal repayments on a borrower’s total debt over one year;</p>	<p>6. The following definitions shall apply for the purposes of this Directive:</p> <p>a) ‘Annual Repayment <u>Total Debt Service</u>’ —includes<u>means</u> the combined interest and principal repayments on <u>the total debt of the</u> borrower/²s total debt over one year;</p>
<p>b) ‘Bank’ – means the Central Bank of Malta established by Article 3 of the Act;</p>	<p>b) ‘Bank’ —means the Central Bank of Malta <u>as</u> established by Article 3 of the Act;</p>
<p>c) ‘Borrower’ – means the signatory, or cosignatory, of a RRE loan contract and receiving financing from the lender;</p>	<p>c) ‘Borrower’ —means <u>a natural and/or legal person/s, the signatory, or cosignatory, of who is granted an</u> RRE loan contract and <u>is</u> receiving financing from the lender;</p>
<p>d) ‘Buy-to-Let (BTL) Housing’ – means any RRE directly owned by a private natural and legal persons primarily for letting to tenants;</p>	<p>d) ‘Buy-to-Let (BTL) Housing’ – means any RRE directly owned by a <u>private</u>-natural and <u>/or a</u> legal person/s primarily for letting to tenants;</p>
<p>e) ‘Buy-to-Let (BTL) Loan’ – means the sum of all loans or loan tranches secured by the borrower on the BTL housing at the moment of loan origination;</p>	<p>e) ‘Buy-to-Let (BTL) Loan’ – means the sum of all loans or loan tranches secured by the borrower/<u>s</u> on the BTL housing at the moment of loan origination;</p>
<p>f) ‘Category I Borrowers’ – comprises first-time buyers (FTBs) and non-FTBs purchasing their primary residence;</p>	<p>f) ‘Category I Borrowers’ comprises <u>means</u> first-time buyers (FTBs) and non-FTBs purchasing their primary residence <u>as defined in Paragraph 6(x), not having outstanding RRE loans upon the signing of the deed, and includes borrowers who already own or have owned a primary residence, and at the origination of the mortgage loan such primary residence has either already been sold or a promise of sale agreement (‘konvenju’) has been entered into or there are pending proceedings before the Civil Court (Family Section) which hinder the sale of the primary residence;</u></p>
<p>g) ‘Category II Borrowers’ – any other loan to purchase an RRE excluding Category I Borrowers. This category comprises borrowers purchasing their second or additional RRE and natural and legal persons borrowing for BTL purposes;</p>	<p>g) ‘Category II Borrowers’ <u>means</u>— any other loan to purchase an RRE excluding Category I Borrowers. This category comprises borrowers purchasing their second or additional RRE and natural and legal persons borrowing for BTL purposes;</p>
<p>h) ‘Credit Institution’ – has the same meaning assigned to it by Article 2 of the Act;</p>	<p>h) ‘Credit Institution’— has the same meaning assigned to it by Article 2 of the Act;</p>
<p>i) ‘Commercial Real Estate (CRE)’ – means any income-producing real estate, either existing or under development, and excludes (i) social</p>	<p>h) ‘Commercial Real Estate (CRE)’ – means any income-producing real estate <u>located in the domestic territory</u>, either existing or under</p>

housing; (ii) property owned by end-users; and (iii) BTL housing;	development, and excludes (i) social housing; (ii) residential property owned by end-users; and (iii) BTL housing;
New definition of the term ‘debt’	i) ‘Debt’ means the total committed secured and unsecured borrowing by a natural and/or legal person/s;
j) ‘Debt Service to Income Ratio at Origination’ (DSTI-O) – means the annual total debt service relative to the borrower’s total annual gross income at the moment of loan origination;	j) ‘Debt Service to Income Ratio at Origination’ (DSTI-O) – means the annual total debt service relative to the borrower’s total annual gross income of the borrower/s at the moment of loan origination;
New definition of ‘Directive No. 11’	k) ‘Directive No 11’ means the Central Bank of Malta Directive No 11 on ‘Macro-prudential Policy’ ;
New definition of the term ‘end-users’	l) ‘End-users’ means a natural and/or legal person/s owning and occupying an RRE property;
k) ‘First-time Buyer’ – means a borrower who acquired his/her first immovable RRE property;	m) ‘First-time Buyer’ – means a borrower/s who acquired his/her first immovable RRE property;
l) ‘Gross Income’ – means the total monetary income received by the household over a specified income reference period, before deduction of income tax, regular taxes on wealth, employees’ or self-employed social security contribution and any recurrent sources of income. For joint loan accounts, income should include the joint gross income, unless the bank decides otherwise at loan evaluation stage. For BTL loans, rental income derived from the mortgage-backed property shall not be considered as gross income for the purpose of this Directive;	n) ‘Gross Income’ means the total annual monetary income received by the household borrower/s over a specified income reference period, which is stable and recurrent, including actual rental income before deduction of income tax, regular taxes on wealth, employees’ or self-employed social security contribution, including the gross income for joint loan accounts, the gross income for BTL loans and the gross income for corporates, and any recurrent sources of income
New definition of the term ‘Gross Income for Joint Loan Accounts’	o) ‘Gross Income for Joint Loan Accounts’ means income which includes the joint gross income, unless the lender decides otherwise at the loan evaluation stage;
New definition of the term ‘Gross Income for BTL loans’	p) ‘Gross Income for BTL loans’ means the prospective rental income to be derived from the mortgage-backed property supported by adequate and sufficient supporting documentation, provided that such rental income shall be subject to haircuts in accordance with the internal policy of the lender;
New definition of the term ‘Gross Income for Corporates’	q) ‘Gross Income for Corporates’ means income that is calculated on the basis of Earnings before Interest, Taxes, Depreciation and Amortisation (EBITDA);
New definition of the term ‘lender’	r) ‘Lender’ means a regulated financial service provider licenced by the Malta Financial Services Authority that provides an RRE loan to a borrower/s;

m) 'Loan' – means the total amount made available to the borrower by means of a contract for the purchase, improvement and/or finishing of an RRE which is backed by the said RRE;	s) 'Loan' – means the total amount made available to the borrower/s by means of a contract for the purchase, improvement and/or finishing of an RRE which is backed -secured by the said RRE;
n) 'Loan-to-Value Ratio at Origination (LTV-O)' – the sum of all loans or loan tranches secured by the borrower on the immovable property at the moment of loan origination relative to the market value of the property at the moment of loan origination;	t) 'Loan-to-Value Ratio at Origination (LTV-O)' – means -the sum of all loans or loan tranches secured by the borrower/s on the immovable property at the moment of loan origination relative to the market value of the property at the moment of loan origination;
o) 'Market Value of the Property' – has the same meaning as assigned to it in point (76) of Article 3 of the Capital Requirements Regulation (Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012);	u) 'Market Value of the Property' <u>means, for the purposes of immovable property, the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without being under compulsion;</u>
p) 'Maturity at Origination' – the duration of the RRE loan contract expressed in years at the moment of loan origination;	v) 'Maturity at Origination' means the duration of the RRE loan contract expressed in years at the moment of loan origination;
New definition of the term 'MFSA'	w) 'MFSA' means the Malta Financial Services Authority as established by Article 3 of <u>Malta Financial Services Authority Act (Cap. 330 of the Laws of Malta);</u>
q) 'Non-First Time Buyers purchasing their Primary Residence' – means a borrower who already owns or owned a primary residence and intends to sell or sold his/her primary residence;	q) 'Non-First Time Buyers purchasing their Primary Residence'—means a borrower who already owns or owned a primary residence and intends to sell or sold his/her primary residence;
r) 'Primary Residence' – means the RRE in which an individual habitually resides in or intends to habitually reside in as his/her principle place of abode;	x) 'Primary Residence' means the RRE in which an individual habitually resides in or intends to habitually reside in as his/her principle place of abode;
s) 'Residential Real Estate Loan' – means a loan to a private individual secured by RRE collateral;	y) 'Residential Real Estate Loan' means a loan to a private individual <u>natural and/or legal person/s</u> secured by RRE collateral;
t) 'Residential Real Estate' – means any immovable property located in the domestic territory, available for RRE purposes, acquired, built or renovated by a private individual and that is not qualified as a CRE property;	z) 'Residential Real Estate' means any immovable property located in the domestic territory, available for RRE purposes, acquired, built or renovated by a private individual <u>natural and/or legal person/s</u> and that is not qualified as a CRE property;
u) 'Second Residential Real Estate' – means property classified as residence other than primary residence and includes summer residence, vacant property, or BTL property;	aa) 'Second Residential Real Estate'—means property classified as residence other than primary residence and includes summer residence, vacant property, or BTL property;
v) 'Speed Limit' – restricts the share of new RRE lending at LTV-O over the thresholds stipulated in this Directive;	aa*) 'Speed Limit' restricts the share <u>means the restriction of the volume (in terms of number of loans)</u> of new RRE lending at LTV-O over the

	thresholds stipulated in this Directive;
New provision inserted	Unless otherwise defined in this Directive, terms used in this Directive shall have the same meaning as are assigned to them under the Act.
Exemptions 7. Loans of Category I Borrowers with a collateral market value below EUR175,000 (<i>excluding haircuts</i>) are exempted from the LTV-O and DSTI-O limits specified in this Directive. Credit institutions shall still apply prudent lending policies in terms of the MFSA Notice on the Management of Credit Risk by Credit Institutions authorised under the Banking Act 1994 (BN/01/2002) in relation to loans of Category I Borrowers with collateral market value falling below EUR175,000 (excluding haircuts);	Exemptions 7. Loans of Category I Borrowers with a collateral market value below EUR175,000 (<i>excluding haircuts</i>) are exempted from the LTV-O and DSTI-O limits specified in this Directive. <u>Provided that, Credit institutions lenders</u> shall still apply prudent lending policies in terms of the <u>MFSA Banking Notice on the Management of Credit Risk by Credit Institutions</u> authorised under the Banking Act 1994 (BN/01/2002), in relation to loans of Category I Borrowers with collateral market value falling below EUR175,000 (excluding haircuts);
Borrower-Based Measures Compliance with LTV-O Limits for New Residential Real Estate Loans 8. A credit institution shall ensure that the LTV-O for Category I Borrowers shall not exceed the 90 per cent LTV-O; 10. A credit institution shall ensure that the total volume of RRE loans provided to Category I Borrowers with an LTV-O beyond the 90 per cent threshold does not exceed 10 per cent of the total volume of RRE loans provided to Category I Borrowers in a given quarter;	Borrower-Based Measures Compliance with LTV-O Limits for New Residential Real Estate Loans 8. A <u>credit institution lender</u> shall ensure that the LTV-O <u>ratio of an RRE</u> for Category I Borrowers shall not exceed the 90 per cent LTV-O. ; 10. Provided that, A credit institution shall ensure that the total volume of RRE loans <u>provided granted</u> to Category I Borrowers with an LTV-O beyond the 90 per cent threshold, does not exceed 10 per cent of the total volume of RRE loans <u>provided granted</u> to Category I Borrowers in <u>on a given quarter semi-annual basis.;</u>
9. A credit institution shall ensure that the LTV-O ratio of an RRE loan for Category II Borrowers shall not exceed 85 per cent in the first year of the coming into force of this Directive and 75 percent in the years thereafter; 11. A credit institution shall ensure that the total volume of RRE loans advanced for Category II Borrowers with an LTV-O beyond that set in paragraph 9 shall not exceed 20 per cent of the total volume of RRE loans provided in a given quarter;	9. A <u>credit institution lender</u> shall ensure that the LTV-O ratio of an RRE loan for Category II Borrowers shall not exceed 85 per cent in the first year of the coming into force of this Directive and 75 percent in the years thereafter. ; 11. Provided that, A credit institution shall ensure that the total volume of RRE loans <u>advanced for granted to</u> Category II Borrowers with an LTV-O beyond that set in <u>this</u> paragraph 9 shall not exceed 20 per cent of the total volume of RRE loans provided in on <u>on a given quarter semi-</u>

	annual basis. ;
12. Credit institutions shall follow established prudent credit risk management practices when exercising the speed limits;	102. Credit institutions Lenders shall follow established prudent credit risk management practices when exercising the speed limits.;
13. For the purposes of calculating the LTV-O, credit institutions shall determine the collateral value in a prudent and conservative manner in accordance with paragraphs 11-14 of the MFSA Banking Rule on the Measures addressing credit risks arising from the assessment of the quality of asset portfolios of credit institutions authorised under the Banking Act 1994 (BR/09/2016);	113. For the purposes of calculating the LTV-O, credit institutions lenders shall determine the collateral value in a prudent and conservative manner in accordance with paragraphs 11, 12, 13 -and 14 of the MFSA Banking Rule on the Measures addressing credit risks arising from the assessment of the quality of asset portfolios of credit institutions authorised under the Banking Act 1994 (BR/09/2016) .
14. No additional collateral (financial and non-financial) besides that backing the RRE loan should be taken into account when calculating the LTV-O, except when exercising the speed limit;	124. In calculating the LTV-O, only the RRE backing the loan should be considered. Without prejudice to the above provision, No additional collateral (financial and non-financial) besides that backing the RRE loan should be taken into account when calculating the LTV-O, except shall be requested by the lender when exercising the speed limit is exercised. ; Provided that, such additional collateral shall be in accordance with the internal policies of the lender.
<u>Compliance with DSTI-O Limits for New Residential Real-Estate Loans</u>	<u>Compliance with DSTI-O Limits for New Residential Real Estate Loans</u>
15. A credit institution shall assess the borrowers' ability to service the RRE loan by applying a stressed DSTI-O of 40% limit, subject to an interest rate shock of 150 basis points for both Category I and Category II Borrowers. The stressed DSTI-O shall be calculated as follows:	135. A credit institution lender shall assess the ability of the borrower/s- ability to service the RRE loan by applying a stressed DSTI-O of 40 per cent % limit, subject to an interest rate shock of 150 basis points for both Category I and Category II Borrowers. The interest rate shock shall be reviewed subject to market conditions. The stressed DSTI-O shall be calculated as follows:

$\text{DSTI-O}_{\text{stressed}} = \frac{(\text{Annual total debt service} \Delta r_{\text{stressed}})}{\text{Gross Income}}$ $\Delta r_{\text{stressed}} = +150 \text{ bp}$	$\text{DSTI-O}_{\text{stressed}} = \frac{(\text{Annual total debt service} \Delta r_{\text{stressed}})}{\text{Gross Income}}$ $\Delta r_{\text{stressed}} = +150 \text{ bp}$
<p>16. A credit institution shall identify the total amount of the borrower's debt servicing when applying the affordability test specified in para 15 of this Directive;</p>	<p>146. A credit institution lender shall identify the total amount of the borrower/s debt servicing of the borrower/s when applying the affordability test as specified stipulated in paragraph 135 of this Directive;</p>
<p>Compliance with Maturity Limits for <u>All</u> New Residential Real-Estate Loans</p> <p>17. The maturity term at origination of an RRE loan provided for Category I Borrowers shall not exceed the horizon of 40 years or the official retirement age, whichever occurs first;</p>	<p>Compliance with Maturity Limits for <u>All</u> New Residential Real-Estate Loans</p> <p>157. The maturity term at origination of an RRE loan provided for granted to Category I Borrowers shall not exceed the horizon of 40 years or the official retirement age, whichever occurs first.;</p>
<p>18. The maturity term of an RRE loan provided for Category II Borrowers shall not exceed the horizon of 20 years or the official retirement age, whichever occurs first;</p>	<p>168. The maturity term at origination of an RRE loan provided for granted to Category II Borrowers shall not exceed the horizon of 250 years or the official retirement age, whichever occurs first.;</p>
<p>19. The official retirement age referred to in paragraphs 17 and 18 of this Directive is based on the statutory pension age as follows:</p> <p>a. In the case of a person born during the years 1952 to 1955: the pension age shall be 62 years;</p> <p>b. In the case of a person born during the years 1956 to 1958: the pension age shall be 63 years;</p> <p>c. In the case of a person born during the years 1959 to 1961: the pension age shall be 64 years;</p> <p>d. In the case of a person born after 1961 the pension age shall be 65 years;</p>	<p>179. The official retirement age referred to in paragraphs 157 and 168 of this Directive is based on the statutory pension age as follows:</p> <p>a. In the case of a person born during the years 1952 to 1955: the pension age shall be 62 years;</p> <p>b. In the case of a person born during the years 1956 to 1958: the pension age shall be 63 years;</p> <p>c. In the case of a person born during the years 1959 to 1961: the pension age shall be 64 years;</p> <p>d. In the case of a person born after 1961 the pension age shall be 65 years.;</p>

Summary of Borrower-Based Measures as specified in Articles 8-19

	LTV-O	DSTI-O	Maturity
<u>Category I Borrowers</u>	90% LTV-O cap with a 'speed limit' of 10% on the volume of loans, for loans with a market value in excess of EUR175,000	A stressed DSTI-O of 40% for loans with a market value in excess of EUR175,000 with a shock to interest rates of 150 bps	A maturity term of 40 years or the official retirement age – whichever occurs first: 1952 – 1955: 62 years 1956 – 1958: 63 years 1959 – 1961: 64 years Born after 1961: 65 years
<u>Category II Borrowers</u>	<u>Gradual Phase-in:</u> <u>1st year:</u> 85% LTV-O cap with a 'speed limit' of 20% on the volume of loans <u>2nd year:</u> 75% LTV-O cap with a 'speed limit' of 20% on the volume of loans	A stressed DSTI-O of 40% with a shock to interest rates of 150 bps	A maturity term of 20 years or the official retirement age – whichever occurs first: 1952 – 1955: 62 years 1956 – 1958: 63 years 1959 – 1961: 64 years Born after 1961: 65 years

Summary of Borrower-Based Measures as specified in Articles 8-17

	LTV-O	DSTI-O	Maturity
<u>Category I Borrowers</u>	90% LTV-O cap with a 'speed limit' of 10% on the volume of loans, for loans with a market value in excess of EUR175,000	A stressed DSTI-O of 40% for loans with a market value in excess of EUR175,000 with a shock to interest rates of 150 bps	A maturity term of 40 years or the official retirement age – whichever occurs first: 1952 – 1955: 62 years 1956 – 1958: 63 years 1959 – 1961: 64 years Born after 1961: 65 years
<u>Category II Borrowers</u>	<u>Gradual Phase-in:</u> <u>1st year:</u> 85% LTV-O cap with a 'speed limit' of 20% on the volume of loans <u>2nd year:</u> 75% LTV-O cap with a 'speed limit' of 20% on the volume of loans	A stressed DSTI-O of 40% with a shock to interest rates of 150 bps	A maturity term of 205 years or the official retirement age – whichever occurs first: 1952 – 1955: 62 years 1956 – 1958: 63 years 1959 – 1961: 64 years Born after 1961: 65 years

Assessment of Compliance with the Regulations

20. Credit institutions shall be required to assess their compliance with the Directive through an annual external audited self-assessment on the adherence to these measures. This without prejudice to on-site and off-site supervision by the MFSA. The audited self-assessment is to be forwarded to the Bank;

21. Non-compliance with the requirements set out in this Directive shall be subject to administrative penalties imposed by the Bank in terms of

Assessment of Compliance with the Regulations

~~1280. Credit institutions shall be required to assess their eCompliance with the this Directive shall be verified through an annually by the internal auditor of the reporting lender and by an external auditor at the end of the financial year of the third year of application of the Directive and every third year, thereafter. self assessment on the adherence to these measures.~~ This without prejudice to on-site and off-site ~~supervision inspection~~ by the MFSA ~~and that the Bank may request a report by the external auditor subject to its discretion to carry out its functions under the Act and under any other applicable legislation.~~ The ~~external and internal audited self-~~assessment is to be forwarded to the Bank ~~and the MFSA.;~~

~~1924. In case of breaches of this Directive, the Bank shall have the right to Non-compliance with the requirements set out in this Directive shall~~

Article 56 of the Act;	be subject to administrative penalties imposed <u>sanctions in accordance with by the Bank in terms of Article 56 of the Act and the provisions of Directive No 12 on Administrative Measures and Penalties for Infringement under the Central Bank of Malta Act.;</u>
Final Provisions	Final Provisions
22. This Regulation shall enter into force upon publication.	202. This Regulation-Directive shall enter into force upon publication on <u>1 July 2019.</u>
New paragraph 21	21. The Directive may be amended subject to the prevailing developments in market conditions.