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BANKING ON IT

The Central Bank of Malta has a new Governor, but certainly not a new face to the industry, as [Giselle Borg Olivier](#) speaks to the former Minister of Finance, [Prof. Edward Scicluna](#), who has taken the helm of one of the most bureaucratic institutions on the island amid a pandemic, discussing the way forward for the adoption of the digital euro, the economic impact of climate change, and what's going to happen with the banking industry in Malta.

G The Central Bank of Malta (CBM) was active during COVID-19 by rolling out measures such as the moratorium issuance and increased payment limits for contactless payments. How important is it for the CBM to take a stand in times like these, and are people aware of the work done by the CBM?

E The CBM took an active role in seeking to minimise as much as possible disruptions in banking services to the public during the COVID-19 pandemic. It updated and issued several measures while keeping abreast with ongoing developments. Possibly the measure which was most impactful for several businesses and households alike was the introduction of Directive No. 18 on Moratoria on Credit Facilities in Exceptional Circumstances issued in April 2020; and which has been reactivated in January 2021 subject to certain conditions.

Another measure to ensure that the public remains well-served by banks during the pandemic in terms of cash services and other paper-based instruments, while at the same time minimising the need for visits to a branch, particularly for the more vulnerable in society—such as pensioners—was the issue of Directive No. 17. This Directive allowed cheques marked as 'only' for use by

the beneficiary to be deposited by trusted third parties, which enabled further social distancing for vulnerable people, limiting their need to visit bank branches.

Subsequently, in agreement with the domestic banks, the contactless limit on EPOS terminals was increased to limit as much as possible human contact in the provision of banking services and hence reduce the likelihood of the spread of the virus and protect both the public and bank staff.

These initiatives have a common theme—an attempt to avoid as much as possible economic and financial disruptions, which in turn, is what financial stability is all about. This is the most important motivation for the CBM's actions during such difficult times.

In terms of awareness, central banks' activity is quite complicated for the public to comprehend. However, financial markets follow the European Central Bank (ECB) statements and actions like a hawk. In a sense, the developments of the pandemic and the CBM's response have shown how the Bank's actions could directly affect people's lives. The Bank took various initiatives to ensure that people understand these measures and how they can make the best

use of them. Apart from using social media and simple 'Q&A' guides to disseminate this information, the Bank made itself available for physical interviews with the press. For the future, I intend to see that the Bank's strategic direction will be towards making itself more accessible. This direction is also in line with the ECB's renewed emphasis on reaching out to the public to explain better its role. In this regard, last year, the Central Bank also organised a series of outreach events to explain the European System of Central Banks' role, of which the CBM forms part. You can expect a much more extensive programme for the future.

G How is the Central Bank managing the banking crisis in Malta regarding the lack of correspondent banks?

E A banking crisis is marked by bank failures, unpaid debt and loss of confidence. However, Malta did not experience this even during the international financial crisis of 2008. This showed our banking system's resilience and good management.

The issue of correspondent banking is a complex one. In recent years, the number of banks offering correspondent banking services worldwide has been dwindling as several international banks have been >



retreating after several of them—such as Deutsche Bank, ING and Danske, among others—were slapped with hefty fines by regulators for money laundering. These banks have had to de-risk. Several small jurisdictions, such as Malta, where turnover is relatively small compared to the costs and risks involved, were no longer sufficiently profitable for such business offered by the correspondent banks. Indeed, this problem affects several countries and many banks as evidenced by various reports and studies from the World Bank, the International Monetary Fund and the Financial Stability Board.

During Malta's EU presidency, the topic was even on the G20's meeting agenda. Last October, the Small States Forum under the auspices of the World Bank issued a communique where it expressed its concerns that increasing pressures in the provision of correspondent banking services is threatening the external trade business and inward investment of small states.

While the maintenance of correspondent banking relationships is ultimately up to individual banks to deal with, the CBM has been taking various actions to ensure that domestic banks maintain their correspondent banking relationships. The CBM, in collaboration with other authorities like the FIAU and the MFSA, has been very active in organising a series of meetings with international banks to explain the evolution of the local regulatory framework, its implementation and resources devoted to the oversight in respect of anti-money laundering and countering the financing of terrorism activities. The aim is to reassure banks offering correspondent banking services that Malta as a jurisdiction has undertaken several reforms in Anti-Money Laundering/Counter Financing Terrorism field.

On their part, domestic banks have also undergone significant de-risking and stepped up their investment in KYC compliance processes as requested by the authorities. This approach is yielding positive results. We are now seeing interest from some banks in offering correspondent banking services in currencies other than the euro which are in discussions with Maltese banks. Although this is good news, nevertheless



the global supply of correspondent banking services remains challenging. Both the local authorities and the domestic banks need to keep the momentum of upholding the standards of governance, risk and compliance management required by correspondent banks for such services.

G What is your short-term and long-term vision for the CBM, in terms of modern payment systems?

E Statistics in Malta show that the local community still makes extensive use of both cash and cheques at the retail level. However, card usage—especially for online purchases—is growing fast. In the coming years, the Bank will continue to promote credit transfers and direct debits at the retail level, which have a much broader reach through SEPA compliance. Through their automated processing, they are highly effective and efficient for users and processors alike. Indeed, this was another reason why the Central Bank of Malta, through its payments hub, is providing payment processors located in Malta with a viable link to the euro area clearing system for both products.

In the future, direct credits and debits need to be complemented with a possible point of sale solution using instant payments to reduce delivery delay. In this regard, the Bank will also evaluate the possibility of providing instant payment services to public sector entities. Instant payments can change the retail experience and, from now on, become

the mainstay product that consumers will need as part of their retail experience. Together with its euro area partner central banks, the Central Bank already offers credit institutions in Malta a clearing system for instant payments, known as TIPS. However, more work is required through legislation to ensure that such a service becomes practical for both vendors and consumers and provides a suitable alternative in face-to-face and digital interactions. Indeed, in the eventuality of introducing a digital euro, this would ensure that central bank money, whether in cash or digital form, entertains all the requirements of users in the euro area for their payment needs, within an infrastructure without traditional borders.

Up to 2019, Malta had no automated clearing house, with banks relying on foreign correspondent banks to clear even domestic payments in euro. Back then, the CBM had decided to embark on an ambitious project to modernise its payment systems infrastructure and offer new services to financial market participants and public sector entities regarding euro payments, which until then only required the use of costly correspondent banks. In 2020, the CBM launched its payments hub project by first becoming a direct participant in the EBA Step2-T platform, which is a pan-European automated clearing house within the Single Euro Payments Area (SEPA), to remove the reliance on foreign commercial banks and the CBM taking over the role of representing indirect participants and clear

SEPA payments for them. Today, participants in the CBM's payments hub can undertake credit transfers and direct debits of euro-denominated payments through the CBM without the need for a correspondent bank. The infrastructure allows for the clearing of both euro payments within Malta and those cross-border. Over the past year, the Bank has already onboarded three participants. A fourth is in the testing phase before participation, while other financial market players have expressed interest in joining. The project is still ongoing, and this year the Bank will be implementing an automated tool to strengthen further its AML and FATF monitoring capabilities for such transactions.

G What is the Maltese stand on the adoption of the digital euro?

E Technological developments in retail payment systems have prompted central banks worldwide to explore a digital currency's issuance. The Eurosystem is also exploring the possible issuance of a digital euro. In October 2020, a report was published by the ECB that examines a central bank digital currency's issuance from the Eurosystem perspective. A digital euro would complement the current offering of cash and wholesale central bank deposits. However, the ECB Governing Council has yet to decide whether to introduce a digital euro.

There are undoubtedly benefits for European citizens from a digital euro as this could make their daily payments fast, easy and secure. Indeed, a digital euro may become essential

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if there is a decline in banknotes and coins, as is the trend in several countries, especially following the COVID-19 pandemic, which has accelerated the pace in the use of electronic means of payment.

The introduction of a digital euro is not free from challenges. First and foremost, the system needs to ensure a high degree of security, especially concerning cyber-attack attempts, to instil confidence in its use by European citizens. Secondly, there are issues concerning privacy protocols. The use of cash offers the highest level of privacy and anonymity, and therefore European citizens may expect the same degree of privacy from a digital euro. However, one needs to consider AML/CFT regulations and considerations in designing a digital euro to ensure traceability of payments.

Another challenge is that a digital euro must address the issue of financial inclusion. Other challenges may arise from a digital euro that concerns the banking sector and financial stability through monetary policy. Much will depend on the strategies adopted in the design of the digital euro to address these challenges.

G The CBM forms part of the Network for Greening the Financial System (NGFS); are you as committed as ECB President Christine Lagarde to raise awareness of climate change's economic impact?

E Our participation in the NGFS stems from our belief that even central banks can do their part in contributing to addressing the challenge of climate change, which is indeed one that requires immediate action. Indeed, the CBM agrees with the ECB stand that although central banks are not in the 'driving seat', they cannot ignore the impact of climate change on economies and—more directly within their remit—its impact on financial stability and monetary policy. This goes beyond embarking on policies to reduce the CBM's carbon footprint in how the Bank conducts its business.

What is happening within the Eurosystem is developing a common stance on climate change—related to sustainable and responsible investments in national central banks' non-monetary policy portfolios. The

CBM has already been on the path towards greener investments in its portfolio as it had begun doing so for the last few years. In the CBM's investments strategy, the Bank has already included Environmental Social and Governance (ESG) considerations. We are focusing on thematic bond investing, where some three years ago, we had invested in green bonds, which account for almost 4 per cent of our assets under management, excluding cash.

Furthermore, the Bank is also adopting a negative screening approach by excluding specific sectors, such as those engaged in coal production, nuclear weapons and tobacco among others, from its portfolios, based on internationally recognised exclusion lists. In this regard, the Bank will be gradually divesting from investments in such sectors, although such holdings currently are minimal and account for about only 0.3 per cent of our portfolio. The Bank also adopted a positive screening approach, wherein 2020 it invested in a Sustainable Response Investments compliant externally managed fund. Currently, we have also stepped up our monitoring of ESG related metrics for our externally managed funds by requesting and monitoring such ratings of these funds.

G What do you feel that you should contribute to the Central Bank as the new governor? Will you ever retire?

E I see the coming five years as an excellent opportunity to use my professional experience to serve my country through the Bank, as I did as Finance Minister for the last eight years and before that. Before that in my various other headship roles. I will join my ex-colleagues and friends now central bank governors in the ECB's Governing Council at the European level. Together, we take important decisions that leave an impact on all of us. There are significant issues at the Eurosystem level—like reviewing our policy instruments, facing climate challenges, and introducing the digital euro. At the local level, I look forward to co-ordinating the long overdue task to bring the two financial regulators, the CBM and the MFSA closer together as has been done in the rest of the Eurosystem.

If I manage to do all this successfully, I will seek to retire and not seek an extension. **M**