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INTERIM FINANCIAL STABILITY REPORT 2019

The *Interim Report* covers the first six months of 2019 and evaluates developments which may impact the resilience of the domestic financial system since the publication of the *Financial Stability Report* 2018. It also analyses whether any new risks have emerged.[1] The *Interim Financial Stability Report* is prepared by the Financial Stability Department and is subsequently reviewed and endorsed by the Financial Stability Committee of the Central Bank of Malta.

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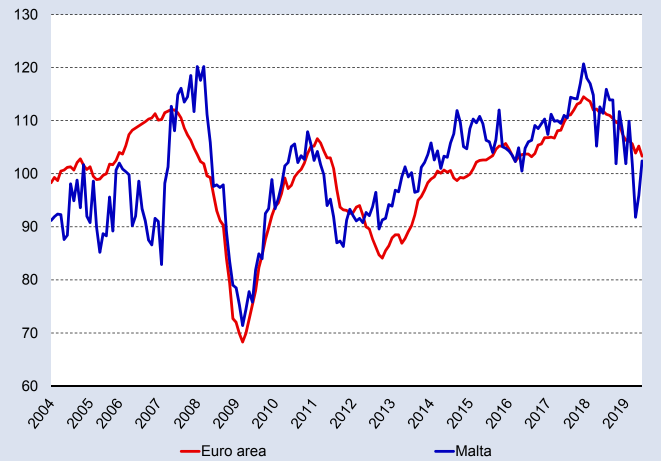
Introduction

Global economic activity weakened further reflecting a confluence of factors including rising trade tensions affecting business sentiment, prolonged uncertainty surrounding Brexit, and weaker fiscal and structural reform in some euro area countries. Although growth in some advanced economies surpassed expectations, this was overshadowed by slower activity in emerging and developing economies. Against this backdrop, downside risks to the euro area's economy remained elevated with economic sentiment abating, also on the back of lower industrial confidence (see Chart 1). The euro area economy is projected to continue expanding, albeit at a slower pace than previously anticipated and lower than in 2018.

In view of the current low and declining inflation rate in the euro area, the European Central Bank (ECB) cut the interest rate on the deposit facility in September 2019 by 10 basis points to -0.50%. In addition, the ECB reactivated the Asset Purchase Programme (APP) as from November to reinforce the accommodative impact of its policy rates. The prolonged low interest rate environment may induce search-for-higher-yield behaviour for some institutions in a period when valuations in certain markets remain stretched. An abrupt reassessment of global risk premia therefore remains a risk, also reflecting a weaker economic outlook and geopolitical uncertainty. On the upside, the current favourable financing conditions continue to mitigate short-term public debt sustainability

Chart 1
ECONOMIC SENTIMENT INDICATOR



Source: European Commission.

[1] The cut-off date for the analysis is 6 September 2019.

concerns, though renewed economic, political and policy uncertainties may exert pressure on more vulnerable countries.

Despite a challenging international environment, the stability and resilience of the domestic financial system persisted throughout the first half of 2019, supported by a buoyant economy. Indeed, although economic growth is forecasted to moderate, the Maltese economy is still expected to maintain a relatively strong pace. Stress test results also reaffirmed that the Maltese banking system is resilient to a weakening economic environment, with capital levels remaining above regulatory minima.

Core domestic banks have historically outperformed their European peers but pressures on profitability will persist on the back of the prolonged low interest rate environment and increasing regulatory and administrative expenses such as costs related to implementing mechanisms to detect and prevent fraudulent activities, in a bid to address rising operational risks. At the same time, these banks have managed to increase their income from intermediation on the back of higher lending volumes and generally stable interest rate margins. Core domestic banks have also tapped into other sources of income, with the share of non-interest income to gross income remaining relatively stable.

Credit by core domestic banks grew, largely driven by resident mortgages, although lending to private corporates has recovered and is also growing. Despite this positive sentiment, banks kept conservative lending standards.

Credit risk in the banking sector abated further, supported by improved creditworthiness of borrowers on the back of a growing economy, as well as active efforts by banks to enhance their balance sheets. As a result, the NPL ratios of the domestic banking sector decreased considerably in recent years. Furthermore, banks remained generally well-capitalised and continued to operate with ample liquidity buffers, also reflecting the rising inflows of customer deposits.

Risks stemming from the domestically-relevant insurance companies remained contained as they continued to operate on the basis of strong capital buffers and ample liquidity. A prolonged low yield environment remains a key challenge for the insurance sector and this will continue to put pressure on profitability. Similarly, the domestically-relevant investment funds remained prudent and continued to adopt a conservative investment strategy.

In general, the financial sector in Malta remained sound with most potential risks and vulnerabilities arising from the current international economic and financial environment. Going forward, risk to performance could intensify due to the increased competition from other market players coupled with a fragile external environment and risks in the event of prolonged current domestic uncertainties. Banks are encouraged to maintain prudent lending practices while at the same time continue with their efforts in addressing legacy non-performing loans. As the low interest rate environment will continue to adversely affect profitability, banks should continue to seek alternative income sources to limit these negative effects though the search-for-yield behaviour should remain in check. At the same time institutions should improve on their cost efficiencies. This must be carried out on the back of sound governance structures and prudent business models, without compromising capital and liquidity buffers.

Table 1 presents the key vulnerabilities of the domestic financial sector together with the changes in risk levels since the *Financial Stability Report* 2018, coupled with the risk outlook for the second half of 2019.

Table 1
SUMMARY OF RISKS

Main vulnerabilities and risks for the financial system	Type of risk	Nature of risk	Change in risk level since FSR 2018	Risk assessment for 2019 H2
Vulnerabilities within the financial system				
The level of non-performing loans	Credit	Cyclical/ Structural	↔	↔
Concentration in sectoral lending	Credit	Structural	↑	↔
Developments in bank credit	Credit	Cyclical/ Structural	↔	↔
Interlinkages between banks and the non-bank financial sector	Contagion	Structural	↔	↔
Operational risk	Contagion/Profitability	Structural	↑	↔
Domestically-relevant Insurances	Liquidity/Solvency/ Profitability	Cyclical/ Structural	↔	↑
Domestically-relevant Investment funds	Credit/Solvency/ Profitability	Cyclical/ Structural	↔	↑
Vulnerabilities outside the financial system				
Domestic macroeconomic developments	Credit/Profitability	Cyclical	↔	↔
Real estate market developments	Credit/Contagion	Cyclical	↔	↔
Exposures of the financial sector to domestic sovereign securities	Profitability	Structural	↔	↔
Economic conditions in the euro area and public debt sustainability	Credit/Profitability	Cyclical	↑	↑
Geopolitical uncertainties	Contagion	Structural	↔	↔
Prolonged low interest rate environment	Profitability	Cyclical	↑	↑
Reversal in risk premia	Profitability	Cyclical	↔	↔

Risk position		Direction of risk	
Moderate	(yellow)	Increased risk	↑
Medium	(orange)	Stable risk	↔
Elevated	(red)	Decreased risk	↓

The Policy Response

Local and supranational Authorities continued to take steps to address potential vulnerabilities in the financial system. The following include the main measures which address both cyclical and structural risks.

Borrower-based measures

On 29 March 2019, the Central Bank of Malta published Directive No. 16 on the regulation on Borrower-based measures (BBMs) with an effective date of 1 July 2019, as a pre-emptive response to the momentum in the residential real-estate (RRE) market.[2] The Directive is complementary to the current lenders' credit risk management practices and is not intended to replace the lenders' existing internal credit risk assessment policies. Lenders may adopt stricter lending limits according to their current credit risk policies, provided that such limits comply with the Directive. In this respect, the Directive seeks to consolidate these banking practices with the aim to achieve minimum standards that are now binding on lenders and no longer based on voluntary practices. This policy response by the Authorities is expected to strengthen the resilience of both lenders and borrowers against a potential build-up of vulnerabilities stemming from the real estate market.

Public consultation on the revised methodology for the identification of other systemically important institutions (O-SIIs) and the related capital buffer calibration

Following a recommendation from the Joint Financial Stability Board (JFSB), the Central Bank of Malta in conjunction with the Malta Financial Services Authority (MFSA) published a public consultation on a

[2] Directive No. 16: Regulation on Borrower-Based Measures https://www.centralbankmalta.org/file.aspx?f=72401

revised methodology for the identification of other systemically important institutions (O-SIIs) and the related capital buffer calibration.[3] This consultation paper proposes a new framework for the O-SII identification methodology, aiming to reflect better recent developments in the domestic financial sector. In addition, the new framework further aligns the domestic O-SII methodology with the European Banking Authority (EBA) Guidelines.[4]

The revised methodology aims to identify domestic systemically important institutions on the basis of their domestic relevance across a number of distinct characteristics – namely size, importance, complexity and interconnectedness. Furthermore, a revised capital buffer calibration methodology is being proposed, whereby O-SIIs will be allocated to different buckets attracting diverse buffer rates, subject to pre-determined thresholds and criteria. A public consultation on the revised methodology was launched on 25 October 2019 with a deadline for feedback set for the 8 November. The revised methodology is envisaged to come into force from January 2020.

Countercyclical capital buffer

The Central Bank of Malta maintained the CCyB rate at 0% for the fourth quarter of 2019 on the basis that cyclical risks remained contained.[5] The relevant credit-to-GDP ratio stood at 75.9% and its deviation from the long-term trend remained in negative territory, reaching -18.5 percentage points. Moreover, all the relevant quantitative and qualitative information utilised by the Central Bank of Malta as part of its assessment does not indicate any signs of excessive credit growth.

Identification of material third countries

In line with ESRB Recommendation 2015/1, the Central Bank of Malta identifies, on an annual basis, material third countries to which the domestic banking sector is exposed.[6] As per the methodology outlined in Article 4 of the ESRB Decision 2015/3, the third countries identified as material for the Maltese banking system for the period 2019 Q2 till 2020 Q2 remain similar to the previous year – namely, United Arab Emirates, the Russian Federation, the Republic of Turkey and the United States of America.[7]

Macroprudential policy reciprocity

The 2015 *ESRB Recommendation on the assessment of cross-border effects of and voluntary reciprocity for macroprudential measures (ESRB/2015/2)* has the objective to coordinate macroprudential policy across the EU and thus mitigate cross-border spillover effects.[8] During 2019, the Central Bank of Malta decided not to reciprocate the Belgian, Finnish and Swedish measures recommended for reciprocation by the ESRB. These measures were intended for institutions which operate an internal rating-based model, and hence were not applicable to Maltese banks which apply a standardised formula approach.[9,10] Furthermore, domestic credit institutions have no material exposures towards these countries' respective markets.

[3] https://www.centralbankmalta.org/file.aspx?f=82622

[4] https://eba.europa.eu/sites/default/documents/files/documents/10180/930752/964fa8c7-6f7c-431a-8c34-82d42d112d91/EBA-GL-2014-10%20(Guidelines%20on%20O-SIIs%20Assessment).pdf.

[5] Central Bank of Malta CCyB assessment for 2019Q3 (June 2019). Source: https://www.centralbankmalta.org/countercyclical-capital-buffer

[6] ESRB/2015/1: Recommendation of the ESRB of 11 December 2015 on recognising and setting countercyclical buffer rates for exposures to third countries. Source: https://www.esrb.europa.eu/pub/pdf/recommendations/ESRB_2015_1.en.pdf?f368460c8363b65bdd86658d608b7bec

[7] ESRB/2015/3: Decision of the ESRB of 11 December 2015 on the assessment of materiality of third countries for the Union's banking system in relation to the recognition and setting of countercyclical buffer rates. Source: https://www.esrb.europa.eu/pub/pdf/other/Decision_ESRB_2015_3.pdf

[8] ESRB/2015/2: Recommendation of the ESRB of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures. Source: https://www.esrb.europa.eu/pub/pdf/recommendations/2015/ESRB_2015_2.en.pdf

[9] Institutions which operate an internal rating-based model are allowed to use their own estimated risk parameters for the purpose of calculating regulatory capital.

[10] A standardised formula approach entails a set of credit risk measurement techniques proposed under Basel II capital adequacy rules for banking institutions. Under this approach, banks are required to use ratings from External Credit Rating Agencies to quantify required capital for credit risk.

Main MFSA regulatory notices and decisions

MFSA Fintech Strategy Consultation document

On 31 January 2019, the MFSA published a Consultation Document on the MFSA Fintech Strategy.[11] The public consultation closed on 18 March 2019. This Strategy aims to establish Malta as an international fintech hub, taking into consideration the European Commission's Fintech Action Plan whose objective is to build a true Digital Single Market. The MFSA's Fintech Strategy is based on the following six pillars:

1. Regulation – Innovation and regulatory efficiency which are enhanced through regulatory and supervisory initiatives;
2. Ecosystem – Promotion of demand and collaboration among financial institutions, as well as enhancement of access to finance;
3. Architecture – Collaboration encouraged through the adoption of shared platforms and open Application Programming Interface (API);[12]
4. International Links – Collaboration and trust promoted through the creation of international links across jurisdictions;
5. Knowledge – Stimulus for research and collaborative ideas;
6. Security for the MFSA – Establishment of an environment which is resilient to cybersecurity threats.

A finalised fintech strategy document and a feedback statement were published on 15 May 2019.[13,14]

MFSA Guidance Notes on Cybersecurity

A consultation document relating to guidance notes on cybersecurity was published by the MFSA on 8 February 2019 and ran till 25 March 2019.[15] Overall, the feedback received from stakeholders indicated that proactive monitoring should be more emphasised while a data loss prevention and a privileged access management policy would be very beneficial in enhancing cybersecurity. The finalised Guidance was published on 17 June 2019 with the primary aim being the setting up of a minimum set of best practices and risk management procedures to address and effectively mitigate cyber risks.[16] The Guidance is intended for Professional Investor Funds investing in virtual currencies and all those entities regulated under the Virtual Financial Assets (VFA) Rulebooks including VFA Agents and VFA Service Providers.

Consultation Document: Pillar 1 – Regulations

On 4 July 2019, the MFSA issued a Pillar 1 – Regulations Consultation Document aiming to support innovation and improve regulatory efficiency through the adoption of regulatory and supervisory initiatives.[17] To this end, in its Consultation Document, the MFSA proposed a Regulatory Sandbox to encourage financial technology ('fintech') innovation and also put forward proposals in relation to Regulatory Technologies ('RegTech') and Supervisory Technologies ('SupTech'). Particularly, the Consultation Document sets out a number of approaches towards the establishment of a regulatory sandbox. It also advocates a number of RegTech and SupTech solutions to improve regulatory processes with the objective of helping authorised entities to comply with regulatory and supervisory requirements in a more certain and efficient way. The consultation period closed on 30 August 2019.

[11] Link: https://www.mfsa.mt/wp-content/uploads/2019/01/MFSA-Fintech-Strategy-visual.pdf
[12] A set of programmable instructions that allow one program, or part thereof, to interface with another.
[13] Link: https://www.mfsa.mt/wp-content/uploads/2019/05/MFSA-Fintech-Strategy.pdf
[14] Link: https://www.mfsa.mt/wp-content/uploads/2019/05/20190515_FS_FeedbackStatement.pdf
[15] https://www.mfsa.mt/wp-content/uploads/2019/02/MFSA-Guidance-on-Cybersecurity-Consultation-Document1.pdf
[16] https://www.mfsa.mt/wp-content/uploads/2019/06/Cybersecurity-Guidance-Notes.pdf
[17] https://www.mfsa.mt/wp-content/uploads/2019/07/20190704_MFSA-FinTech-Strategy-Pillar-1.pdf

Main European regulatory policies

European Central Bank (ECB) Consolidated Guide to assessments of licence applications
On 9 January 2019, the ECB published a Consolidated Guide on assessments of licence applications.[18] The objective of this Consolidated Guide is to act as a supportive tool for those involved in the process of authorisation in order to ensure a smooth and effective procedure and assessment. Furthermore, it aims to promote a level playing field throughout the euro area; to reduce the risk that entities will circumvent banking regulation and supervision; and to enhance the transparency of the assessment criteria and processes for establishing a credit institution within the euro area. The Guide is applicable to all credit institution licence applications that fall under the Capital Requirements Regulation (CRR).

Progress on European Deposit Insurance Scheme (EDIS)
During the first six months of 2019, under the Romanian Presidency, the Ad Hoc Working Party on the Strengthening of the Banking Union (AHWP) focused on the technical aspects of the EDIS proposal. In parallel, discussions at a political level were undertaken by the High Level Working Group (HLWG) on EDIS. The AHWP built on the work of the previous Presidency by analysing the impact of EDIS on non-Banking Union Member States and the internal market.

With regards to the political discussions on EDIS, the HLWG considered what the Banking Union should look like in the steady state, particularly what elements in addition to EDIS would be needed in order to achieve a fully integrated Banking Union. In this regard, the path towards the steady state ought to include the following principles.

i) A stable, profitable and resilient banking system, given that measures agreed upon covering various aspects of the financial system – such as the NPL Action Plan, the Banking Package, the build-up of the national Deposit Guarantee Schemes (DGS) and the Anti-Money Laundering Action Plan – would have been implemented.

ii) An efficient allocation of resources through the enhancement of integration of the European banking sector. In order to achieve this, the institutional and regulatory framework should be robust and coherent across the Banking Union, removing unjustified barriers to cross-border banking. Other measures such as depositor protection and resolution are introduced.

iii) A similar level of protection for depositors across the Banking Union irrespective of their geographical location.

iv) Consistency of the overall architecture of the Banking Union.

In order to achieve these objectives, the HLWG felt that more technical work was needed. Indeed, the Group identified the following actions needed to further define the possible way forward on EDIS, namely:

i) analysing different models of EDIS to ensure equal coverage of covered deposits in the Banking Union;

ii) furthering work on bank supervision, resolution and insolvency focusing on the crisis management framework including bank insolvency law and the supervisory framework;

iii) limiting the feedback loop between banks and national sovereigns to ensure financial stability;

iv) ensuring the effective and efficient management of financial resources within cross-border groups.

Anti-Money Laundering (AML): Directive (EU) 2019/1153 laying down rules facilitating the use of financial and other information for the prevention, detection, investigation or prosecution of certain criminal offences.
In August 2019, Directive 2019/1153 entered into force. The Directive further complements the 5th Anti-Money Laundering Directive (Directive 2018/843) and the Directive on combating money laundering by criminal law (Directive 2018/1673). This new Directive lays down measures to facilitate the access to and

[18] Link: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.201901_guide_assessment_credit_inst_licensing_appl.en.pdf?639083c1690b108e5a4a32fc90b110a6

use of financial and other information by competent authorities for the prevention, detection, investigation or prosecution of serious criminal offences, including financial fraud and money laundering. The Directive also introduces measures to facilitate access to financial information by Financial Intelligence Units (FIUs) as well as to facilitate cooperation between the FIUs for the prevention and combating of money laundering, associated predicate offences and terrorist financing. Member States have until August 2021 to transpose the Directive into national law.

MONEYVAL

In September 2019, the Council of Europe's anti-money laundering body, MONEYVAL, published a report on Malta's anti-money laundering and the countering of financing of terrorism (AML/CFT) system.[19] MONEYVAL had been reviewing Malta's AML/CFT laws and their practical application since the start of 2018, culminating with a two-week on-site visit in Malta in November 2018. The report includes a comprehensive assessment of Malta's AML/CFT regime and its level of compliance with the Financial Action Task Force (FATF) Recommendations.[20] The report acknowledges that over the past years Malta has made significant effort in addressing its money laundering and financing of terrorism risks. These include the conduct of a national risk assessment (NRA), which was updated in 2017, as well as a number of actions, including the implementation of the National AML/CFT Strategy which was published in April 2018. The report issued by MONEYVAL identifies some shortcomings relating to the lack of expertise and assessment – specifically in the areas of predicate offences, financing of terrorism, legal persons and arrangements, the development of new technologies and in the use of cash transactions. In order to tackle these findings, as well as to continue strengthening the regulatory and law-enforcement institutions, Malta is currently in the process of implementing further reforms within the timeframes set in the three-year National AML/CFT Strategy, including increasing resources within various national authorities with the aim of further preventing and combating money laundering and terrorist financing activities.

Single Resolution Board (SRB) Policy on the Minimum Requirement for Own Funds and Eligible Liabilities (MREL)

Following the publication of the first wave of the SRB's MREL Policy of resolution plans in November 2018, the SRB published the second part of its policy during January 2019, aimed at addressing the MREL policy of the "most complex" banking groups.[21] The policy introduces a series of new features to further reinforce the resolvability of banks within the Banking Union, mainly:

i) ***Increased binding subordination requirements:***
In line with the global Total Loss-Absorbing Capacity (TLAC) standards published by the Financial Stability Board (FSB), global systemically-important institutions (G-SIIs) should meet a minimum subordination requirement of 16% of risk-weighted assets (RWA) plus the Combined Buffer Requirements (CBR). On the other hand, other systemically-important institutions (O-SIIs) and all other resolution entities should meet a minimum subordination requirement of 14% of RWA plus the CBR.

(ii) ***Binding MREL targets at individual level:***
The SRB will be issuing binding MREL targets to subsidiaries of banking groups at the individual level. The methodology followed to set these MREL targets will be similar to that applied for consolidated targets.[22] This measure will ensure that a sufficient amount of loss-absorbing capacity is available in all parts of the resolution group. The targets will be applied to those subsidiaries which are considered as relevant legal entities (RLEs).[23]

[19] https://rm.coe.int/moneyval-2019-5-5th-round-mer-malta2/168097396c

[20] Financial Action Task Force (FATF) Recommendations are recognised as the global anti-money laundering and countering terrorist financing standards.

[21] The term 'complexity' is usually associated with the extent of cross-border activity and size. Such banks would in the majority be considered as G-SIIs or those banks whose ultimate parent is not domiciled in the EU.

[22] The MREL calibration formula follows the provision outlined in the Delegated Regulation 2016/1450 and is calculated as a Loss Absorption Amount (LAA) + Recapitalisation Amount (RCA) + Market Confidence Charge (MCC). The LAA is calculated as Pillar 1 Capital Requirement + Pillar 2 Capital Requirement + Combined Buffer Requirement. The RCA is calculated as Pillar 1 Capital Requirement + Pillar 2 Capital Requirement, adjusted for the change in asset size of the entity following resolution. The MCC is calculated as Combined Buffer requirement less 125 basis points.

[23] Entities are identified as relevant if they provide more than 5% of the Group's: i) total risk exposure amount or ii) total leverage exposure or iii) total operating income or iv) provide critical functions as defined in the BRRD.

iii) ***A refined approach for determining eligible instruments for consolidated MREL targets:*** Liabilities will be assessed at point-of-entry level only. Liabilities other than own funds instruments will only be considered eligible to meet consolidated MREL targets if these are issued directly by the resolution entity.

Core Domestic Banks

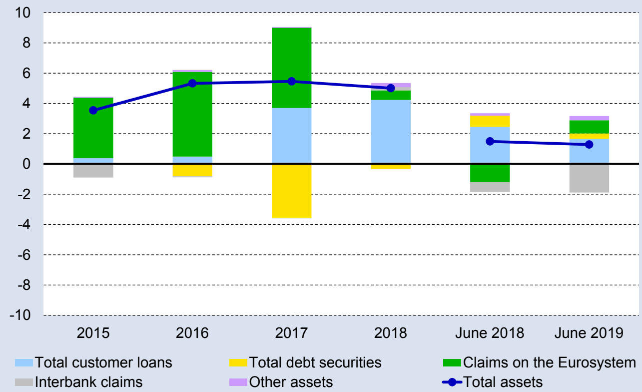
Some core domestic banks consolidated further their business to focus more on primary activities with local economic substance. Liquidity remained ample with banks strengthening further their capital, while at the same time improving their asset quality.

During the first half of 2019, the balance sheet of the core domestic banks continued to expand by around 1.3% to €24.4 billion and was equivalent to about 190% of GDP. This rise was due to growth in customer loans which accounted for almost half of these banks' assets (see Chart 2). Resident lending grew by 4.4% to €10.4 billion, driven by higher household loans, largely mortgages which went up by 4.8%. Consumer credit and other lending rose marginally. Lending to resident corporates continued its upward trend, increasing by 4.3%. This reflected higher credit to professional, scientific and technical activities, administrative and support service activities, construction and real estate and accommodation and food services activities. Conversely, non-resident lending contracted by 1.3% with lower lending towards manufacturing and the information and communication sectors.

The larger lending volumes generated higher net interest income (NII) on intermediation which grew by 3.6%, as otherwise weighted average interest rates remained largely unchanged at 3.7%. In contrast, other NII – which mainly captures interest income from securities – fell by 13.6% as banks rolled over maturing assets into lower yielding ones, reducing the overall growth in NII to 1.5%. Non-interest income rose marginally owing to higher dividend income received and trading profits, as otherwise fees and commissions decreased slightly. As a result, gross operating income increased by 1.1%.

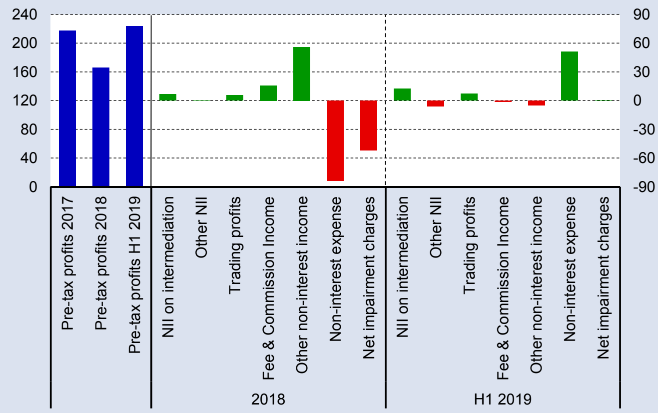
At the same time, non-interest expenses declined by 12.7%, reflecting the litigation provisions set aside by one bank in the first half of 2018 which did not recur in 2019 (see Chart 3). Adjusting for such one-off provisions, non-interest expenses would have risen by around €24 million, owing to higher operating expenses and staff wages. Furthermore, should pre-tax

Chart 2
CONTRIBUTIONS TO BALANCE SHEET GROWTH – CORE DOMESTIC BANKS
(percentage points; per cent)



Source: Central Bank of Malta.
Note: June 2018 and June 2019 figures refer to growth in the first half of the respective years.

Chart 3
MAIN COMPONENTS OF PROFITS – CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.
Note: Blue bars indicate pre-tax profits in absolute amounts. Green (positive) and red (negative) bars indicate yearly changes in profit components. NII stands for net interest income.

profits be adjusted to exclude this one-off item in 2018, profits for core domestic banks would have contracted by around 7%. As a result the adjusted pre-tax ROE and ROA would fall to 11.2% and 0.9% in June 2019 from 12.3% and 1.0% in December 2018, respectively.

The post-tax ROE and ROA strengthened to 8.0% and 0.7%, respectively from 6.5% and 0.5% in December 2018, exceeding somewhat the returns posted by other EU banks.[24] The operational cost-to-income ratio improved by 8.8 percentage points to 54.0% in June 2019, remaining more efficient than other banks in the EU with an average cost-to-income ratio of about 64%.[25,26]

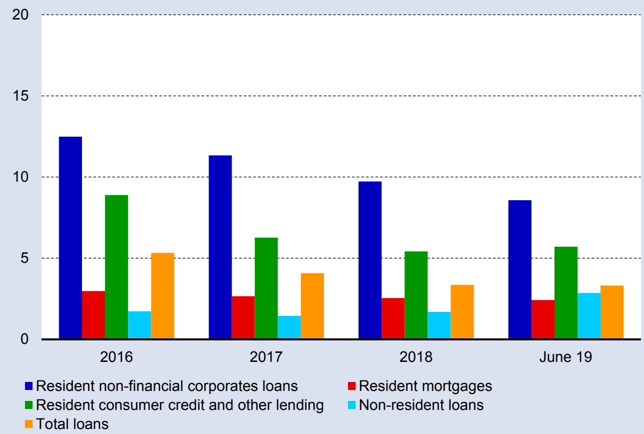
Meanwhile, asset quality of core domestic banks improved further with the non-performing loans (NPL) ratio standing at 3.3% as at June 2019, 0.1 percentage point lower than six months earlier (see Chart 4). This decrease was entirely driven by lower resident NPLs, which contracted by 5.5%. As a result, the resident NPL ratio decreased by 0.4 percentage point to 3.4% in June 2019. This was mainly driven by developments in the resident corporate sector, which saw related NPLs drop by 9.0%. This decline largely reflected improved performance in the construction and real estate sectors, with related NPLs contracting by almost 14%. This led the resident NFC NPL ratio to decline by 1.2 percentage points to 8.6% in June 2019.

Resident household NPLs rose, largely driven by consumer lending, as otherwise the growth in non-performing mortgages was mute. The resident mortgages NPL ratio dropped by 0.1 percentage point to 2.4% as the increase in lending outpaced the rise in non-performing mortgages. Although the resident consumer credit NPL ratio increased by 0.3 percentage point to 5.7% in June 2019, it is still below the level reported a year earlier. The overall asset quality of non-resident loans remained generally positive with a NPL ratio of 2.9%.

Provisions (including the Reserve for General Banking Risks as specified in the BR/09/2019) of the core domestic banks remained generally stable in the first half of the year, with the total coverage ratio standing at 44.2%. Taking into consideration collateral which backed around 60% of total NPLs together with provisions, NPLs would be more than covered.

Holdings of securities increased by 1.5% to €5.9 billion in June 2019 and accounted for almost a quarter of the core domestic banks' balance sheet. Equity holdings increased by around 1% and represented 7.7% of their securities portfolio. Debt securities holdings rose by 1.5%, largely due to higher holdings of foreign sovereign bonds (+16.9%) and to a lower extent domestic sovereign debt (+4.9%), which represented 29.6% and 28.3%, respectively of the total debt securities portfolio (see Chart 5). Holdings of domestic non-bank corporate bonds increased but still remained a limited share of the overall bond

Chart 4
NPL RATIOS – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.

[24] The EU banks ROE and ROA as at June 2019 are estimated to stand at 7.0% and 0.5%, respectively. Source: European Banking Authority, Risk Dashboard data as at 2019 Q2.

[25] Adjusting for the one-off litigation provisioning cost of June 2018, the cost efficiency of core domestic banks would deteriorate by 3.3 percentage points in June 2019.

[26] Source: European Banking Authority, Risk Dashboard data as at 2019 Q2.

portfolio. The core domestic banks shed some of their foreign corporate and bank bonds, but these still accounted for around 40% of their total debt securities.

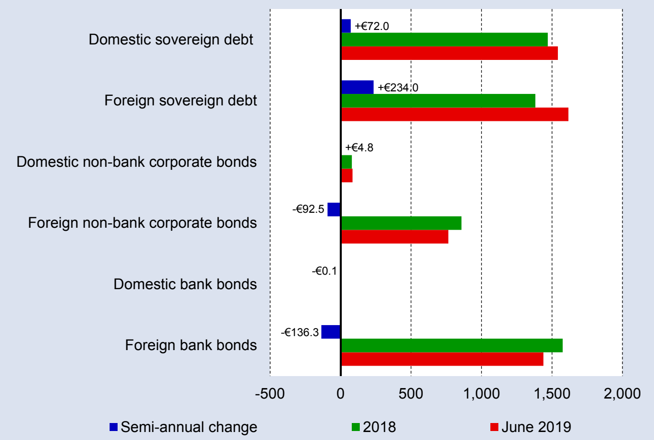


Chart 5
BOND PORTFOLIO – CORE DOMESTIC BANKS
(EUR millions)

Source: Central Bank of Malta.

The growth in the debt securities portfolio was exclusively driven by bonds booked at fair value through other comprehensive income, which rose by 14.8% to €1.9 billion by June 2019. Conversely, bonds at amortised cost declined by 4.3% but still accounted for almost two-thirds of the bond portfolio. About 45% of the bonds were classified as medium-rated investment grade bonds, reflecting holdings of MGS, while almost another 40% were high-rated bonds which increased by 2.0 percentage points over December 2018. Low-rated bonds accounted for only 4.8% of total holdings while the remaining 10.0% were unlisted or unrated. Over six months, the share of low-rated bonds increased by 0.4 percentage point while that of unrated/unlisted bonds declined by 2.4 percentage points. The overall grade of the banks' securities portfolios remained high – evidencing that these banks are not stepping up their search-for-yield behaviour.[27] Furthermore no debt securities were classified as non-performing, and consequently the non-performing exposures ratio declined by 0.1 percentage point to 2.5%.

Core domestic banks reported a drop of almost a quarter in interbank placements. In June 2019 these amounted to 5.9% of total assets compared to 7.8% six months earlier. This drop mainly reflected a change in strategy by one bank. Consequently, placements with the Central Bank of Malta increased to 16.0% of assets from 15.3% in December 2018.

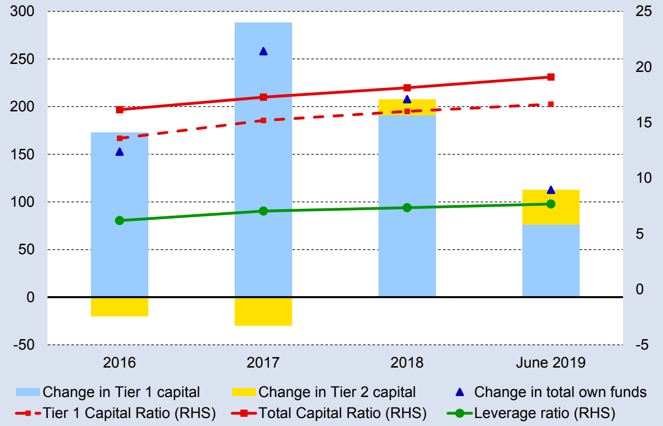
On the funding side, deposits grew by 1.3% to fund around 80% of the banks' assets, with the weighted average interest rate on deposits remaining stable at 0.32%. This increase was driven by higher resident deposits, largely from households, as otherwise non-resident deposits declined as banks continued with their de-risking strategies focusing on business more closely related to the domestic economy. Still, the customer loan-to-deposit ratio increased by 1.3 percentage points to 62.2% in June 2019, as customer loans increased at a faster pace than deposits. Notwithstanding, this ratio remained significantly below the euro area's average which stood at almost 104% by the end of June 2019.[28] Depositors continued to have a strong preference for a substantial degree of liquidity with demand deposits expanding by 1.9% to represent 77.0% of overall deposits. Short-term deposits with a maturity of less than a year fell by 3.6% to almost 15% of deposits. Conversely, long-term deposits with a maturity in excess of one year increased by 5.0%, but were still limited to 8.1% of overall deposits.

Compared to six months ago, the LCR ratio of the core domestic banks narrowed by around 30 percentage points to 287%, owing to a faster increase in net liquidity outflows than liquid assets, which increased at a slower pace of 5.1%. The latter reflected higher 'central bank assets', 'central government assets', and 'multilateral development bank and international organisations assets'. Liquidity stress tests confirm the banks' ample liquidity buffers and their resilience to severe liquidity shocks (refer to liquidity stress-testing results on page 17).

[27] Investment-grade bonds carrying a rating of AA- or above are regarded as 'high-rated bonds'. 'Medium-rated bonds' are those rated between A- and A+, whereas 'low-rated bonds' are those rated between BBB- and BBB+.
[28] Source: ECB Statistical Data Warehouse.

Core domestic banks remained well capitalised, with their total own funds expanding by 5.4% in the first half of 2019 following an increase in both the Tier 1 and Tier 2 capital (see Chart 6). Tier 1 capital increased by 4.2% mainly reflecting higher paid-up capital instruments funded via previous retained earnings. Moreover, Tier 2 capital instruments increased by 14.9% on the back of subordinated loans issued by one bank. As a result, the Total and Tier 1 capital ratios rose by 1.0 and 0.6 percentage points to 19.1% and 16.6%, respectively. Furthermore, the risk profile of the core domestic banks, defined as total risk weighted assets (RWA) to total assets, decreased by 0.5 percentage point to 48.0% in June 2019, as total assets grew at a faster pace than RWA. The improved solvency position was also reflected in a higher leverage ratio of 7.7%, 0.3 percentage point higher than the previous six months.

Chart 6
CHANGE IN TOTAL OWN FUNDS, CAPITAL AND LEVERAGE RATIOS – CORE DOMESTIC BANKS
(EUR millions; per cent)



Source: Central Bank of Malta.

Non-core Domestic Banks

The main business focus of non-core domestic banks remained with non-residents, though a few are increasingly tapping the domestic market.
The balance sheet of the five non-core domestic banks grew by 1.7% to €2.7 billion, corresponding to around 21% of GDP. This group of banks remained focused on international business activities although some banks are increasingly tapping the resident retail market for both loans and deposits, albeit to varying degrees.

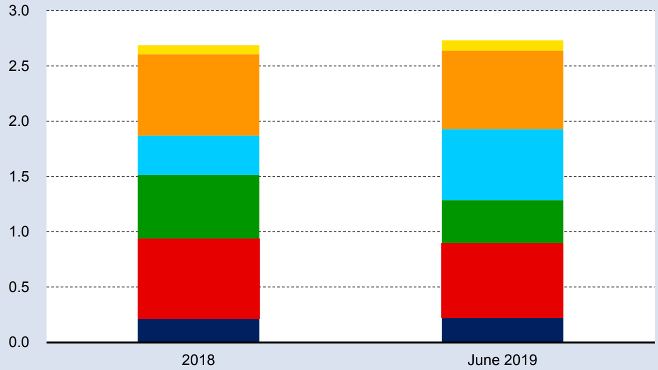
Profitability deteriorated slightly in the first half of the year, mainly on the back of lower fees and commission income coupled with trading losses on their investment portfolio. Non-interest expenses also contributed negatively to profitability, largely reflecting higher staff expenses and depreciation charges. Otherwise, net impairment charges declined, while net interest income – which represents almost half of gross income – increased and is mostly earned from intermediation activities rather than from their investments. As a result, the after-tax ROE and ROA fell by 0.3 and 0.02 percentage points, respectively to 1.9% and 0.22% in June 2019. Consequently, cost-efficiency deteriorated with the cost-to-income ratio increasing by around 2 percentage points to 64.1%

The expansion of these banks' balance sheet largely reflected higher placements with the Central Bank of Malta, which were partly offset by lower interbank placements with unrelated credit institutions by the same banks. As a result, placements with the Central Bank of Malta increased substantially to account for almost a quarter of these banks' balance sheet (see Chart 7).

Although non-resident customer loans declined somewhat, such lending remained the most important asset component representing a quarter of their business activities. Still, non-residents continued to represent the main segment of these banks, predominately targeting entities in the financial and insurance activities, wholesale and retail trade, manufacturing, construction and real estate sectors. At the same time, resident customer lending increased, largely concentrated in the construction and real estate sector, and to a lower extent, in household consumer credit and the wholesale and retail trade sector. Notwithstanding, lending to residents is still limited to just 2.1% of the overall resident lending in the domestic banking system.

The quality of the loan portfolio deteriorated during the first half of 2019, as the level of NPLs rose, pushing the NPL ratio to 4.7% from 3.6% six months earlier. This increase was largely driven by one bank. Excluding this one bank, the NPL ratio would stand at just 0.1%. Although provisions rose, the coverage ratio weakened by 11 percentage points to 53.6%, given the faster rate of increase in NPLs than provisions. Even when taking into consideration collateral backing NPLs, a third of NPLs remained unsecured.

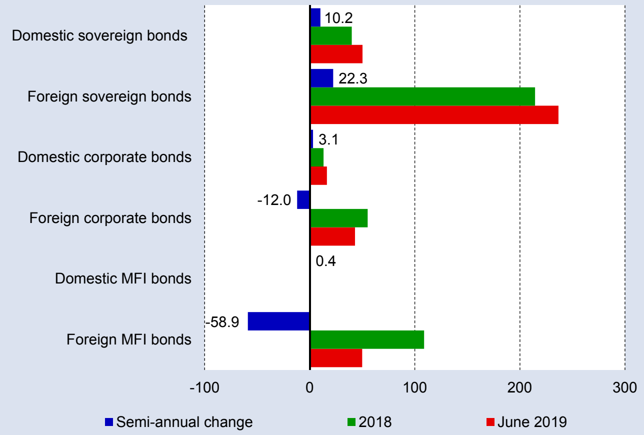
Chart 7
DISTRIBUTION OF ASSETS – NON-CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta

The debt securities portfolio of this group of banks contracted by 8.1% to €397.3 million, accounting for 14.5% of total assets, as they shed almost half of their holdings of foreign MFI bonds (see Chart 8). Foreign corporate bonds also declined by just over a fifth, while holdings of foreign sovereign bonds edged higher. Meanwhile, non-core domestic banks increased their holdings of domestic sovereign paper. In terms of ratings, around half of these banks' debt securities portfolio was highly-rated, while just over a third was classified as either low rated or unrated/speculative. Non-performing securities accounted for a mere 0.1% of the debt securities portfolio, bringing the overall non-performing exposures ratio of such banks to 3.9%.

Chart 8
BOND PORTFOLIO – NON-CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.

This group of banks increased their domestic equity holdings by 2.9% to 44.1% of their securities portfolio.

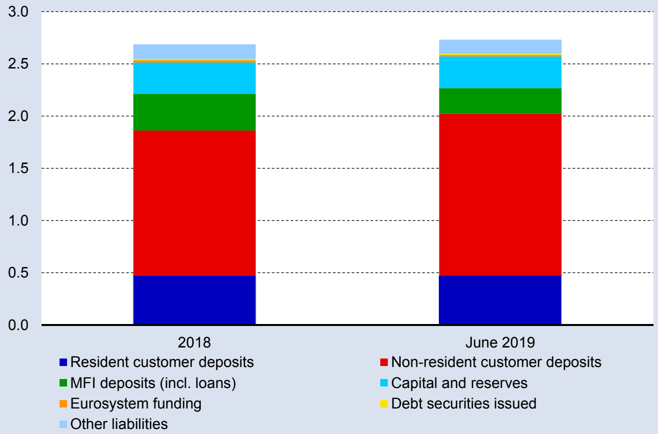
Non-core domestic banks continued to rely on retail deposits to finance their business activities. These grew by 8.5% in the six months under review to finance almost three-quarters of their balance sheet, up from 69.3% in December 2018 (see Chart 9). Non-resident deposits grew by 11.9%, on the back of stronger reliance from the OFIs sector, particularly by one bank. Although non-resident household deposits remained the largest source for retail deposits, their share in overall deposits declined. Similarly, deposits from non-resident private corporates also contracted. Resident customer deposits fell by 1.2% in the first half of 2019 to account for 17.2% of their total assets. This is equivalent to 2.6% of the total resident customer deposits in the Maltese banking system.

The changing funding strategy of these banks was also visible in the wholesale market. These banks managed to partly reduce their reliance on wholesale deposits as interbank funding decreased by almost 30% in the first six months of 2019, to finance just 9% of total assets.[29] These placements, mainly in the form of deposits,

[29] Interbank funding include loans granted by unrelated credit institutions which are reported on the liabilities side of the balance sheet.

mostly originated from unrelated credit institutions. Similarly, reliance on the domestic interbank market fell further to account for just 10.5% of total interbank funding as at June 2019. Meanwhile, only one bank participated in Eurosystem funding operations as at end June 2019, equivalent to just 0.5% of these banks' assets. The level of debt securities issued remained relatively unchanged during the first half of the year to finance a mere 0.4% of total balance sheet size. These bonds were held by resident OFIs and households.

Chart 9
DISTRIBUTION OF LIABILITIES – NON-CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.

In the first half of the year, total own funds of these banks remained fairly stable, but RWA dropped by 4.3%. As a result, the total capital ratio improved by 0.8 percentage point to 18.0%. Similarly, the CET1 ratio rose by 1.0 percentage point to 18.0% in June 2019. The leverage ratio, which is a non risk-based measure of solvency, hovered around 10%, significantly exceeding the 3% benchmark. Owing to the high holdings of central bank reserves and sovereign paper, the liquidity position of these banks remained strong with an LCR ratio shy of 400%.

International Banks

International banks consolidated their balance sheet further, posting higher profitability while capital and liquidity remained healthy.

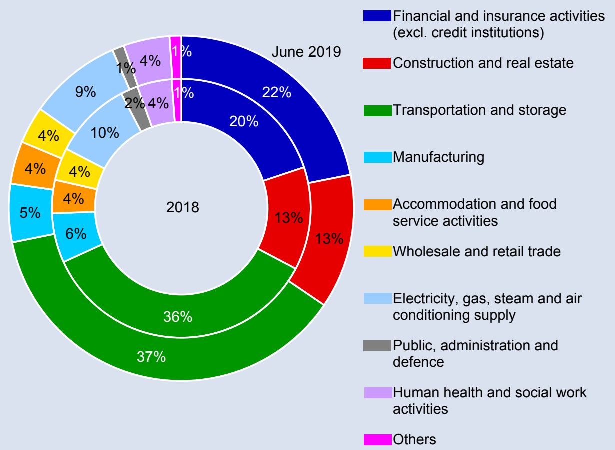
Thirteen banks were classified as international banks, three of which were branches of foreign banks while the rest were either subsidiaries of foreign banks or stand-alone banks. The consolidation process experienced in previous years persisted in the first half of 2019, largely driven by the branches, with the overall assets of international banks contracting by 10.3% over 2018 to 123.3% of GDP in June 2019. These banks have heterogeneous business models, with some venturing into trade financing, factoring and wealth management apart from traditional banking activities. Nevertheless, they continued to deal predominately with non-residents, having limited links with the domestic economy on both sides of the balance sheet.

Branches of Foreign Banks

The branches of foreign banks posted a marginal increase in profits during the first half of 2019, with the post-tax ROA improving by 0.2 percentage point to 1.6% in June 2019. These branches of foreign banks reported lower losses on foreign exchange revaluations than those reported in 2018, coupled with higher income earned from securities trading, thus significantly pushing up non-interest income. Meanwhile NII declined by a fifth, reflecting lower interest income earned from their investment portfolio, as otherwise income from lending activities increased. The securities portfolio invested by these branches of foreign banks fell by 15.1% over December 2018, driven by the disposal of government paper and bank bonds. By the first half of 2019, the investment portfolio accounted for around a third of their balance sheet with the majority of holdings in non-EU sovereign paper. The branches of foreign banks have not reported any non-performing securities. Non-interest expense fell by a third over the first six months of the year, driven by lower general expenses, as otherwise staff-related expenses rose by 0.7% over 2018. Meanwhile net impairment charges increased by 5.2%, driven by higher bad debts written off by one branch.

By June 2019, customer loans declined by 2.5% to represent just over a third of their balance sheet. Non-financial corporate loans represented more than three quarters of their customer loan portfolio and were mainly concentrated in the transportation and storage sector and to a lesser extent in the construction and energy-related sectors (see Chart 10). Loans towards OFIs rose by 7.4% over 2018, pushing up their share of total assets by 1.3 percentage points to 7.8%, whereas the share of household loans in total customer loans remained negligible. Although outstanding NPLs fell by 1.4% over December 2018, the NPL ratio increased marginally to 1.5% in June 2019, as lending activity shrank at a faster pace than NPLs.

Chart 10
CUSTOMER LOANS BY SECTOR – BRANCHES OF FOREIGN BANKS



Source: Central Bank of Malta.

Interbank exposures fell by 8.2% since end 2018, although their share of total assets increased by 0.3 percentage point, to 12.5% in June 2019. This occurred on the back of higher loans with unrelated foreign banks, which were offset by a significant drop in placements with the head office and other related entities. Funds placed with the Central Bank of Malta under the reserve requirement fell by almost a third to 5.1% of total assets.

Interbank funding remained the most preferred source of funding, financing around four-fifths of the branches' balance sheet. The branches of foreign banks continued to benefit from intragroup funding, which increased by 1.9% over December 2018, accounting for around 84% of interbank exposures and funding about 69% of total assets. Interbank placements from unrelated foreign banks declined by 15.3%. Additionally, reverse repos from unrelated foreign banks stood at 10.4% of total liabilities. Customer deposits more than halved to fund 8.2% of total assets in June 2019, down from 16.4% in December 2018. This outflow stemmed predominantly from NFCs and to a lower extent insurance, pension funds and financial intermediaries located mostly in non-EU countries. Customers' preference to hold short-term deposits persisted, given that all customer deposits carry a maturity of less than one year, indicating possible roll-over risk.

Subsidiaries of foreign banks and stand-alone foreign banks[30]

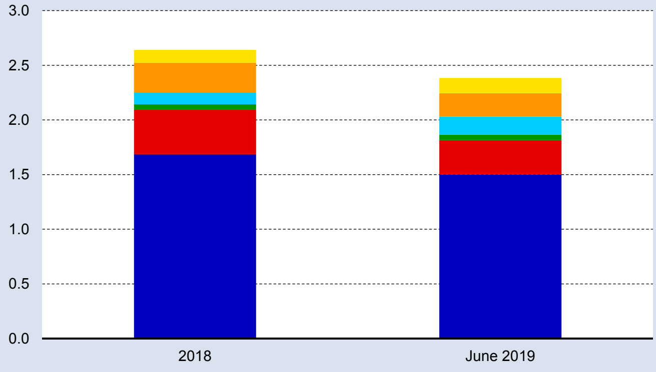
During the first six months of 2019 these banks' pre-tax profits improved by 61.2% driven by higher gross operating income. As a result, the post-tax ROA and ROE strengthened to 3.1% and 7.6%, respectively from 2.0% and 5.3% in December 2018. NII increased by 13.5% over 2018, accounting for just over half of gross income. This increase mirrored higher interest income generated by banks engaged in micro-lending activities. Non-interest income – predominantly in the form of fees and commissions – also improved, up by 11.6% over six months. Although non-interest expenses increased by 5.4% on the back of higher administrative expenses, the improvement in profitability remained supported by a 7.6% fall in net impairment losses. Moreover, the overall cost-efficiency of this group of banks improved, with the cost-to-income ratio falling by 3.4 percentage points to 52.2% in June 2019, as the increase in gross income outpaced that in non-interest expenses.

Customer loans declined by 10.6% over end 2018 – in line with the balance sheet contraction reported by this group of banks. Still, they remained the largest asset component, accounting for 63.0% of total assets (see Chart 11). Around three-quarters of customer loans were granted to non-resident NFCs, largely in the manufacturing, transportation and storage, real estate, and the mining and quarrying sectors. Meanwhile, loans issued towards other financial institutions fell by 2.7% to account for 6.8% of total customer loans.

[30] Satabank plc is being excluded from this assessment given the MFSA's decision to appoint Ernst and Young Ltd as a competent person in October 2018 in terms of Article 29(1)(c) and (d) of the Banking Act.

Household loans remained exclusively targeted towards consumer credit, which rose by 9.4% to account for 14.8% of total customer loans. Resident customer loans remained negligible, equivalent to a mere 0.2% of total resident lending in the banking sector in June 2019.

Chart 11
ASSET COMPOSITION – SUBSIDIARIES OF FOREIGN BANKS AND STAND-ALONE FOREIGN BANKS
(EUR millions)



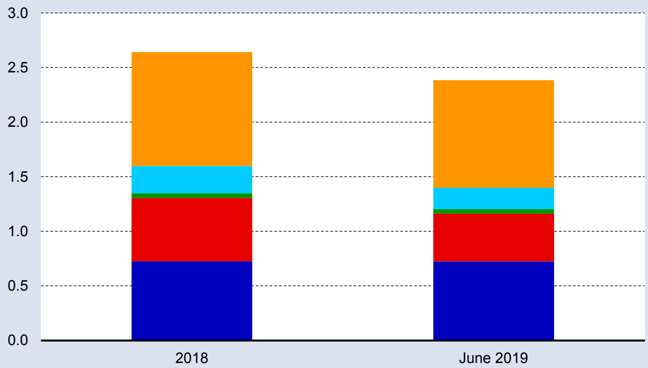
Source: Central Bank of Malta.

Loan asset quality improved during the first half of 2019, with the NPL ratio narrowing by 1.4 percentage points to 4.6% in June 2019, owing to a faster drop in the outstanding level of NPLs. The reduction in NPLs stemmed from the NFC sector, predominantly from transportation and storage and real estate sectors, as otherwise non-performing household consumer loans increased by 6.9% over December 2018. In line with the decline in NPLs, total provisions dropped by 11.9% over December 2018, but the coverage ratio strengthened from 62.2% in December 2018 to 82.2% in June 2019. Taking together provisions and collateral, NPLs would be fully-covered.

Interbank placements fell by a fifth, on the back of lower placements from related group institutions, as otherwise placements from unrelated credit institutions increased by almost 16.9% over 2018. Claims with the Central Bank of Malta fell by more than a fifth in the first six months of the year, to account for 9.0% of total assets.

Meanwhile, the securities portfolio grew by 51.4%, pushing up its share of total assets by 2.8 percentage points to 6.9% in June 2019. This expansion was attributable to higher investments in long-term sovereign debt of euro area countries. Holdings of sovereign debt accounted for around 43% of the securities portfolio. Investments in corporate bonds rose by 5.6%, but remained at a very conservative share in the overall portfolio. In contrast, bank bonds fell marginally over 2018. The overall credit quality of the securities portfolio of these banks is considered high since more than 95% of their bond holdings are rated as medium and high investment grade bonds. Despite one bank reporting higher non-performing securities, overall non-performing exposures fell by 1.4 percentage points over December 2018 to 4.4% in June 2019. Equity exposures grew by almost a fifth, equivalent to 2.5% of total assets in June 2019, as one bank continued to increase its stake in a NFC located in the euro area.

Chart 12
LIABILITIES COMPOSITION – SUBSIDIARIES OF FOREIGN BANKS AND STAND-ALONE FOREIGN BANKS
(EUR millions)



Source: Central Bank of Malta.

Customer deposits remained an important source of funding for this group of banks. Although in volume terms, deposits remained generally stable, their importance in the balance sheet increased by 2.8 percentage points to around 30.3% by June 2019 (see Chart 12). Retail deposits, which are mostly withdrawable on demand, are mainly split between households and OFIs, with deposits from private NFCs accounting for 20% of all customer deposits in June 2019. Resident customer deposits increased by 41.4% during the first six months of 2019, due to deposits inflows by OFIs, representing 0.2% of total resident deposits in the Maltese banking sector.

Interbank funding mainly in the form of placements from parent companies and deposits from other related foreign institutions declined by just under a quarter since end 2018. However, these banks tapped foreign unrelated credit institutions as an alternative source of funding, up by 21.7% over the first six months of 2019, funding 2.5% of total assets.

Overall capital and reserves declined but these accounted for the second largest source of funding for this group of banks, equivalent to 41.2% of the aggregate balance sheet. Nonetheless, the total capital ratio stood at 51.9% in June 2019. These banks were highly liquid, with an LCR standing at 511.5% in June 2019.

Stress tests reaffirm the robustness of credit institutions' solvency and liquidity buffers

During the first half of the year, the Central Bank of Malta continued to monitor the resilience of the banking system's capital and liquidity adequacy by running its suite of stress tests and sensitivity analyses which form part of the Central Bank of Malta's financial stability toolkit. The sensitivity analyses test the banks' robustness to a credit quality downgrade in the banks' securities portfolio and severe downward correction in house prices. The stress test exercises include two frameworks which assess the banks' liquidity stance following persistent deposit withdrawals and adverse shocks to the components of the liquidity coverage ratio; and also a framework for quantifying interest rate risk in the banking book. The results are directly comparable to those presented in Chapter 3 of the *Financial Stability Report* 2018 as both methodology and assumptions remain similar. The results are therefore an update to the December 2018 position.[31]

Banks continued to enhance their capital positions resulting in an improved capital buffer that can sustain severe yet plausible hypothetical shocks. The post-shock Tier 1 capital ratios of the core and non-core domestic banks as well as international banks remained comfortably above the regulatory threshold of 6%, while their LCR also remained well above the regulatory limit of 100%.[32]

Sensitivity tests

Credit quality deterioration stress test

Core and non-core domestic banks and international banks are assessed against a potential deterioration in the credit quality of their debt securities portfolio, with the methodology and assumptions differing by accounting treatment and sector of exposure.

The relative share of securities accounted for at amortised cost, fair value through other comprehensive income, and fair value through profit and loss, remains broadly similar to the December 2018 position. Moreover, even under the current persistently low interest rate environment, core and non-core domestic banks do not seem to be increasing their search-for-yield behaviour, as the share of securities rated at A- or better has increased from 85% and 80%, to 95% and 85% respectively by June 2019. Conversely the quality of international banks' portfolio is not as strong with only around 22% of debt securities rated at A- or better. This ratio improves significantly to 88% when considering securities rated at BBB- or better, i.e. the investment grade. Nonetheless, given the rather high capital ratios and the low share of debt securities to total assets for this category of banks – even following the application of shocks – these banks' capital position was more than sufficient to absorb the potential losses.

Following an assumed three-notch rating downgrade in securities accounted for at amortised cost (AMC), as well as a widening of credit spreads and valuation haircuts applied respectively for non-sovereign and sovereign non-AMC debt securities, the resulting capital ratios remain comfortably above the 6% minimum regulatory requirement. In such a scenario, capital ratios would fall to 15.8%, 17.0% and 52.0%, respectively

[31] The Macro Stress Testing Framework is run on an annual basis thus results are not included in the *Interim Financial Stability Report*.

[32] Branches of foreign banks are excluded from the stress testing sample given that these branches do not hold capital locally. Stress testing exercises are carried out with the intention of assessing banks' capital adequacy.

for core domestic, non-core domestic and international banks, equivalent to a drop of -0.9, -0.6 and -0.9 percentage points relative to their initial Tier 1 capital ratio.

House price correction stress test
This particular test assumes an adverse exogenous shock to house prices of 7.5% and 30% respectively under a baseline and an adverse scenario, and assesses the impact on the core domestic banks' balance sheets given that these are the main providers of mortgages. The drop in house prices translates fully into a drop in collateral values, given that a large part of the collateral backing loans is property. A simultaneous increase in NPLs is assumed which, coupled with the drop in collateral values, pushes banks to step up loan loss provisions.

The impact of the test is slightly higher when compared to the results published in *Financial Stability Report* 2018 as banks reported a mild decrease in loan collateralisation and provisioning. Nonetheless, banks have ample capital buffers to withstand this adverse shock – even more so when considering the recent capital injections. Indeed, core domestic banks' Tier 1 capital ratios would fall marginally from 16.6% to 16.2% under the baseline and 15.4% under the adverse scenario.

Liquidity Stress Testing Framework

Persistent Deposit Withdrawals
The test assesses the banks' resilience against a deposit-run type of scenario over a survival period of five consecutive days, and the subsequent three weeks. All core and non-core domestic banks, as well as international banks, are in scope for the test. Banks are assumed to become illiquid in the event that their stressed counterbalancing capacity (CBC) is not sufficient to meet persistent deposit withdrawals. The CBC is composed, *inter alia* of: cash, excess to their reserve requirement with the Central Bank of Malta, and funds raised following the sale of marketable securities. The extent of liquidity outflows from deposits is determined according to the term-to-maturity, as well as customer category.

Tables 2 and 3 present the share of the remaining CBC following the application of shocks. While the overall CBC diminishes as the test progresses over time, all three banking groups remain amply liquid even beyond the stress test horizon.

Table 2
STRESS TEST RESULTS – IMPACT OF PERSISTENT DEPOSIT WITHDRAWALS – SCENARIO 1, RESTRICTED ECB FUNDING, EXCESS LIQUIDITY TO TOTAL COUNTERBALANCING CAPACITY
Per cent

Scenario	Day 1	Day 2	Day 3	Day 4	Day 5	Week 2	Week 3	Week 4
Core domestic banks	87	82	77	72	67	62	57	52
Non-core domestic banks	93	87	81	75	69	63	57	51
International banks	85	84	83	82	80	78	75	72

Source: Central Bank of Malta.

Table 3
STRESS TEST RESULTS – IMPACT OF PERSISTENT DEPOSIT WITHDRAWALS – SCENARIO 2, UNRESTRICTED ECB FUNDING, EXCESS LIQUIDITY TO TOTAL COUNTERBALANCING CAPACITY
Per cent

Scenario	Day 1	Day 2	Day 3	Day 4	Day 5	Week 2	Week 3	Week 4
Core domestic banks	90	87	83	80	76	72	69	65
Non-core domestic banks	94	89	83	78	74	68	63	58
International banks	86	84	83	82	81	78	75	73

Source: Central Bank of Malta.

Table 4
DESCRIPTION OF BASELINE AND ADVERSE SCENARIOS

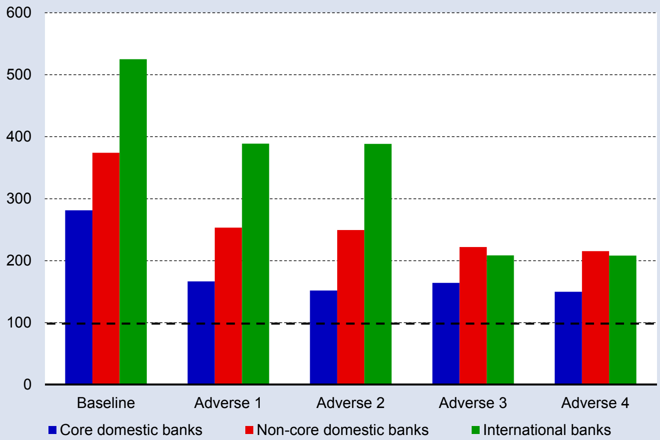
Scenario	Description
Baseline	Haircuts and outflow/inflow rates as prescribed by the LCR Delegated Regulation
Adverse:	
Scenario 1	Higher outflows compared to the LCR Delegated Regulation
Scenario 2	Scenario 1 with additional withdrawals of resident time deposits (>30 days)
Scenario 3	Scenario 1 with additional withdrawals of non-resident time deposits (>30 days)
Scenario 4	Scenario 1 with additional withdrawals from both resident and non-resident time deposits

Source: Central Bank of Malta.

LCR-based Liquidity Stress Test

This test benchmarks core domestic, non-core domestic and international banks' liquidity coverage ratio (LCR) with the regulatory minimum of 100% following adverse shocks to the banks' net outflows. The LCR is assessed under four different scenarios, which measure the banks' reliance on a particular source of funding, such as – for example – resident or non-resident deposits, as well as its term to maturity. Furthermore the framework is also designed to run additional scenarios so as to test other dimensions of liquidity risk.

Chart 13
STRESS TEST RESULTS – LCR RESULTS FOR ALL BANKS
(per cent)



Source: Central Bank of Malta calculations.

As can be seen in Table 4, the four tested scenarios include as, a minimum, adverse shocks to the inflow and outflow rates prescribed in the Commission Delegated Regulation (EU) 2015/61 and applied in the baseline. The outflows are paired with withdrawals from resident contractual deposits maturing beyond 30 days, non-resident contractual deposits with a fixed term exceeding 30 days and a combination of both, for scenarios two, three and four respectively.

All three banking groups surpass the 100% LCR requirement under all four adverse scenarios (see Chart 13). The largest impact originates in adverse scenario 1 as most of the outflows are of a short-term nature, with the LCR dropping from 281% to 167%, 374% to 253% and 534% to 397%, respectively for core domestic, non-core domestic and international banks. These ratios drop further as a result of the assumed withdrawals of resident term deposits (mainly affecting core and non-core domestic banks) or non-resident term deposits (mainly affecting international banks) to reach 150%, 215% and 210%, respectively under their combined effect under adverse scenario 4.

Interest Rate Risk in the Banking Book

This test quantifies the impact of changes in the shape of the yield curve on banks' business models under six exhaustive scenarios. These scenarios consist of a parallel shift upwards and downwards of the yield curve as at the reference date; an increase and a decrease in the short rate end of the curve; and two composite shifts in the short and long-term rates referred to as the 'steepener' and 'flattener' scenarios. The idiosyncratic shocks applied are assumed to influence the extent of interest rate risk on the basis of the interest rate type (fixed, variable or a combination thereof), the currency denomination and the reset date of interest-bearing assets and liabilities.

Table 5
STRESS TEST RESULTS – IMPACT OF CHANGES IN NET INTEREST INCOME ON THE TIER 1 CAPITAL RATIO
Per cent

Scenario	Initial Tier 1 capital ratio	Parallel up	Parallel down	Steepener	Flattener	Short rate up	Short rate down
Core domestic banks	16.6	19.1	14.6	15.1	19.0	19.6	14.3
Non-core domestic banks	17.6	19.0	16.3	16.7	18.7	19.0	16.2
International banks	51.9	53.2	50.8	51.1	53.0	53.3	50.7

Source: Central Bank of Malta.

As illustrated in Table 5, results remain broadly similar to those published in the 2018 Report with the 'short rate down' having the highest negative impact on the three banking groups, all other things being equal, although for the non-core domestic banks the 'parallel down' scenario has almost the same impact. While profit margins would continue to narrow in the event of further falls in interest rates and weaknesses could arise for a small number of banks, the post-shock Tier 1 capital ratios at the aggregate remain well-above the regulatory threshold of 6% even under the scenarios that would hit the banks the most.[33] Indeed, all banks would be able to absorb the impact and have a total capital ratio which exceeds the respective OCR requirement following the largest negative impact. Conversely, the 'short rate up' is the most positive scenario for the core domestic and international banks, while non-core domestic banks, would benefit most from the scenario of 'parallel shift up'.

Domestic Insurance Companies

Risks for the domestically-focused insurance sector remained under control, reflecting their ample capital and liquidity buffers.
During the first half of 2019, the number of insurance undertakings licensed to operate from Malta increased by three to 69 with total assets of €10.9 billion, equivalent to around 86% of GDP. Still, the number of insurance companies which underwrite risks situated in Malta as their main line of business remained unchanged at eight. Their assets rose by 7.9% to €3.7 billion, equivalent to 28.8% of GDP. These consisted of three life insurance companies and five non-life insurance companies, with one of the latter operating as a protected cell company.

Domestic insurance companies reinsured a median of 17.4% of their premia with foreign reinsurance companies.[34] Contagion risks remained limited and contained, given that the reinsurance companies are highly-rated and risk is spread across a large number of companies. Risks stemming from Brexit are also deemed to be manageable as exposures with the UK and in Pound Sterling accounted for less than 4% of domestic assets in June 2019.

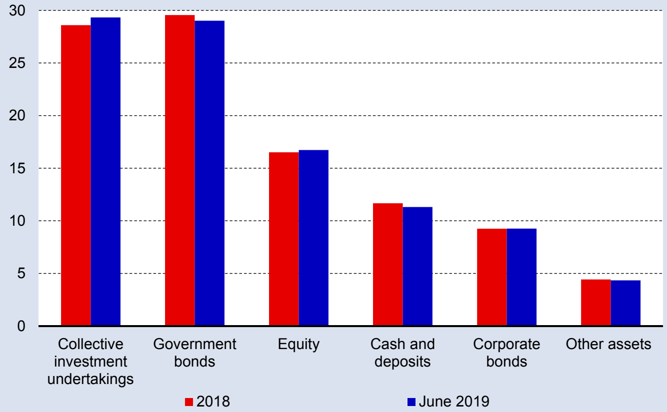
The profitability of the domestic insurance companies improved mainly on the back of higher revaluation gains on their investment portfolios. A prolonged low-yield environment remains the key challenge for the insurance sector potentially exerting pressure on profitability which could in turn trigger further search-for-yield behaviour.

The domestic life insurance companies
Assets of the domestic life insurance companies rose by 8.1% in the first six months of the year to €3.2 billion, equivalent to 25.4% of GDP. These assets remained concentrated in two companies, which together made up 97.0% of gross premia written by the life insurance sector.

[33] For illustrative purposes, results in the *Interim Financial Stability Report* are benchmarked against a common 6% minimum Tier 1 capital ratio, however, the results are also assessed in terms of the 4.5% minimum CET1 capital ratio as well as the respective Total SREP Capital Requirement (TSCR) and Overall Capital Requirement (OCR). The TSCR includes the 8% minimum total capital requirement and the bank-specific Pillar 2 requirements, while the OCR consists of the TSCR, and the combined capital buffers.
[34] The median reinsurance part of premia for the life and non-life sectors in June 2019 stood at 6.1% and 34.5%, respectively.

In terms of lines of business, 'index and unit-linked' products – where the obligation for the life insurance company is represented by the value of the underlying unit – rose by 1.2 points to around 18% of total premia written. Technical provisions for such products remained limited to 17.3%, with the rest classified as non-unit linked technical provisions. The most dominant line of business remained 'insurance with profits participation' – a savings product with a bonus rate as the annual investment return. Such business characterised around 75% of gross written premium which, however, contracted by 1.5 percentage points over December 2018. The remaining share is classified as 'other life insurance'.

Chart 14
ASSET COMPOSITION OF THE DOMESTIC LIFE INSURANCE SECTOR
(per cent of total assets)



Source: Central Bank of Malta.
Note: Other assets mainly include property, recoverables and receivables, collateralised securities, mortgages and loans.

The asset composition of the domestic life insurance companies remained stable during the first half of the year with bonds, collective investment undertakings (CIU) and equity accounting for 38.4%, 29.3% and 16.7%, respectively (see Chart 14).[35] The remaining assets were mainly cash and deposits largely placed with related domestic credit institutions. Still, contagion risk is somewhat curtailed as these firms are set up as separate legal entities with their own specific capital requirements.

The bond portfolio of life insurance companies is principally composed of sovereign bonds, with almost half invested in MGS. The other sovereign bonds were mainly from other euro area countries, bringing the overall rating of the portfolio to A-. During the first half of 2019, sovereign bond holdings increased by 6.1% reversing the decline reported in 2018.

Holdings of corporate bonds also rose, up by 8.2%, although their share in total assets remained unchanged at 9.3%. More than half (54.1%) of the corporate bond holdings are low-rated bonds, up by 3.3 percentage points compared to six months earlier, with medium-rated bonds accounting for 42.4% of corporate bonds, the latter rising by almost 10 percentage points. The rest are almost equally split between high-rated and unrated bonds.[36] Almost two thirds of these bonds were issued in other euro area countries by NFCs, banks and captives financial institutions and money lenders (CFIML).[37] Another 28.7% were issued in the US and related to NFCs, banks and other financial intermediaries (OFIs). The remaining were domestic corporate bonds, largely issued by CFIMLs, banks and NFCs.

Equities rose by 9.5% to account for 16.7% of life assets, largely reflecting increases in market prices. These were mainly concentrated in NFCs located in the US and in Europe predominantly euro area countries, though almost a fourth of the portfolio reflected holdings in Maltese NFCs. More than a third of these domestic equities are related to real estate investments.

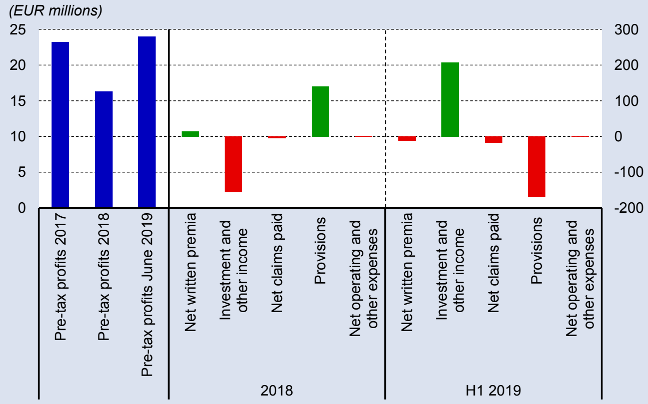
Participations in collective investment undertakings also increased, up by 10.9% to almost 30% of the life insurers' assets reflecting higher investments in equity, debt and money market funds. The majority of CIUs are issued in the euro area other than Malta.

[35] The bond portfolio is made up of government bonds, corporate bonds and collateralised securities.
[36] Investment-grade bonds carrying a rating of AA- or above are regarded as 'high-rated bonds'. 'Medium-rated bonds' are those rated between A- and A+, whereas 'low-rated bonds' are those rated between BBB- and BBB+. Sub-investment grade bonds are rated lower than BBB-.
[37] The CFIML consist also of holding companies that hold controlling levels of equity of a group of subsidiary corporations and whose principal activity is of owning the group without providing any other service to the businesses in which the equity is held.

Domestic life insurers' participation in non-traditional non-insurance activities remained negligible with loans channelled to related NFCs accounting for less than 0.4% of their assets. Meanwhile, domestic life insurers have exposures to tangible real estate which stood at 3.9% of total life insurers' assets, down from 4.1% in December 2018, with the bulk held for investment purposes.

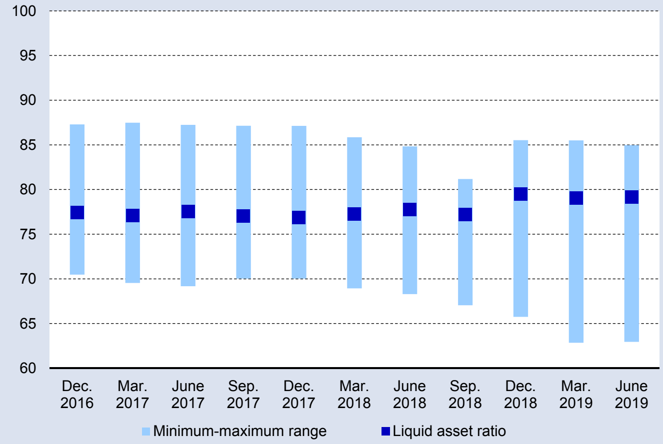
During the first half of 2019, life insurers' pre-tax profits improved by 47.2% to around €24 million (see Chart 15). This boost in profitability was driven by higher revaluation gains owing to the rally in financial markets in the first half of the year. This increase was partly offset by the drop in net written premia coupled with higher net claims. Furthermore, life insurance companies significantly increased their provisions against claims, which affected profitability adversely. Yet, pre-tax ROE rose from 6.2% in 2018 to 9.2% in June 2019, with the pre-tax ROA also increasing from 0.5% to 0.7%. Pre-tax return on net premia stood at 6.4%, up from 4.2% in 2018.

Chart 15
MAIN COMPONENTS OF PROFITS – DOMESTIC LIFE INSURANCE SECTOR
(EUR millions)



Source: Central Bank of Malta.
Note: Blue bars indicate pre-tax profits in absolute amounts. Green (positive) and red (negative) bars indicate yearly changes in profit components. These figures are based on management accounts.

Chart 16
LIQUID ASSETS RATIO OF THE DOMESTIC LIFE INSURANCE SECTOR
(per cent)



Source: Central Bank of Malta.

The life insurance sector remained highly liquid with a liquid asset ratio of 79.2%, although it narrowed slightly compared with the levels recorded as at end of 2018 (see Chart 16).[38] The high liquidity reflected considerable holdings of government bonds and listed equities, both of which rank high in the liquidity ladder.

All the domestic life insurers remained adequately capitalised with an overall solvency ratio of 226.5%. In the first six months, the solvency ratio rose by 22.4 percentage points creating further buffer over the minimum threshold of 100%, mainly due to a stronger solvency capital requirement (SCR) than own funds. The capital composition remained of very high quality, almost entirely in Tier 1 own funds.

The domestic non-life insurance companies

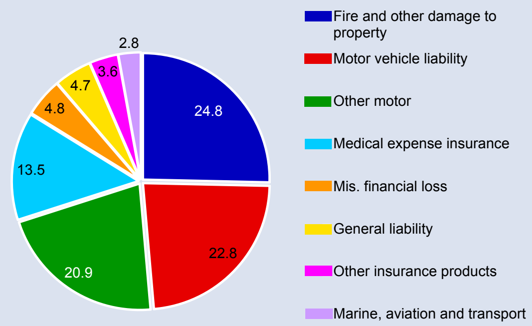
Assets held by the domestic non-life insurance sector rose by 6.6% to €437.6 million in June 2019, equivalent to just 3.4% of GDP. Their business is mainly concentrated in motor vehicle-related segment, which in total accounted for 43.7% of the total premia written, followed by fire and other property damage at around 25.0% (see Chart 17).

[38] The liquid assets ratio shows the proportion of liquid assets to total assets (excluding assets held for unit-linked). The ratio is calculated by applying different weights (ranging from 100% for cash to 0% for intangible assets) to different assets, according to their liquidity profile).

Despite decreasing slightly during the first half of 2019, at 28.4% of assets, equity holdings remained the largest asset component driven by one company's investment in a related firm (see Chart 18). In contrast, holdings of foreign equities were limited to 4.0% of assets, mostly held as common equity in insurance corporations and NFCs in Europe and the US. Participation in CIUs – which are mainly debt funds, equity and money market funds – declined by 1.1%, accounting for 7.7% of non-life insurers' assets.

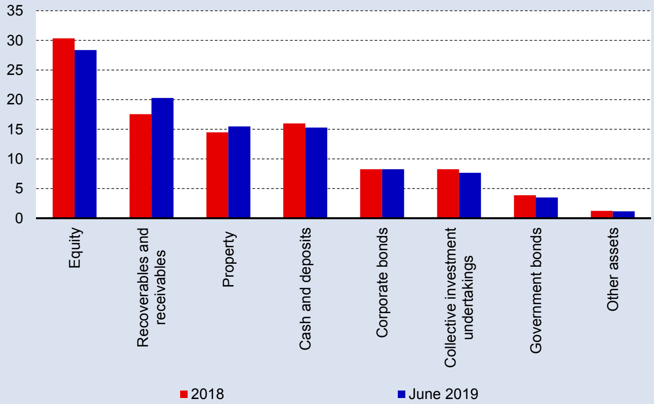
Recoverables, receivables and bond holdings accounted for 20.3% and 11.8% of the non-life insurers' assets, respectively. Corporate bonds made up 70.3% of the bond portfolio, around two-thirds of which were related to foreign corporates in other EU countries and the US, with almost another third invested in Maltese corporates. Around 36% of the corporate bond holdings are unrated, while another 30.0% are of a low rating, indicating some potential search for yield behaviour. Medium and highly-rated bonds stood at 28.4% and 5.5% of the corporate bond portfolio, respectively. Meanwhile, foreign sovereign bonds amounted to 10.6% of the insurers' bond portfolio whilst another 19.1% were MGS.

Chart 17
GROSS WRITTEN PREMIUM OF THE DOMESTIC NON-LIFE INSURANCE SECTOR BY LINE OF BUSINESS
(per cent of total gross written premia)



Source: Central Bank of Malta.
Note: Solvency II Reporting. Other insurance products include workers' compensation, income protection, other life insurance and profit participation, index-linked and unit-linked insurance.

Chart 18
ASSET COMPOSITION OF THE DOMESTIC NON-LIFE INSURANCE SECTOR
(per cent of total asset)



Source: Central Bank of Malta.
Note: Other assets mainly include mortgages and loans.

Only 0.3% of non-life assets were uncollateralised loans to domestically-related insurance companies. Furthermore, by June 2019 tangible real estate exposures stood at 15.5% of the non-life insurers' assets, compared to 14.5% in December 2018. More than half of these assets were in the form of office and commercial buildings held for investment purposes, with the rest mainly held for own use.

Compared to 2018, pre-tax profits increased by 65% to €40.7 million (see Chart 19). Such a surge occurred on the back of substantial fair value gains as markets recovered from the weakening experienced in 2018. Net written premia rose by 5.1% to €159.1 million in June 2019 which contributed positively to profitability. These were, however, partly offset by higher net claims paid which increased by 5.1% to €77.6 million mainly attributable to growth in business and coverage for damages from adverse weather conditions earlier in the year.

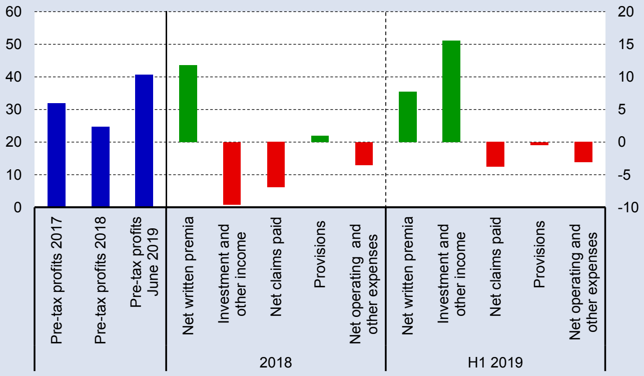
The loss ratio fell slightly to 51.7%, representing positive underwriting activities as premia earned outpaced the extent of claims incurred. Similarly, the combined ratio rose by 2.3 percentage points to around 86% in

June 2019, remaining below 100%, indicating that non-life insurers were still able to generate positive underwriting results. At the same time, the overall net expense ratio stood at 32.3%, rising by 1.9 percentage points over December 2018, but still indicating an underwriting profit. Consequently, the pre-tax ROE rose from 15.1% in 2018 to 24.1% in June 2019, while the pre-tax ROA rose from 5.8% to 9.5%. Similarly, the pre-tax return on net premia stood at 25.6% up from 16.3% in 2018.

Compared to end 2018, liquidity narrowed slightly to 39.3% reflecting a significant share of intragroup equity holdings and recoverables and receivables held by these insurers which, however, are deemed less liquid (see Chart 20).[39]

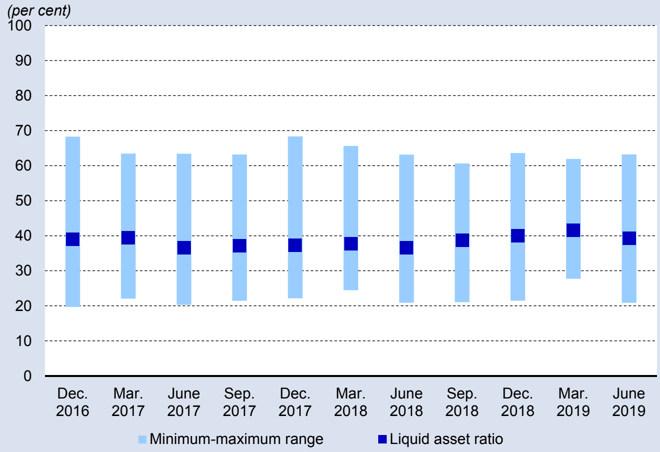
The non-life insurers remained adequately capitalised with an overall solvency ratio of 257.5%, surpassing the minimum regulatory threshold of 100%. The ratio strengthened by 15.9 percentage points when compared to December 2018 due to a stronger increase in total eligible own funds. The large majority of total own funds of the domestic non-life sector was held in the form of Tier 1 own funds, with these firms staying very well capitalised.

Chart 19
MAIN COMPONENTS OF PROFITS – DOMESTIC NON-LIFE INSURANCE SECTOR
(EUR millions)



Source: Central Bank of Malta.
Note: Blue bars indicate pre-tax profits in absolute amounts. Green (positive) and red (negative) bars indicate yearly changes in profit components. These figures are based on management accounts.

Chart 20
LIQUID ASSETS RATIO OF THE DOMESTIC NON-LIFE INSURANCE SECTOR
(per cent)



Source: Central Bank of Malta.

Domestically-relevant Investment Funds

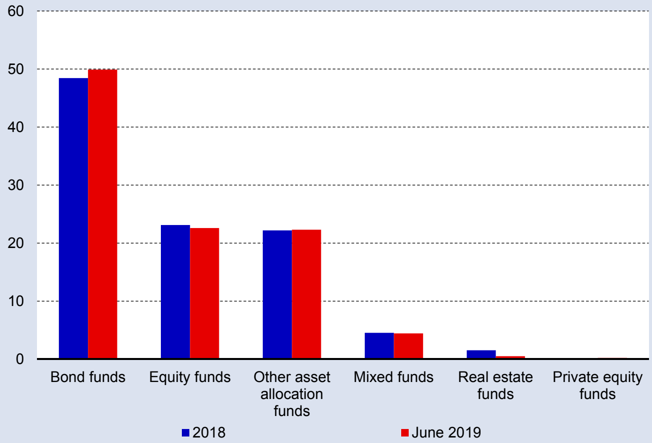
The domestic investment funds maintained an overall stable investment strategy.
During the first six months of 2019, the number of domestically-relevant investment sub-funds contracted by two to 66, with assets totalling €2.5 billion.[40] Yet, assets grew by 4.3% to stand at 19.8% of GDP, up by 0.1 percentage point. Resident investment funds comprised of 35 retail Undertakings for the Collective Investment in Transferable Securities (UCITS) which captured about 56.9% of the domestic sub-funds' total assets. This was followed by 16 Professional Investor Funds (PIFs), representing 19.7% and 11 Alternative Investment Funds (AIFs), accounting for 23.0% of total assets. Retail non-UCITS were limited to three entities accounting for just 0.2% of total assets while one Notified AIF (NAIF) was licensed accounting for 0.2% of total assets.

[39] Intragroup equity holdings accounted for 21.8% of assets and receivables and recoverables represented another 20.3% of assets. These carry a zero weighting when determining the extent of liquidity.
[40] As at December 2018, the total number of domestically-relevant sub-funds was revised to 68, with total assets amounting to €2.4 billion.

Investment Strategy

The investment strategy of the domestic investment sub-funds remained rather stable, with almost half of them classified as bond funds, up by 1.5 percentage points compared to December 2018. Equity funds represented 22.6% of the total sub-funds, with their share narrowing by 0.5 percentage point, while other asset allocation funds accounted for 22.3% of domestic investments funds, almost unchanged compared to six months ago. The rest are predominantly split among mixed funds, real estate funds – which dropped somewhat in the first half of 2019 – and private equity funds, which remained very marginal (see Chart 21).

Chart 21
DOMESTIC INVESTMENT FUNDS BY MAIN STRATEGY
(per cent of total assets)

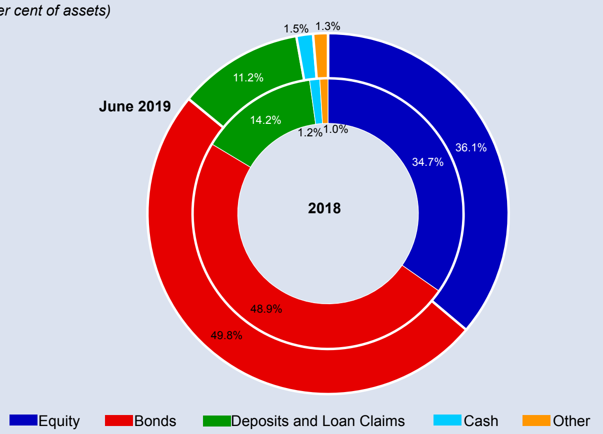


Source: Central Bank of Malta.

Asset Composition

Since end 2018, bond holdings grew by 6.3% to €1.3 billion, equivalent to 49.8% of the sub-funds' assets (see Chart 22). Half of the bonds were sovereign, with the bulk in Maltese Government paper, followed by bonds of US and other euro area sovereigns. Another 22.7% were invested in OFIs, financial auxiliaries and captives, and 13.3% in NFCs, mainly from Malta and the US. The rest of the bond portfolio was invested in banks (7.6%) – mostly from Malta, UK and other EU countries, households and non-profit institutions serving households (NPISH) (4.7%), and insurance corporations (0.9%).

Chart 22
ASSET COMPOSITION OF THE DOMESTIC INVESTMENT FUNDS
(per cent of assets)



Source: Central Bank of Malta.
Note: The 'Other' category mainly consists of financial derivatives and, to a lesser extent, non-financial assets.

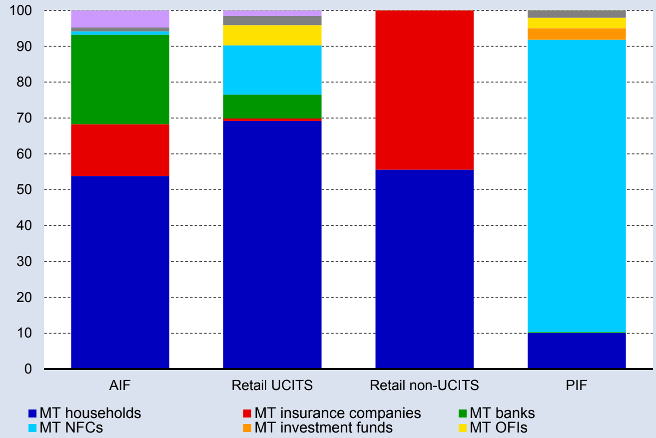
The equity portfolio of the domestically-relevant investment funds amounted to approximately €915 million, accounting for just over a third of total assets. Such holdings expanded by 8.6% since December 2018, predominantly in money market funds (MMFs), OFIs, financial auxiliaries and captives, and non-MMF investment funds. Almost half of the equities were invested in NFCs, mainly situated in Malta and the US, with around another third held in non-MMF investment funds – mainly from Luxembourg and Ireland. Meanwhile, shareholdings in MFIs amounted to 8.4% of total equity holdings – the majority of which in Maltese banks, while investments in OFIs, financial auxiliaries and captives accounted for another 4.4% of the equity portfolio.

Other assets included deposits and loan claims which fell by 3.0 percentage points to 11.2% of total assets, while cash holdings rose, albeit still restricted to 1.5% of assets. Furthermore, in these past six months there was a significant increase in the use of financial derivatives.

Investors

Domestic households and NPISH remained the largest investors in domestically-relevant funds, accounting for 53.8% of total net asset value (NAV). These were followed by NFCs and MFIs, which accounted for 24.2% and 9.5% of total NAV respectively. Meanwhile, non-resident holdings represented only 4.1% of the overall NAV of the domestic funds.

Chart 23
DOMESTIC INVESTMENT FUNDS' NAV BY COUNTERPARTY
(per cent of NAV)



Source: Central Bank of Malta.

PIFs were particularly tapped in by resident NFCs which represented 81.5% of their NAV, whereas resident households and NPISH held another 10.1%. In the meantime, Maltese households and NPISH were the main shareholders in AIFs (53.8% of their NAV), retail UCITS (69.2% of their NAV) and retail non-UCITS (55.6% of their NAV). A quarter of the units in AIFs were owned by Maltese banks. Furthermore, Maltese insurance companies also held a significant amount of units in retail non-UCITS (44.4%) and in AIFs (14.5%) (see Chart 23).

Overall, such investments accounted for around 4.6% of households' financial wealth and just 1.9% of domestic NFC's financial assets.

Risk Outlook

Compared to six months ago, the assets of the domestically-relevant investment funds grew moderately though the overall investment strategy remained largely unchanged.

Structural

With several sub-funds being managed by asset management companies owned by the core domestic banks, an element of potential group contagion risks remains – particularly in the form of reputational and step-in risks. However, these funds are set up as separate legal entities, and are subject to the provisions of the Maltese Companies Act and the Investment Services Act. Funds also employ tools such as redemption gates and redemption fees to avoid possible destabilising liquidation requests to mitigate such risks.

Cyclical

If the current low interest rate environment persists, it may drive fund managers to step up their search-for-yield behaviour. The potential risk of disorderly asset price adjustments could result in downgrades and subsequently fire sales of assets. This also ties in with concerns of a slowdown in the euro area together with geopolitical uncertainties including Brexit. However, the direct impact of Brexit on the domestically-relevant investment funds is contained with exposures to the UK and in Pound Sterling limited to 3.6% and 3.8% of assets, respectively. Furthermore, in a bid to prevent cliff-edge effects, a number of regulations have been amended, granting a Temporary Permission Regime to UK-licensed investment funds, investment firms and asset managers that possess a European passporting right and that already passport into Malta in the case of a no-deal Brexit.

APPENDIX

Appendix:
Financial Soundness Indicators

	Core Domestic Banks					Non-Core Domestic Banks					International Banks[1]					Total Banks[1]				
	2015	2016	2017	2018	June 2019	2015	2016	2017	2018	June 2019	2015	2016	2017	2018	June 2019	2015	2016	2017	2018	June 2019
Core FSIs																				
Regulatory capital to risk-weighted assets	15.00	16.16	17.28	18.13	19.09	22.11	15.48	16.68	17.21	18.02	56.63	49.20	47.93	52.97	51.95	21.75	21.17	21.68	22.67	23.01
Regulatory Tier 1 capital to risk-weighted assets	12.15	13.58	15.19	16.00	16.65	18.59	12.27	13.31	17.00	18.02	56.19	46.69	45.28	50.38	51.86	19.19	18.53	19.39	20.69	21.11
Non-performing loans net of specific provisions & interest in suspense to total own funds[2]	42.84	28.90	22.37	19.78	19.22	7.86	11.98	6.87	11.54	18.06	3.79	8.15	6.89	7.71	5.08	24.32	20.10	16.34	15.34	15.21
Non-performing loans to total gross loans	7.22	5.35	4.07	3.36	3.30	4.04	3.99	2.26	3.64	4.66	1.18	1.70	1.88	2.50	2.19	4.68	4.12	3.23	3.08	3.04
Sectoral distribution of resident loans to total loans																				
Agriculture	0.23	0.19	0.16	0.14	0.12	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.14	0.12	0.09	0.08	0.07
Fishing	0.10	0.07	0.35	0.23	0.16	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.06	0.05	0.20	0.14	0.10
Mining and quarrying	0.09	0.07	0.01	0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.05	0.04	0.01	0.00	0.00
Manufacturing	2.75	2.57	2.64	2.49	2.50	0.57	0.31	0.43	0.34	0.41	0.00	0.01	0.01	0.00	0.00	1.68	1.60	1.55	1.50	1.55
Electricity, gas, steam and air conditioning supply	2.15	2.30	1.55	1.38	1.39	0.00	0.00	0.00	0.88	0.00	0.00	0.00	0.00	0.00	0.00	1.30	1.41	0.90	0.87	0.85
Water supply; sewerage waste management and remediation activities	0.54	0.46	0.43	0.39	0.36	0.00	0.00	0.00	0.00	0.02	0.00	0.00	0.00	0.00	0.00	0.33	0.28	0.25	0.23	0.22
Construction	5.24	4.88	4.54	4.37	4.33	0.00	0.03	2.51	3.30	3.91	0.00	0.00	0.00	0.00	0.00	3.15	2.99	2.74	2.78	2.83
Wholesale and retail trade; Repair of motor vehicles and motor cycles	8.19	7.80	6.85	6.27	5.56	1.11	0.42	2.23	5.24	3.30	0.00	0.00	0.00	0.01	0.23	4.99	4.80	4.07	4.01	3.56
Transportation and storage	2.80	2.30	2.27	1.68	1.43	0.00	0.00	0.00	0.00	0.09	0.22	0.15	0.16	0.24	0.00	1.76	1.46	1.38	1.09	0.96
Accommodation and food service activities	4.12	3.47	2.78	2.96	3.04	0.00	0.00	0.00	0.00	0.02	0.00	0.00	0.00	0.00	0.00	2.48	2.12	1.61	1.77	1.86
Information and communication	0.83	0.67	0.48	0.52	0.50	0.11	0.02	0.07	0.05	0.06	0.00	0.00	0.00	0.00	0.00	0.50	0.41	0.28	0.31	0.31
Financial and insurance activities	5.86	6.79	6.26	6.13	6.25	0.90	2.59	3.71	1.91	1.61	0.03	1.31	0.06	0.00	0.00	3.58	4.74	3.81	3.76	3.90
Real estate activities [includes inputed rents of owner-occupied dwellings]	6.70	7.26	6.95	6.90	6.89	3.50	4.18	4.36	4.76	6.39	0.45	0.03	0.00	0.00	0.00	4.37	4.70	4.21	4.36	4.52
Professional, scientific and technical activities	1.12	1.26	1.42	1.69	2.26	0.00	0.00	0.86	0.80	0.62	0.00	0.00	0.00	0.00	0.00	0.68	0.77	0.86	1.05	1.41
Administrative and support service activities	1.22	1.02	0.81	0.65	1.24	0.11	0.69	1.09	0.76	1.33	0.01	0.01	0.03	0.03	0.00	0.74	0.67	0.52	0.43	0.82
Public administration and defence; Compulsory social security	1.58	1.13	1.30	1.21	1.28	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.95	0.69	0.76	0.72	0.78
Education	0.44	0.33	0.29	0.28	0.27	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.27	0.21	0.17	0.17	0.17
Human health and social work activities	0.73	0.71	0.72	0.79	0.75	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.00	0.00	0.44	0.44	0.42	0.47	0.46
Arts, entertainment and recreation	0.47	0.38	0.32	0.27	0.24	0.00	0.00	0.00	0.00	0.02	0.02	0.02	0.00	0.00	0.00	0.29	0.24	0.18	0.16	0.15
Other services activities	0.27	0.21	0.18	0.19	0.23	0.00	0.00	0.00	0.26	0.04	0.00	0.00	0.00	0.00	0.03	0.16	0.13	0.11	0.13	0.15
Households and individuals (excl. Sole Proprietors)	46.18	48.26	47.51	46.85	47.26	0.14	0.14	2.62	3.45	5.99	0.01	0.01	0.00	0.01	0.00	27.78	29.56	27.66	28.16	29.22
Mortgages	39.77	42.28	42.37	42.29	42.82	0.01	0.01	0.00	0.00	0.00	0.01	0.01	0.00	0.00	0.00	23.91	25.89	24.57	25.26	26.22
Activities of extraterritorial organisations and bodies	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Non-resident loans to total loans	8.37	7.84	12.16	14.62	13.93	93.57	91.60	82.10	78.25	76.17	99.26	98.46	99.73	99.72	99.73	44.31	42.57	48.22	47.81	46.08
Return on assets[3]	0.71	0.76	0.70	0.54	0.66	0.18	0.30	0.25	0.24	0.22	1.01	0.96	1.48	1.45	1.78	0.85	0.84	1.04	0.91	1.07
Return on equity[3]	9.84	10.06	9.20	6.54	7.96	1.44	3.38	2.94	2.22	1.93	3.38	3.65	4.91	5.34	7.63	5.87	6.72	7.33	5.81	7.32
Interest margin to gross income	64.48	62.25	70.79	62.28	62.56	43.54	31.24	31.06	37.65	49.26	137.81	92.57	78.82	80.82	68.80	92.96	72.99	73.28	69.79	64.93
Non-interest expense to gross income	54.15	52.21	58.80	64.34	55.54	73.39	66.52	78.25	61.97	64.14	24.78	31.89	28.13	30.73	29.66	43.31	44.70	44.04	48.42	43.45
Non-interest income to gross income	35.52	37.75	29.21	37.72	37.44	56.46	68.76	68.94	62.35	50.74	-37.81	7.43	21.18	19.18	31.20	7.04	27.01	26.72	30.21	35.07
Liquid assets to total assets[4]	31.77	36.52	29.36	28.32	29.40	36.34	33.45	28.58	32.02	37.12	22.72	30.14	20.56	12.43	6.83	31.19	35.56	16.60	26.51	28.20
Liquid assets to short-term liabilities[4]	50.24	55.80	43.49	37.16	38.96	63.26	67.79	37.36	38.81	44.76	83.59	96.31	43.69	46.72	13.02	52.61	58.71	42.96	37.81	38.00
Other FSIs																				
Total coverage ratio[5]	43.52	45.91	45.24	44.35	44.17	65.24	53.86	65.89	64.61	53.63	50.37	54.81	51.85	53.19	56.97	39.98	47.96	47.44	45.61	45.29
Liquidity Coverage Ratio	165.10	164.43	188.29	316.07	286.60	100.17	194.89	263.87	421.34	389.83	188.27	357.63	279.41	411.72	511.48	159.65	173.87	198.23	329.38	298.92
Domestic debt securities to total assets	9.30	7.90	7.00	6.45	6.69	7.74	4.86	3.16	2.00	2.47	0.17	0.09	0.15	0.10	0.05	4.54	4.02	3.57	3.67	4.01
Foreign debt securities to total assets	21.80	20.62	16.83	15.82	15.65	12.45	14.96	11.87	14.08	12.07	50.39	46.91	42.65	29.47	28.27	35.99	32.83	28.89	21.05	19.99
Unsecured loans to total lending	27.41	25.36	27.70	28.59	16.61	70.87	65.39	67.16	73.39	76.24	30.69	26.69	16.23	17.21	18.05	30.83	28.18	24.97	26.83	19.90
Assets to total capital and reserves	13.72	13.33	11.99	12.16	11.62	8.42	12.12	11.49	8.92	9.01	1.96	2.91	3.36	2.84	2.71	7.98	9.56	9.25	8.92	8.79
Large exposure to total own funds	96.48	110.94	88.40	92.82	82.25	157.63	268.59	274.94	205.66	194.10	129.94	128.77	119.22	78.14	85.94	115.83	130.11	111.05	97.51	92.56
Gross asset position in financial derivatives to total own funds	1.27	1.65	0.87	0.63	0.47	0.33	0.61	0.29	0.03	0.18	67.23	103.03	131.24	166.75	174.94	25.85	37.83	42.68	52.69	48.78
Gross liability position in financial derivatives to total own funds	2.02	2.04	1.03	0.92	1.24	0.27	3.60	0.29	0.90	0.39	15.86	69.19	80.24	102.81	113.80	15.34	22.57	26.41	32.88	32.35
Personnel expenses to non-interest expenses	51.18	48.76	48.05	37.85	45.99	42.46	49.74	45.61	49.76	48.91	23.18	19.88	16.22	14.11	14.07	43.95	40.52	37.58	31.51	35.67
Customer loans to customer deposits	58.22	55.95	58.87	60.88	62.19	60.68	46.51	47.14	50.47	44.41	104.08	108.14	111.55	207.73	342.14	67.89	65.66	70.35	78.95	82.28
Net open position in equities to total own funds	15.44	14.01	13.10	10.83	10.44	81.83	146.79	138.75	107.43	110.15	2.74	1.13	3.40	4.56	6.18	18.10	20.17	18.58	16.83	17.54
Loan-to-value:[6]																				
Residential	77.77	75.12	73.53	72.71	75.83															
Commercial[7]	56.88	67.49	65.14	56.65	62.48															

[1] Satabank plc is being excluded in 2018 and June-19 figures following the MFSA's decision to appoint Ernst and Young Ltd as a competent person in October 2018 in terms of Article 29(1)(c) and (d) of the Banking Act.
[2] Specific provisions for September 2018 refer to Stage 3 allowances.
[3] Based on profit after tax.
[4] The liquid assets to total assets and liquid assets to short-term liabilities figures from 2017 are based on COREP returns.
[5] For the core domestic banks the ratio includes 'Reserve for General Banking Risks' as per the revised Banking Rule 09/2019.
[6] The loan-to-value is a weighted average ratio.
[7] The market share of the banks was adjusted to cater solely for the banks that provided commercial real estate loans. Also, the limited transaction of these loans explains the volatility in the weighted indicators.