

BOX 6: THE SYSTEMIC IMPORTANCE OF O-SIIs IN MALTA¹

1. Background

The CBM jointly with the MFSA annually identify O-SIIs, which are domestic credit institutions that, due to their systemic importance, could potentially create risks to financial stability. The identified O-SIIs are to maintain an O-SII capital buffer rate that enhances the resilience of these institutions by providing an additional layer of loss absorbing capital. A higher capital requirement acknowledges the greater impact that such banks could potentially have on the domestic financial system in case of failure.

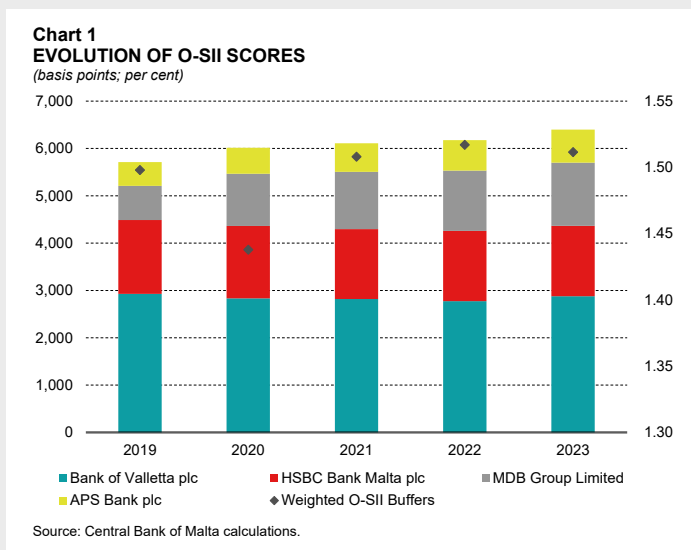
The O-SII methodology is outlined in the CBM-MFSA policy document which is based on a set of EBA O-SII identification criteria guidelines, with some modifications to reflect national characteristics.^{2,3} In line with the EBA guidelines, CBM and MFSA calculate the O-SII score by determining the weighted average market share for each indicator – this is a proxy of overall importance of a given credit institution for the Maltese financial system. The score is then multiplied by 10,000 to be expressed in terms of basis points. If the final O-SII score exceeds the threshold of 425 basis points, that credit institution is identified as an O-SII, and depending on the magnitude of the score, it will be classified into one of five buckets that correspond to an O-SII buffer.

Against this background, section 2 delves into the relevance and coverage of this buffer in Malta. The box in section 3 compares MT O-SII buffers with other O-SII buffers applied in other European countries, while section 4 concludes.

2. O-SIIs significance to the Maltese banking sector

To investigate the relevance and coverage of this methodology, the CBM monitors a number of standard metrics. These help the Bank to gauge the extent of domestic systemic risk as measured by O-SII scores and the appropriateness of the 425 basis points O-SII identification threshold.

As can be observed from Chart 1, looking at the past five yearly assessments, a rising cumulative O-SII score can be observed. This highlights a trend of growing systemic importance of these institutions, reflecting potential higher risks to financial stability in case of failure. This increase can be attributed to the growth of APS Bank plc (39% increase in O-SII score since 2019) and MDB



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² The CBM-MFSA O-SII policy document is available on the following [link](#).

³ [EBA Guidelines on the criteria to determine the conditions of application of Article 131\(3\) of Directive 2013/36/EU \(CRD\) in relation to the assessment of other systemically important institutions \(O-SIIs\) \(EBA/GL/2014/10\)](#).

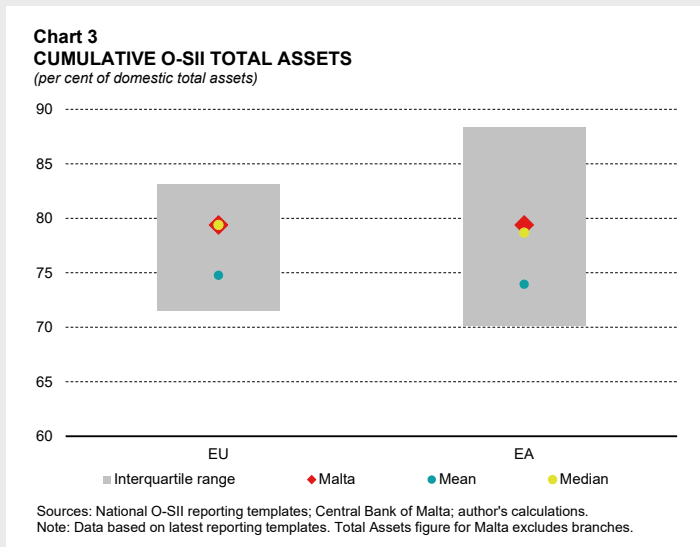
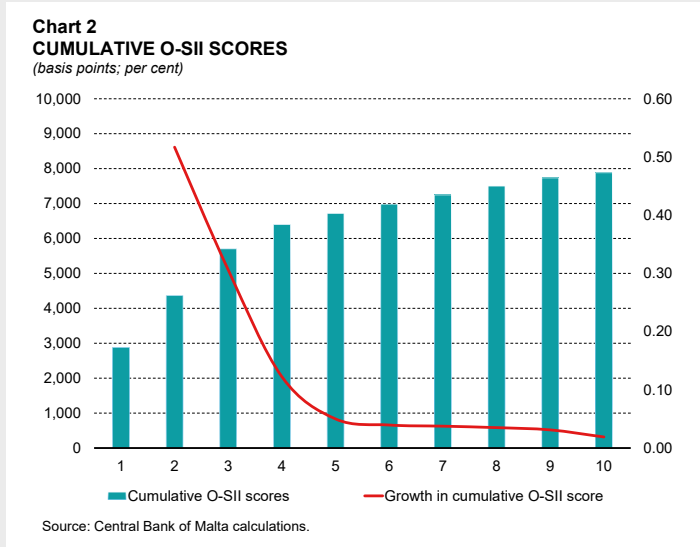
Group Ltd (85% increase in O-SII score since 2019). The increased potential risk to the domestic financial system, has been reflected in the application of higher O-SII buffers. In fact, the weighted average O-SII buffers in Malta hovered around 1.5% between 2020 and 2023.⁴ MDB Group Ltd and APS Bank plc were also requested to hold higher O-SII buffer rates through the years to reflect their growth and the related risk.

In a methodology based on weighted market shares, the total sum of all O-SII scores amount to 10,000 basis points, equivalent to a 100% share in all the risk categories captured in the O-SII methodology. Out of a maximum of 10,000 basis points, the latest assessment captured a total of 6,398 basis points of O-SII score through the identified four O-SIIs (see Chart 2). This is equivalent to around 64% of the total O-SII score of all credit institutions in Malta.⁵

When considering the O-SIIs on a scale of representativeness as seen in Chart 2, if a fifth institution is added to the list, the growth in cumulative O-SII score would only increase marginally by 5% and continue to decrease thereafter, tending to zero. This indicates that the current identification threshold of 425 basis points capturing four credit institutions is appropriate to address the Maltese banking sector's specificities, and adding further institutions adds little value.

3. Comparison of MT O-SII buffer rates with EU counterparts

It is important to assess whether the applied O-SII buffers adequately align with the elevated risk that the macro financial system is potentially exposed to by O-SIIs. This is a combined function of the number of O-SIIs being identified, their relative importance within the domestic economy, and the applied O-SII buffer rates. On average, EU Member States identify five

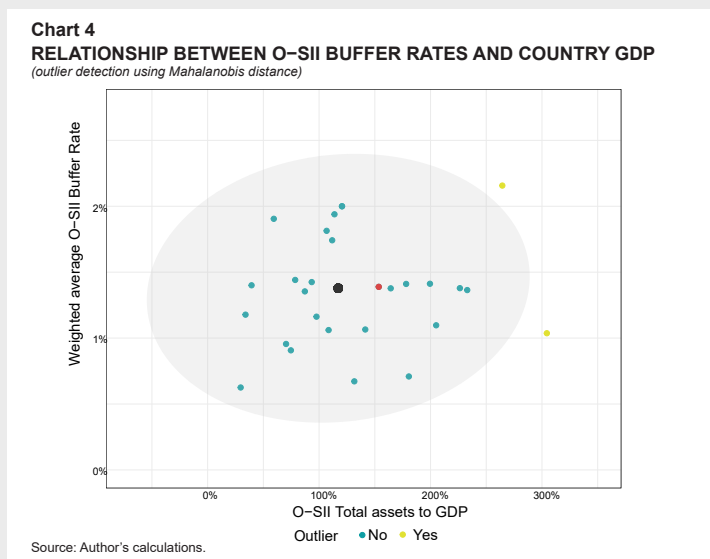


⁴ O-SII buffers are weighted by respective O-SII scores.

⁵ A total of 21 credit institutions (including four branches of credit institutions exercising the right of establishment in Malta) comprise 10,000 basis points. For the purpose of Chart 2, only ten out of 21 credit institutions are taken into consideration.

O-SIIs within their jurisdiction. In Malta, four institutions are identified as O-SIIs. However, together they capture 79.4% of domestic total assets. As shown in Chart 3, this is in line with the EU median, and above the EU mean of 74.8%.⁶ Compared with the euro area, Maltese O-SIIs capture a higher share of total assets than the euro area median (78.7%) and higher than euro area average (74.0%). This also indicates that the O-SII measure captures a substantial level of the domestic banking sector's core activities.

The range of buffer rates under the CBM-MFSA methodology reaches a maximum of 2.00%, which is below the 3% maximum allowed under the CRD. Some euro area countries revised their policies, with O-SII buffers in some jurisdictions reaching a maximum of 2.50%. These national variations can be compared by examining the relationship between applied O-SII buffer rates vis-à-vis the activity of the O-SII banking sector relative to GDP. In Chart 4, the weighted average O-SII buffer rate is compared with O-SII total assets as a percent of GDP, to capture the relevance of O-SIIs within domestic economies.⁷



Countries to the upper left-hand side of the graph have high O-SII buffer rates despite the smaller size of O-SIIs relative to GDP. Conversely, countries to the bottom-right set low O-SII buffers despite the larger size of total assets relative to GDP. Malta, depicted by the red point, has a weighted average rate for O-SIIs of 1.53%, which is close to the centre of the distribution.⁸ When compared to other European peers, this could indicate that given their importance, Maltese O-SII have well balanced O-SII buffer rates.

4. Concluding remarks

O-SII buffers continue to play a crucial role in the resilience of the domestic banking sector. In fact, O-SII buffers account for 34.6% of total CBR, and the 2024 O-SII buffers added 0.97% worth of resilience to the domestic banking system's total capital ratios, a 0.027 percentage-point increase from last year. This buffer increases the loss absorption capacity of credit institutions through the increased availability of capital, thereby making them more resilient to financial stress. Upon evaluating the degree of importance of O-SIIs for the financial system, and following a comparison with other EU peers, the applicable buffer rates in Malta are reflective of the importance of such institutions to the domestic financial system.

⁶ EU mean and median derived by estimating O-SII total assets to domestic total assets at the individual country level.

⁷ Respective O-SII buffer rates are weighted by O-SII total assets.

⁸ The large black dot represents the centroid of the distribution, based on the median. This point is a relative measure that could indicate a proxy for O-SII buffer rates which are appropriate given O-SII importance relative to GDP.