



BANK ĊENTRALI TA' MALTA  
EUROSISTEMA  
CENTRAL BANK OF MALTA

# THE CATEGORISATION OF BANKS ACCORDING TO DOMESTIC RELEVANCE

## BOX 1: THE CATEGORISATION OF BANKS ACCORDING TO DOMESTIC RELEVANCE<sup>1</sup>

### Background

The categorisation of banks according to domestic relevance was first introduced in the *Financial Stability Report 2011* with the classification of such banks last updated in the 2014 edition of the Report.<sup>2</sup> Since then, although the classification of banks has been monitored regularly using the same methodology, no reclassifications of banks were warranted.<sup>3</sup> More recently, the methodology was slightly updated to better reflect the domestic relevance of banks in the financial system. Following this change in methodology, the classification exercise was conducted again to compare and analyse any changes resulting from this review in the methodology.

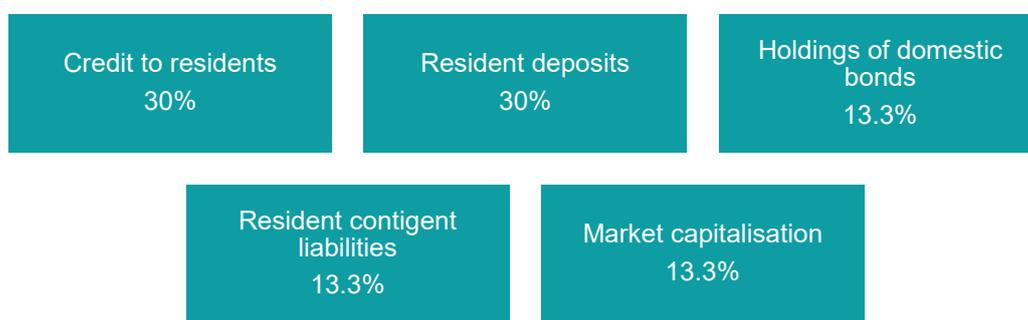
### Main changes in the Central Bank of Malta's methodology for classifying banks

The current methodology is an indicator-based exercise that classifies banks according to their linkages with the domestic economy, and hence their possible systemic impact on the financial system, should an institution-specific adverse event occur. It incorporates five indicators with respective weightings, reflecting the importance of such indicators to determine domestic relevance (see Figure 1).

The revised methodology is more sensitive to the holdings of capital instruments listed on the Malta Stock Exchange (MSE). The previous methodology took into consideration all the banks' bonds and shares issued on the MSE, without distinguishing between resident and non-resident holders of such securities. In this regard, it also captured non-resident investors. However, given that the aim of this exercise is to classify banks according to their linkages with the domestic economy and potential propagation of risk on the domestic financial system and economy, the indicator was updated to capture solely domestic investors, such as resident corporates, households' and other domestic financial institutions. The indicator-based exercise is then executed on the basis of the above-mentioned five indicators, arriving to a domestic systemic score used to classify banks into the respective categories.

A major aspect of the updated methodology is the inclusion of a second step that focuses on business models in borderline cases, where the extent of the banks' domestic relevance is assessed. This is of utmost importance for a borderline bank, which is classified in between categories of banks and may have increased its systemic relevance but its main business is still predominately carried out with non-residents, and therefore its domestic relevance remains limited. Thus, for the business

**Figure 1**  
**CATEGORISATION OF BANKS – INDICATORS AND WEIGHTING**



<sup>1</sup> This Box was prepared by Christian Mamo, a Senior Economist within the Financial Stability Surveillance and Research Department of the Central Bank of Malta.

<sup>2</sup> *Financial Stability Report 2011* – Special Feature – Methodology to categorise institutions for financial stability purposes (<https://www.centralbankmalta.org/file.aspx?f=77>); *Financial Stability Report 2014* – Box 3 – Categorisation of Banks according to system relevance (<https://www.centralbankmalta.org/file.aspx?f=11186>)

<sup>3</sup> Since the last update, some banks closed down, while another bank started operations.

**Table 1**  
**BUSINESS MODEL AND COVERED DEPOSITS CRITERIA**

	Core Domestic Banks	Non-Core Domestic Banks
Business Model Criteria Resident Lending bank (x)/Total Loans bank (x)	≥ 50%	≥ 25%
and/or		
Resident Deposits bank (x)/Total Deposits bank (x)	≥ 50%	≥ 25%
and		
Covered Deposits Criteria Covered Deposits bank (x)/Total DCS fund	≥ 100%	≥ 50%

model indicators, the updated methodology considers two variables, namely, the extent of resident lending and deposits. As indicated in Table 1, specific thresholds are set, conditional to at least one of the variables meeting the set criteria. In addition, the entity must also meet a criterion related to its relative importance in terms of covered deposits under the Depositor Compensation Scheme (DCS).

The methodology also caters for banks that fall in between categories. For a bank to be classified as a core domestic bank, it should have at least one of the two business model indicators exceeding 50% while covered deposits must be at least equal to the overall fund (100%). On the other hand, for a bank to be considered as a non-core domestic bank, at least one of the two business model indicators should exceed 25%, with the covered deposits to be at least 50% of the fund (see Table 1). Any updates to the classification shall be backdated to the time when the relevant bank had started its operations.

## Results

Based on the updated methodology, the current six core domestic banks were re-confirmed. These banks have the most significant linkages with the domestic economy, and hence are the most systemically relevant. In addition, Merkanti bank, which to date was classified as an international bank, will be categorised as a non-core domestic bank (see Table 2). This reclassification was due to

**Table 2**  
**BANK CATEGORISATION**

Size and list of Banks under each Bank category		
Core domestic banks	Non-core domestic banks	International banks
APS Bank plc	FCM Bank Limited	AgriBank plc
Bank of Valletta plc	FIMBank plc	Akbank T.A.S (Branch)
BNF bank plc	IIG Bank (Malta) Limited	CommBank Europe Limited
HSBC Bank Malta plc	Izola Bank plc	Credit Europe Bank NV (Branch)
Lombard Bank Malta plc	Merkanti Bank Limited	Credorax Bank Limited
Medirect Bank (Malta) plc	Sparkasse Bank Malta plc	European Depositary Bank SA (Malta Branch)
		ECCM Bank plc
		Ferratum Bank plc
		NBG Bank Malta Limited
		Novum Bank Limited
		Turkiye Garanti Bankasi A S (Branch)
		Yapi Kredi Bank Malta Limited
Total assets (EUR millions) December 2020		
25,726	3,053	11,579
Total assets (% share of GDP)		
200.6	23.8	90.3

Sources: Central Bank of Malta; NSO.

increased links with the domestic economy, mainly through the bonds listed on the MSE, which are mostly held by residents. The €25 million bond was issued in 2019 by Merkanti Holdings plc, of which €4.5 million were earmarked to be utilised as a subordinated loan to Merkanti Bank to qualify as Tier 2 capital. Additionally, €10.5 million of these bonds were deposited with Merkanti Bank, contributing in part to the increase in its resident deposits.<sup>4</sup> Resident loans also increased significantly since end 2019. No other changes emanated from the revised methodology with respect to international banks. Table 2 shows the updated list of banks within each specific category, which will apply as from this edition of the *Financial Stability Report*.

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<sup>4</sup> Out of the total €25 million issued, only €4.5 million are considered within the market capitalisation indicator. The €10.5 million deposited within the bank are not considered within this indicator, as these are included together with other resident deposits. Meanwhile the remaining funds are not related to Merkanti Bank, and thus not considered for classification purposes.