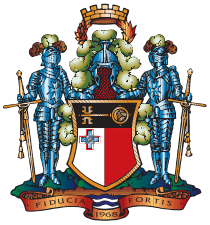
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FINANCIAL STABILITY REPORT

2025



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EIGHTEENTH FINANCIAL STABILITY REPORT

2025

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Unless otherwise stated, the cut-off date for regulatory and prudential returns is 26 February 2026. The general risk assessment in this edition of the Financial Stability Report primarily focuses on developments in 2025, although in some cases it has been updated to reflect more recent events. Unless otherwise indicated, the source of data in the tables and charts is the Central Bank of Malta.

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CONTENTS

Executive summary 8

1. Macroprudential risk assessment 10

2. Developments in the banking sector 26

3. Stress tests 64

4. Insurance companies and investment funds 94

5. Macroprudential policy response 108

Appendices 113

LIST OF BOXES

Box 1: Monitoring financial stability risks: A heatmap approach 19

Box 2: Insights from the Bank Lending Survey 34

Box 3: Systemic risk perceptions of Maltese banks (H1 2026 Survey) 47

Box 4: Evolution of banks' sovereign investment holdings 57

Box 5: Enhancing the credit risk module: From a Z-Factor to a bridge equation approach 68

SPECIAL FEATURE

Using T2 to assess payment-system flows relevant for cyber stress testing in Malta 85

ABBREVIATIONS

AAD	Average absolute deviation
AI	Artificial Intelligence
AFS	Available-for-Sale
AMC	Amortised Cost
ARDL	Autoregressive Distributed Lag
AS	Ancillary System
ASF	Available Stable Funding
AUM	Assets Under Management
BCBS	Basel Committee on Banking Supervision
BI	Business Indicator
BIC	Business Indicator Component
BLS	Bank Lending Survey
BMA	Bayesian Model Averaging
BTL	Buy-to-Let
BU	Banking Union
CB	Central Bank
CBC	Counterbalancing Capacity
CBM	Central Bank of Malta
CCP	Central Counterparty
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1
CLM	Central Liquidity Management
CLS	Continuous Linked Settlement
CMDI	Crisis Management and Deposit Insurance
CMU	Capital Markets Union
CCoB	Capital Conservation Buffer
CRR	Capital Requirements Regulation
CRD	Capital Requirements Directive
CRE	Commercial Real Estate
cSRI	Cyclical Systemic Risk Indicator
DCA	Dedicated Cash Account
EA	Euro area
EBA	European Banking Authority
EBITDA	Earnings Before Interest, Tax, Depreciation and Amortisation
ECAIs	External Credit Assessment Institutions
ECB	European Central Bank
ECL	Expected Credit Loss
EEA	European Economic Area
ESAP	European Single Access Point
ENISA	European Union Agency for Cybersecurity
ETF	Exchange-traded fund
EU	European Union
EUR	Euro
ESCB	European System of Central Banks
ESI	Economic Sentiment Indicator
ESRB	European Systemic Risk Board
FRTB	Fundamental Review of the Trading Book
FSB	Financial Stability Board
FSR	Financial Stability Report
FV	Fair Value
FVTPL	Fair Value Through Profit or Loss
FVOCI	Fair Value Through Other Comprehensive Income
FX	Foreign exchange
GBP	Great British Pound
GDP	Gross Domestic Product
GPR	Geopolitical Risk
GWP	Gross Written Premia
HICP	Harmonised Index of Consumer Prices
HH	Household
HHI	Herfindahl-Hirschman Index
HLTF	High-Level Task Force
HQLA	High-Quality Liquid Assets
ICT	Information and Communications Technology
IFRS	International Financial Reporting Standards
IL	Index-Linked
IMF	International Monetary Fund

ITS	Implementing Technical Standards
IRRBB	Interest Rate Risk in the Banking Book
LCR	Liquidity Coverage Ratio
LGD	Loss-Given-Default
LSTI	Loan Service-to-Income
LTRO	Longer-Term Refinancing Operations
LTV	Loan-to-Value
MCR	Minimum Capital Requirement
MENA	Middle East and North Africa
MFI	Monetary Financial Institution
MFSA	Malta Financial Services Authority
MMF	Money Market Fund
MREL	Minimum Requirements for own funds and Eligible Liabilities
MST	Macro Stress Testing
NAV	Net Asset Value
NACE	Statistical classification of economic activities in the European community
NFC	Non-Financial Corporation
NII	Net Interest Income
NNII	Net Non-Interest Income
NTI	Net Trading Income
NPE	Non-Performing Exposure
NPL	Non-Performing Loan
NPS	Non-Performing Securities
NSFR	Net Stable Funding Ratio
NSO	National Statistics Office
ODP	Online Deposit Platform
OFI	Other Financial Intermediary
O-SII	Other Systemically Important Institution
PCC	Protected Cell Company
PD	Probability of Default
PDW	Persistent deposit withdrawals
PSN	Number of Participants in Payments Systems
RCR	Redemption Coverage Ratio
RMSE	Root Mean Squared Error
ROA	Return on Assets
ROE	Return on Equity
RRE	Residential Real Estate
RSF	Required Stable Funding
RTGS	Real-Time Gross Settlement
RWA	Risk-weighted assets
SDW	Statistical Data Warehouse
SCR	Solvency Capital Requirement
sDSCR	Stressed Debt Service Coverage Ratio
sDSTI	Stressed Debt Service-to-Income
SITO	Systemic Impact Tolerance Objective
SIU	Savings and Investments Union
SME	Small and Medium-Sized Enterprise
SREP	Supervisory Review and Evaluation Process
SRPS	Systemic Risk Perceptions Survey
sSyRB	Sectoral Systemic Risk Buffer
STREAM	Structural and TRaditional Econometric model for Malta
SWIFT	Society for Worldwide Interbank Financial Telecommunication
T2	Eurosystem's Real-Time Gross Settlement System
T2S	TARGET2 Securities
TIBER	Threat Intelligence-based Ethical Red Teaming
TIPS	TARGET Instant Payment Settlement
TLPT	Threat-Led Penetration Testing
TP	Transition Probability
TPU	Trade Policy Uncertainty
TRN	Transaction Report
TSCR	Total SREP Capital Requirement
UCITS	Undertakings for Collective Investment in Transferable Securities
UL	Unit-Linked
UK	United Kingdom
US	United States
USD	United States dollar
WAIR	Weighted Average Interest Rate
WEF	World Economic Forum

THE DOMESTIC FINANCIAL SECTOR

Banks

Core Domestic Banks	Non-core Domestic Banks	International Banks
APS Bank plc	FCM Bank Limited	Akbank T.A.S. (Branch)
Bank of Valletta plc	FIMBank plc	European Depositary Bank SA (Malta Branch)
BNF Bank plc	IIG Bank (Malta) Limited	ECCM Bank plc
HSBC Bank Malta plc	Izola Bank plc	Lidion Bank plc
Lombard Bank Malta plc	Merkanti Bank Limited[1]	Multitude Bank plc
MeDirect Bank (Malta) plc	Sparkasse Bank Malta plc	Nexent Bank NV (Branch)
		Novum Bank Limited
		The Access Bank Malta Limited
		Turkiye Garanti Bankasi A.S. (Branch)

Domestically Relevant Investment Funds

BOV Asset Management Limited	Calamatta Cuschieri Investment Management Limited	Jesmond Mizzi Financial Advisor Limited
BOV Balanced Portfolio Fund	Balanced Strategy Fund	Merill Global Equity Income Fund
BOV Capital Guaranteed Fund 2027	Global Balanced Income Fund	Merill High Income Fund
BOV Capital Guaranteed Fund 2026	Global Opportunities Fund	Merill Total Return Income Fund
BOV Capital Guaranteed Fund GBP 2027	Growth Strategy Fund	
BOV Conservative Portfolio Fund	High Income Bond Fund	**Reaps Asset Management Limited**
BOV Growth Portfolio Fund	Income strategy Fund	APS Diversified Bond Fund
Vilhena Euro Income Fund	Malta Government Bond Fund	APS Income Fund
Vilhena European Multi Manager Fund	Malta High Income Fund	APS Ethical Adventurous Fund
Vilhena Global Themed Fund		APS Ethical Cautious Fund
Vilhena High Yield Fund	**HSBC Global Asset Management (Malta) Limited**	APS Ethical Balanced Fund
Vilhena Malta Bond Fund	Equity Growth Fund	
Vilhena Malta Fund	International Bond Fund	**Self-managed**
Vilhena Malta Government Bond Fund	Malta Bond Fund	Amalgamated Growth and Income Fund
Vilhena Maltese Opportunities Fund	Malta Government Bond Fund	
Vilhena Sterling Income Fund	Maltese Assets Fund	
Vilhena US Multi Manager Fund		

Domestically Relevant Insurance Companies

Life Insurance Companies	Non-life Insurance Companies
HSBC Life Assurance (Malta) Limited	Argus Insurance (Europe) Limited
IVALIFE Insurance Limited	Atlas Insurance PCC Limited
LifeStar Insurance plc	Citadel Insurance plc
MAPFRE MSV Life plc	Elmo Insurance Limited
	GasanMamo Insurance Limited
	MAPFRE Middlesea plc

This edition of the *Financial Stability Report* is based on the above categorisation of banks, domestically relevant insurance companies and investment funds.

[1] Merkanti Bank is in the process of surrendering its Maltese banking licence.

EXECUTIVE SUMMARY

The global macroeconomic environment became increasingly challenging in 2025, reflecting heightened geopolitical tensions and a renewed shift towards protectionist trade policies. Against this backdrop, the Maltese economy continued to expand strongly, with real gross domestic product (GDP) growth reaching 4.0% in 2025, outpacing the euro area average, supported by both domestic demand and exports. While inflation in the euro area moderated, inflation in Malta remained largely stable, though higher than the euro area, almost entirely due to differences in energy inflation. Looking ahead, inflation could pick up slightly before moderating reflecting the impact of the Middle East conflict, with risks to the outlook tilted to the upside.

The share of government debt in GDP rose but remained well below the euro area average and the Maastricht criteria threshold. Concurrently, the financial position of private business firms and households in Malta remained broadly sound, bolstered by sustained economic growth and favourable labour market conditions. Nonetheless, overall leverage within the household segment increased with some pockets of potential vulnerabilities at the tail end of the distribution.

The domestic banking system remained resilient, supported by strong capital, ample liquidity buffers and further improvement in asset quality. The latter reflected historically low non-performing loan ratios coupled with strong coverage levels. Notwithstanding this, increases in Stage 2 loans could signal a potential deterioration in credit quality going forward. Aggregate profitability increased only marginally, but the return-on-assets (ROA) remained broadly in line with EU averages. These developments reflected a recovery in profitability of international banks, while profitability eased among both core and non-core domestic banks amid weaker net interest income (NII) and higher operating costs. Credit growth strengthened further, driven primarily by continued robust mortgage lending and a strong and increasingly broad-based pick-up in lending to non-financial companies, although growth remained more pronounced in property-related sectors. While this supported economic activity, it also contributed to a further build-up of concentration risks within banks' loan portfolios, with elevated exposure to property-related lending and emerging signs of a potential cyclical risk build-up.

The Bank's macro-stress test results continue to confirm banks' resilience under both the baseline and adverse scenarios. In the baseline scenario, banks' profitability is supported by interest income, and capital ratios remain comfortably above the supervisory requirements. The adverse scenario assumes a sharp deterioration in the macro-financial environment, driven by an escalation of geopolitical tensions and trade fragmentation. This, in turn, weakens foreign demand, raises energy and commodity prices, and tightens financial conditions. Under the severe scenario, solvency levels deteriorate, but the results indicate that aggregate buffers remain sufficient for the financial system to absorb such shock. Liquidity and interest-rate sensitivity exercises likewise indicate that banks retain ample capacity to withstand funding pressures and rate shocks.

The domestic non-bank financial sector continued to expand, supported by both the insurance and investment funds sectors. The domestically relevant insurance sector recorded strong balance sheet growth, with the most pronounced expansion observed among the non-life insurers. Premia related to non-life insurance were driven primarily by property insurance, which together with motor and health accounted for most of the premia written. Growth in the life segment was meanwhile driven by index-linked (IL) and unit-linked (UL) products, reflecting increased interest in demand for products combining protection and investment returns. While overall profitability remained strong, it moderated in the life segment but strengthened in non-life insurance. Both sectors maintained robust capital buffers, while liquidity conditions remained broadly in line with the euro area average, driven by strong liquidity within the life segment.

Despite periods of elevated volatility amid heightened global market uncertainty, the investment funds sector recorded moderate growth, supported by strong overall returns. Portfolio allocation continued to shift gradually towards equities and units in investment funds, although bonds remained the dominant asset class. Profitability weakened slightly as the rise in expenses outweighed the increase in revenues. Liquidity positions remained at sustainable levels, although they declined over the year. Portfolio positioning continued

to tilt towards a shorter modified duration, reflecting a cautious stance amid heightened market uncertainty, leaving the sector well-positioned to absorb evolving market risks.

Operational vulnerabilities, including cyber-related risks, continued to gain relevance amid rapid digitalisation and heightened geopolitical tensions, while climate-related risks and other novel risk drivers, including those linked to artificial intelligence (AI), also became more important for financial stability given their potential to amplify shocks across the financial system.

The Report also includes six thematic articles. Box 1 introduces a financial stability risk heatmap designed to support the early identification and prioritisation of emerging systemic risks for macroprudential policy purposes, while Box 2 presents the results from the 2025 Bank Lending Survey (BLS). Box 3 presents the results from the Systemic Risk Perceptions Survey (SRPS) conducted by the Bank among 11 domestic banks, capturing key risks affecting the banking sector. Box 4 examines the evolution of banks' sovereign investment holdings over time, highlighting changes in portfolio composition, while Box 5 discusses a refinement to the credit risk module of the macro stress testing (MST) framework, via a more direct modelling of probabilities of default based on macro-financial variables. Finally, the Special Feature presents a preliminary analysis of TARGET2 transaction data and discusses their potential use for detecting cyber-related sources of risk.

1. MACROPRUDENTIAL RISK ASSESSMENT

The global economic and financial environment in 2025 was characterised by heightened geopolitical tensions and the renewed shift towards protectionist trade policies. Such developments fuelled uncertainty on global supply chains, and contributed to volatility in energy, commodity and financial markets. Geopolitical fragmentation further weighed on global growth prospects, and increased the risk of cyber-attacks, including state-sponsored ones.

Against this backdrop, the near-term global outlook has weakened with the IMF (April 2026) projecting global GDP growth to slow to 3.1% in 2026.[1] Notwithstanding these adverse developments, financial markets benefitted from the strong investment in advanced technologies, including AI, broadly accommodative financial conditions, and efforts by the private sector to adapt to the evolving challenges.

Nevertheless, across the euro area, elevated public debt levels, together with structural pressures and new demands related to defence-related expenditure, are reducing fiscal space, while increasing borrowing requirements. Meanwhile, concerns over stretched asset valuations and vulnerabilities among leveraged non-bank financial intermediaries persisted, heightening the risk of abrupt market repricing. Such dynamics could spill over to the broader financial system through tighter financial conditions, cross holdings of these assets, and increased credit and liquidity risks. Despite these challenges, both the euro area and Malta's financial system continued to demonstrate resilience, supported by a strong regulatory environment. The Maltese financial system continues to remain sound, underpinned by existent macroprudential and supervisory measures and favourable economic conditions.

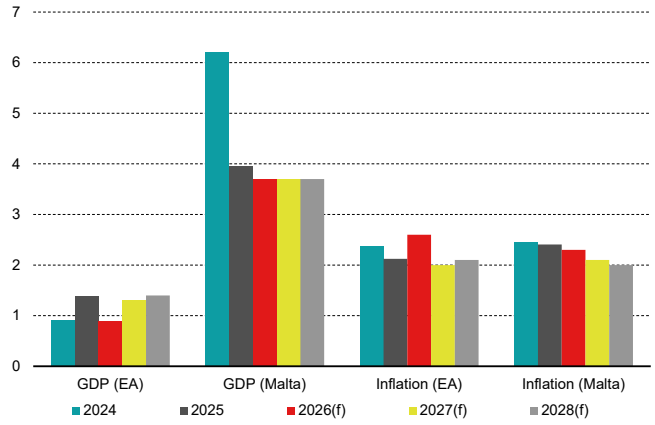
1.1 Vulnerabilities outside the financial system

Economic activity and inflation

In 2025, the euro area economy grew by 1.4% in real terms, driven primarily by robust domestic demand (see Chart 1.1).[2,3] Investment activity showed tentative signs of improvement reflecting better financing conditions, as monetary policy eased gradually. Inflationary pressures moderated compared to 2024, with harmonised index of consumer prices (HICP) inflation declining to 2.1%, supported by the fading impact of past energy price shocks, the normalisation of supply chains and subdued imported inflation. Overall, inflation fluctuated in a narrow range around 2% during most of the year, although upside risks persisted due to geopolitical developments and renewed volatility in energy and commodity prices.

While Malta's economic growth has eased somewhat from recent elevated levels, to 4.0% in 2025, it nevertheless continued to outperform the euro area. Activity was driven primarily by both domestic and foreign demand amid tight labour market conditions and resilience in key services sectors, including tourism, remote gaming and professional services.[4] HICP inflation stood largely stable at about 2.4%, although still exceeding the euro

Chart 1.1
ECONOMIC GROWTH AND INFLATION DEVELOPMENTS
(annual growth rate; per cent)



Sources: Eurostat; ECB; Central Bank of Malta.
Note: GDP and inflation figures for 2026 onwards represent forecasts.

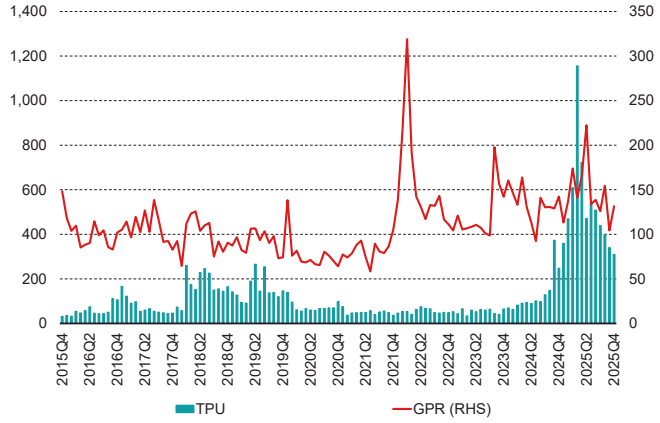
1 World Economic Outlook, April 2026: Global Economy in the Shadow of War
2 Economic Bulletin Issue 2, 2026.
3 Eurostat, ECB staff macroeconomic projections for the euro area – March 2026.
4 Central Bank of Malta, *Quarterly Review*, 2025 Vol.58 No. 4.

average, almost entirely due to the negative contribution of energy inflation in the euro area, which in Malta remained at zero. Inflationary pressures stemmed primarily from food prices and services, especially tourism-related activities, alongside strong wage growth in the context of a tight labour market.[5]

Geopolitical and trade-related uncertainty

The renewed shift to protectionist trade policies led to a significant increase in various measures of policy uncertainty. In particular, the trade policy uncertainty (TPU) index peaked in April 2025.[6] Subsequently, it retreated somewhat but remained high by historical standards, owing to a partial easing of trade-related tensions and greater policy clarity among key economies (see Chart 1.2). The geopolitical risk (GPR) index also followed a similar pattern, retreating in the second half of the year after peaking in June. This reflected fewer abrupt escalations, clearer diplomatic signalling and partial de-escalation in some conflict hotspots, which collectively reduced the perceived likelihood of severe tail-risk events.[7] Concurrently, in the latter half of 2025, financial market pricing pointed to a degree of investor complacency, with compressed risk premia and subdued volatility.

Chart 1.2
TPU AND GPR INDEX



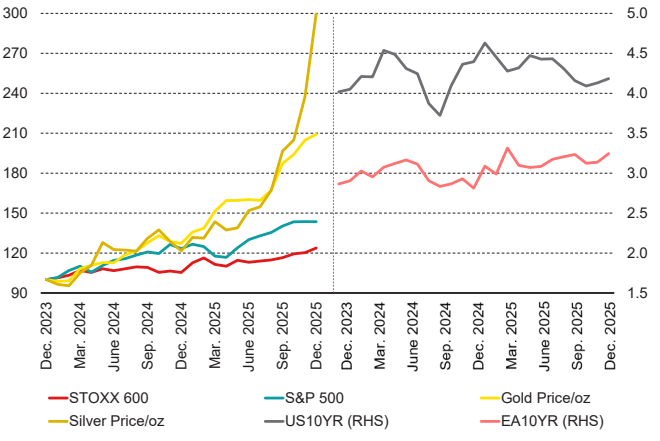
Sources: "The Economic Effects of Trade Policy Uncertaintity", Caldara et al. (2020) and "Measuring Geopolitical Risk", Caldara and Iacoviello (2022).

These developments set the backdrop for the strong performance in several asset classes during 2025, notably equities and precious metals.

Financial market developments and asset valuations

After a slow and volatile start in the first half of the year, equity markets recovered markedly in the second half, with the STOXX 600 and the S&P 500 recording annual gains of around 17% (see Chart 1.3). This performance reflected a combination of supportive developments, including expectations of monetary policy easing and improved investor sentiment. Corporate profitability also proved more resilient than anticipated, underpinned by continued productivity gains, especially in the technology sector, cost containment and strong balance sheets. However, the strong performance

Chart 1.3
FINANCIAL MARKET DEVELOPMENTS
(Index, Dec. 2023 = 100, per cent)



Sources: Investing.com; ECB.

[5] National Statistics Office (NSO), NR 009/2026.

[6] Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo (2020), "The Economic Effects of Trade Policy Uncertainty," *Journal of Monetary Economics*, 109, pp.38-59. Caldara, Dario and Matteo Iacoviello (2022), "Measuring Geopolitical Risk," *American Economic Review*, April, 112(4), pp.1194-1225.

[7] Both the GPR and TPU indices rose sharply in the beginning of 2026 amid reignited GPRs, especially with the war in the Middle East.

contributed to increasingly stretched valuations in certain market segments, heightening the risk of abrupt repricing.

Developments in government bond markets diverged across major regions in 2025. In the United States, the ten-year Treasury yield declined slightly, driven by moderating inflation and increasing confidence in future policy easing. By contrast, long-term government bond yields in the euro area increased over the year, a trend evident across key ten-year benchmarks. This upward pressure reflected several factors, including a repricing of term premia amid persistent fiscal concerns, higher sovereign issuance to finance elevated deficits, and the diminished presence of central banks as marginal buyers, following balance sheet normalisation.

Precious metals were by far the best performing asset class in 2025, with gold and silver prices rising by almost 65% and 150%, respectively.[8] During the year, expectations of US monetary policy easing, the depreciation of the US dollar and declining real interest rates raised the appeal of non-yielding precious metals, while heightened geopolitical and fiscal uncertainties reinforced safe-haven demand, including from central banks, as investors sought diversification amid elevated market uncertainty. In the case of silver, these factors were complemented by robust industrial demand linked to the energy transition, notably in solar and electrification technologies, as well as ongoing supply constraints.

Public debt sustainability

The euro area government debt-to-GDP ratio increased slightly to 87.8% in 2025, up from 87.0% a year earlier.[9] This reflected several factors, including primary deficits, higher interest expenditure and increased sovereign issuance amid rising borrowing costs. All of these factors, in turn, constrained the pace of debt reduction. These effects were partly offset by favourable growth-interest rate differentials and the unwinding of crisis support in some of the euro area countries. However, structural pressures such as ageing, defence spending, and green and digital investment persist, and are expected to weigh on fiscal sustainability over the medium term. Furthermore, public debt levels across the euro area remained highly heterogeneous, reflecting differences in legacy debt levels, fiscal policy choices, growth performance and exposure to past crises. This divergence implies uneven fiscal space and varying sensitivities to interest rate shocks across Member States.

In Malta, government debt-to-GDP ratio remained well below the euro area average and the Maastricht threshold standing at 46.4% in 2025, thereby providing more fiscal space relative to the euro area. This favourable position was supported by strong economic growth and a significant narrowing of the fiscal deficit. Nevertheless, the debt ratio continued to face upward pressure in 2025, driven by persistent fiscal deficits, in part driven by subsidies.[10]

Private sector indebtedness

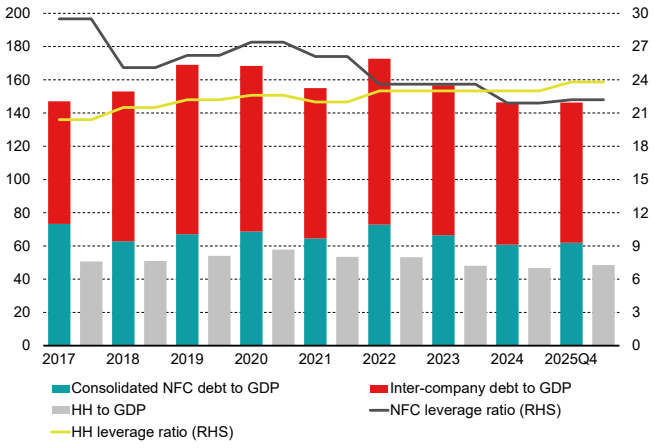
In 2025, euro area private sector debt as a share of GDP contracted, on the back of developments in both the corporate and household sectors. Euro area corporate debt-to-GDP ratios declined from 67.3% to 65.8% in 2025. However, while lower interest rates helped ease financing pressures, the full effects of past rate increases continued to filter through and thus continued to weigh on corporates.[11] Meanwhile, households' vulnerabilities remained contained, supported by easing financing conditions, higher real incomes and strong labour markets. This resilience was also reflected in a comparatively high household savings ratio, although part of this may have stemmed from precautionary behaviour amid elevated geopolitical uncertainty.

Domestically, corporate debt remained stable at about 146% of GDP, largely reflecting intra-company lending. On a consolidated basis, indebtedness stood at 61.9% of GDP, below the euro area average

[8] Gold and silver prices experienced a sharp sell-off towards the end of January 2026, in part reflecting profit-taking after the sharp rally and appreciation of the USD.
[9] Source: Eurostat.
[10] Refer to Annual Report, 2025 – Box 3 – The Sustainability of Maltese Government Debt.
[11] *ECB Financial Stability Review*, November 2025.

(see Chart 1.4). The leverage ratio remained low at 22.2%, below the euro area average of 25.4%, partly due to the predominance of services-oriented sectors with lighter balance-sheet. The household sector also remained resilient, supported by favourable labour market conditions. Household debt stood at 48.5% of GDP, below the euro area average of 50.5%, and was supported by significant financial assets amounting to 145.8% of GDP.

Chart 1.4
HOUSEHOLD AND CORPORATE DEBT
(per cent)



Sources: Central Bank of Malta; NSO.

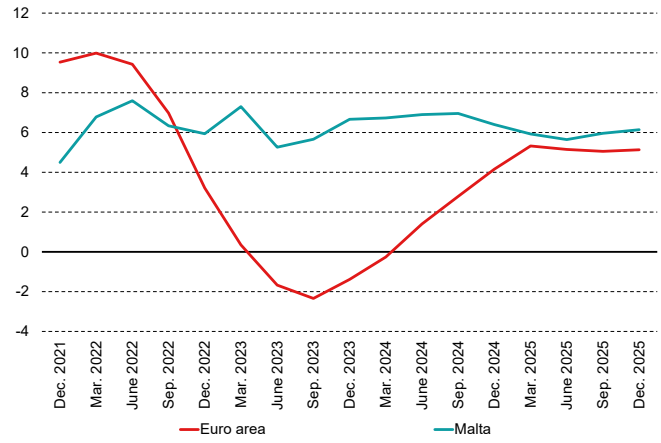
The majority of these assets were held in cash and deposits, consistent with the elevated savings rate, which reached 19.4% in 2024, the third highest in the EU.[12] Although disposable income grew by 7.7%, the leverage ratio continued to trend upwards, increasing to 23.8%, slightly above the euro area average of 22.6%.

Real estate market developments

The euro area real estate market recorded broadly positive developments, with both the residential and commercial markets showing signs of recovery and stabilisation. The residential real estate (RRE) market remained resilient, supported by robust mortgage demand, driven by lower interest rates and improved housing market prospects. These developments are consistent with evidence from the euro area BLS.[13]

At the same time, the commercial real estate (CRE) market stabilised following a sharp correction earlier in the year. Transaction activity saw a modest pickup, and while the quality of CRE loan portfolios has continued to weaken, the pace of deterioration slowed, with nonperforming loan (NPL) flows standing at close to zero in recent quarters.[14] Nevertheless, in the euro area, certain segments, particularly office space and non-prime assets, continued to experience subdued market activity.

Chart 1.5
RRE PRICES
(per cent; year-on-year growth)



Source: Eurostat.

At the domestic level, RRE price growth stabilised at around 6% (see Chart 1.5). This was mirrored in transaction-based indicators, with registered deeds involving households increasing by 4.5% and promises-of-sale agreements rising by 6.2%, pointing to sustained activity in the near term. On

[12] Source: NSO, NR 226/2025.
[13] Refer to Box 2 *Insights from the Banking Lending Survey*.
[14] See footnote 11.

the supply side, building permits for dwellings rose by just over 40%, helping to accommodate the persistent strong demand for housing.

Lending standards remained prudent, as evidenced by the average Loan-to-Value (LTV) ratio of around 76% and an average Loan Service-to-Income (LSTI) ratio at just above 25%. As expected, first-time buyers exhibited higher ratios, with their average LTV and LSTI standing at 80% and 26.5%, respectively.

In the CRE segment, evidence points to emerging signs of recovery, corroborated by the NSO's statistical insights showing that commercial property prices rose by 11% in 2024, after the declines recorded in 2020.[15]

1.2 Vulnerabilities within the financial system

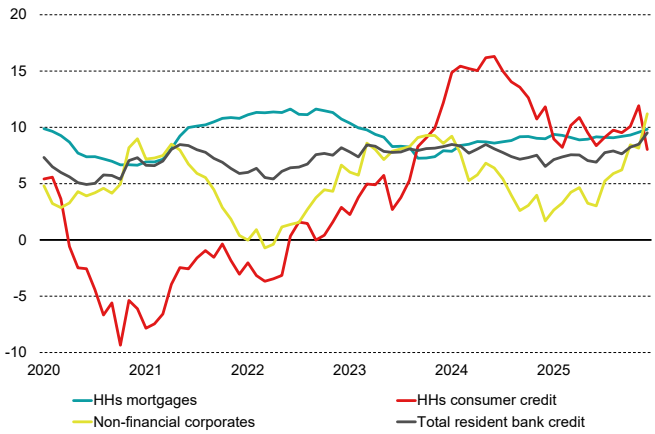
Banking sector developments

Profitability of euro area banks increased only marginally in 2025, although it remained at healthy levels, with an ROA of 0.73%.[16] The modest improvement in profitability was driven by non-income sources, including trading and investment income as well as net fee income. At the same time, NII continued to decline amid further compression in net interest margins, with the NII as a share of operating income dropping by 2 percentage points to 58.3%. Euro area banks maintained solid cost efficiency with a cost-to-income ratio of 53.3%, alongside strong capital and liquidity buffers. The total capital ratio stood at 20.4%, while liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) stood at 163.1% and 126.9%, respectively. Asset quality improved further, with the NPL ratio declining slightly to 1.8%.

Domestic banks recorded a marginal improvement in profitability, with the ROA rising to 0.8%. This improvement was driven by the return to profitability of international banks, as both core and non-core domestic banks experienced a decline in profitability, with ROA declining by 0.3 and 0.2 percentage points to 0.8% and 0.2%, respectively. These developments reflected lower NII alongside higher operating expenses across both groups. At the same time, growth in non-interest income highlighted the increasing importance of diversifying revenue streams.

Resident credit continued to expand at a robust pace, increasing by 9.5% in 2025, exceeding the 6.5% growth registered in the previous year (see Chart 1.6). This acceleration was driven primarily by strong growth in resident credit to non-financial corporations (NFCs), which increased by 11.2%, compared to just 1.7% in the previous year. Resident mortgage lending also remained buoyant, with annual growth reaching 9.8%. The dynamics on both mortgage and NFC credit to real estate related sectors continued to contribute to an already elevated concentration risk in the banks' loan books, with such property-related lending accounting for 73.7% of overall resident loan portfolio. The strong expansion of such credit is also reflected in the widening positive

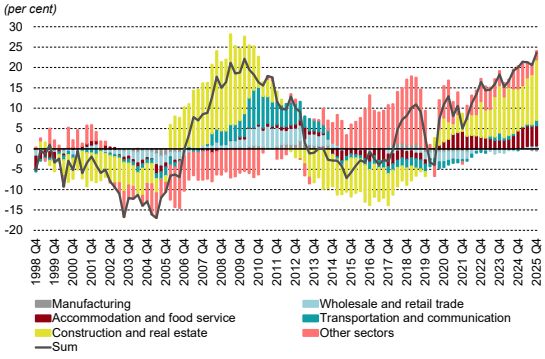
Chart 1.6
ANNUAL RESIDENT CREDIT GROWTH RATE
(per cent)



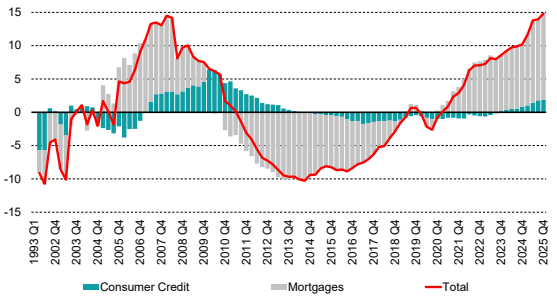
Source: Central Bank of Malta.

[15] NSO: Commercial Property Price Index 2024.
[16] EBA risk dashboard 2025Q4.

Chart 1.7
SECTORAL CREDIT GAPS BASED ON THE HAMILTON REGRESSION FILTER – CORPORATES
(per cent)



SECTORAL CREDIT GAPS DERIVED USING HAMILTON FILTER – HOUSEHOLDS
(per cent)



Source: Author's estimates; Central Bank of Malta.
Note: The sectoral credit gaps are weighted by the share of loans of each sector in total loans.

credit gaps, signalling the potential build-up of cyclical pressures (see Chart 1.7). Domestic banks reported a further improvement in asset quality, with the NPL ratio declining to 1.7%. At the same time, they continued to operate with ample capital and liquidity buffers, as evidenced by a total capital ratio of 27.8%, LCR of 370.4% and an NSFR of 179.7%, respectively.

Insurance and investment fund sectors

The euro area insurance sector continued to exhibit solid solvency metrics, with ratios remaining comfortably above regulatory requirements across both life and non-life segments. In December 2025, the median Solvency Capital Requirement (SCR) ratios stood at 244.4% for life insurers and 219.0% for non-life insurers.[17] Underwriting and investment performance remained broadly stable, with a sector-wide ROA of 0.9%. Premium growth moderated compared to the previous year, easing to 6.6% for the life segment and around 4.5% for non-life insurance.

Domestically relevant insurers mirrored this solid performance supported by robust capital buffers across both business lines. SCR ratios for 2025 stood at 271.5% and 238.3% for life and non-life insurers, comfortably above euro area medians. Life premia grew by 6.8%, while non-life insurers continued to outperform their euro area peers in underwriting efficiency. In fact, the combined ratio of non-life insurers stood at 71.8%, significantly below the euro area median of 94.8%. Profitability remained strong, with a median ROA of 6.8%, driven primarily by the non-life sector. Liquidity across both sectors remained broadly in line with the euro area, with a median liquid assets ratio of 45.2%.

The euro area investment funds sector recorded strong growth in 2025, with total assets expanding by 12.2%. This growth was largely underpinned by favourable conditions in both equity and bond markets. Leverage increased modestly, as reflected in the rise in the assets-under-management to net-asset-value (AUM-to-NAV) ratio rising from 109% to 110.5%. Euro-area funds maintained an equity-heavy portfolio structure, with equities and investment funds units accounting for 57.5% of total assets at end-2025.

By contrast, domestically relevant investment funds experienced a more subdued growth of 2% during the year. The slower expansion largely reflected differences in portfolio composition, as domestically relevant funds exhibited lower exposure to equities and fund units, which accounted for 34.4% of portfolios at the end of 2025. These funds also continued to operate at significantly lower leverage levels, with an AUM-to-NAV ratio of 100.2%. From a liquidity perspective, domestically relevant investment funds held high-quality liquid assets (HQLA) equivalent to 57.7% of total assets, although this share has continued its gradual decline in recent years. Redemptions increased during the year but remained within manageable levels, while holdings of cash and deposits decreased. Overall, profitability of domestically relevant funds declined slightly over the year.

[17] See Insurance Risk Dashboard, April 2026.

1.3 Risk outlook and emerging risks

Macroeconomic outlook and external risks

Looking ahead, the euro area economy is expected to grow by 0.8% in 2026, representing a downward revision compared with previous forecasts. This mainly reflected expected weaker contribution from net trade and government consumption, alongside the adverse impact of higher energy prices, and elevated geopolitical uncertainty. Growth is expected to recover thereafter to 1.2% in 2027 and 1.5% in 2028. Inflation is projected to reach 3.0% in 2026 before converging to the 2% target.[18,19]

Nevertheless, risks to the outlook remain tilted to the downside. Heightened geopolitical tensions, particularly related to the war in the Middle East, and ongoing trade fragmentation pose material risks to growth and inflation dynamics. These risks are already starting to materialise, notably through higher global energy prices and disruptions to oil supply routes. Such developments may keep inflation high, tighten financial conditions and weigh on global growth, especially if the conflict is prolonged.

Domestically, economic growth is expected to remain robust, stabilising at around 3.7% for the next three years. Growth will continue to be primarily driven by private consumption, alongside contributions from investment and net exports.[20] Inflation is projected to remain at around 2.4% in 2026 and gradually decline towards the ECB's medium-term target by 2028.

Fiscal and sovereign risks

Despite the monetary policy easing in the first half of 2025, limited fiscal space in several Member States may constrain the ability of policymakers to respond to adverse shocks. Rising public financing needs, also driven by higher defence spending and population ageing, are expected to increase sovereign vulnerabilities and strengthen sovereign-bank linkages, thereby heightening sensitivity to fiscal shocks.

In Malta, however, public debt remains well below the euro area average. The debt-to-GDP ratio is projected to peak in 2026 before gradually declining, supported by narrowing of fiscal deficits and favourable growth-interest rate differential.[21]

Private sector outlook and domestic macroeconomic risks

A deterioration in the macroeconomic outlook could weaken the debt servicing capacity of the private sector, with implications for credit quality and bank profitability. At the same time, abrupt market repricing could lead to valuation losses and tighter financial conditions.

While the domestic sector remains broadly resilient, a deterioration in confidence, particularly in the context of intensified geopolitical tensions, could weigh on consumption. This risk is, however, more pronounced for low-income and highly indebted households, which remain more exposed to adverse shocks despite the overall resilience of the household sector supported by favourable labour market conditions.

Financial sector risks

Both the euro area and domestic banking systems remained resilient, supported by strong capital and liquidity buffers, and profitability. Nevertheless, downside risks remain. A weaker macroeconomic outlook may lead to higher credit losses with some early signs of a modest increase in Stage 2 loans already observed. At the same time, elevated market volatility may weigh on fee and trading income. Rising operational and investment costs, particularly those related to digitalisation, may also pose challenges to profitability. Indeed,

[18] Eurosystem staff macroeconomic projections for the euro area, June 2026.
[19] Economic Bulletin Issue 2, 2026.
[20] Central Bank of Malta, Outlook for the Maltese Economy 2026:1.
[21] See footnote 20.

some domestic banks have already experienced higher cost-to-income ratios, underlining the importance of maintaining cost discipline and diversifying income sources.

The high concentration of domestic banks' loan portfolios in property-related loans remains a key vulnerability, although the sector continues to be supported by strong economic environment, a resilient labour market and a sound household financial position.

The insurance and investment funds sectors also entered 2026 in a broadly sound position. However, they remain exposed to downside risks stemming from geopolitical developments and heightened market volatility, which could affect liquidity conditions and profitability.

Structural and systemic risks

Structural risks remain significant. The rapid digitalisation of financial services has increased exposure to cyber threats, with potential cross-sectoral and cross-border spillovers. The growing use of generative AI, while enhancing efficiency, introduces new operational and model risks and may increase the potential for market disruptions.

Moreover, rising regulatory fragmentation at the global level could encourage regulatory arbitrage and the build-up of risks in less-regulated segments of the financial system.

The transition to a low-carbon economy entails financial risks arising both from the adjustment process itself, as well as from the physical impacts of climate change, with implications for financial institutions' lending, investment and underwriting activities. These structural challenges, combined with existing cyclical vulnerabilities, may interact in ways that amplify shocks through feedback loops, posing risks to financial stability.

Table 1.1
SUMMARY OF RISKS

Main vulnerabilities and risks to financial stability		Risk assessment (2025) and Outlook (2026)
Vulnerabilities outside the financial system		
Geopolitical uncertainties	GPR affecting the euro area remained characterised by persistent global trade tensions, renewed protectionist measures, and heightened political uncertainty, alongside escalating regional conflicts, including the ongoing war in the Middle East. These developments heightened economic uncertainty and amplified downside risks to growth and upside risks to inflation. External shocks, including shifts in US trade policy and continued global supply chains disruptions may further weigh on the economic outlook, while also affecting confidence and financial market sentiment.	
Inflationary pressures	Domestic inflation remained broadly stable during 2025, although it continued to be driven by food prices and tourist-related services and is projected to return to around 2% by 2028. Across the euro area, inflationary pressures eased further and stabilised at around 2% until early 2026. Looking ahead, upside risks remain across the euro area, particularly from energy and commodity prices, with possible spillovers to domestic inflation through indirect effects, prompting the ECB to raise its key policy rates by 25 basis points in June 2026.	
Reassessment in risk premia	Global financial markets hovered close to record levels despite lingering concerns over elevated asset valuations. Such conditions increase the likelihood of abrupt repricing episodes and disorderly market corrections in the event of adverse shocks. Sovereign bond yields also remained relatively high, reflecting geopolitical uncertainty and renewed concerns regarding public debt sustainability in several euro area countries. Despite a temporary sell-off in early 2026, valuation pressures continued to pose risks to market stability.	
Euro area economic activity and public debt sustainability	Economic growth in the euro area remained modest in 2025. At the same time, rising defence expenditure, structural spending pressures linked to population ageing, and persistently elevated sovereign yields continued to weigh on public finances. In several Member States these factors may intensify existing debt sustainability concerns and increase sensitivity to fiscal shocks.	
Domestic macroeconomic activity and public debt sustainability	The domestic economy remained resilient, supported by strong labour market despite a volatile external economic environment. Public debt dynamics remained sound, and although the government debt-to-GDP ratio increased in 2025, it continued to remain comfortably below the levels observed in most other euro area economies, while the fiscal deficit declined markedly to 2.2% of GDP.	
Real estate market developments	Malta's RRE market remained resilient, with house price growth staying firm, albeit on a gradually moderating path and increasingly converging with euro area levels. The sector continues to be underpinned by solid macroeconomic fundamentals, sustained labour market strength, and robust tourism activity, and generally healthy household balance sheets. Strong supply dynamics, as reflected in rising building permits, also helped accommodate persistent demand.	
Vulnerabilities within the financial system		
Developments in mortgage lending	Growth in resident mortgage lending remained buoyant, in line with continued strength in the domestic housing market. This was reflected in a positive household credit gap, suggesting that credit growth may be outpacing underlying fundamentals. Nevertheless, prudent lending standards and targeted macroprudential measures continue to provide important safeguards against the accumulation of systemic risks.	
Developments in NFC lending	After moderating in 2024, lending to resident NFC rebounded strongly in 2025, with growth registered across most sectors. This contributed to the widening of positive sectoral credit gaps, particularly in property-related activities, which remained a key driver of overall credit expansion and a potential source of vulnerability.	
Concentration in sectoral lending	Loan portfolio concentration in the Maltese banking sector increased further, with resident mortgages and lending to construction, real estate, and accommodation activities now accounting for almost three-quarters of total resident credit. This rising concentration heightens the sector's sensitivity to cyclical downturns and sector-specific adverse shocks.	
Credit quality of the loan portfolio	Asset quality indicators showed continued improvement underpinned by continued declines in NPL ratios across both mortgage and NFCs portfolios, as well as reduced forborne exposures. Nevertheless, the marginal increase in Stage 2 loans may point to the potential emergence of some credit risk and thereby warrants continued close monitoring.	
Profitability developments	Profit growth was primarily driven by international banks, while both core and non-core domestic banks recorded weaker profitability. Nonetheless, the ROA of core domestic banks, as well as the overall banking sector, remained strong and broadly in line with the EU average and well above pre-pandemic levels. Looking ahead, downside risks to profitability remain, stemming from both income and cost pressures.	
Liquidity developments	Domestic banks maintained a strong liquidity position, supported by continued deposit inflows. Funding conditions improved further during the year, with funding costs continuing to decline in line with the lower-interest rate environment.	
Operational risk	Accelerated digitalisation across the financial sector improved operational efficiency but also increased exposure to cyber risks, potential data breaches, and technological disruptions. Despite these emerging threats, operational risk-weighted assets have remained broadly stable, however, close monitoring is warranted given potential systemic implications from such improvements.	
Domestically relevant insurances	Both life and non-life insurers expanded their balance sheets while maintaining strong capital positions. Life insurers sustained their recovery in gross written premia and profitability improved notably. Non-life insurers continued to post solid results, supported by resilient underwriting performance. However, vulnerabilities persist due to euro area macroeconomic and geopolitical uncertainty.	Life insurers  Non-life insurers 
Domestically relevant investment funds	Domestically relevant investment funds recorded modest asset growth amid market volatility. Leverage declined slightly and remained contained, while liquidity weakened due to falling cash holdings. Cross-sector interconnectedness remained elevated and profitability stayed strong. Looking ahead, sustained market volatility and tighter financial conditions could pose challenges for liquidity management and asset valuations.	
Cross-cutting risks		
Climate and nature-related risks	Climate and nature related risks are becoming increasingly evident, including through more frequent and severe weather-related events, which are affecting market behaviour and risk assessment. While transition risks remained relevant, physical risks are becoming more prominent, with the potential to disrupt economic activity, infrastructure, and financial stability. These risks are also relevant for Malta, given its geographic exposure and structural characteristics.	

Risk level: Limited | Moderate | Elevated

Risk direction: Increased  Stable  Decreased 

BOX 1: MONITORING FINANCIAL STABILITY RISKS: A HEATMAP APPROACH[1]

Introduction

Effective monitoring of financial stability depends on the timely identification of emerging risks and vulnerabilities that could undermine the resilience of the financial system. By aggregating information across a broad set of indicators, including macroeconomic conditions, financial market developments, credit dynamics and confidence measures, the financial stability heatmap facilitates the identification of areas where vulnerabilities may be gradually accumulating. Within the broader financial stability surveillance framework, the heatmap provides a concise system-wide perspective that complements the more in-depth sectoral analyses presented elsewhere in the *Financial Stability Report*.

From a financial stability perspective, this approach strengthens risk monitoring by enabling policymakers to track changes in the risk environment over time and across sectors. It supports the identification of emerging vulnerabilities, helping to prioritise areas for further analysis and inform discussions on appropriate macroprudential responses. This boxed article begins by describing the methodology underpinning the heatmap, then presents the results and associated insights, and concludes with a summary of key findings.

Methodology

The heatmap monitors potential risks and vulnerabilities across seven broad categories. Of these, three capture developments in the financial sector, while the remaining indicators cover macroeconomic conditions and developments in the real economy relevant for financial stability assessment.

For the financial sector, the framework evaluates key indicators for the core domestic banks, domestically relevant insurance companies, and domestically relevant investment funds. It focuses on metrics related to solvency, profitability and liquidity alongside business model-specific indicators, as derived from the respective internal dashboards (see Table 1a). Given that most of the categories comprise multiple indicators, variables were standardised using z-scores to ensure comparability. These standardised indicators are then aggregated within each category using equal weighting. The aggregated standardised indicators for each category are weighted according to the relative size of the respective financial institutions, ensuring that larger entities have a proportionate influence on the final assessment. Where necessary, indicators are transformed so that higher values consistently correspond to higher levels of risk, thereby ensuring a coherent and intuitive interpretation across indicators and categories.[2]

The domestic and external macroeconomic environment also serves as a backdrop through which potential risks may transmit to the financial sector. Accordingly, the framework incorporates indicators capturing the economic sentiment and systemic stress for both Malta and the euro area, alongside other headline macroeconomic variables such as GDP growth, inflation, government debt levels and the current account balance.[3] In addition, the heatmap considers vulnerabilities arising from domestic non-financial corporates (NFC) and households, including indicators related

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[1] Authored by Mr Christian Mamo, Principal Economist within the Financial Stability Surveillance and Risk Assessment Department. The author would like to thank Mr Stefan Scerri, Ms Luana Camilleri, and Mr Luke Camilleri for their work on the risk dashboards, as well as Mr Andrew Spiteri, Ms Wendy Zammit, Mr Alan Cassar, Deputy Governors Oliver Bonello and Rita Schembri, and Governor Alexander Demarco for their valuable suggestions.

[2] These include indicators such as Tier 1 capital, LCR and ROA.

[3] For the ESI, the current account-to-GDP ratio and the GDP growth rate, scores are inverted, such that higher values correspond to lower levels of risk. GDP growth and the inflation rate refer to annual growth rates. GDP growth is in real terms. The current account as a share of GDP is calculated as a four-quarter moving average.

Table 1a
SUMMARY OF RISKS

Risk Category	Core Domestic Banks	Domestically relevant Insurance companies	Domestically relevant Investment funds
Solvency	Tier 1 capital buffers	SCR coverage ratio	Leverage ratio
	Leverage ratio	Quality of own funds	
	Total risk exposures as a share of overall risk exposure	MCR coverage ratio	
		Gross technical reserves / gross premium written	
Credit	NPL ratio	Weighted external credit rating for bond holdings	Weighted external credit rating for security holdings
	Coverage ratio	Weighted external credit rating for equity holdings	
	Forbearance ratio	Exposure to non-traditional investments	
	Share of low & unrated securities		
Profitability	ROA	ROA	ROA
	Cost-to-income	Expense ratio (Life)	Net profit margin
		Combined ratio (Non-life)	
Liquidity	LCR	Liquid assets ratio	Liquid assets ratio
	Customer loans to deposits ratio		Price spread on bonds
	Asset encumberance ratio		Redemption coverage ratio
Operational	Operational risk exposure to total risk exposures		
Concentration	Net large exposures		
	Top three sectoral loans over total assets		
Market	Trading financial assets to total assets	Modified duration	Modified duration
		Corporate bonds volatility indicator	Securities volatility indicator
		Sovereign bonds volatility indicator	
		Equity volatility indicator	
Underwriting		Premia growth	
		Claims growth	
		Reinsurance part of premium	

to indebtedness, leverage and credit gaps.[4,5] Monitoring these sectors is important as financial distress in these sectors can lead to higher defaults, tighter credit conditions, and spillovers to the banking system and the wider economy.

[4] William Gatt (2024), A semi-structural credit gap for Malta: A multivariate filter approach, Central Bank of Malta *Working Paper* 04/2024.
[5] The classification of the CSRI, together with the household and corporate credit gaps, is derived from their position within the quintile distribution of historical observations, rather than from indicator-specific risk thresholds.

The heatmap is based on quarterly data, with most indicators available from December 2015 onwards.[6] Indicators are assessed relative to their historical distributions, allowing for the identification of deviations from past patterns and help distinguish between normal cyclical fluctuations and developments that may signal the accumulation of vulnerabilities. To operationalise this approach, observations are classified into quintiles of each indicator's historical distribution. Values falling within the lowest quintile (bottom 20%) are considered significantly below their historical range and are denoted in dark green, while those in the highest quintile (top 20%) reflect relatively elevated positions within the historical distribution, and denoted in red (see Table 1b). Importantly, these classifications are distribution-based and relative in nature. As such, higher quintiles may point to a build-up of risks or increased vulnerabilities, but do not necessarily imply elevated risk in absolute terms. In some cases, an indicator may lie in the upper part of its historical distribution while remaining within levels that are not, per se, associated with material financial stability concerns.

Table 1b
HEATMAP CLASSIFICATION BASED ON QUINTILES OF HISTORICAL DISTRIBUTION

Historical distribution percentile	Colour scale
0 - 20%	
20 - 40%	
40 - 60%	
60 - 80%	
80 - 100%	

Overall, this framework facilitates a consistent interpretation of developments over time and supports crosssectoral comparison of risk signals.

Interpretation of results

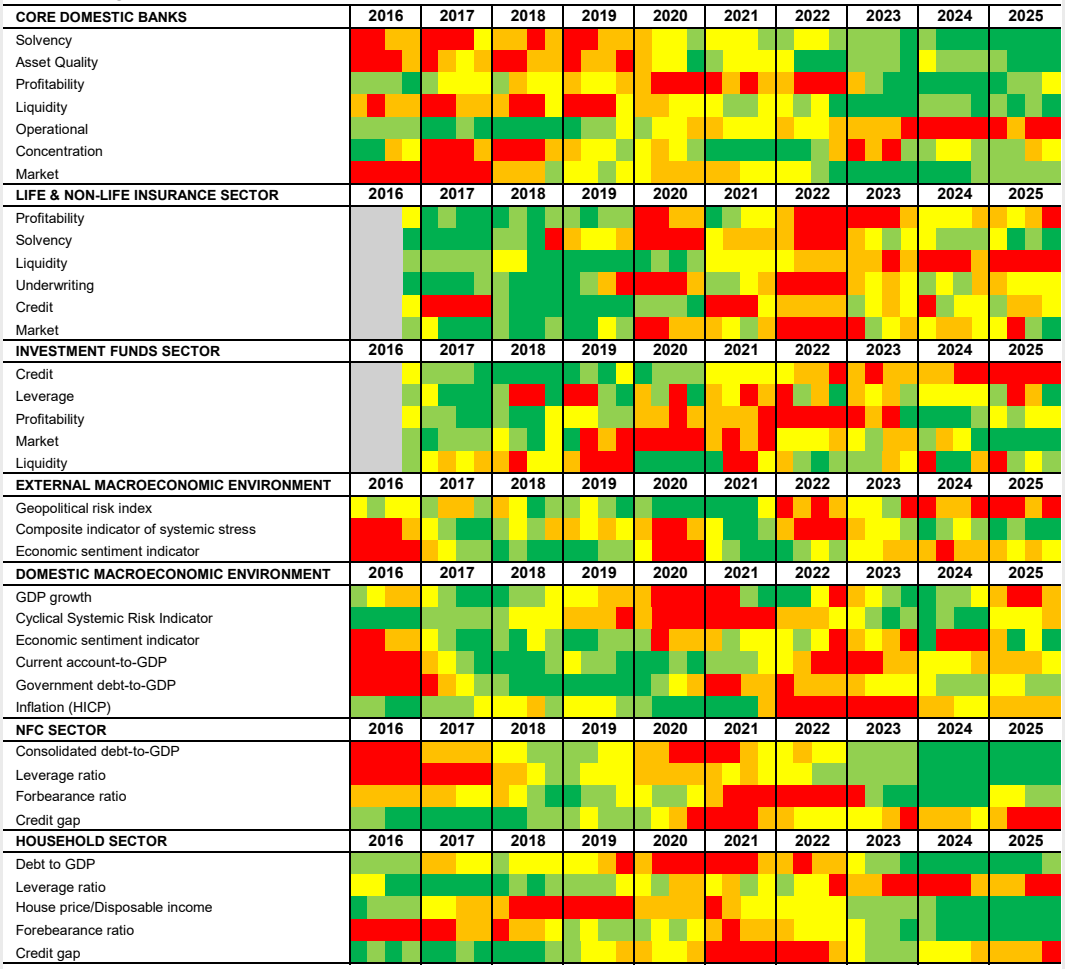
Core domestic banks

The heatmap indicates a broad-based improvement in the profile of the core domestic banks over time, with most categories falling within the lower two quintiles by the end of 2023 and remaining at those levels thereafter (see Table 1c). This improvement is partly attributable to a combination of strengthened regulatory frameworks, proactive de-risking strategies by the banks themselves, and ongoing supervisory-driven reforms. The positive developments are particularly evident in asset quality, with indicators having shown sustained improvement. Notably, the NPL ratio declined to a historical low of 1.8% by end-2025, reflecting the continued resilience of both the household and corporate sectors, as well as the underlying strength of the domestic economy. Banks have maintained strong solvency positions, supported by ample capital buffers. The main exception is operational risk, remaining in the higher quintiles since 2023. This reflects a relative increase in operational risk exposures, with their share of total risk exposures rising to 9.9% as at December 2025 from around 8.8% in 2021. Notwithstanding this increase, operational risk exposures remained lower than the EU average, where the corresponding share stood at 13.4%.[7]

Profitability shows a slight deterioration, to move in the third quintile as at end 2025. This reflects in large part the shift towards a more neutral monetary policy stance, as declining interest rates have weighed on banks' NII. In addition, some banks registered higher operational costs, partly driven by one-off factors. Notwithstanding, the ROA of core domestic banks is still slightly higher than the euro area average. Concentration risk indicators rose, reflecting a more concentrated loan portfolio, as otherwise the share of net large exposures to total capital declined. Overall, the

[6] Insurance and investment funds data is available from December 2016.
[7] EBA risk dashboard 2025Q4.

Table 1c
FINANCIAL STABILITY HEATMAP



Source: GPR, STOXX 50 Volatility, CISS, ESI, GDP, Current account, Government debt, Inflation rate (HICP), Consolidated debt, NFC leverage, HH leverage, NFC and HH credit gaps, House price to disposable income.

heatmap suggests that banking sector vulnerabilities have generally improved over recent years and remained contained, with no evidence of a broad-based or persistent deterioration across risk categories.

Domestically relevant insurers

Turning to the domestically relevant insurance sector, overall conditions remained favourable, with most risk indicators improving since 2022-23. The sector remained well capitalised, with underwriting and credit risk generally around the historical norm. Market risk also recovered significantly following the peaks reported in the second quarter of 2025. Profitability stood in the fourth quintile, largely reflecting the moderation in the life insurance segment, although the ROA remained broadly in line with the euro area median. Meanwhile, the liquidity metric stood in the top quintile, largely driven by larger insurers recording liquidity positions below their own historical averages, alongside some operators with relatively weaker liquidity ratios. Nonetheless, the median liquidity ratios of domestically relevant insurers remained broadly in line with the euro area median, indicating no widespread deterioration across the sector.

Domestically relevant investment funds

The domestic investment funds sector also appears broadly resilient, with gradual improvements in market and profitability indicators. Profitability, however, moderated somewhat in 2025, settling in the middle quintile.[8] While leverage and liquidity indicators[9] have been more volatile, these generally remained benign, with leverage in particular showing only marginal divergences. At the same time, the heatmap highlights that credit risk has remained in the top quintile, following a deterioration in 2024. This may partly reflect increased risk-taking and search-for-yield behaviour as the ECB entered a rate-cutting cycle, which however seems to have ended in mid-2025.

External macro-financial environment

Financial systems are influenced by the global and domestic macroeconomic and geopolitical environment in which they operate. Looking at the indicators related to the external environment, the heatmap points to a scenario shaped primarily by geopolitical developments. The GPR index[10] rose sharply following the outbreak of war in Ukraine in February 2022. While it recovered somewhat during the first three quarters of 2023 as markets and policymakers adjusted, it peaked once again in the last quarter of that year as the Israel-Hamas war erupted, giving rise to heightened uncertainty and risks of regional escalation. It has since remained elevated amid ongoing tensions, including in the Middle East, reaching very high levels in 2025. The heatmap shows that while the initial shock in 2022 was associated with a pronounced increase in the composite indicator of systemic stress,[11] more recent geopolitical tensions have not resulted in comparable increases in market-based stress indicators as some risks may have already been priced in. This divergence reflects strong financial sector fundamentals, which have resulted in contained market volatility and limited transmission of geopolitical shocks to financial markets. By contrast, the economic sentiment indicator fluctuated within the top two quintiles, highlighting that expectations among firms and households have remained sensitive to heightened uncertainty and persistent cost pressures.

Domestic macro-financial environment

On the domestic front, the financial sector can be seen as operating in a benign macroeconomic environment when one interprets the statistical movement of the indicators in relation to economic fundamentals. Annual real GDP growth stood in the top two quintiles throughout 2025. This, however, largely reflected base effects following exceptional growth rates recorded in previous years. Indeed, while real GDP growth remained strong at 4.0%, significantly exceeding the euro area average, it fell below the long-term average of 6.4% estimated since 2015Q4, and was well below the peaks recorded in late 2021 and early 2022, when the economy was recovering from the pandemic. The government debt-to-GDP ratio has declined from around 51% in the first quarter of 2022, to now stand in the second-lowest quintile.

Domestic inflation rose sharply following the outbreak of war in Ukraine, exceeding 7% in late 2022 and early 2023. Since then, inflation has moderated considerably to hover between 2.0% and 2.5% as earlier supply-side pressures unwound. This moderation also reflects the lagged effects of the previous tightening monetary policy cycle of 2022-2023. Nevertheless, it remains within the top quintile, given that average inflation stood at just above 1% prior to 2022.

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[8] Profitability is assessed using data up to September 2025 to ensure consistency in the analysis, given the implementation of revised reporting templates towards the end of the year.

[9] The RCR within the liquidity indicators is estimated based on the worst-case outflow observed over the previous three years. For observations between December 2016 and June 2019, this measure reflects the worst-case outflow within that specific period. This approach differs from the Section 4.2 of the 2025 FSR, which instead considers the worst-case outflow recorded since December 2016 on a cumulative, to-date basis.

[10] The GPR index is based on Caldara Dario and Matteo Iacoviello (2022), "Measuring Geopolitical Risk". It measures the level of geopolitical tensions based on news coverage (e.g. wars, terrorism, political conflicts).

[11] The Composite Indicator of Systemic Stress captures actual stress in financial markets (e.g. volatility, credit spreads, market liquidity), reflecting how those risks are being priced by investors.

The cSRI, which measures the potential build-up of cyclical systemic risks, fluctuated between the third and fourth quintile in 2025, mainly driven by strong real bank credit and debt levels. Improving financial conditions and a supportive banking sector may have incentivised economic agents to take on more leverage, potentially contributing to a build-up of vulnerabilities in the system. Meanwhile, both the domestic Economic Sentiment Indicator (ESI) and the current account balance as a share of GDP point to an improved position in 2025. The improvement in the ESI reflects rising confidence and optimism among businesses and consumers about the economic outlook, partly due to stronger economic activity. Moreover, after recording a current account deficit in 2022, the current account balance swung to a surplus.

Overall, the heatmap suggests that domestic macroeconomic conditions have been shaped by specific and largely exogenous events, rather than indicative of sustained macro-financial stress. While several indicators, mostly outside the domestic financial system, remained in the top two quintiles, this primarily reflected the exceptionally low levels observed prior to the pandemic and the intensification of geopolitical conflicts, rather than the emergence of new or intensifying underlying imbalances. In contrast, the resilience of the domestic financial system has improved over the time period under review, buttressed by strong capital and liquidity buffers. Therefore, most risks to the domestic financial system originate from the volatile external macroeconomic environment.

Conditions in the domestic NFC and household sectors improved markedly over the review period, as reflected by the generally stable or declining risk signals across most balance sheet indicators. The key exception relates to the semi-structural credit gap, which has remained in the higher two quintiles for the past two years, indicating significantly elevated levels with respect to the historical distribution. This development is primarily driven by strong credit growth, particularly in mortgage lending and lending to corporates mainly operating in property-related activities. It is however noted that during 2025, private corporate lending growth became more broad-based, with a recovery also observed in non-property-related sectors. The household leverage ratio is also indicating historically elevated levels, with the leverage ratio standing at around 23.8%, slightly exceeding the euro area average of 22.7%. However, households' net financial wealth remained very strong and highly liquid, providing an important buffer at the aggregate level. Taken together, this suggests that while credit dynamics warrant continued close monitoring, balance sheet buffers currently provide a meaningful degree of resilience.

Conclusions

The analysis indicates that the domestic financial sector remains sound. However, some well-identified pockets of vulnerability have emerged, particularly in the banking sector's operational risk profile, in tentative signs of concentration risks, and credit risk developments within the investment funds sector. The heatmap shows that these vulnerabilities are largely concentrated rather than system-wide, with limited evidence of risk spillovers across segments. The observed overall improvement is largely driven by tighter regulatory standards, strategic de-risking initiatives, and sustained reform efforts prompted by supervisory expectations, which together have reinforced resilience and compliance. Externally, geopolitical events have been the primary driver behind the top quintile position of some macroeconomic indicators compared to historical distributions. Importantly, the heatmap highlights a divergence between elevated geopolitical uncertainty and relatively contained market-based systemic stress, pointing to the resilience of financial markets amid heightened global tensions.

Domestically, the above-historical-norm levels of certain macroeconomic indicators largely reflected base effects following exceptionally strong economic growth and historically benign fiscal and inflation conditions, rather than a material weakening in fundamentals or the emergence of macro-financial imbalances. Despite some moderation, overall domestic economic conditions remained robust and continued to support financial stability. The heatmap therefore points to a resilient domestic financial system which is nonetheless navigating an uncertain and stressed external environment.

At the same time, risks associated with strong and persistent credit growth dynamics both for mortgages and, more recently, in the domestic corporate sector, appear to be building. While the balance sheets of both households and NFCs remained strong, the persistence of elevated credit gaps and debt levels may suggest a potential build-up of risks. In response, the Bank has expanded the coverage of its sectoral systemic risk buffer (sSyRB) with effect from 30 June 2026 to capture loans backed by all real estate, and not only residential property.[12]

When using the heatmap as a tool to assess financial stability, certain limitations should be acknowledged. A purely mechanical approach cannot fully distinguish between phases of financial deepening and periods characterised by excessive risk-taking or economic overheating. This reflects the fact that the heatmap evaluates risk levels solely relative to historical distributions, which may be influenced by structural shifts in the economy or financial system. Accordingly, expert judgement remains essential when interpreting the signals provided by the heatmap, which should therefore be regarded as a complementary tool supporting ongoing financial stability analysis. The heatmap will be updated regularly, with a summary table included in future *Financial Stability Reports*.

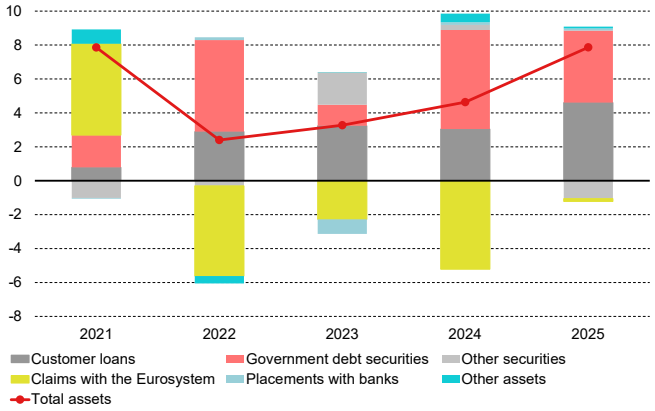
[12] Central Bank of Malta: Statement of decision on the extension of the sectoral systemic risk buffer in Malta, December 2025.

2. DEVELOPMENTS IN THE BANKING SECTOR

2.1 Core domestic banks

Core domestic banks' balance sheet continued to grow in 2025, expanding by nearly 8% to reach approximately 135% of GDP. Growth was mainly driven by continued expansion in customer lending and a further increase in holdings of government debt securities, which rose by 9.3% and 16.8%, respectively (see Chart 2.1). Customer loans accounted for just over half of these banks' assets. Exposures to government debt securities rose to about 27.4% of assets, supported by elevated sovereign bond yields amid higher inflation expectations. By contrast, placements with the Eurosystem declined to account for 7.2% of total assets, as banks continued to reallocate liquidity towards higher-yielding assets to improve returns. Overall, the balance sheet remained focused on traditional intermediation activity, supported by a strong domestic economic environment.

Chart 2.1
CONTRIBUTION TO BALANCE SHEET GROWTH – CORE DOMESTIC BANKS
(percentage points)



Source: Central Bank of Malta.

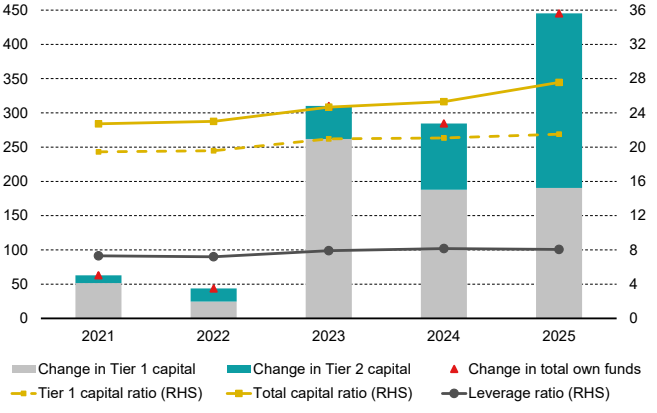
Profitability eased, reflecting lower income from placements with the Eurosystem, higher operating costs and lower net impairment reversals, although this was partly offset by stronger income from traditional lending, sovereign securities and fees. At the same time credit quality improved further, and the banks reported stronger capital ratios and sustained ample liquidity.

2.1.1 Capital and leverage

Total own funds increased by almost 15% in 2025, largely driven by a higher issuance of subordinated debt instruments, which lifted Tier 2 capital, while Tier 1 capital also rose markedly, underpinned by higher retained earnings (see Chart 2.2). Although total risk exposures expanded as total assets continued to grow, this increase was more moderate at 5.3%. As a result, the total capital ratio improved by 2.2 percentage points to 27.6%.

Credit risk continued to dominate the risk profile of core domestic banks, with related risk-weighted assets (RWAs) increasing by

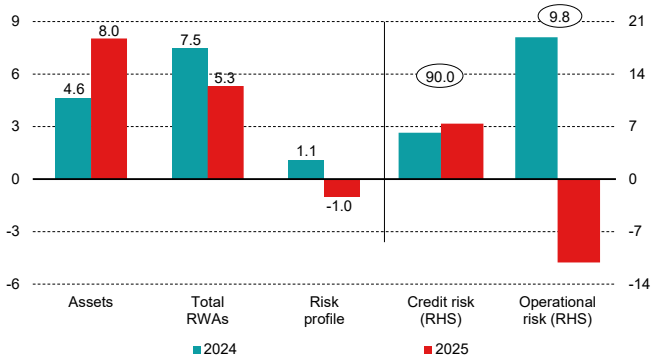
Chart 2.2
CHANGE IN TOTAL OWN FUNDS, CAPITAL AND LEVERAGE RATIOS – CORE DOMESTIC BANKS
(EUR millions; per cent)



Source: Central Bank of Malta.

7.4% and accounting for 90.0% of total risk exposures (see Chart 2.3). Operational risk remained the second-largest risk component, representing 9.8% of total RWAs, despite a decline over the year.[1] At the same time, banks continued to place increased emphasis on operational risk management, in response to evolving technology-related and cyber risks.

Chart 2.3
GROWTH IN ASSETS AND TOTAL RISK EXPOSURE – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.
Note: Asset growth figures within the chart are obtained from FINREP returns, differing slightly from the BR/06 Statutory Financial Information on which balance sheet developments is based. Percentages in circles represent the share of total risk exposure in 2025. Other percentages refer to the annual growth rate.

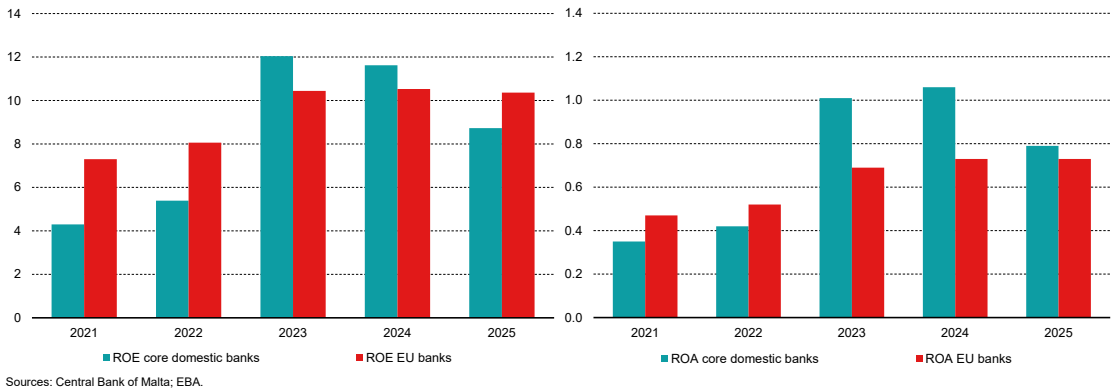
Amid the strengthening of capital ratios and continued balance sheet expansion, the overall risk profile of core domestic banks improved by 1.0 percentage point to 38.8%, moving closer to the EU average of 35.2%.[2] Moreover, the leverage ratio remained relatively stable at 8.0%, pointing to continued balance sheet strength and robust loss-absorbing capacity.

2.1.2 Profitability

The core domestic banks' profitability eased in 2025, marking the first decline since the pandemic period. Following a prolonged period of earnings expansion, net profit before tax fell by 18.7% year-on-year. Consequently, key profitability indicators weakened, with post-tax return on equity (ROE) and ROA declining by 2.9 percentage points and 0.3 percentage points, to 8.7% and 0.8%, respectively (see Chart 2.4). As a result, ROE fell below the euro area average, while ROA remained comparatively higher, reflecting lower leverage and a more conservative business model.

NII declined by 3.1%, largely reflecting lower income from placements with the Eurosystem, as key interest rates fell since 2024 (see Chart 2.5).[3] By contrast, NII from traditional intermediation activities recorded

Chart 2.4
PROFITABILITY RATIOS
(per cent)



Sources: Central Bank of Malta; EBA.

[1] Such development in part reflects the methodological change in the computation of RWA for operational risk. See: *Interim FSR 2025* – Box 1: Impact of CRR3 on Maltese Banks' Risk Weights.
[2] EBA risk dashboard 2025Q4.
[3] The deposit facility rate dropped from a high of 4% until 11 June 2024 to 2% by 11 June 2025.

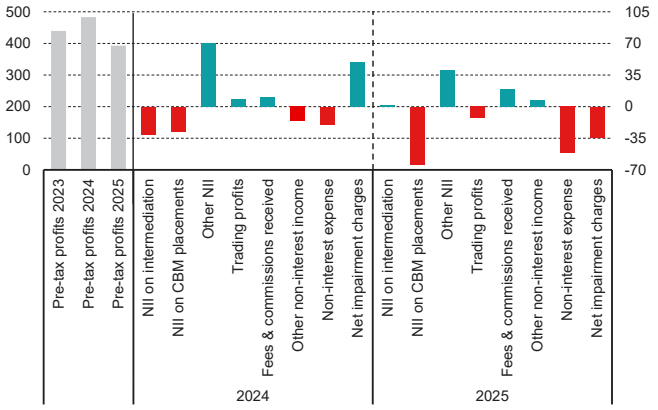
a modest increase of 0.3%, following a contraction observed in the previous year. This improvement was volume-driven, underpinned by continued growth in lending to resident corporates and continued expansion in residential mortgage lending, as otherwise net interest margins remained broadly stable as both lending and deposit rates fell (see Chart 2.6).

Other components of NII rose by over 25%, supported by higher yields on sovereign debt securities coupled with increased holdings of such assets. Non-interest income also improved, driven by higher fee and commission income, although this was partially offset by weaker trading income. On the other hand, profitability was further weighed down by a notable increase in operating expenses, partly driven by higher staff costs. As a result, cost efficiency deteriorated with the cost-to-income ratio rising by 6 percentage points to 58.4%, now exceeding the euro area average of 53.3%.[4] This marked a change from the pre-2019 period, when Malta consistently recorded a lower ratio than the EU average. The domestic ratio began trending upwards from 2019 onwards, also driven by rising operating costs. At the same time, net impairment reversals went down from around €45 million in 2024 to almost €11 million in 2025, further weighing on profitability.

2.1.3 Credit dynamics

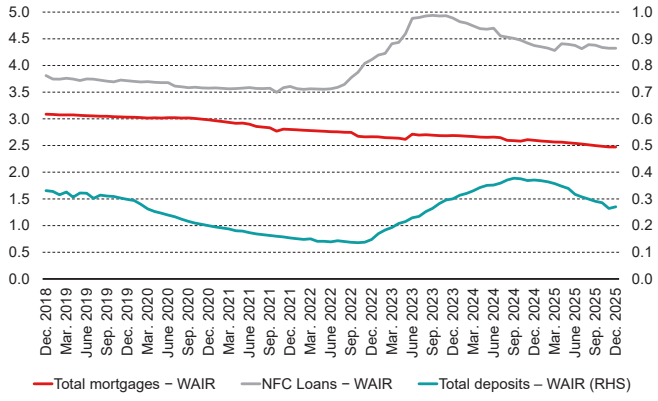
Growth in credit to residents gained further momentum, reaching 10.0% by the end of 2025 from 6.4% a year earlier (see Chart 2.7). This acceleration was mainly driven by NFC lending. Following growth of 1.2% in 2024, it rose by 11.7% in 2025. At a sectoral level, the most notable increase continued to be concentrated in property-related sectors,

Chart 2.5
MAIN CONTRIBUTORS TO PROFITS – CORE DOMESTIC BANKS
(EUR millions)



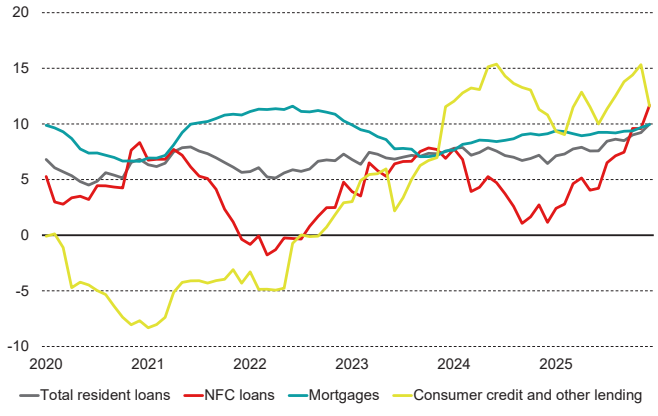
Source: Central Bank of Malta.
Note: Grey bars indicate pre-tax profits in absolute amounts. Teal (positive) and red (negative) bars indicate yearly contributions to profits.

Chart 2.6
INTEREST RATE DEVELOPMENTS – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.
Note: Data refers to the annualised agreed WAIR on outstanding resident exposures by core domestic banks.

Chart 2.7
ANNUAL GROWTH RATE OF RESIDENT LOANS – CORE DOMESTIC BANKS
(per cent)



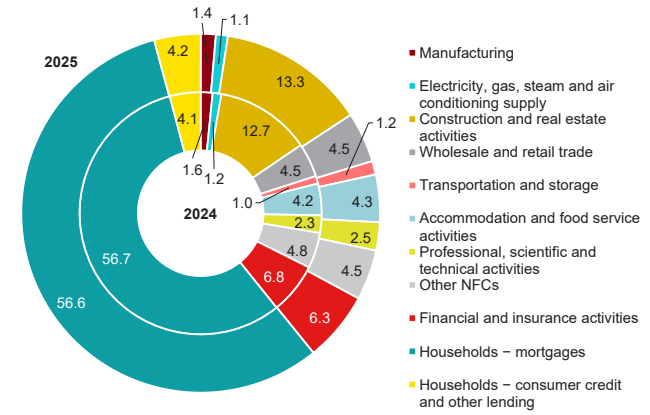
Source: Central Bank of Malta.

[4] See footnote 2.

where lending rose by 14.2% and accounted for 53.5% of resident NFC loans (see Chart 2.8).[5]

Several other sectors also experienced strong growth, partly driven by base effects after the contraction recorded in the previous year. These include professional, scientific and technical activities, wholesale and retail trade, information and communication and transport and storage. By contrast, the human health and social work, and manufacturing sectors contracted. In the aggregate, non-property related sectors contributed to around a third of the overall resident NFC credit growth.

Chart 2.8
RESIDENT LOANS BY NACE – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.

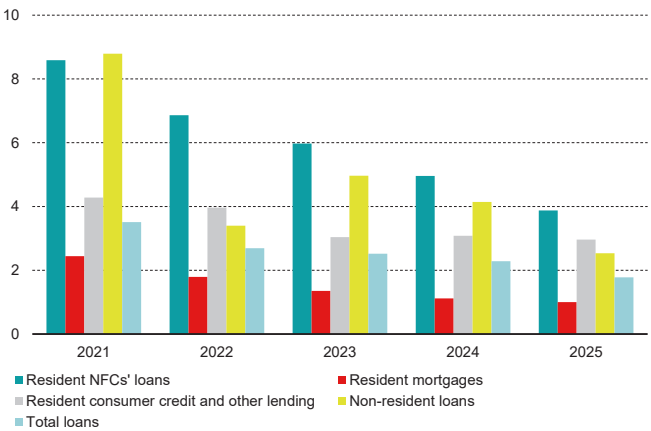
Meanwhile, resident mortgage lending continued to grow strongly, increasing by 9.9%, and further contributing to the concentration of these banks' loan portfolios towards the property market. Consumer credit growth remained elevated at 11.6%, supported by rising household income and strong domestic demand.

By contrast, loans to non-residents declined by 6.6%, largely due to reduced lending to firms operating in manufacturing, professional, scientific and technical activities, and the financial and insurance sector. Lending to non-resident households remained contained, accounting for just 0.5% of their overall loan portfolio.

2.1.4 Credit quality

The credit quality of loan portfolios improved further in 2025, with NPLs declining by 16.4%, underpinned by a strong domestic economy, prudent lending practices and favourable financial conditions, which continued to support borrowers' repayment capacity. Consequently, the overall NPL ratio declined by 0.5 percentage points to a historically low level (at least since 2004) of 1.8% by the end of 2025 (see Chart 2.9). Excluding placements with the Eurosystem, the NPL ratio declined more markedly, by 0.6 percentage points to 2.1%.

Chart 2.9
NPL RATIOS – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.

The resident NPL ratio improved by 0.4 percentage points to 1.7%, reflecting a broad-based improvement across all loan categories. This improvement was most pronounced in the resident NFC segment, where the NPL ratio declined by 1.1 percentage points to 3.9%. This reflected continued expansion in the loan portfolio alongside a near-20% decline in corresponding NPLs,

[5] Property-related sectors include construction, real estate, and accommodation and food services activities.

most notably in the health and social work sector, and to a lesser extent in transportation and storage and real estate activities (see Chart 2.10).

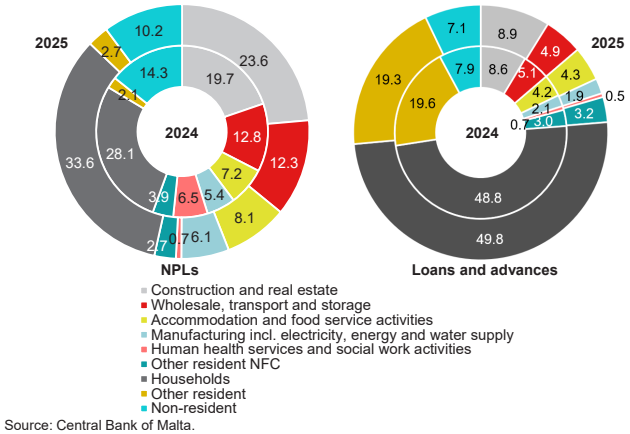
Resident mortgage NPLs declined by 1.8%, driven by both lower mortgage NPLs and further growth in lending volumes. The corresponding NPL ratio thus edged down to just 1.0%. Although resident consumer credit NPLs rose moderately over 2024, continued growth in consumer lending kept the associated NPL ratio broadly stable at around 3.0%.

Credit quality also improved in the non-resident portfolio, with the NPL ratio declining significantly from 4.1% in the previous year to 2.5% in 2025. This improvement was mainly driven by a substantial 40.5% reduction in NPLs, which more than offset the slight contraction recorded in the non-resident loans.

The reduction in NPLs translated into a lower share of Stage 3 loans, which declined by 16.4%, mainly reflecting developments in lending to corporates. However, Stage 2 loans increased by a quarter, across both the households and corporate segments, rising to 5.8% of total lending, although still standing below the average of 7.4% recorded since 2018. This development may signal emerging asset quality pressures going forward (see Chart 2.11). At the same time, continued expansion of the loan book led to an 8.8% increase in Stage 1 loans, consistent with the strong growth in new lending activity.

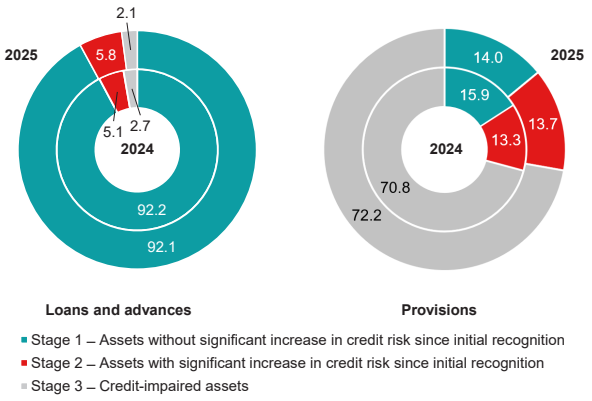
Overall provisions declined by a moderate 2.1%, mainly reflecting lower Stage 1 provisions, although Stage 3 provisions also fell marginally. Nevertheless, the coverage ratio improved significantly, increasing by 6.8 percentage points to 46.3%, supported by the substantial decline in NPLs (see Chart 2.12).

Chart 2.10
SECTORAL ALLOCATION OF LOANS AND ADVANCES AND NPLs – CORE DOMESTIC BANKS
(per cent)



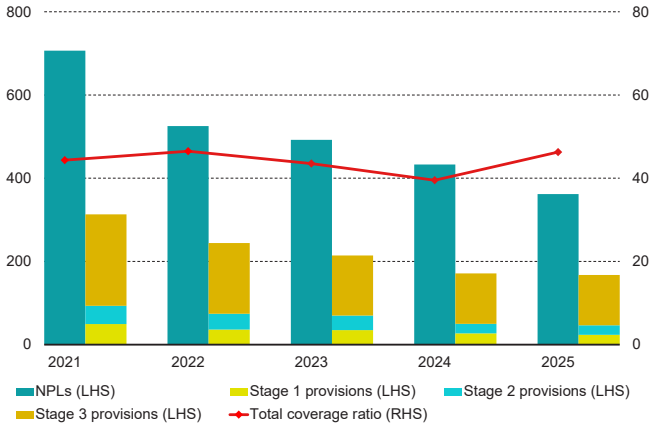
Source: Central Bank of Malta.
Note: "Other resident" loans and advances include placements with the Central Bank of Malta.

Chart 2.11
STAGE ALLOCATION OF LOANS AND ADVANCES AND PROVISIONS – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.

Chart 2.12
COVERAGE RATIO – CORE DOMESTIC BANKS
(EUR millions; per cent)



Source: Central Bank of Malta.

Additionally, after accounting for the value of collateral supporting NPLs, credit risk remained more than fully covered.

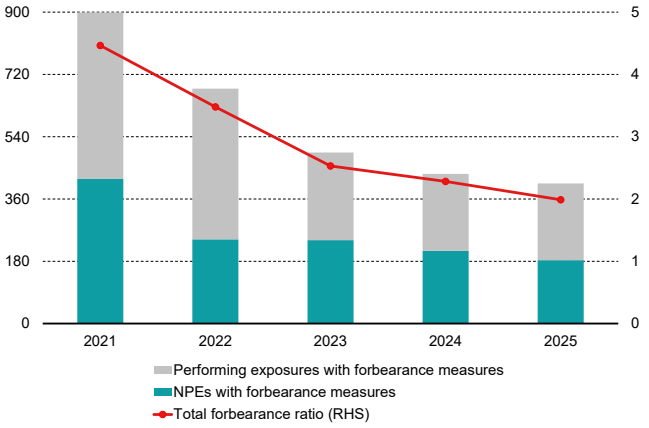
Forborne loans decreased further, falling by 6.4%, largely reflecting lower non-performing exposures (NPEs). As a result, the forbearance ratio declined by 0.3 percentage points to just 2.0% (see Chart 2.13).

2.1.5 Securities portfolio

While the lower deposit facility rate led to reduced placements with the Eurosystem, the still-elevated euro area government bond yields supported a continued shift in asset composition towards increased investment in euro area government securities. Indeed, an almost 10% increase in bond holdings was entirely driven by sovereign paper, predominantly issued by foreign governments, as private sector bond holdings contracted over the same period. As a result, sovereign paper remained the most dominant investment class, accounting for around 86% of core domestic banks' bond holdings (see Chart 2.14). The high concentration in sovereign securities highlights the need to continue monitoring exposures to sovereign risk developments (see Box 4).

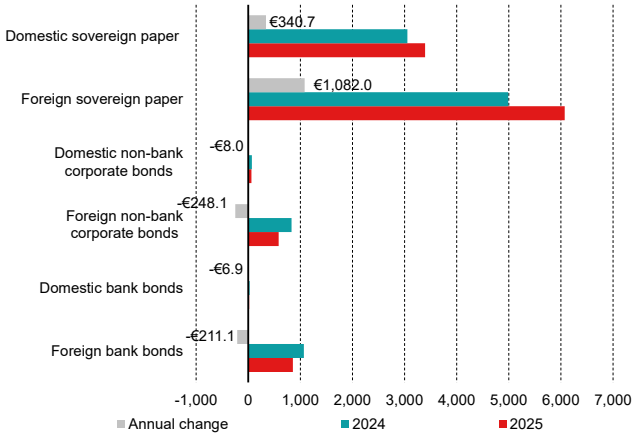
Overall, the bond portfolio continued to exhibit strong credit quality. While high-rated holdings decreased, this was more than offset by an increase in medium-rated holdings. As a result, around 95% of the portfolio remained in the medium-to-high rating category, limiting exposure to low-rated or unrated securities (see Chart 2.15). Equity holdings increased by 7.4% but remained limited to 1.5% of total assets.

Chart 2.13
FORBORNE LOAN EXPOSURES – CORE DOMESTIC BANKS
(EUR millions; per cent)



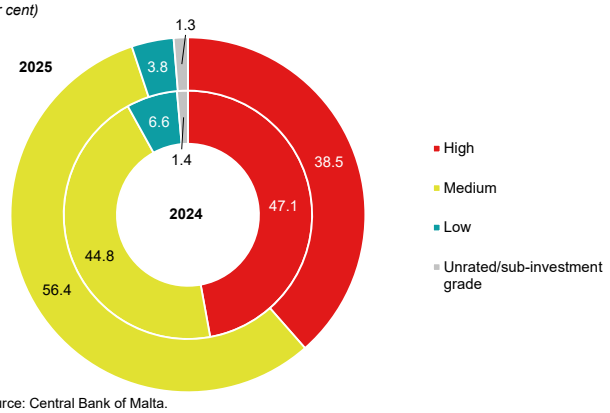
Source: Central Bank of Malta.

Chart 2.14
TOTAL DEBT SECURITIES – CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.

Chart 2.15
TOTAL DEBT SECURITIES BY RATING – CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.

Note: Investment-grade debt securities carrying a rating of AA- or above are regarded as 'high-rated bonds'. 'Medium-rated debt securities' are those rated between A- and A+, whereas 'low-rated debt securities' are those rated between BBB- and BBB+. Sub-investment grade debt securities are rated lower than BBB-.

2.1.6 Funding and liquidity

Customer deposits

Growth in customer deposits remained strong, up by 7.3%, driven entirely by higher resident customer deposits, which accounted for just over 94% of total customer deposits. Non-resident customer deposits fell further during the year (see Chart 2.16). Resident household deposits remained the main source of retail funding, increasing by 8.6% to account for close to 70% of total customer deposits (see Chart 2.17).

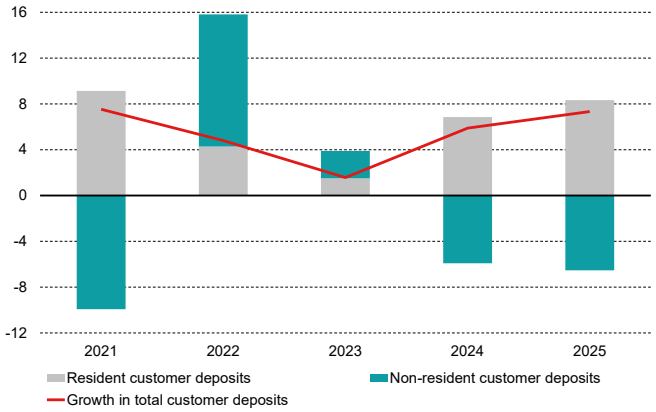
Resident corporate deposits also increased, rising by 2.7%, mainly driven by firms operating in the public administration and construction sectors. Several other sectors also registered growth, albeit to a much lower extent. Meanwhile, resident deposits from the financial and insurance activities sector expanded strongly over the year.

Deposit growth remained concentrated in on-demand instruments, with current and savings deposits rising by 13.0% and 8.5%, respectively. Together, these accounted for 86.7% of total deposits. By contrast, fixed-term deposits declined by nearly 10%, partly reflecting the absence of new fixed-term deposits by some core domestic banks. As a result, their share of total deposits dropped by 2.4 percentage points to 13.3% by year-end.

Wholesale funding

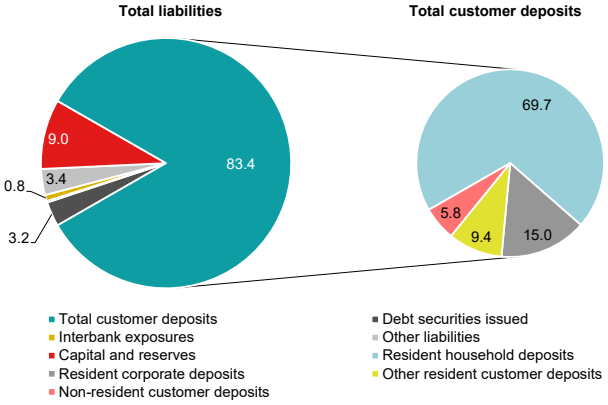
Wholesale funding remained limited, financing just 4.2% of total assets. It continued to be largely concentrated in issued debt securities, which rose by almost 35% during the year, following the issuance of subordinated instruments to strengthen further the banks' Minimum Requirements for own funds and Eligible Liabilities (MREL) (see Chart 2.18).

Chart 2.16
CONTRIBUTION TO GROWTH IN CUSTOMER DEPOSITS – CORE DOMESTIC BANKS
(percentage points; per cent)



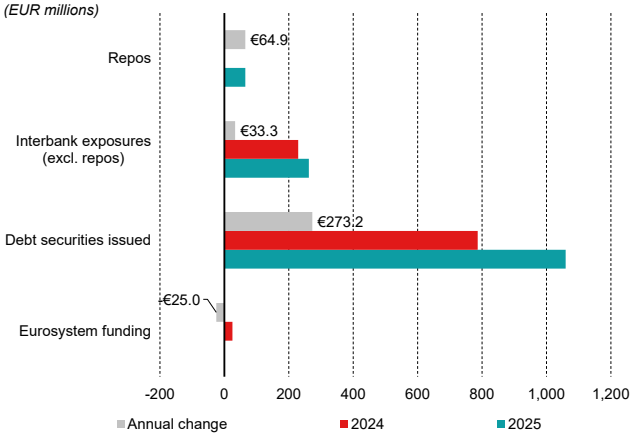
Source: Central Bank of Malta.

Chart 2.17
BANKS' LIABILITIES COMPONENTS – CORE DOMESTIC BANKS (2025)
(per cent)



Source: Central Bank of Malta.
Note: Total customer deposits pie chart represents the 83.4% in the total liabilites pie chart. This adds up to 100%.

Chart 2.18
DEVELOPMENTS IN WHOLESALE FUNDING – CORE DOMESTIC BANKS
(EUR millions)



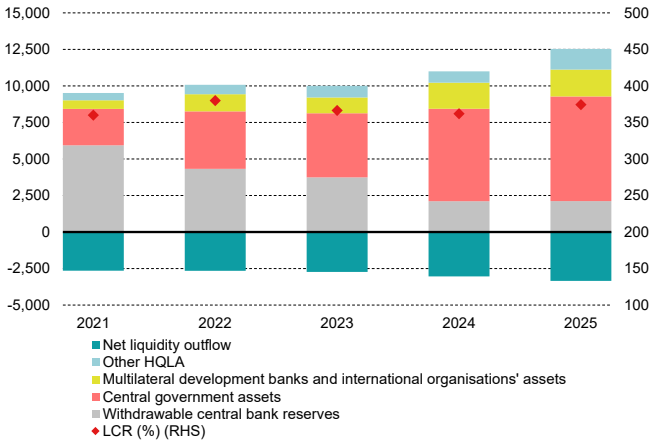
Source: Central Bank of Malta.

Interbank funding and repurchase agreements remained negligible despite a slight increase. Core domestic banks also made no use of Eurosystem funding at year-end, reflecting their already ample liquidity positions.

Liquidity

Core domestic banks maintained ample liquidity buffers, as evidenced by the strong LCR of 374.4%, which increased by 12.5 percentage points over the previous year (see Chart 2.19). Despite higher net liquidity outflows, holdings of HQLA increased at a faster pace, mainly driven by increased investments in sovereign bonds.

Chart 2.19
LCR – CORE DOMESTIC BANKS
(EUR millions; per cent)



Source: Central Bank of Malta.

Longer-term liquidity conditions also improved, with the NSFR rising by 2.6 percentage points, to 186.5%. Despite edging up slightly, the customer loans-to-deposits ratio stood at just over 60%. This was well below the weighted average of 104.8% for euro area banks, which underscores domestic banks' strong funding and liquidity positions.[6]

2.1.7 Risk outlook

Despite the current sound financial position of core domestic banks, the prevailing headwinds from an adverse geopolitical environment pose downside risks to the macroeconomic outlook. Heightened geopolitical tensions, particularly the conflict in the Middle East and the protracted war in Ukraine, are contributing to a highly uncertain global macro-financial environment.

Elevated global uncertainty arising from geopolitical fragmentation, trade tensions and energy market volatility could weaken external demand, disrupt supply chains, and increase input costs for Maltese firms, particularly in those sectors that are sensitive to transportation costs or disruptions such as tourism, manufacturing and wholesale trade. Should further adverse developments materialise and persist, corporate profitability could deteriorate, undermining borrowers' debt-servicing capacity, with adverse implications for banks' asset quality. Some incipient signs of increase in credit risk have been already observed in Stage 2 loans.

A more risk-averse environment and tighter financial conditions could dampen credit growth, thereby constraining income generation from traditional intermediation activities. At the same time, the still-elevated bond yields should continue to support banks' net interest margins. This would partly offset the pressure on margins from the monetary policy easing cycle that had begun in mid-2024.

Beyond macro-financial risks, cross-cutting operational risks, including cyber-threats, remain a key vulnerability. These risks could intensify further amid elevated geopolitical tensions and increased cyber activity. In this context, banks need to continue strengthening their technological capabilities while further enhancing and rigorously implementing robust cybersecurity frameworks. Such efforts remain essential to safeguard sensitive data, preserve confidence in the financial system and ensure the uninterrupted operational continuity of critical financial services.

Overall, while banks' performance continues to be supported by a resilient domestic economy and strong balance sheet positions, vigilance remains warranted. The upward trend in cost-to-income ratios highlights the importance for banks to closely monitor cost dynamics and operational efficiency. At the same time, maintaining prudent lending standards, effective NPL recovery strategies, and robust capital and liquidity buffers remain essential to preserve the sector's resilience should downside risks materialise.

[6] See footnote 2.

BOX 2: INSIGHTS FROM THE BANK LENDING SURVEY[1]

Introduction

The ECB's Bank Lending Survey (BLS) is a key tool providing National Central Banks with direct qualitative insights from credit experts at a representative sample of commercial banks across the euro area. This approach complements traditional quantitative information by providing a deeper understanding of factors underpinning changes in banks' lending policies and developments in borrower demand.[2] In addition, the survey addresses topical issues such as banks' response to climate-related risks, the geopolitical uncertainty and trade tensions as well as changes in the monetary policy framework.

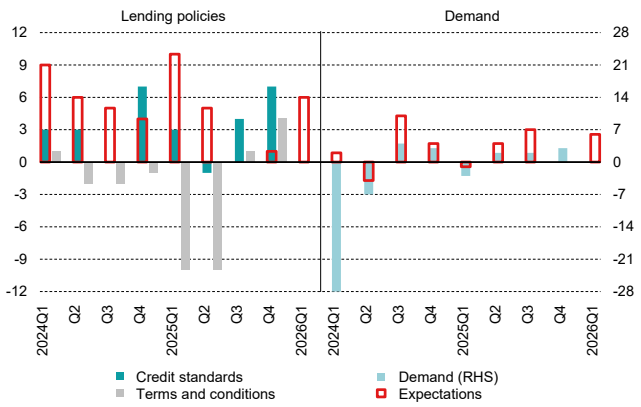
In 2025, more than 150 banks participated in the survey, including four Maltese banks which together accounted for around 92% of resident loans within the Maltese banking system.[3]

Loans to enterprises

Euro area

Across the euro area, developments in corporate lending during 2025 were characterised by a combination of tightening credit standards alongside generally easing terms and conditions (see Chart 2a). Sampled banks reported heightened perceived risks related to both the general economic environment and firm-specific outlooks, which weighed on their credit standards throughout the year. These concerns were closely associated with NPL ratios and related indicators exerting a persistent tightening influence. Heightened geopolitical uncertainty and changes in trade policies further dampened banks' risk tolerance and contributed to increased differentiation across sectors and firms when granting new loans. In this context, some banks reported intensified monitoring of more vulnerable corporate borrowers, notably exporters with high exposures to the United States. Banks mainly reported tighter standards for CRE, manufacturing (especially motor vehicles and energy-intensive industries), construction as well as wholesale and retail trade.

Chart 2a
EURO AREA CORPORATE LENDING POLICIES AND LOAN DEMAND
(+ indicates net tightening or net increase/- indicates net easing or net decrease)



Source: ECB Data Portal.
Note: Banks' expectations are for one quarter ahead.

[1] Prepared by Mr Shaun Zaffarese, Senior Analyst within the Financial Stability Surveillance and Risk Assessment Department. The author would like to thank Mr Christian Mamo, Principal Economist, Mr Andrew Spiteri, Deputy Head, and Ms Wendy Zammit, Head, within the same Department and Mr Alan Cassar, Chief Officer Financial Stability and Statistics Division, for their valuable suggestions.

[2] Lending policies consist of credit standards and terms and conditions. Credit standards refer to the banks' internal guidelines or loan approval criteria determined prior to the loan negotiation, including borrower characteristics such as income levels, age, and employment status used in credit scoring. Credit terms and conditions relate to specific features of the loan offered, including the interest rate, loan size, fees, collateral requirements, maturity, and other contractual conditions.

[3] Domestic results are weighted according to the size of each participating bank's resident loan portfolio, with separate weights applied to corporate loans, mortgages, and consumer credit.

Despite this cautious stance, terms and conditions on euro area corporate loans eased during the first half of the year. This was primarily driven by lower benchmark interest rates, heightened competition, particularly from other banks, and improved access to market financing. From the beginning of the year until mid-June 2025, the ECB implemented four policy rate cuts which were transmitted to benchmark rates, contributing to lower lending rates and narrower margins on average loans. Together with ample liquidity and declining capital costs, these developments supported an overall easing of lending terms and conditions. However, some tightening was reported in the second half of the year, as euro area risk-free rates increased, reflecting heightened trade-related and geopolitical uncertainty, while risk perceptions and tolerance related to specific industry or firms deteriorated. As a result, banks reported some tightening in collateral requirements, credit limits, maturities and loan covenants.

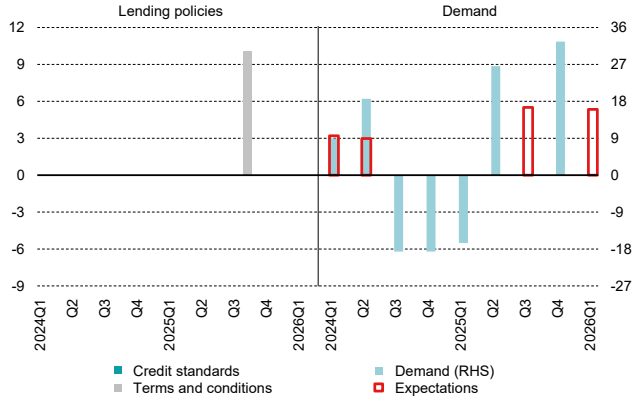
Loan demand from euro area firms remained subdued, although it improved gradually over the course of the year (see Chart 2a). Early in the year, demand weakened despite more favourable terms and conditions, reflecting sufficient inventories and working capital buffers. As borrowing costs declined further in the second quarter, loan demand recovered modestly. Demand for corporate loans was also supported by increased needs for debt refinancing and restructuring amid weaker profitability and limited internal funds. However, elevated global uncertainty and trade tensions continued to weigh on firms' investment plans. By the end of the year, demand was increasingly driven by working capital, inventory needs and other financing needs, as well as mergers and acquisitions activity, while the supportive role of interest rate declines faded as borrowing costs broadly stabilised.

Looking ahead, surveyed euro area banks expected a further tightening of credit standards in the first quarter of 2026, reflecting ongoing uncertainty related to trade policies and their implications on risk tolerance and asset quality, while demand for corporate loans was projected to continue increasing on a net basis.

Malta

Against this euro area backdrop, developments in Malta remained comparatively stable, amid a more resilient sentiment amongst banks. Indeed, Maltese banks did not report heightened risks stemming from the general economic outlook or firm-specific conditions that would warrant tightening credit standards or lending terms for NFCs. Improved asset quality continued to support corporate lending policies with only one domestic BLS respondent reporting some uncertainty related to US trade policy developments, with overall risks perceived as mitigated due to diversified supply chains and limited direct exposures. As a result, credit standards and terms and conditions on corporate lending in Malta were reported to have remained largely unchanged during the year (see Chart 2b). The sole exception was a marginal net tightening of terms and conditions in the third quarter, attributable to

Chart 2b
MALTESE CORPORATE LENDING POLICIES AND LOAN DEMAND
(+ indicates net tightening or net increase/- indicates net easing or net decrease)



Source: ECB Data Portal.
Note: Banks' expectations are for one quarter ahead.

a single bank increasing its margins on average loans to both small and medium-sized enterprises (SMEs) and large firms. This tightening reflected higher capital costs and tighter liquidity conditions for that institution. The same bank also reported a tightening of non-interest charges following a review of processing and commitment fees. Looking ahead, Maltese banks were not foreseeing any changes to their corporate lending policies in the short term.

Sampled Maltese banks indicated that on balance, corporate loan demand declined in the first quarter of 2025, reflecting weaker fixed investment and reduced working capital needs. However, towards the end of the year, loan demand strengthened notably, driven by a rebound in fixed investment activity, increased working capital requirements, and the redemption of debt securities by a large firm. The rise in loan demand for fixed investment purposes was particularly evident in the transportation, wholesale and retail trade, scientific and health sectors, as well as in real estate activities. Beyond this, demand was expected to remain sustained.

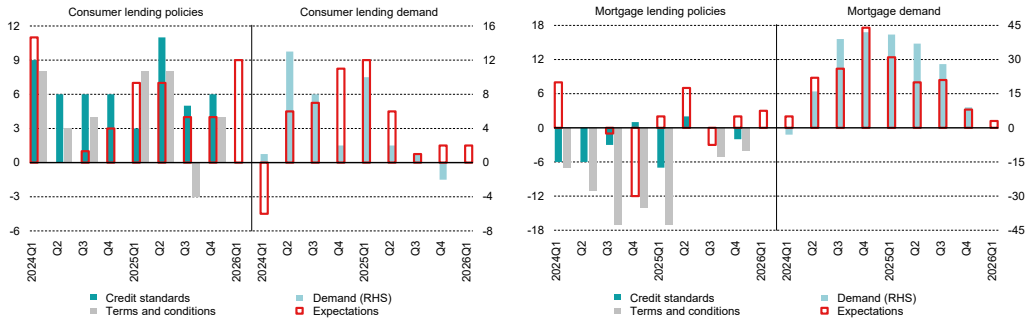
Loans to households

Euro area

Survey respondents reported heterogenous lending developments across euro area households. While lending policies for consumer credit and other household lending tightened, mortgage lending generally experienced an easing over the year (see Chart 2c).

For consumer credit, tighter lending policies were mainly driven by higher risk perceptions and lower risk tolerance related to concerns about borrowers' creditworthiness and the broader economic outlook. From the beginning of the year, euro area banks adopted a more cautious lending behaviour, driven by stricter assessments of borrower risk. This caution was reinforced by the higher perceived risk related to NPL ratios and other credit quality indicators. In practice, tighter lending policies were reflected in higher margins on riskier loans, reduced credit limits, shorter loan maturities, and stricter collateral requirements. Overall, this prudent approach outweighed the accommodative effect of lower lending rates observed earlier in the year. Towards the last quarter, as lending rates resumed their upward trajectory, the gap between margins on average and riskier loans widened further, suggesting increased discrimination by borrower risk profile and heightened risk aversion. Demand for consumer credit increased moderately in the first half of the year, supported by lower interest rates, marketing campaigns and stronger spending on durable goods, but weakened gradually thereafter amid falling consumer confidence (see Chart 2c).

Chart 2c
EURO AREA HOUSEHOLD LENDING POLICIES AND LOAN DEMAND
(+ indicates net tightening or net increase/- indicates net easing or net decrease)



Source: ECB Data Portal.
Note: Banks' expectations are for one quarter ahead.

In contrast, lending conditions for housing loans in the euro area generally eased in 2025, supported by intensified competition among banks. Terms and conditions eased strongly in the first quarter, driven mainly by lower lending rates and narrower margins on average loans, and to a lesser extent, on riskier loans. This easing quickly translated into a surge in mortgage demand, though the latter was also supported by improved housing market prospects and higher consumer confidence. As the year progressed, however, the decline in lending rates slowed, while the steepening of the euro area risk-free yield curve eventually led to higher mortgage rates in the last quarter, exerting a tightening influence. Notwithstanding this, overall mortgage terms and conditions continued to ease moderately, as competition continued to compress banks' margins, while demand continued to grow, albeit at a slower pace. Credit standards for housing loans also generally eased throughout the year, with only a small net tightening recorded in the second quarter of 2025 as some banks reassessed borrowers' creditworthiness amid rising macroeconomic risks.

Looking ahead, surveyed euro area banks expected a net tightening of credit standards for households in the first quarter of 2026, particularly for consumer credit. Meanwhile, household credit demand, while still positive, was expected to grow at a slower pace.

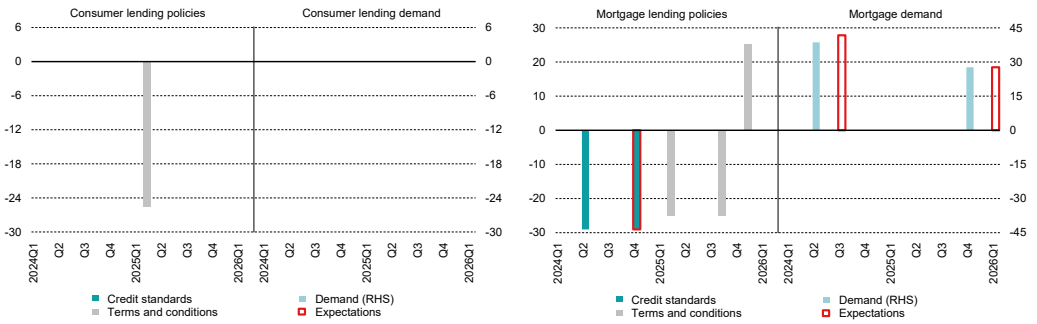
Malta

Domestically, household lending policies remained broadly stable throughout 2025, with credit standards and lending conditions for both mortgages and consumer credit largely unchanged, reflecting the continued prudent stance of domestic banks supported by the presence of borrower-based macroprudential measures (see Chart 2d).[4] This was particularly evident for consumer credit, where only a modest easing was observed in the first quarter of the year, driven by competitive pressures that resulted in slightly lower lending rates and narrower margins.

Mortgage lending policies displayed mixed dynamics over the year. Modest easing was reported in the first and third quarters, as competitive pressures led to lower lending rates, particularly through the introduction of targeted promotional offers linked to specific property values and energy performance criteria. Given the temporary nature of these offers, a mild tightening effect was however recorded in the final quarter of the year. Looking ahead, credit standards for overall household lending were anticipated to remain unchanged over the first quarter of 2026.

Household credit demand was reported to have remained broadly stable during 2025, remaining at elevated levels. The housing market remained resilient, with mortgage lending expanding at a solid

Chart 2d
MALTESE HOUSEHOLD LENDING POLICIES AND LOAN DEMAND
(+ indicates net tightening or net increase/- indicates net easing or net decrease)



Source: ECB Data Portal.
Note: Banks' expectations are for one quarter ahead.

[4] Directive No. 16 Regulation on Borrower-Based Measures

pace, supported by strong employment conditions, rising disposable income, and sustained tourism activity. At the same time, BLS results indicate that mortgage demand remained broadly unchanged on a quarter-on-quarter basis during most of the year, albeit at elevated levels. A net increase in mortgage demand was recorded in the last quarter. Similarly, demand for consumer credit remained broadly stable during the year at relatively high levels. This sustained level of demand continued to support steady growth in lending during 2025. The surveyed banks were not anticipating any significant changes in household credit demand in the first quarter of 2026, with growth expected to be sustained.

Additional insights on current conditions

Funding conditions

BLS results indicate that euro area banks experienced broadly stable access to retail funding in 2025, while access to market-based financing improved gradually over the year. The easing was most pronounced for debt securities and, to a lesser extent, for money markets and securitisations, with improvements particularly evident in medium to long-term funding. These developments were supported by favourable financial conditions, including narrowing credit spreads. For the first quarter of 2026, banks expected access to market financing to stabilise with only moderate further easing for debt securities.

In Malta, access to short-term deposits generally improved over the year, reflecting lower funding costs and reduced competitive pressures among banks. At the same time, the lack of new fixed-term deposits offerings by some of the surveyed banks resulted in a net decline in long-term retail funding, prompting a corresponding shift towards overnight deposits. These trends were expected to persist into the first quarter of 2026. With regards to wholesale funding, a net improvement was reported in the access to medium to long-term debt securities around mid-2025.

Climate-related risks and lending practices

Survey results point to euro area banks, including Maltese institutions, increasingly integrating climate-related risks into their lending practices. Banks reported greater differentiation between environmentally sustainable (green), transitioning and high-emission (brown) firms.[5,6] In general, lending policies were eased for green and transitioning firms, while they were tightened for brown firms, reflecting both transition and physical climate risks. Correspondingly, loan demand shifted towards environmentally sustainable and transition-related financing, while weakening for high-emission sectors. Climate considerations also became more prominent in mortgage lending, with more favourable conditions for energy-efficient buildings and stricter terms for less energy-efficient properties. Overall, climate-related fiscal support measures contributed to easing lending conditions, supported by preferential lending rates for green projects or technologies, while banks continued to refine their risk assessment frameworks.

Looking ahead, these trends were expected to broadly continue, with Maltese surveyed banks also mentioning the possibility of higher LTV haircuts to properties exposed to high physical climate risk. At the euro area level, banks noted that uncertainty around future climate regulation may dampen firms' credit demand, while climate-related fiscal support is likely to underpin the ongoing shift towards greener lending.

[5] "Green firms" – Firms that do not contribute or contribute little to climate change; "Firms in transition" – Firms in sectors that highly contribute to climate change, which are making relevant progress in the transition; "Brown firms" – Firms in sectors that highly contribute to climate change, which have not yet started or have so far made only little progress in the transition.

[6] In Malta, exposure to brown firms was reported to be concentrated mainly in manufacturing, and mining and quarrying sectors.

Impact of monetary policy balance sheet normalisation

Surveyed euro area banks reported that the ongoing reduction in the ECB's monetary policy asset portfolio had a small negative impact on market financing conditions and liquidity positions in early 2025. This reflected a gradual tightening linked to the ongoing redemptions of Eurosystem bond holdings. However, banks' assets and overall profitability were reported to be largely unaffected, as banks maintained stable holdings of high-quality liquid assets (HQLA) and, in some cases, slightly increased sovereign bond holdings.

In Malta, surveyed banks similarly reported a modest net increase in their holdings of sovereign and high-quality bonds during 2025, contributing to a rise in total assets. This reallocation was linked to expectations regarding the future path of monetary policy, with banks seeking to lock in yields ahead of anticipated interest rate declines. Overall, these portfolio adjustments supported higher NII and improved capital positions, with these trends at the time expected to persist in the near term. Lending conditions and credit volumes remained broadly unchanged, while a further increase in euro area sovereign bond holdings was expected going forward.

Profitability and interest rate developments

Euro area banks participating in the survey reported that interest rate developments continued to weigh on net interest margins during 2025. However, the impact on lending volumes improved progressively, moving from slightly negative to positive. Despite some support from stronger loan volumes and fee income, overall profitability remained under pressure due to the persistent compression of margins, with banks expecting this challenge to continue in the near term.

In Malta, surveyed banks reported mixed developments with respect to profitability. Some banks reported trends similar to the euro area aggregate, with pressure from weaker non-interest income and narrower margins. Others, however, reported benefits from lower interest rates through reduced funding costs, resulting in a supportive impact on NII. Lending volumes provided some modest support, while the contribution from non-interest income was limited or negative. These developments were expected to persist over the short term.

Regulatory and supervisory environment

The surveyed banks generally acknowledged that regulatory and supervisory actions in 2025, including outcomes of the Supervisory Review and Evaluation Process (SREP), higher Pillar 2 Common Equity Tier 1 (CET1) requirements, macroprudential buffer increases, the implementation of Capital Requirements Regulation (CRR III), and the application of currency-specific liquidity buffers, contributed to stronger bank resilience across the euro area. Banks also reported increases in capital and liquid assets alongside declines in RWAs. This more cautious environment reinforced conservative lending behaviour and contributed to the tightening of credit standards across all loan categories. Banks are also expecting a tightening regulatory impact in 2026, as well as higher capital, liquid assets and RWAs.

In Malta, the surveyed banks stated that CRR III implementation also contributed to a net increase in capital levels, supported by retained earnings and capital issuance. These developments were accompanied by increases in risk-weighted and liquid assets. At the same time, the revised regulatory framework encouraged a more cautious approach to risk-taking, particularly with respect to higher-risk or speculative lending activities.

Conclusion

During 2025, banks across both the euro area and at a national level indicated generally supportive funding conditions, strengthened capital positions following regulatory and supervisory actions, and a growing integration of climate-related considerations into lending practices. Nevertheless, the BLS replies still pointed to a divergence between the euro area and Maltese lending developments.

Overall, while euro area banks navigated a more cautious and tightening credit environment amid heightened external risks, Malta stood out for its relative stability and more muted response to these external shocks. Indeed, in the euro area, lending developments were shaped by elevated uncertainty, which weighed on banks' risk perceptions and led to a tightening of credit standards, especially for corporate and consumer loans. This occurred despite some easing in lending terms and conditions earlier in the year, driven by lower interest rates and competitive pressures. Loan demand remained relatively weak and volatile, constrained by GPRs, trade-related uncertainty and subdued investment activity, although it showed gradual improvement as the year progressed. By contrast, Malta's banking sector experienced a more stable macroeconomic environment. Credit standards and lending conditions remained largely unchanged across both firms and households, reflecting more benign risk perceptions, supportive credit quality indicators, and resilient domestic environment fundamentals. While corporate loan demand weakened initially, it recovered later in the year, supported by renewed investment activity. Household credit demand remained broadly stable at elevated levels, supported by a resilient housing market and favourable labour market conditions.

Looking ahead to 2026, downside risks persist, particularly in the euro area, where geopolitical uncertainty, trade tensions and interest rate uncertainty may continue to weigh on credit conditions. In Malta, while resilience remains, risks may stem from external spillovers and the growing role of climate-related risks affecting collateral values.

2.2 Non-core domestic banks

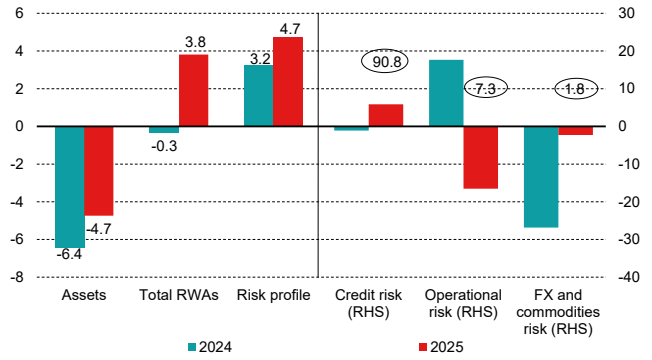
Monetary policy easing and the associated interest rate cuts by non-core domestic banks contributed to a decline in deposits held with these institutions. In parallel, Eurosystem placements fell by 12.7%, although they still accounted for slightly more than one quarter of these banks' assets. Banks' overall securities portfolios also decreased, mainly reflecting lower holdings of government paper, while customer lending contracted only marginally and continued to represent a core pillar of these banks' business model. From a financial performance perspective, profitability remained supported by contributions from non-interest income and the marked reduction in impairment charges. However, these were more than offset by lower NII and higher expenses, leading to an overall decline in profitability. Credit quality stayed strong amid low NPEs. Liquidity buffers also remained ample, with regulatory ratios staying well above minimum requirements despite some easing over the year. Against this backdrop, the balance sheet contracted further, declining by 5.0% and standing at 13.0% of GDP.

2.2.1 Capital and leverage

The capital position of the non-core domestic banks continued on a downward trajectory, although it remained robust overall. At year-end, the total capital ratio and Tier 1 capital ratio stood at 22.0% and 19.8%, respectively, down from 23.2% and 22.1% in 2024. The decline was attributed to a 3.8% increase in RWA and a 1.5% decline in total own funds, the latter exclusively driven by lower Tier 1 capital. The leverage ratio fell marginally to 10.4%, yet it remained comfortably above the minimum regulatory requirement, indicating continued resilience despite the weakening capital metrics.

The surge in RWA was predominantly driven by credit risk-related exposure, which expanded by 5.9% to account for almost 91% of the overall RWA (see Chart 2.20). Meanwhile, RWA linked to operational risk and foreign exchange risks fell, representing 7.3% and 1.8% of total RWA, respectively. Additionally, the risk profile of these banks deteriorated as the sustained drop in assets coincided with the increase in RWA. This pushed the ratio of RWA to overall assets higher, from 52.8% in 2024 to 57.5% in 2025.

Chart 2.20
GROWTH IN ASSETS AND TOTAL RISK EXPOSURE – NON-CORE DOMESTIC BANKS
(per cent)

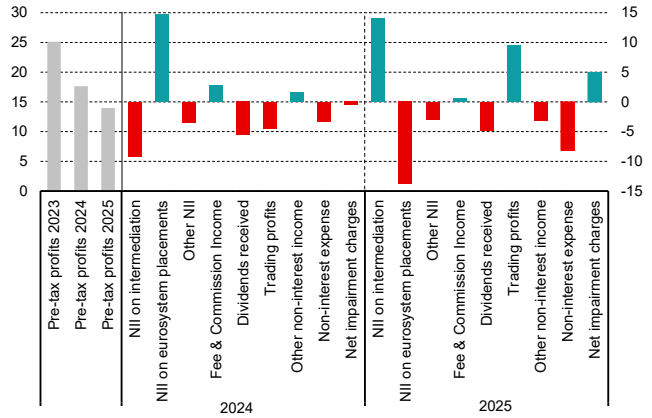


Source: Central Bank of Malta.
Note: Asset growth figures are obtained from FINREP returns, differing slightly from the BR/06 Statutory Financial Information on which balance sheet developments is based. Percentages in circles represent the share of total risk exposure in 2025. Other percentages refer to the annual growth rate.

2.2.2 Profitability

For the second consecutive year, non-core domestic banks' pre-tax profitability declined further by nearly 21% (see Chart 2.21). Consequently, their post-tax ROE and ROA weakened by 2.8 and 0.3 percentage points to 1.5% and 0.2%, respectively.

Chart 2.21
MAIN CONTRIBUTORS TO PROFITS – NON-CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.
Note: Grey bars indicate pre-tax profits in absolute amounts. Teal (positive) and red (negative) bars indicate annual and semi-annual changes in profit components.

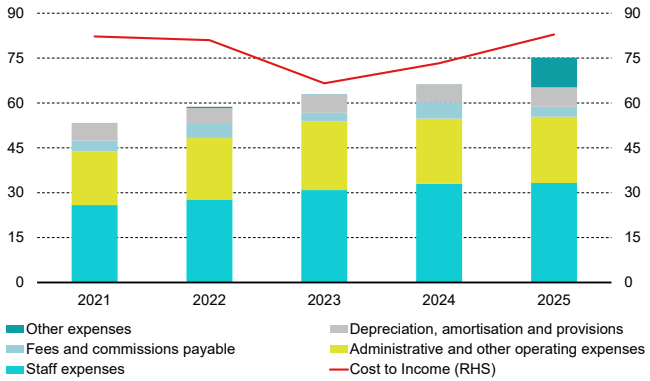
A key contributor to this decline was the reduction in NII, which decreased by 4.3% and accounted for 68.5% of overall gross income. This was primarily driven by lower NII on Eurosystem placements, which fell sharply by around 42%, reflecting both the lower deposit facility rates and reduced volumes of placements. Other NII also retreated by nearly 30%, mainly due to lower government bond holdings.

In contrast, NII from intermediation activities rose by two-thirds, accounting for more than half of total NII. This increase was driven by a faster decline in interest expenses payable on deposits, relative to the drop in interest income on loans. These developments are consistent with the easing monetary policy stance, which has alleviated funding cost pressure.

Non-interest income also contributed positively to these banks' profitability, as trading losses recorded in 2024 shifted to gains in 2025 on account of gains on the disposal of financial assets. Fees and commission income also increased modestly, further underpinning revenues. However, these improvements were partly offset by lower dividends received and reduced earnings from other non-interest sources. Net impairment charges dropped by a substantial 83.2%, reducing their share of gross income by 5.5 percentage points, to just 1.1%.

Meanwhile, profitability was further constrained by a 12.3% increase in non-interest expenses, driven primarily by currency revaluation losses related to US exposures (see Chart 2.22 – classified as 'other expenses'). Higher administrative and other operating costs, and to a lower extent rising staff expenses, also contributed to higher non-interest expenses. Consequently, the combined effect of higher operating expenditure and lower gross income pushed the cost-to-income ratio up by 9.6 percentage points to 82.9% by the end of 2025. This is significantly above the EU average of 53.3%, signalling potential concerns about operational efficiency in this segment.[7]

Chart 2.22
BREAKDOWN OF NON-INTEREST EXPENSES – NON-CORE DOMESTIC BANKS
(EUR millions; per cent)



Source: Central Bank of Malta.
Note: The extraordinary increase in other expenses in 2025 relate to currency revaluation losses related to US exposures.

2.2.3 Credit dynamics

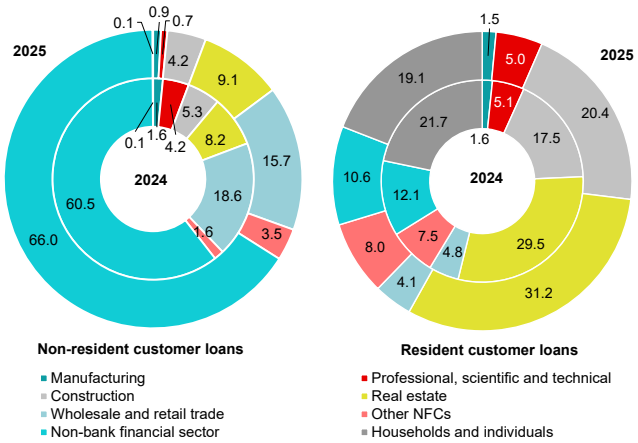
Customer loans granted by the non-core domestic banks declined marginally, but at 39.9% they continued to account for a substantial share of their total assets. The decline was entirely driven by a 1.4% decrease in non-resident customer loans, representing 44.7% of the overall customer loan book. This reduction stemmed exclusively from lower credit to foreign NFCs, which fell by around 15%, primarily reflecting lower lending to the professional, scientific and technical activities sector, as well as the wholesale and retail trade sector (see Chart 2.23). In contrast, lending to foreign non-bank financial entities increased by 7.5%, further strengthening their importance within the non-resident segment, to account for 66% of the non-resident customer loan portfolio. Meanwhile, loans to foreign households remained broadly unchanged and continued to represent a negligible share of the overall portfolio.

Resident customer loans grew by just under 1%, driven exclusively by higher credit to NFCs, particularly those operating in the construction and real estate sectors (see Chart 2.23). As a result, the share of NFC loans increased to 70.3% of the resident customer loan book. In contrast, lending to resident

[7] See footnote 2.

households contracted by 11.5%, reducing their share to just under one-fifth of resident customer loans. This decline was largely driven by one bank in the domestic consumer credit market. In addition, credit extended to resident non-bank financial entities fell by around 11%, bringing their share of the resident customer loan book to 10.6%.

Chart 2.23
CUSTOMER LOANS BY SECTOR – NON-CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.

2.2.4 Credit quality

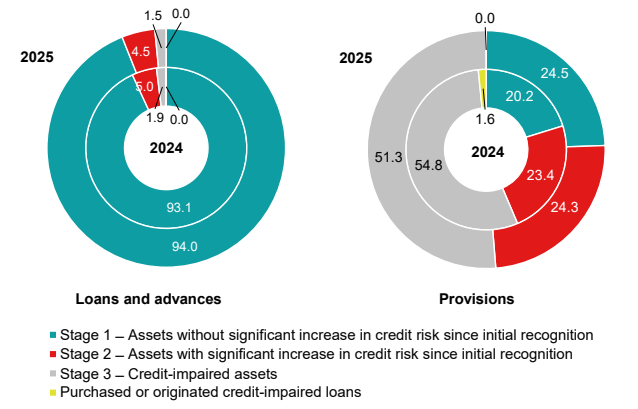
The challenging global macroeconomic environment did not lead to a deterioration in credit quality. Instead, non-core domestic banks' NPL ratio improved by 0.2 percentage points to 0.9%, as the stock of NPLs declined by 20.6%, outpacing the reduction in total outstanding loans and advances. This improvement was even more pronounced when excluding placements with the Central Bank of Malta, with the NPL ratio falling to 1.6% in 2025 from 2.0% in 2024.

The decline in NPLs was primarily driven by lower impairments among NFCs, particularly within the non-resident construction and manufacturing sectors, as well as resident firms operating in the accommodation and food and services activities, and in the real estate sectors. Consequently, the overall NFC NPL ratio decreased by 0.5 percentage points to 2.7%. Asset quality within the household segment also strengthened further, with the household NPL ratio declining from 0.8% in 2024 to 0.5% in 2025, supported by lower impairments on both mortgages and consumer credit. This improvement is consistent with a reduction in Stage 3 loans, which fell by nearly 20% to account for just 1.5% of overall loans and advances. At the same time, Stage 2 loans decreased by around 9%, particularly from NFC exposures, reducing their share to 4.5% of overall loans (see Chart 2.24). Consequently, the relative share of Stage 1 loans within the total loan portfolio increased.

The decline in NPLs led to a reduction in provisions, driven primarily by lower Stage 3 provisions, which nevertheless continued to account for just over half of the overall provisions. Stage 2 provisions decreased, while Stage 1 provisions increased in line with the growth in performing exposures. However, because the drop in NPLs exceeded the decline in provisions, the overall coverage ratio improved by 5.8 percentage points, reaching 77.0% in 2025.

Meanwhile, the forbearance ratio edged up marginally to 1.6%, driven entirely by an increase in performing

Chart 2.24
STAGE ALLOCATION OF LOANS AND ADVANCES AND PROVISIONS – NON-CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta.

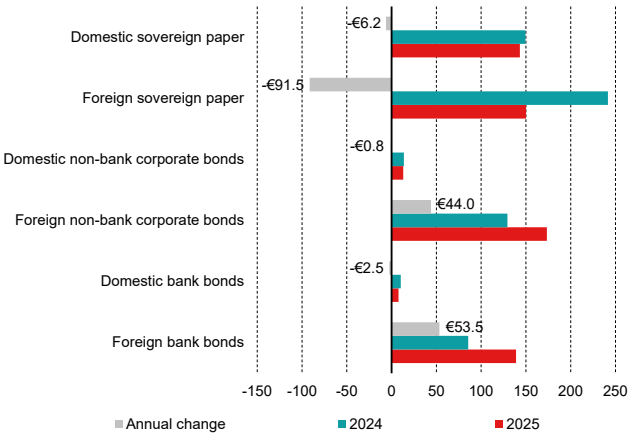
exposures with forbearance measures, which accounted for 72.6% of all forborne loans, as otherwise non-performing exposures with forborne measures fell.

2.2.5 Securities portfolio

The non-core domestic banks' overall securities portfolio declined by 3.0%, reflecting reductions in both equity and fixed-debt securities, to represent 25.0% of overall assets. Equity holdings declined further by 11.0%, to account for 21.4% of the overall securities portfolio. This drop was driven mainly by a decrease in direct equity investments in subsidiaries by one bank, which represents 95% of the overall equity exposures. The remaining holdings consisted largely of positions in non-money market investment funds.

At the same time, the overall decline in debt securities holdings was more contained, at 0.6%, though notable shifts occurred within the portfolio composition. The contraction was driven primarily by a significant reduction in sovereign paper holdings, which fell by one-quarter, largely reflecting lower exposures to foreign sovereign debt (see Chart 2.25). This was entirely attributable to developments at one bank related to its holdings of Luxembourg and United States sovereign paper. Domestic sovereign exposure also declined, though more moderately, by 4.2%. Taken together, these developments reduced the share of sovereign paper within overall debt securities by 15.2 percentage points to around 47%. In contrast, holdings of bank and corporate bonds expanded markedly by 53.3% and 30.1%, respectively, increasing their shares to 23.4% and 29.7% of total debt securities holdings. While these increases partly reflected offsetting portfolio rebalancing by the same bank referred to above, they were also driven by increases in holdings by other banks.

Chart 2.25
DEBT SECURITIES PORTFOLIO – NON-CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.

These shifts led to a decline of around 34% in the share of high-rated debt securities, lowering their contributions to total securities by 13.5 percentage points to 27.2%. Nevertheless, an increase in medium-rated holdings partly offset this drop, with the overall portfolio remaining predominantly invested in high and medium-rated bonds, which together accounted for 79.0% of total debt securities. Furthermore, the share of low-rated bonds decreased to 5.0% of the overall securities. However, unrated and speculative bonds increased significantly, largely as one bank increased its holdings in non-resident bonds issued by UK investment companies. This led to a 12.5 percentage points rise in the share of speculative and unrated to the overall securities, to 16.0%. Notwithstanding, this group of banks did not report any non-performing securities (NPS) by the end of 2025.

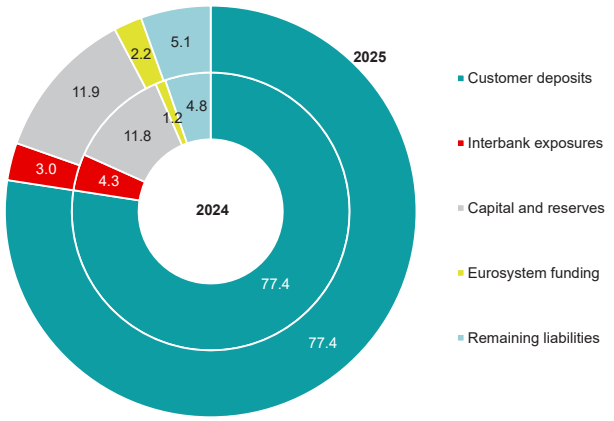
2.2.6 Funding and liquidity

The contraction in these banks' balance sheet is consistent with a 5.0% reduction in customer deposits. Nonetheless, deposits remained the primary funding source, financing approximately 77% of their assets (see Chart 2.26). The decrease in deposits was entirely driven by non-resident customers, whose balances fell by around 15%, largely due to outflows from non-bank financial entities, which comprise 31.4% of overall customer deposits. Further declines were observed among non-resident private NFCs and households, which represented nearly 6% and 27% of total retail funding, respectively. These outflows partly reflect the

drop in deposit rates by non-core domestic banks.

Conversely, resident customer deposits grew strongly, up by 19.4%, increasing their share of total customer deposits by 7.4 percentage points to around 36%. This growth was mainly driven by higher inflows from non-bank financial entities and households, with the latter accounting for around 56% of resident customer deposits held with these banks. These inflows occurred as deposit rates, despite having declined, remained relatively competitive compared with those offered by core domestic banks. The increase in resident deposits was mainly concentrated in savings accounts, indicating a preference for liquidity. Concurrently, time-deposits also rose, though at a more moderate pace.

Chart 2.26
FUNDING STRUCTURE – NON-CORE DOMESTIC BANKS
(per cent)

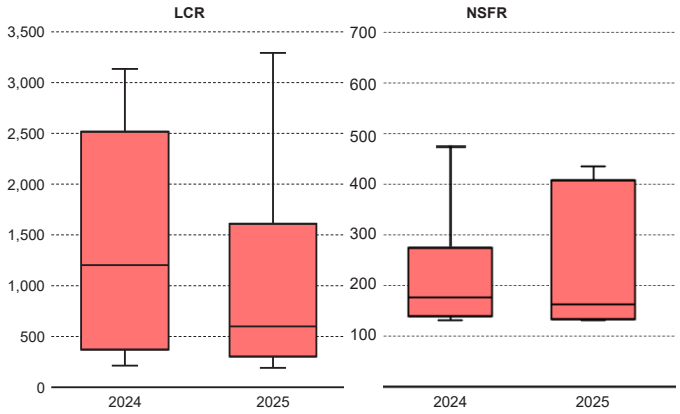


Source: Central Bank of Malta.

Interbank funding declined by more than a third, financing just 3.0% of total assets. Capital and reserves also fell, but remained an important source of financing, accounting for almost 12% of total assets. In contrast, Eurosystem funding rose substantially by year-end, reflecting higher participation in the main refinancing operations, three-month longer-term refinancing operations (LTROs), and USD operations. As a result, Eurosystem funding financed 2.2% of overall assets by the end of 2025.

The liquidity position of the non-core domestic banks weakened over the year and was particularly reflected in a lower LCR, which declined by 51.1 percentage points to 387.2%. Despite this drop, the ratio remained substantially above the regulatory minimum, with the lowest ratio among these banks still at a supportive 190.8% (see Chart 2.27). This decrease was driven by lower holdings of liquid assets, particularly central bank assets and government securities. The NSFR also declined, falling by 8.2 percentage points to 172.7%, with ratios ranging between 131.1% and 434.5%. Nevertheless, it too remained above regulatory requirements, signalling continued resilience in longer-term funding structures.

Chart 2.27
LIQUIDITY RATIOS – NON-CORE DOMESTIC BANKS
(per cent)



Source: Central Bank of Malta
Note: The minimum requirement of LCR and NSFR ratios is 100%.

2.2.7 Risk outlook

The risk profile of non-core domestic banks is expected to remain elevated over the coming year, shaped by the contraction in their balance sheet and the sustained pressures on profitability. The reduction in Eurosystem placements and lower securities holdings will continue to weigh on core income streams, particularly in an environment characterised by lower interest rate

stance. At the same time, structurally high operating costs and rising cost-to-income ratios suggest that earnings may remain constrained unless these banks implement measures aimed at improving efficiency or broadening their non-interest revenue sources.

Looking ahead, GPRs are likely to play a more prominent role, given these banks' meaningful exposure to cross-border activities. The involvement of some of these banks in regions that are more susceptible to geopolitical tensions, such as parts of the Middle East and North Africa (MENA) region, could heighten vulnerabilities through potential disruptions in non-interest income, and foreign NFC credit exposures. This reinforces the need for close monitoring of their cross-border activities, particularly in markets where volatility, sanctions risk, and policy uncertainty remain elevated.

Despite profitability pressures, current asset quality remained robust, with low NPL ratios, declining Stage 2 exposures and stronger coverage ratios. However, concentration risks, both in foreign sectors and increasingly in the domestic construction and real estate markets, could amplify credit risk should economic conditions weaken or geopolitical uncertainty intensifies. The shift in their funding structures away from non-resident deposits towards resident on-demand deposits helped cushion profitability pressures but may continue to influence balance sheet composition. The decline in liquid asset holdings has somewhat weakened liquidity metrics, and further adjustments in portfolio structures may continue to place pressure on their liquidity buffers, underscoring the need for continued vigilance. However, both the LCR and NSFR remain comfortably above regulatory minima, which together with the strong capital buffers signal continued resilience.

BOX 3: SYSTEMIC RISK PERCEPTIONS OF MALTESE BANKS (H1 2026 SURVEY)[1]

The Central Bank of Malta conducted its first edition of the SRPS among 11 domestic banks.[2] The survey was conducted between April and May 2026, with responses provided primarily by Chief Risk Officers and other senior risk professionals operating in the Maltese banking sector. The survey captures both quantitative and qualitative assessments of key risks affecting the banking sector, as well as forward-looking views on vulnerabilities and profitability. Results are presented on an unweighted basis, with each responding institution assigned equal weight.

Perceptions on the current risk environment

Survey results indicate that banks' risk perceptions are increasingly shaped by operational and external factors, rather than traditional balance sheet risks (see Chart 3a). Cybersecurity and operational factors were the top risks identified by almost two-thirds of banks. Respondents highlighted the increasing sophistication of cyber threats, reliance on third-party infrastructure, and the potentially severe operational and reputational consequences of a major incident.

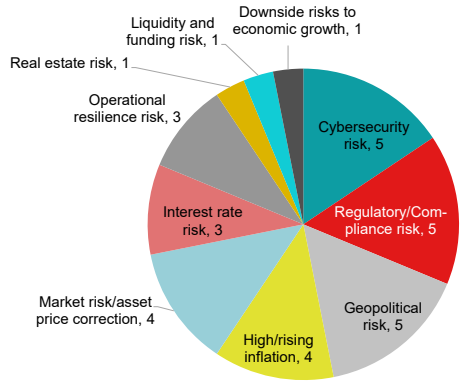
Regulatory and compliance risks were cited by just under half of the banks, reflecting the continued expansion in supervisory expectations, reporting requirements, and capital constraints. Several institutions emphasised the growing operational burden and resource intensity associated with compliance.

GPRs were reported by five out of 11 banks, primarily due to their indirect macro-financial effects, including weaker external demand, supply chain disruptions, and financial market volatility. In this context, inflationary pressures (four banks), market risks (four banks) and interest rate risks (three banks) were also highlighted as key transmission channels affecting borrowers' affordability, funding conditions, and asset valuations.

More traditional risks such as real estate and liquidity risk were generally of secondary importance in banks' current risk assessments. Downside risks to growth were also sparsely mentioned. Overall, results point to a risk environment increasingly driven by external macro-financial shocks and rising operational complexity.

Consistent with these findings, almost two-thirds of banks reported no major concerns regarding systemic risk in the domestic banking sector. However,

Chart 3a
WHICH THREE RISKS DO YOU EXPECT WILL POSE THE GREATEST THREAT TO YOUR INSTITUTION TODAY?
(count)



Source: Central Bank of Malta.

[1] Authored by Mr Andrew Spiteri, Deputy Head within the Financial Stability Surveillance and Risk Assessment Department. The author would like to thank Ms Wendy Zammit, Mr Alan Cassar, Deputy Governors Oliver Bonello and Rita Schembri, and Governor Alexander Demarco for their valuable suggestions. Special thanks are also extended to the survey respondents.

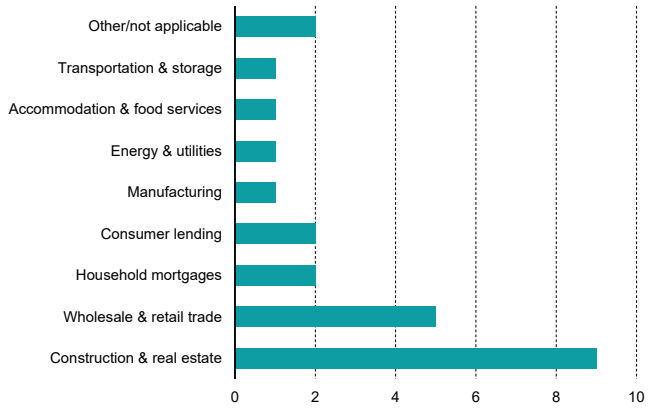
[2] The banks surveyed consist of the six core domestic banks and five of the non-core domestic banks.

36% of banks identified a moderate build-up of systemic risk, citing factors such as macroeconomic uncertainty, sectoral concentration, notably in real estate, and external shocks. This suggests that, while the banking system is perceived as broadly resilient, vulnerabilities remain in specific areas, warranting continued monitoring.

Sectoral sources of credit risk

Credit risk perceptions are strongly concentrated in the construction and real estate sector, which was identified by around four-fifths of banks as one of the most vulnerable sectors (see Chart 3b). This reflects both the significant exposure of banks to property-related lending and concerns regarding sensitivity to interest rate increases, costs escalation, and potential corrections in property valuations. The next most common sector identified was the wholesale and retail trade sector (five banks), reflecting pressures from subdued consumption and structural shifts. Household lending was selected by three banks, including mortgages and consumer credit, which were seen as particularly vulnerable to potential rising debt-servicing costs, especially among the more vulnerable borrower segments and in specific cases such as separations. Additional sector-specific risks (such as commodities or energy) were mentioned by individual banks, typically reflecting business model specialisation.

Chart 3b
WHICH SECTORS POSE THE GREATEST CREDIT RISK TO YOUR INSTITUTION OVER THE NEXT 12 MONTHS?
(count)

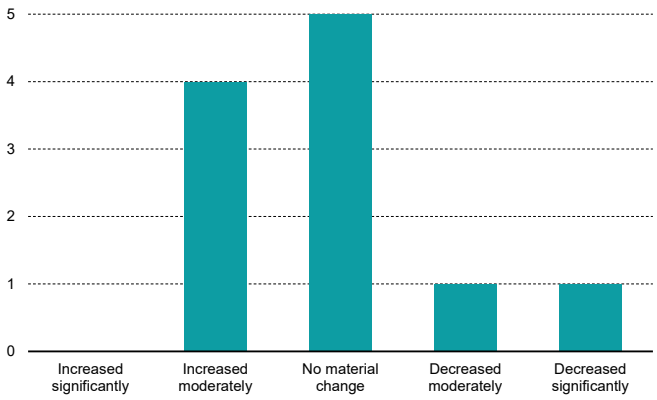


Source: Central Bank of Malta.

Evolution of risk over the past 12 months

Almost half of the banks (five out of 11 banks) reported no material change in their overall risk profile over the past year (see Chart 3c). At the same time, four banks indicated a moderate increase in risk, often associated with balance sheet expansion, digital transformation, or adverse external developments. Two banks reported a decrease in risk exposure, reflecting their de-risking strategies.

Chart 3c
THINKING ABOUT YOUR INSTITUTION'S AGGREGATE RISK PROFILE, HOW HAS YOUR OVERALL RISK EXPOSURE CHANGED IN THE PAST 12 MONTHS?
(count)

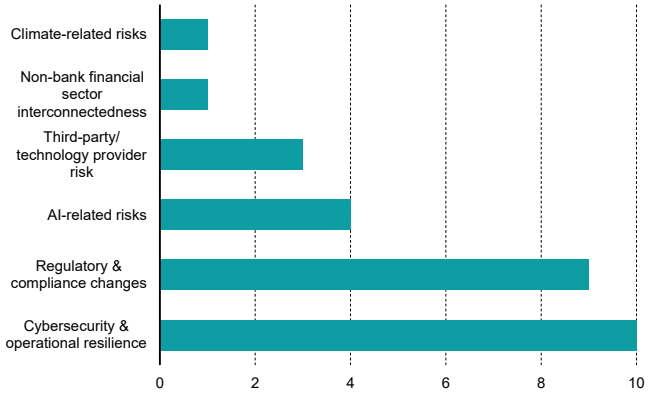


Source: Central Bank of Malta.

Emerging and rapidly evolving risks over the medium term

Looking ahead, banks expect structural and technology-driven risks to play an increasingly important role. Cybersecurity risks and operational resilience were identified as a key and intensifying concern by almost all respondents, underscoring their systemic relevance and expected persistence (see Chart 3d).

Chart 3d
WHICH EMERGING OR RAPIDLY EVOLVING RISKS ARE MOST CONCERNING FOR YOUR INSTITUTION OVER THE NEXT THREE YEARS?
(count)



Source: Central Bank of Malta.

In addition, banks identified a range of related technology-driven risks, including AI-related risks (four banks), reflecting growing awareness of model risk, governance challenges, and data integrity concerns, as well as third-party and technology provider risk (three banks), pointing to increasing reliance on external service providers.

Regulatory and compliance risks were cited by around four-fifths of banks, reflecting expectations of continued regulatory tightening and increasing complexity, as well as the associated operational and resource burden on institutions. Meanwhile, climate-related risks were mentioned only by one bank, suggesting that these remain less immediate relative to other emerging vulnerabilities.

Profitability outlook

Banks' profitability expectations for the next 12 months are generally stable to moderately positive. Slightly less than half expect a broadly unchanged ROA. Meanwhile, four banks anticipate an increase in profitability, including two banks expecting increases of above 10 basis points, while two banks expect a decline in profitability, including one anticipating a pronounced reduction.

Respondents identified a number of negative factors, such as lower market interest rates, higher funding costs and rising operating expenses. At the same time, supportive factors include balance sheet growth, cost containment, digitalisation, and the expansion of fee-based income. Overall, profitability is expected to remain resilient, albeit subject to potential margin compression and rising cost pressures.

Conclusion

The survey results suggest that the risk landscape for Maltese banks is increasingly shaped by external, operational, and structural factors, with cybersecurity and operational resilience emerging as the most prominent concerns, alongside regulatory and compliance changes. Geopolitical developments continue to be viewed mainly through their macro-financial effects, including related inflationary pressures, market risks, and interest rate risks.

At the same time, more traditional vulnerabilities remain concentrated in specific areas, particularly in the construction and real estate sectors reflecting banks' significant exposure. Notwithstanding, overall risk levels are perceived as broadly stable.

Looking ahead, the growing importance of technology-driven and system-wide risks, including AI-related challenges and dependence on third-party service providers, highlight the need for continued adaptation of risk management frameworks and supervisory approaches. This underscores the importance for continued vigilance and further strengthening of risk management frameworks, particularly in the areas of operational risk and sectoral concentration, consistent with the Bank's macroprudential policy stance aimed at addressing sectoral vulnerabilities.

2.3 International banks

The balance sheet of international banks' contracted by 12.3% to represent 46.4% of GDP. This reduction was driven entirely by the branches of foreign banks, whose assets shrank by 20.4%, largely due to lower holdings of foreign government securities. This development in part reverses the expansion reported in 2024. In contrast, non-branches continued to grow, with their total assets increasing by 14.6%, fuelled primarily by increased lending activity. Profitability strengthened markedly in 2025, shifting back into profit, with the turnaround driven mainly by the branches, while non-branches continued to record solid earnings despite some margin compression.

The business model of the international banks remained largely oriented towards non-residents, with resident assets accounting for just over one-fifth of total assets, largely in the form of Central Bank of Malta placements. Liquidity conditions differed across business models. Non-branches maintained comfortable regulatory liquidity buffers, whereas branches continued to rely more heavily on wholesale funding. Asset quality improved marginally, with a slightly lower NPL ratio supported by loan growth, although rising Stage 2 exposures point to some early signs of credit-risk migration.

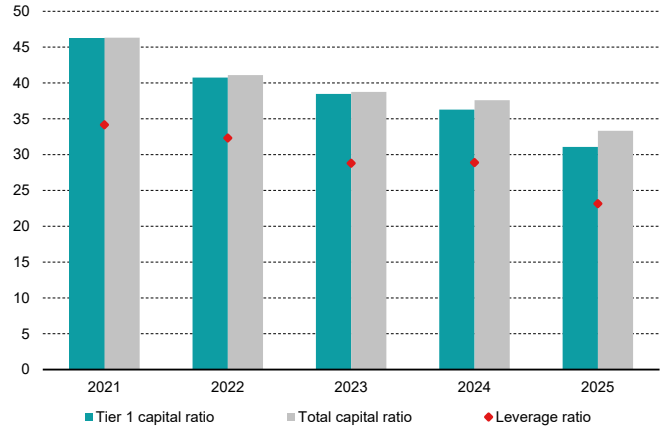
2.3.1 Capital and leverage

The capital position of the subsidiaries and stand-alone banks remained sound, with the total capital ratio and the Tier 1 capital ratio standing at 33.3% and 31.1%, respectively, notwithstanding the declines relative to 2024 (see Chart 2.28).

This decline was driven solely by a 21.5% increase in RWA, which outpaced the 4.1% growth in total own funds. The rise in RWA was primarily attributable to a 37.7% increase in credit-risk exposures, which accounted for 73.0% of total RWA in 2025. RWA for market risk also rose, more than doubling compared with 2024, and represented 19.0% of total RWA among non-branches. In contrast, RWA for operational risks dropped by almost 60%. Collectively, these developments raised the overall risk profile of the non-branches, with the ratio of RWA to total assets increasing by 4.0 percentage points to 76.0%.

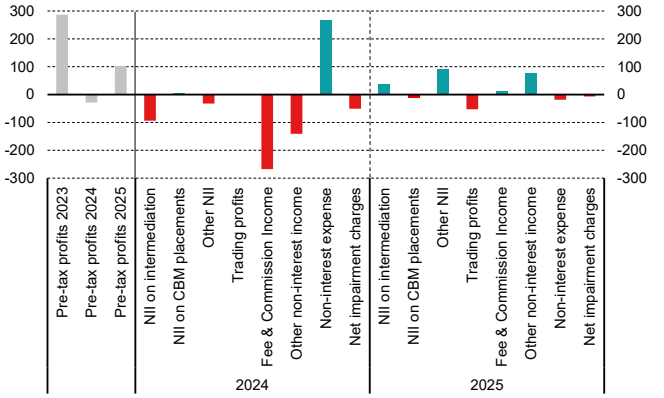
Meanwhile, the leverage ratio for the non-branches declined by 5.7 percentage points relative to 2024, but remained comfortably strong, standing at 23.1%.

Chart 2.28
CAPITAL AND LEVERAGE RATIOS – INTERNATIONAL BANKS
(per cent)



Source: Central Bank of Malta.

Chart 2.29
MAIN CONTRIBUTORS TO PROFITS – INTERNATIONAL BANKS
(EUR millions)



Source: Central Bank of Malta.
Note: Grey bars indicate pre-tax profits in absolute amounts. Teal (positive) and red (negative) bars indicate yearly contribution to the change in profits.

2.3.2 Profitability

The financial performance of international banks strengthened in 2025, shifting from a pre-tax loss of almost €30 million in 2024 to a pre-tax profit exceeding €100 million in 2025 (see Chart 2.29).

Consequently, the overall post-tax ROA improved from -0.3% to 0.9%. This turnaround was largely driven by the branches of foreign banks and was supported by stronger operational income. Their post-tax ROA recovered to 0.4% from a negative 1.1% in 2024. Non-branches also saw an increase in their pre-tax profits, up by 8.0%, mainly reflecting stronger net fee and commission income. However, this increase fell short of the balance sheet growth, leaving their post-tax ROE unchanged at 8.7%, while their post-tax ROA narrowed by 0.2 percentage points to 2.1%.

Across all international banks, the strongest contribution to the improvement in profitability stemmed from higher NII, which rose by 82.4%. This increase boosted NII's share of gross income by 2.8 percentage points to 72.6%. The main driver was the sharp decline in interest expenses on repurchase agreements within the branches, which more than offset the weaker interest income earned on government securities. As a result, NII from non-intermediation activities improved significantly.

NII from intermediation activities also increased by around a third, reflecting lower funding costs on branches' interbank placements, as otherwise income generated on the assets declined. Overall growth in NII was driven entirely by the branches, as non-branches reported a 2.9% drop in NII due to lower interest income from their lending portfolios.

Non-interest income went up by 58.7%, mainly reflecting lower FX valuation losses by one branch of foreign bank. In addition, fee and commission income rose by 17%, entirely attributable to the non-branches. In contrast, trading profits more than halved over the year, reflecting lower, albeit still positive, fair value (FV) gains on financial instruments.

Meanwhile, non-interest expenses rose by 12.8%, owing to higher staff and administrative costs, particularly among the non-branches. Non-interest expenses of branches also rose but at a more modest rate. Despite the increase in operating expenses, the stronger growth in operating income resulted in improved cost efficiency across international banks, with the cost-to-income ratio improving markedly from almost 70% in 2024, to 45.0% in 2025, placing it below the EU average.

Net impairment charges rose by 7.4%, reflecting higher charges booked by non-branches, as well as fewer impairment reversals among foreign bank branches.

2.3.3 Credit dynamics

The customer loan portfolio of international banks, composed almost entirely of non-resident loans, grew by 10.8%, with the share in total assets increasing by 8.0 percentage points to 38.5%.[8] This growth was driven primarily by the non-branches, which reported an increase of nearly 24%, supported by higher lending to households and non-bank financial entities, and to a lower extent, to NFCs. Lending by the branches also rose, though at a slower rate of 1.5%, driven exclusively by higher NFC lending.

Loans to households, composed entirely of non-resident consumer credit by the non-branches, rose by more than one-quarter, to 18.4% of overall customer loans. This was followed by growth in NFC lending, which rose by 5.3%, supported by both branches and non-branches. Despite the increase, NFC loans' share of total customer loans declined by 3.6 percentage points, though it remained substantial at 69.0%. At a sectoral level, the growth in NFC lending stemmed mainly from higher lending to non-resident firms operating in the energy, construction and real estate sectors, which were partly offset by a significant contraction in lending to the transportation and storage sector (see Chart 2.30). Loans to non-bank financial entities also increased markedly, up by more than a quarter compared with 2024, exclusively driven by the non-branches.

Interbank placements rose by more than a half, with their share in total assets rising from 4.7% to 8.2%. This expansion was entirely driven by a significant increase in intragroup placements by branches. As a result, the composition of the interbank deals shifted markedly, with intragroup placements now accounting for almost

[8] Resident customer loans remained marginal, accounting for only 0.5% of total customer loans. They declined by 5.4%, reflecting mainly lower lending to NFCs and, to a lesser extent, households.

half of the overall interbank placements, up from just 8.7% in 2024. In contrast, placements with unrelated credit institutions declined by 15.3%. This change ensured that available liquidity was preserved within the respective banking group.

Placements with the Central Bank of Malta fell by 3.4%, mainly driven by lower balances from the non-branches, and to a lower extent from the branches. Despite the decline, such placements still accounted for around 20% of total assets.

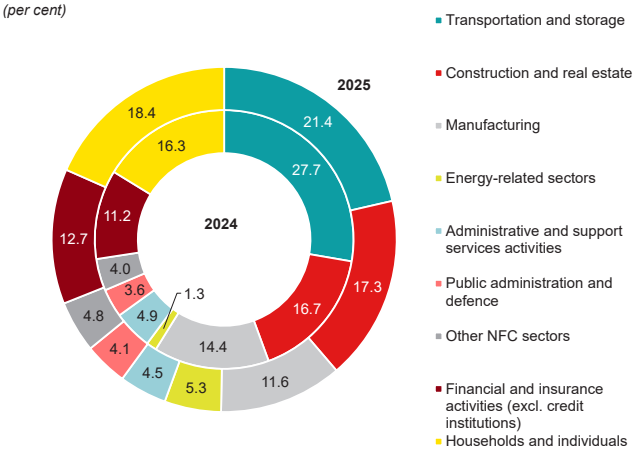
2.3.4 Credit quality

The credit quality of international banks improved marginally in 2025, with the NPL ratio declining by 0.1 percentage points to 1.5%. When excluding placements with the Central Bank of Malta, the NPL ratio fell by 0.2 percentage points to 2.4%. The dispersion of NPL ratios across international banks narrowed further, reflecting declines among banks with relatively higher NPL ratios (see Chart 2.31).

This improvement was mainly supported by an expansion of the loan book, alongside a marginal drop in the stock of NPLs, which fell by 0.1%. The contraction in NPLs was largely attributable to exposures to non-bank financial entities and households, where NPL balances declined by 10.3% and 7.8%, respectively. Still, consumer credit NPLs continued to account for the largest share of NPLs, at 88.7% of the total. The household NPL ratio fell from 16.6% to 13.6%. On the other hand, NPLs related to NFCs nearly tripled, although from a very low base, driving the NFC NPL ratio to 0.4% from 0.1%, a year earlier.

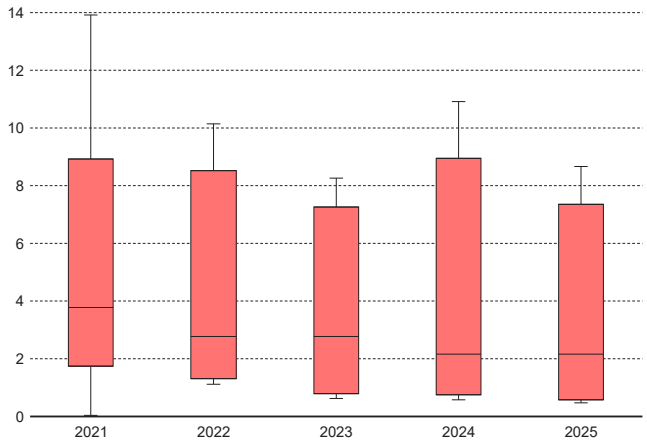
Stage 2 loans grew by 51.8%, largely driven by increasing credit risk on NFCs, and to a lower extent consumer credit loans. As a result, their share of total loans rose from 4.4% to 6.1% (see Chart 2.32),

Chart 2.30
CUSTOMER LOANS BY SECTOR – INTERNATIONAL BANKS
(per cent)



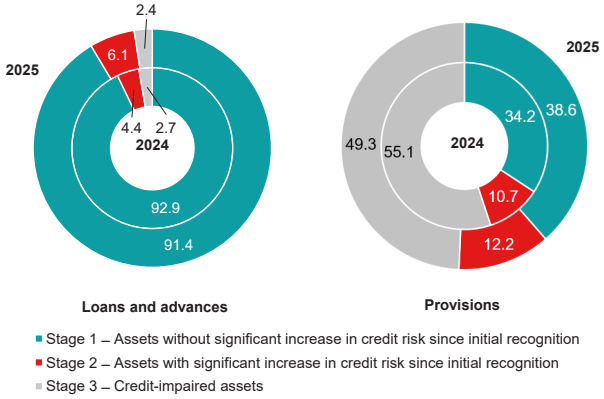
Source: Central Bank of Malta.

Chart 2.31
OVERALL NPL RATIO – INTERNATIONAL BANKS
(per cent)



Source: Central Bank of Malta.

Chart 2.32
STAGE ALLOCATION OF LOANS AND ADVANCES AND PROVISIONS – INTERNATIONAL BANKS
(per cent)



Source: Central Bank of Malta.

which point to higher expected credit risk going forward. Stage 3 loans remained broadly unchanged to account for 2.4% of total loans in 2025. These developments resulted in the share of Stage 1 loans to decline slightly from 92.9% to 91.4%, despite an 8.1% rise in their absolute level.

Concurrently, provisions fell by 5.9%, driven mainly by a 15.8% reduction in Stage 3 provisions, to represent just under half of the overall provisions. This decrease was driven by one bank. Excluding this effect, Stage 3 provisions would have increased. Meanwhile, provisions for Stage 1 and Stage 2 loans rose by 6.0% and 7.4%, respectively. Since provisions declined at a faster pace than NPLs, the coverage ratio fell from 107.4% to 101.2%, although NPLs remained fully covered on aggregate.

The overall forbearance ratio increased from 1.4% to 2.3% over the year, as loans subject to forbearance measures rose by 73.3%. The increase was driven entirely by performing forborne loans, which grew by 80.4%, while non-performing forborne loans fell by 38.1% to just 2.1% of total forborne loans.

2.3.5 Securities portfolio

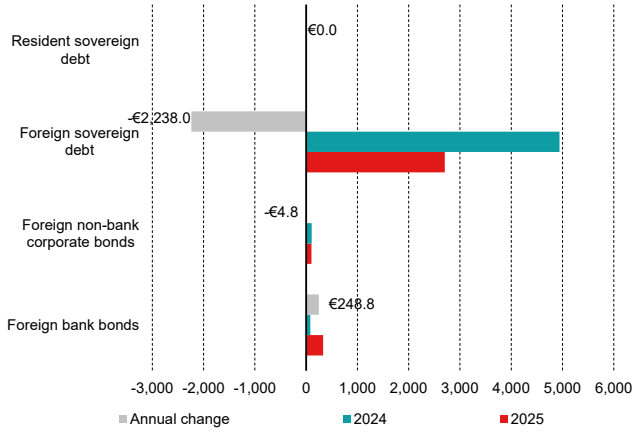
The overall securities portfolio of international banks contracted sharply by 38.6%, reducing its share of total assets to 27.8%. This decline was driven entirely by lower bond holdings, particularly among branches. In contrast, equity investments, held exclusively by the non-branches, increased slightly by 0.7%, though they remained negligible overall.

The drop in bond holdings was driven primarily by a substantial reduction in foreign sovereign bond exposures and was particularly evident among the branches of foreign banks (see Chart 2.33). This reflected both lower holdings, largely through sales and to a lower extent unfavourable exchange rate movements, partly offset by positive market valuation effects. This reduction appears to have been motivated by a deliberate reallocation away from Turkish sovereign bonds amid heightened political uncertainty and macro-financial instability in Turkey. Despite declining by more than two-fifths, foreign sovereign bonds continued to account for the largest component of the bond portfolio, representing 86.1% in 2025, down from 96.3% in 2024.

Similarly, foreign NFC bond holdings declined by 4.4%, reducing their share to 3.3% of total bond holdings. In contrast, investment in bank bonds increased more than threefold, with their share in bond holdings rising by 8.9 percentage points to 10.5%. Meanwhile, investments in domestic sovereign paper remained unchanged and minimal, accounting for only 0.1% of the bond portfolio.

Overall, the rating profile of the bond portfolio remained unchanged as it continued to be skewed towards speculative-grade or unrated instruments. This reflected the continued, but reduced, exposure to Turkish sovereign bonds, as well as holdings of foreign bank bonds, which are also classified as speculative or unrated. In 2025, international banks reported NPS for the first time, although such ratio remained low at 0.9%. This development led to an increase in the NPE ratio to 1.3% in 2025, up from 0.9% in 2024.

Chart 2.33
BOND PORTFOLIO – INTERNATIONAL BANKS
(EUR millions)

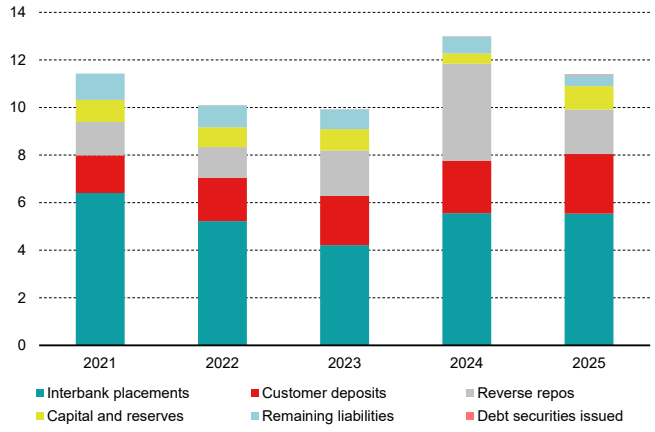


Source: Central Bank of Malta.

2.3.6 Funding and liquidity

The overall contraction in the balance sheet was driven primarily by a sharp reduction in the branches' participation in the repo market, which fell by 54.2%. This decline largely offset the significant increase recorded in 2024. As a result, repo funding financed 16.4% of the international banks' total assets, down from 31.4% in the previous year (see Chart 2.34). These developments are closely linked to shifts in the branches' asset holdings, particularly the change in holdings of high-yielding Turkish sovereign bonds.

Chart 2.34
DISTRIBUTION OF LIABILITIES – INTERNATIONAL BANKS
(EUR billions)



Source: Central Bank of Malta.

Indeed, despite a marginal drop of 0.4%, branches' preferred source of funding remained interbank placements, mostly intragroup, with the former financing more than three fifths of their total assets. In contrast, the non-branches continued to rely predominantly on customer deposits, with the share of deposits funding 65.8% of their total assets, declining by 0.6 percentage points. Notwithstanding this reliance, some non-branches did access the wholesale market during 2025, although to a limited extent. In fact, interbank funding accounted for only 1.8% of total assets of non-branches, with the majority sourced from related foreign banks.

Customer deposits across all international banks, predominantly sourced from foreign clients, grew by 13.7% to finance 22.0% of the overall balance sheet. The overall rise in customer deposits was largely driven by higher withdrawable on-demand balances, which increased by more than a fifth, pushing up their share of total customer deposits by 3.1 percentage points to 43.6%. Term deposits also increased, though to a lower extent, going up by 7.7%. The largest inflows stemmed predominantly from households, which recorded an increase of 30.3% to represent almost half of the overall customer deposits, largely from non-resident households. Deposits from private NFCs also rose, up by 13.3%, driven primarily by foreign companies operating in the manufacturing sector. In contrast, deposits from non-bank financial entities declined by 2.2%. This was entirely due to outflows from the non-branches, as branches registered a 20.1% increase in such deposits.

Residents' customer deposits rose by 18.8%, accounting for 8.1% of total customer deposits, but financing only 1.8% of the banks' total assets. This growth was driven mainly by higher inflows from non-bank financial entities, supported by additional household deposits, partly offset by outflows from NFCs operating in selected services activities.

During 2025, the liquidity position of the non-branches remained comfortably sound. Although the LCR fell sharply by 122.4 percentage points, at 300.3%, it stayed well above the minimum regulatory requirement. The deterioration was driven by a 9.2% reduction in liquidity buffers, mainly reflecting lower government paper and placements with the central banks. At the same time, net liquidity outflows rose by more than one-quarter.

Similarly, the NSFR dropped by 14.0 percentage points to 130.5%. Despite this decline, it continued to signal a stable long-term funding profile and remained broadly in line with the EU average.

2.3.7 Risk outlook

The risk profile of international banks remains sensitive to developments in the external environment, particularly through market- and country-risk channels. While branches reduced their exposures in 2025, their remaining concentration in Turkish sovereign securities continues to be a key vulnerability, given elevated geopolitical uncertainty and the potential for renewed exchange-rate and valuation pressures.

Funding and liquidity risks also remain relevant, although unevenly across business models. Branches' greater reliance on wholesale funding, including repo activity, can amplify procyclicality, as collateral valuations and risk appetite may tighten abruptly under stress. By contrast, non-branches benefit from a predominantly deposit-funded structure. However, the rise in withdrawable-on-demand deposits increases deposit outflow sensitivity if not properly managed. Although liquidity ratios remained comfortably above regulatory minima, the decline in liquid asset buffers and higher net outflows warrant continued monitoring.

On the asset quality side, headline indicators remain favourable, but forward-looking metrics point to emerging vulnerabilities. The increase in Stage 2 exposures and the rise in performing forborne loans signal early signs of credit-risk migration, which could intensify in a weaker global macroeconomic environment or if stress materialises among non-resident borrowers. In addition, the securities portfolio remains a potential risk source, reflecting concentrations in lower-rated or unrated instruments and the possible re-emergence of valuation losses under adverse market conditions.

Overall, international banks maintain strong solvency and leverage buffers, providing resilience against plausible adverse shocks. Nonetheless, the outlook remains subject to heightened external uncertainty. Continued focus on concentration risks, the resilience of funding structures, and the monitoring of credit-risk migration indicators will be important to safeguard these institutions against bouts of renewed external volatility.

BOX 4: EVOLUTION OF BANKS' SOVEREIGN INVESTMENT HOLDINGS[1]

Introduction

Holdings of sovereign securities by domestic banks have increased markedly in recent years and constitute a significant share of banks' balance sheets. Such assets play an important role in liquidity management, are generally perceived as low risk, and benefit from favourable regulatory treatment. While banks can contribute to stabilising sovereign bond markets, elevated sovereign exposures may also give rise to an adverse feedback loop, whereby sovereign stress weakens banks' balance sheets, and tighter financing conditions further amplify risks to financial stability.[2] At the same time, given the small size of the Maltese economy, characterised by a relatively narrow local investor base and limited access to international markets due to liquidity factors, banks act as key investors in domestic sovereign paper, thereby contributing to market stability and acting as an important funding channel for government financing needs.

However, the current external environment, characterised by heightened geopolitical tensions, increased market volatility and elevated sovereign debt levels, has brought renewed attention to the risks associated with large sovereign exposures. While euro area sovereign bonds are not subject to any regulatory haircuts for LCR purposes, they remain exposed to valuation risk and may heighten concerns related to the sovereign-bank nexus. Across major advanced economies, sovereign bond markets have faced sustained pressure from rising yields, partly reflecting increased refinancing needs and concerns about fiscal sustainability.

Against this background, this box examines the evolution of banks' sovereign investment holdings, focusing on changes in composition, underlying drivers, and potential implications for financial stability. For the purposes of this analysis, domestic banks are defined as all domestically incorporated institutions, excluding branches of foreign banks. These branches hold around 22% of the overall sovereign securities, with exposures largely concentrated in Turkey and having very limited links to the domestic economy. The remainder of the box first discusses the macro-financial drivers underpinning the expansion in sovereign exposures. It then analyses changes in the composition of these holdings, including by residency and maturity. Finally, it assesses the associated financial stability implications.

Developments in banks' sovereign exposures

Macro-financial drivers of banks' sovereign exposures

Over the past two decades domestic banks have steadily expanded their sovereign securities portfolios, reflecting both cyclical responses to successive crisis episodes and structural features of the domestic financial system. Total sovereign exposures, including domestic and foreign sovereign holdings of all domestic banks increased from €1.8 billion in 2005 to €9.8 billion in 2025, corresponding to a rise from 10.1% to 24.5% of total assets. This expansion was driven primarily by the core domestic banks, which account for the majority of sovereign holdings. Such exposures increased from €1.4 billion in 2005 to €9.5 billion in 2025, equivalent to an increase from 14.1% to 28.6% of assets (see Chart 4a). This growing exposure underscores the increasing importance of the sovereign-bank

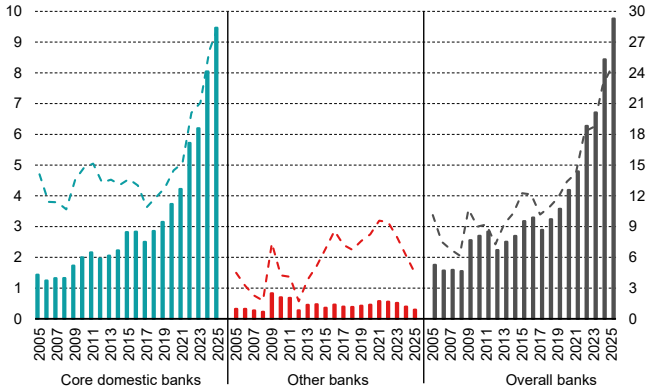
[1] Prepared by Ms Ariana Bartolo, Senior Analyst within the Financial Stability Surveillance and Risk Assessment Department. The author would like to thank Mr Christian Mamo, Principal Economist, Mr Andrew Spiteri, Deputy Head, and Ms Wendy Zammit, Head, within the same Department and Mr Alan Cassar, Chief Officer Financial Stability and Statistics Division, for their valuable suggestions.

[2] Sovereign bond markets and financial stability: examining the risk to absorption capacity, ECB *Financial Stability Review*, November 2023.

nexus within the domestic financial system.

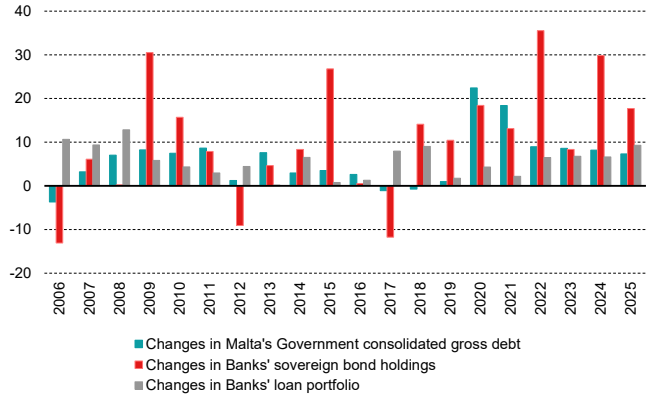
The evolution of these exposures has been closely linked to macro-financial conditions, with certain high-rated sovereign securities often acting as a stabilising asset class during periods of heightened uncertainty, alongside cash and gold. Periods of market stress, notably the global financial crisis, the euro area sovereign debt crisis, and the COVID-19 pandemic, were associated with increases in banks' holdings of sovereign bonds, particularly among core domestic banks (see Chart 4b).[3]

Chart 4a
SOVEREIGN DEBT HOLDINGS AND SHARE OF ASSETS
(EUR billions; % of total assets)



Source: Central Bank of Malta.
Note: Solid columns show holdings in EUR billions (LHS), while the dashed line indicates holdings as a share of assets (RHS). Overall banks exclude the branches of foreign banks.

Chart 4b
ANNUAL DEVELOPMENTS IN MALTA'S GOVERNMENT GROSS DEBT, SOVEREIGN BOND HOLDINGS AND LOAN PORTFOLIO OF CORE DOMESTIC BANKS
(percentage change)



Sources: Central Bank of Malta; Eurostat data.

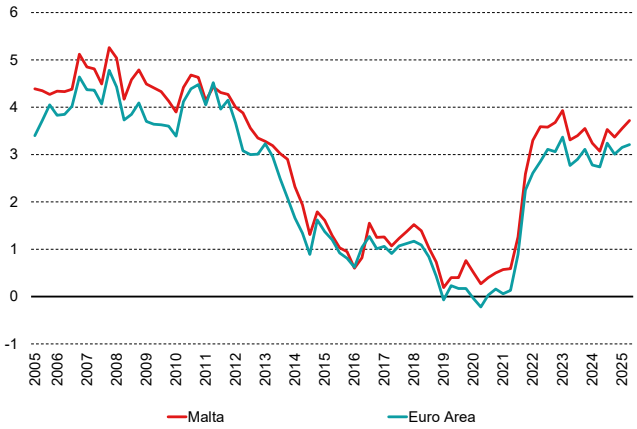
These developments were closely aligned with periods of strong growth in sovereign bond issuance driven by expansionary fiscal policies. At the same time, sovereign bond accumulation by banks often coincided with weaker growth in bank lending, particularly following the global financial crisis, suggesting a reallocation of funds from loans to sovereign securities, and potentially crowding out private credit. However, this relationship should be interpreted with caution, as both developments could be influenced by broader macroeconomic conditions, including weaker loan demand during downturns.[4]

Monetary policy measures also played a key role. In particular, the ECB's asset purchase programmes reinforced this trend through large-scale purchases of government bonds, supporting sovereign bond prices, enhancing market liquidity, and increasing the relative attractiveness of these assets on banks' balance sheets. More recently, monetary policy tightening, including the end of net asset purchases for monetary policy purposes and the related reinvestments, together with the associated rise in sovereign yields, may have increased incentives for banks to expand their sovereign portfolios rather than retaining excess liquidity with the Central Bank of Malta. The sharp increase in

[3] In the case of the sovereign debt crisis, this largely reflected increased holdings of domestic government securities, alongside a gradual reallocation towards higher-rated and more liquid sovereign issuers.
[4] Refer to ECB Working Paper: *Sovereign risk and bank risk-taking, No. 1894 / April 2016.*

both euro area and domestic government bond yields during 2022-23 (see Chart 4c), driven by monetary tightening and elevated geopolitical uncertainty, has sustained the attractiveness of newly issued government securities relative to placements within the Eurosystem, despite the valuation losses on existing holdings triggered by higher interest rates. Yields have remained relatively elevated despite subsequent monetary policy easing, reflecting persistent GPR and ongoing fiscal pressures across advanced economies.

Chart 4c
TEN-YEAR GOVERNMENT BOND YIELDS
(per cent)



Source: ECB Data Portal.

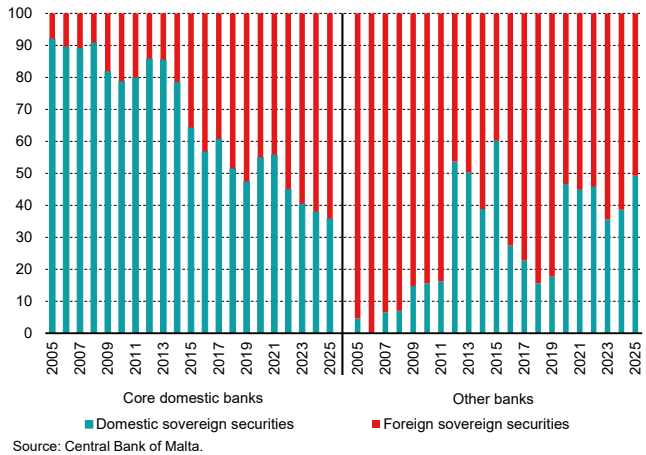
Regulatory developments under Basel III also supported this trend. In particular, the introduction of the LCR increased banks' demand for HQLA, including sovereign bonds.

Sovereign bond holdings by residency

The increase in the overall sovereign bond holdings of domestic banks has been accompanied by a progressive diversification of banks' portfolios, reflecting a gradual decline in home bias. While this has helped to mitigate concentration risk linked to domestic sovereign exposures, it has also altered the risk profile of banks' balance sheets, increasing exposure to cross-border sovereign risk and to global market developments. This trend is particularly evident among core domestic banks.

In 2005, sovereign holdings of core domestic banks were largely concentrated in domestic government securities, with only 7.9% of their holdings invested in foreign sovereign securities (see Chart 4d). Although domestic sovereign holdings continued to grow in absolute terms over time, their relative importance within their portfolios declined steadily. By 2025, domestic exposures accounted for 35.9% of total sovereign securities, indicating a lower home bias compared to the

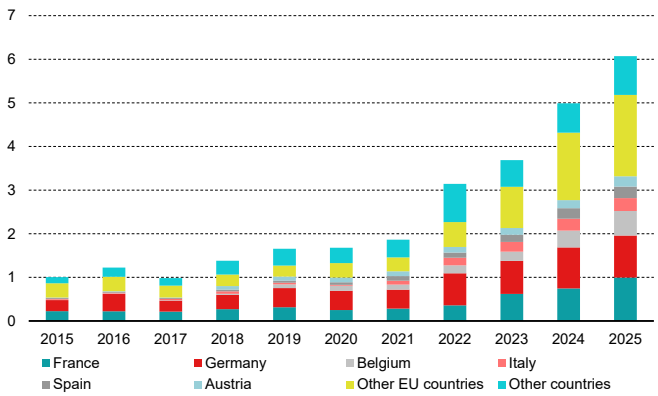
Chart 4d
SOVEREIGN SECURITIES HOLDINGS BY BANK AND RESIDENCY
(per cent)



Source: Central Bank of Malta.

EU/EEA aggregate of 45%.[5] A similar trend has been observed across other euro area countries, where banks have diversified their high-quality liquid asset portfolios towards non-domestic sovereign issuers.[6]

Chart 4e
CORE DOMESTIC BANKS' FOREIGN HOLDINGS OF GOVERNMENT DEBT SECURITIES BY COUNTRY
(EUR billions)



Source: Central Bank of Malta.
Note: Other EU countries include supranational insitutions.

The increase in foreign sovereign exposures was predominantly driven by euro area and supranational institutions. These expanded both in absolute terms and as a share of overall sovereign holdings, reaching around 85% of core domestic banks' foreign portfolios by end-2025. This growth reflected rising exposures to highly rated euro area sovereigns, particularly those of France and Germany, accounting for 16.4% and 15.9%, respectively, and to a lesser extent to issuers in Belgium, Italy and Spain (see Chart 4e). In addition, exposures to non-euro area sovereigns accounted for around 15% of foreign sovereign holdings.

By contrast, other banks were predominantly invested in foreign government paper in 2005, with such exposures accounting for about 95% of their sovereign holdings, reflecting limited participation in domestic government financing. While still relatively small in absolute terms, these banks increased their allocations to domestic government securities during periods of market stress. More recently, however, their overall sovereign holdings have declined, driven primarily by a contraction in foreign holdings, resulting in a more balanced distribution between domestic and foreign sovereign securities. By the end of 2025, foreign sovereign holdings were mainly concentrated in Poland, Spain, and Luxembourg.

Overall, these developments point to increasing diversification of sovereign portfolios among core domestic banks towards highly-rated, predominantly euro-denominated, issuers.[7] An analysis of credit ratings confirms that the majority of foreign sovereign exposures remained concentrated in high-rated categories, which accounted for around 57% in 2025 of their sovereign holdings, with medium-rated holdings representing a further 36%. This composition supports the overall credit quality of banks' foreign sovereign portfolios.

In terms of total sovereign holdings of core domestic banks, around 36% are classified as high-rated, while medium-rated sovereign securities accounted for around 59%. This distribution largely reflects exposures to domestic sovereign debt and continues to underpin the overall stability of the banks' sovereign portfolios.

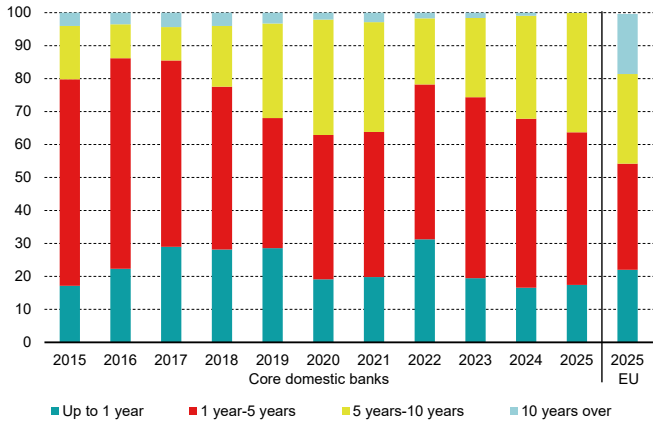
Maturity structure of sovereign portfolios

The residual maturity profile of sovereign holdings provides important insights into the banks' sensitivity to interest rate risk and their ability to manage their balance sheet flexibly. Monetary policy developments

[5] Source: EBA Risk Dashboard, Q4 2025.
[6] Source: ECB *Financial Stability Review*, May 2026.
[7] Investment-grade debt securities carrying a rating of AA- or above are regarded as 'high-rated bonds'. 'Medium-rated debt securities' are those rated between A- and A+, whereas 'low-rated debt securities' are those rated between BBB- and BBB+. Sub-investment grade debt securities are rated lower than BBB-.

play a key role in shaping this profile. During periods of accommodative monetary policy, including low interest rates and asset purchase programmes, banks tend to increase holdings of medium and longer-datedsovereign bonds in search for yield and capital gains.[8] This was also observed during the COVID-19 pandemic, when central banks reduced policy rates to historical lows, compressing yields on short-dated government securities, which in some cases turned negative. Against this backdrop, domestic banks shifted towards medium and longer-dated holdings in 2020, reflecting search for yield (see Chart 4f). However, no strong reversals in medium and longer-dated holdings were observed as interest rates began to rise and remained elevated thereafter. Allocations to such government securities continued to play a central role, allowing banks to benefit from higher yields on newly issued securities.

Chart 4f
TOTAL GOVERNMENT DEBT SECURITIES BY MATURITY
(per cent)



Sources: Central Bank of Malta; EBA Risk Dashboard Q4 2025.

As at end-2025, securities with maturities of between one and five years accounted for around 47% of total sovereign holdings, exceeding the EU/EEA aggregate of about 32%, while holdings with maturities of between five and ten years increased gradually to stand at around 35%, also above the EU/EEA aggregate of about 27%.[9] However, domestic banks maintained a lower share of very long-term maturities (above ten years) compared to the EU/EEA aggregate, indicating a preference for intermediate durations and reduced exposure to long-term interest rate movements.

Overall, the maturity structure of sovereign portfolios suggests a balanced allocation across different maturity buckets, with a notable tilt towards medium-term securities implying greater sensitivity to changes in interest rates, especially in a more volatile macro-financial environment.

Financial stability implications of sovereign exposures

As highlighted in the latest ECB Financial Stability Review, the euro area sovereign bond market may face renewed pressure due to rising long-term yields, elevated public debt levels, and shifts in the investor base.[10]

In this environment, the sizable exposure of domestic banks to sovereign securities represents an important potential channel of risk transmission, particularly through valuation effects on banks' sovereign bond portfolios and the resulting impact on capital positions. Sovereign holdings amount to around 24.5% of total assets (28.6% for core domestic banks), 83.3% of total debt securities portfolios (86.2% for core domestic banks), and 2.7 times the CET1 capital (3.5 times for core domestic banks), indicating that valuation changes could have a material impact on banks' balance sheets and capital positions.

8 Medium and longer-dated securities consist of those maturities of over one year.
9 See footnote 5.
10 See footnote 6.

Owing to the increasing diversification in the sovereign portfolios, the Herfindahl–Hirschman Index (HHI) dropped significantly from around 4,300 in 2015 to about 1,700 in 2025, mainly reflecting the reduced share of domestic sovereign holdings.[11] Similarly, the three largest sovereign exposures now account for 56.1% of total holdings, down from 87.2%, a decade earlier.

While the decline in home bias has reduced direct exposure to domestic sovereign risk, fiscal deficits and public debt in Malta have also declined significantly in the post-COVID period to 2.2% and 46.4% of GDP, respectively, thus lowering risk in domestic sovereign debt exposures. Nevertheless, concentration has remained relatively elevated, becoming increasingly tilted towards a small set of foreign issuers. As such, adverse developments affecting the euro area could still generate significant valuation effects, particularly in a context of heightened global uncertainty and increased sensitivity to sovereign spreads.

The maturity structure and valuation treatment of these exposures are also key to shaping risk transmission. The increasing share of longer-dated assets implies greater sensitivity to interest rate movements and changes to sovereign spreads. While the predominance of amortised cost (AMC) accounting (around four fifths of holdings) mitigates the immediate impact on profit and loss accounts, it does not eliminate underlying economic risks, particularly in the event of liquidity pressures necessitating the sale of such assets.

The increasing allocation to foreign sovereign securities in more recent years introduces an additional layer of risk through cross-border spillovers and foreign currency risk. Although this diversification has contributed to improving the overall credit quality of sovereign portfolios, it also exposes banks to cross-border spillovers, amplifying the transmission of changes in global risk sentiment, sovereign spread widening, and geopolitical developments.

Elevated sovereign exposures may also reinforce the sovereign–bank nexus, whereby vulnerabilities in one sector can amplify weaknesses in the other, potentially creating negative feedback loops.[12] In the event of stress in the banking sector, large holdings of government debt could give rise to contingent liabilities for the public sector, either through explicit support measures or implicit guarantees. In addition, costly resolution policies may adversely affect fiscal accounts. Conversely, a deterioration in sovereign creditworthiness could weaken banks' balance sheets through valuation losses and tighter funding conditions, potentially constraining lending capacity and amplifying macro-financial feedback effects.

Conclusion

Domestic banks' sovereign exposures have increased over time, driven by a combination of cyclical factors, including crisis-related portfolio shifts and changes in the monetary policy environment, as well as structural features of the Maltese financial system and banks' demand for HQLA.

While home bias has declined significantly, the growing exposure to euro area sovereign bonds has altered the risk profile of banks' portfolios. Rising interest rates can generate valuation pressures on medium and longer-dated bond portfolios, increasing sensitivity to changes in yields and sovereign spreads. High sovereign exposures may also reinforce the sovereign-bank nexus, whereby fiscal stress or widening sovereign spreads could affect banks' balance sheets and funding conditions. In addition, while diversification has reduced domestic concentration risk, exposures remain relatively concentrated across a limited number of foreign sovereign issuers, potentially amplifying the transmission of external shocks. Although euro area sovereign bonds remain highly liquid and benefit from

[11] HHI is computed based on available country-level breakdown; therefore, concentration may be underestimated due to the aggregation of smaller exposures under 'Other countries'.

[12] Dell'Ariccia, G. et al. (2018), Managing the sovereign-bank nexus. *ECB Working Paper No. 2177*, Frankfurt: European Central Bank.

favourable regulatory treatment, periods of market stress could still lead to valuation volatility and potential liquidity strains, where assets may need to be sold under pressure.

These risks are partly mitigated by Malta's favourable macro-financial environment, including a resilient economy and a positive domestic fiscal performance in the post-COVID period with public debt declining to significantly below the EU threshold of 60% of GDP. Moreover, domestic banks' increasing allocation towards highly-rated sovereign issuers supports the overall credit quality of their portfolios. In addition, banks' strong capital and liquidity positions, the predominance of AMC accounting, and their largely retail-funded business model contribute to overall resilience and to lower short-term funding pressures.

Nonetheless, the size and concentration of sovereign exposures warrant continued monitoring, including through existing stress-testing frameworks, which already assess banks' resilience to interest rate and sovereign spread shocks. Maintaining strong economic growth coupled with prudent fiscal policies and sound sovereign risk management will be key to limiting vulnerabilities and preventing adverse feedback loops between the banking sector and public finances.

3. STRESS TESTS

Stress testing forms a central part of licensed credit institutions' risk management and supervisory assessment, as it helps gauge resilience to severe but plausible adverse shocks. The Bank operates a suite of stress-testing frameworks to evaluate banks' capacity to withstand emerging vulnerabilities and to assess the resilience of the banking sector as a whole. The exercise is intended to inform an assessment of whether existing supervisory, regulatory, and management buffers would be sufficient should systemic risks materialize.[1]

This chapter presents the methodology and main findings of the Bank's stress-testing exercises and is structured into three sections. The first section outlines the scenario-based solvency stress test namely the MST framework, which maps macroeconomic and financial shocks under alternative scenarios onto banks' balance sheets over a three-year horizon. The framework comprises several risk modules designed to quantify the impact of different risk sources under both a baseline and an adverse scenario. This section also features a focus Box 5 that discusses a refinement to the credit risk module.

This framework also incorporates a market risk module, primarily assessing the losses that could potentially arise following changes in interest rates, as well as a sensitivity analysis framework that examines credit quality deterioration in isolation to complement the market module of the MST.

The second section reports the results of the interest rate risk framework for the banking book, which encompasses six scenarios reflecting interest rate changes, to evaluate their impact on both NII and the market re-valuation of bonds.

Finally, the third section presents the results of liquidity stress-testing frameworks to assess the robustness of liquidity buffers under elevated withdrawal conditions, including a liquidity-to-solvency channel.

3.1 Scenario-based solvency stress test

3.1.1 Outlook and scenario design

The Bank's MST framework assesses the resilience of the banking sector under a baseline and an adverse macro-financial scenario over a three-year horizon. The latest exercise is based on banks' balance sheet data as of December 2025 and evaluates the impacts of the respective scenario paths on the profitability, asset quality, and capital position of the banks in scope through a set of dedicated satellite models and risk modules.[2]

In this year's exercise, the scenario design departs from the approach adopted in the previous publications in two respects. First, the baseline scenario aligns more closely with the Bank's own macroeconomic projections than in previous iterations.[3] Second, although the adverse scenario retains the broad risk narrative of the 2025 EBA/ECB stress test exercise, it updates the transmission of external shocks to the Maltese economy using the Structural and TRaditional Econometric model for Malta (STREAM), with particular emphasis on higher oil prices and a stronger negative foreign-demand shock.[4]

This approach reflects the assessment that the external environment remains highly uncertain and that downside risks to the domestic outlook continue to stem predominantly from persistent geopolitical tensions,

[1] The Bank does not disclose stress test results for individual institutions, as the primary objective of the exercise is to assess the resilience of the banking system at an aggregate level. Bank-specific findings are instead communicated to the relevant authorities where appropriate. In addition, the coverage of banks may differ across stress-testing frameworks, since certain institutions may fall outside the scope of specific exercises. This is particularly relevant in the case of branches of foreign banks, which do not hold capital locally, as well as banks that do not have exposure to the instrument classes captured by a given framework.

[2] Covers six core and five non-core domestic banks. Merkanti Bank Ltd formally ceased accepting new banking business in December 2025, following its decision to voluntarily surrender its banking license, and was excluded from this year exercise given the forward-looking nature of the exercise.

[3] Central Bank of Malta, Outlook for the Maltese Economy 2026:1, February 2026.

[4] The STREAM is the Bank's core model for conducting simulations to assess the potential impact of various economic shocks, generating macroeconomic forecasts and examining the impact of policy actions.

trade fragmentation, and disruptions to energy markets. These risk factors are especially relevant for Malta, as a small and highly open economy, where weaker external demand, higher import costs, and tighter financial conditions can impact exports, especially tourism, as well as private consumption and investment, with relatively strong spillovers to domestic activity.

Baseline scenario

The baseline scenario is based on the Bank's February 2026 central macroeconomic projections for Malta. Real GDP growth is projected to stabilise at 3.7% over 2026-2028, with domestic demand remaining the main driver and net exports continuing to provide a positive, albeit smaller, contribution to growth. Private consumption is expected to remain resilient, supported by continued growth in real disposable income, while investment is projected to recover in 2026 before moderating thereafter, partly reflecting the profile of EU-funded projects. Export growth is also expected to ease from the strong rates recorded in recent years, in line with a more moderate and uncertain external environment, including higher energy costs. At the same time, labour market conditions are projected to remain favourable, with employment growth moderating gradually and the unemployment rate remaining at around 2.8%, while HICP inflation is expected to decelerate only gradually, from 2.3% in 2026 to 2.0% by 2028. Financial conditions are assumed to remain broadly benign. The scenario's short-term interest rates are not model-driven but are assumed to follow a mildly upward path reflecting market expectations over the projection horizon. Domestic sovereign spreads are assumed to remain contained and to narrow slightly over the exercise. RRE prices are assumed to continue rising, albeit at a more moderate pace than in recent years, in line with the expected moderation in overall economic growth and domestic demand. In the baseline scenario, equity prices are kept unchanged over the stress-testing horizon, reflecting the absence of an additional exogenous shock and a prudent treatment of uncertain equity-market developments, as assumed in previous EBA exercises.

Overall, the baseline implies a continued, though more moderate, expansion in nominal incomes, a still supportive domestic demand environment, and broadly stable debt-servicing conditions. These conditions remain consistent with contained credit losses and continued income generation by banks, with NII remaining a strong positive contributor to profitability and broadly in line with the stronger performance observed in recent exercises.

Adverse scenario

The adverse scenario is based on the EBA 2025 EU-wide stress test, with shock magnitudes derived by applying deviations to the Bank's updated baseline projections for the period 2026-2028.[5] The scenario is underpinned by a sharp escalation in geopolitical tensions and the imposition of extensive trade restrictions, which disrupt global supply chains, raise energy and commodity prices, and significantly weaken foreign demand. This external shock is further reinforced by weaker confidence, tighter financial conditions and heightened market volatility.

For this exercise, the broader EBA narrative is retained, but the domestic calibration is updated using the Bank's STREAM to better reflect how the Maltase economy responds to shocks. In addition, the adverse scenario includes a higher oil price and an unprecedentedly strong foreign demand shock than would be implied by mechanically carrying over the previous scenario, reflecting the relevance of energy costs to external demand for the Maltese economy, especially through tourism and other confidence-sensitive components of domestic demand. In this setting, geopolitical tensions and trade fragmentation lead to a marked deterioration in Malta's external environment, with foreign demand weakening sharply, tourism and related service exports declining significantly, and higher oil and commodity prices raising import and production costs, particularly for energy-intensive firms, while tighter financing conditions weigh on investment and household spending.

The combined supply and demand shocks result in a marked deterioration in domestic macroeconomic conditions. GDP growth turns negative in 2026, with the trough reached in 2027, before a partial recovery begins

[5] The adverse scenario is a hypothetical stress scenario rather than a forecast and is calibrated under a no-policy-change convention.

thereafter. Domestic demand weakens as firms cut back on investment and hiring in response to heightened uncertainty, lower external revenues, and tighter financing conditions, while households reduce consumption amid weaker income prospects and precautionary behaviour. Inflation initially rises on the back of imported production costs, but this pressure is gradually offset by weaker demand, so that inflation declines towards the baseline by the end of the horizon. The temporary increase in inflation also feeds into market expectations for interest rates, resulting in tighter financial conditions than under the baseline, including higher short and long-term rates and wider spreads on riskier assets.

Financial markets are assumed to experience a broad-based deterioration in risk sentiment, with equity prices falling sharply, corporate financing conditions tightening and sovereign and corporate risk premia increasing, while lower market liquidity amplifies the repricing of financial assets.[6] For banks, these developments imply weaker earnings capacity, larger valuation losses on market-sensitive exposures and a deterioration in borrowers' repayment capacity, particularly in more vulnerable sectors and portfolios. The adverse scenario also assumes a decline in real estate prices over the stress horizon, with residential prices affected by higher borrowing costs, weaker household income growth, rising unemployment, and lower confidence. These dynamics are reflected in lower collateral values and higher expected losses in banks' credit portfolios.

Macro-financial model inputs

Table 3.1 summarises the macroeconomic projections over the three-year horizon for both the baseline and adverse scenarios applied in the MST. These shocks are estimated to impact banks' profitability and capital position through the respective risk satellite models, with shocks to GDP, inflation, and RRE prices predominantly affecting banks' credit risk, whilst the interest rate variables primarily drive the NII and market risk modules.

Under the baseline scenario and over the three-year horizon, GDP is projected to grow cumulatively from the starting point by 11.5%, RRE prices are expected to increase by 12.2%, while inflation is anticipated to accumulate to 6.5%. The sovereign spread is forecasted to narrow from 0.8 percentage points to 0.7 percentage points by 2028. The short-term interest rate is expected to remain relatively stable at 1.9% in 2026 before rising gradually to 2.0% in 2027 and 2.2% in 2028, reflecting the continued normalization of monetary policy in the baseline scenario.

Under the adverse scenario, real GDP is assumed to contract cumulatively by 4.7% over the test horizon, whilst inflation increases by a further 9.2% and residential property prices decline by 16.9%. Short-term interest rates and sovereign spreads are assumed to spike in 2026 to 3.6% and 1.6 percentage points, respectively, before moderating to 3.4% and 1.0 percentage points by 2028 under the adverse scenario, reflecting the severe but transient nature of the stress event.

Table 3.1
SCENARIO-BASED MACROECONOMIC PROJECTIONS FOR 2026 TO 2028

	Baseline scenario (%)			Adverse scenario (%)		
	2026	2027	2028	2026	2027	2028
MT GDP growth rate	3.7	3.7	3.7	-1.8	-3.9	1.1
MT inflation rate	2.3	2.1	2.0	3.6	4.1	1.2
RRE prices	4.1	3.9	3.7	-3.4	-9.1	-5.4
Short-term rate	1.9	2.0	2.2	3.6	3.4	3.4
Sovereign spread	0.8	0.8	0.7	1.6	1.3	1.0

Source: Central Bank of Malta.

[6] In the adverse scenario, equity prices are assumed to fall by 50% in the first year and then stay at depressed levels, showing only a very limited recovery over the projection horizon, in line with the EBA 2025 specifications.

3.1.2 Methodology

The MST framework continues to follow the approach used in the previous exercise, relying on a static balance sheet assumption to evaluate how macroeconomic shocks affect the balance sheets of both core and non-core domestic banks.[7] Losses across different risk types are estimated using dedicated satellite models and risk modules.

For this round, the credit risk methodology has been updated in line with recent literature. Instead of modelling a Z-factor for each loan segment, the approach now estimates default rates directly as a function of macro-financial variables. The remaining elements of the transition matrix are then derived using bridge equations. A detailed explanation of these methodological changes is provided in Box 5.

The projected impact from additional loan loss provisions arising from the Expected Credit Loss (ECL) module is reported under credit risk in Charts 3.2 to 3.5. In addition, newly classified NPLs also affect income streams through missed monthly repayments, as reflected in the reduced NII contribution. Similarly, the increase in RWAs resulting from the higher risk weight corresponding with the newly classified NPLs is presented separately in the aforementioned charts.

The MST's market module primarily assesses the impact on the valuation of marketable debt securities arising from market price movements and issuer defaults. The former is assessed for debt securities accounted for at FV, for which revaluation of sovereign and corporate bond holdings is estimated using interest rate shocks derived from the EBA 2025 EU-wide stress test scenario.[8] For securities accounted for at AMC, the repricing or unrealised loss is determined by taking into account the discrepancy between the AMC and the scenario-based market value.[9] These valuation effects are subsequently incorporated into the MST framework to evaluate their impact on banks' profit and loss (P&L) positions, except for the impact on AMC bonds, which is added to the ECL under credit risk (see Charts 3.2 to 3.5), and the impact on FVOCI instruments, whose impact goes directly to the banks' balance sheet.

The NII and net non-interest income (NNII) module primarily revises the income and expenses generated by interest-bearing instruments in response to scenario-based changes in interest rates. It also incorporates outputs from the other modules, mainly credit and market risk, to assess changes in income streams from floating-rate instruments and income foregone from NPLs and defaulted bonds. The module then adjusts the income earned and expenses incurred on the remaining stock of assets and liabilities in accordance with the scenario.

The net trading income (NTI) module quantifies market risk on derivatives and economic hedges and is based on the simplified approach of the market risk methodology adopted in the 2016 EBA EU-Wide Stress Test (described in Section 3.6 of the 2016 methodological note).

Finally, the operational risk module assumes the materialisation of losses equal to a share of the own funds requirement for operational risk. Under the revised CRR III framework, this requirement is based on a business indicator component (BIC) derived from relevant income-related items.[10] For the purposes of the stress test, operational loss events are assumed at 40% of the requirement under the baseline scenario and 100% under the adverse scenario, with the resulting impact distributed evenly over the three-year projection horizon.

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[7] The static balance sheet assumption ensures ease of comparison across banks results by requiring banks to retain the same composition of assets and liabilities over the test horizon. In practice, this is achieved by replacing instruments which mature between 2025 and 2027 with similar instruments in terms of type, credit quality and residual maturity as observed in December 2024, adapted to the prevailing market conditions assumed in each scenario.

[8] To construct the shocks, interest rates for the different maturity buckets are estimated through linear interpolation between the one-month Euro swap rate and the ten-year German government bond yield. The same deviations are applied to the starting points under both the baseline and adverse scenarios.

[9] For more details on the accounting treatment and valuation of bonds, refer to Box 4 in the Financial Stability Report 2022.

[10] Under the CRR III framework, the operational risk capital requirement is based on the BIC, derived from the Business Indicator (BI), which proxies a bank's size and income-generating capacity. The BI combines income elements such as interest, fees, trading, and other operating income. The BIC applies a tiered formula with marginal coefficients of 12% up to €1 billion, 15% between €1–30 billion, and 18% above €30 billion. This structure ensures that larger institutions face higher operational risk capital requirements in line with their scale and activity. https://eur-lex.europa.eu/eli/reg/2024/1623/oj/eng

BOX 5: ENHANCING THE CREDIT RISK MODULE: FROM A Z-FACTOR TO A BRIDGE EQUATION APPROACH[1]

The Bank currently applies an ECL model for credit risk quantification, based on methodologies developed by Gross et al. (2020) and Belkin et al. (1998a). In essence, this approach condenses nine transition probabilities into a single latent variable known as a 'Z-factor', which is in turn linked to macro-financial conditions (see Box 3 in FSR 2022 for more details).

The Bank has updated its framework in line with recent literature by adopting the approach outlined in the ECB Occasional Paper by Budnik et al. (2024). This revised methodology first models the default rate and then uses bridge equations to derive the remaining elements of the transition matrix. The main advantage of this approach over the previous Z-factor methodology is that it models default probabilities directly as the macro-sensitive driver of credit transitions. This allows for more detailed projections of stage-to-stage migrations while preserving the economic structure embedded in historical dynamics.[2]

The purpose of this box is to outline how IFRS9 transition matrices are projected under baseline and adverse macro-financial scenarios and explains how the new approach improves the projections of credit migration dynamics relative to the previous Z-factor methodology.

Transition matrix structure and stage definitions

Matrix (1) presents the schematic transition probability (TP) parameters aligned with IFRS 9 staging requirements. The framework defines three distinct credit risk categories: Stage 1 for exposures exhibiting no significant deterioration in credit quality since initial recognition; Stage 2 for exposures showing a material increase in credit risk without having defaulted; and Stage 3 for non-performing (defaulted) exposures. This matrix structure captures the full spectrum of credit migration dynamics across these obligor stages over discrete time periods *t*.

$$TP_t = \begin{bmatrix} TP_t^{1-1} & TP_t^{1-2} & TP_t^{1-3} \\ TP_t^{2-1} & TP_t^{2-2} & TP_t^{2-3} \\ TP_t^{3-1} = 0 & TP_t^{3-2} = 0 & TP_t^{3-3} = 1 \end{bmatrix} \quad (1)$$

$TP^{1\to3}$ and $TP^{2\to3}$ indicate the likelihood of transitioning from a performing category (S1 or S2, respectively) to the non-performing category (S3), thereby, in a combined manner, representing the probability of default (PD). Stage 3 is treated as an absorbing state – meaning that once an exposure reaches S3, in the adverse scenario it cannot return to S2 or S1, and therefore, the cure probabilities ($TP^{3\to1}$ and $TP^{3\to2}$) are set to zero.

Modelling the probability of default (PD)

The PD, expressed in a distance-to-default transformation, is regressed on key macro-financial variables to capture the portfolio's sensitivity to macroeconomic shocks and on its own lag, to account for the persistence of default rates. A Bayesian Model Averaging (BMA) methodology is employed, in which all feasible combinations of default rate and macro-financial drivers are estimated using Autoregressive Distributed Lag (ARDL) specifications. The BMA methodology addresses model uncertainty by incorporating multiple highly probable model specifications, rather than relying on a single model or a fixed

[1] Authored by Mr Kanan Musayev and Mr Pedro Pólvora, Senior Economist and Deputy Head within the Macroprudential Policy, Stress Testing and Research Department. The authors would like to thank Ms Christine Balzan, Mr Alan Cassar, Deputy Governors Oliver Bonello and Rita Schembri, and Governor Alexander Demarco for their valuable suggestions.

[2] The framework retains the LGD modelling block, lifetime ECL calculations and integration with supervisory minimum coverage expectations described in FSR 2022. The methodological change introduced this year is limited to how PDs are projected conditional on macro-financial scenarios.

set of variables. Model coefficients are weighted by their posterior inclusion probabilities, as determined using the Bayesian Information Criterion, and subsequently aggregated to obtain the overall scenario response, following the approach in Raftery (1995).

To ensure economic plausibility, sign restrictions are imposed on macro-financial variables. The estimation is carried out at the portfolio level (mortgages, consumer credit, and NFCs) to account for differential credit risk sensitivity to macro shocks. Following PD estimation and projection under baseline and adverse scenarios, the $TP^{1\to3}$ and $TP^{2\to3}$ transition probabilities are derived using equations (2) and (3), respectively.

$$\Phi^{-1}\left(TP^{1-3}_{T0+h}\right) - \Phi^{-1}\left(TP^{1-3}_{T0}\right) = \Phi^{-1}\left(PD_{T0+h}\right) - \Phi^{-1}\left(PD_{T0}\right) \quad (2)$$

$$\Phi^{-1}\left(TP^{2-3}_{T0+h}\right) - \Phi^{-1}\left(TP^{2-3}_{T0}\right) = \Phi^{-1}\left(PD_{T0+h}\right) - \Phi^{-1}\left(PD_{T0}\right) \quad (3)$$

where Φ^{-1} denotes the standard normal inverse cumulative distribution function. This normal inverse transformation ensures that transition probabilities remain bounded in the [0,1] interval.

Bridge equations for non-default transitions

The projection of the remaining elements of the transition matrices, namely $TP^{1\to2}$ and $TP^{2\to1}$, is based on empirically estimated bridge equations at the portfolio level. These equations capture the historical co-movement between default and non-default transitions. Equation (4) models the relationship between $TP^{1\to2}$ and $TP^{1\to3}$, while equation (5) models the relationships between $TP^{2\to1}$ and $TP^{2\to3}$ respectively.

$$\Phi^{-1}\left(TP^{1-2}_{t}\right) = a + b\,\Phi^{-1}\left(TP^{1-3}_{t}\right) + \varepsilon_t \quad (4)$$

$$\Phi^{-1}\left(TP^{2-1}_{t}\right) = c + d\,\Phi^{-1}\left(TP^{2-3}_{t}\right) + \varepsilon_t \quad (5)$$

The coefficients b and d are expected to be positive and negative, respectively, reflecting the economic intuition that higher default rates are associated with more downgrades from Stage 1 (coefficient $b > 0$) and fewer cures from Stage 2 (coefficient $d < 0$). Empirically, an increase in transition rates from Stage 1 to Stage 3 is also associated with an increase in transition rates from Stages 1 to 2, since both reflect a deterioration in credit quality. Following the same reasoning, higher transition rates from Stages 2 to 3 are associated with lower transition rates from Stages 2 to 1. Scenario paths of $TP^{1\to2}$ and $TP^{2\to1}$are then constructed by applying the estimated slopes b and d to the scenario-conditional changes $TP^{1\to3}$ and $TP^{2\to3}$.

For $TP^{1\to2}$:

$$\Phi^{-1}\left(TP^{1-2}_{T0+h}\right) - \Phi^{-1}\left(TP^{1-2}_{T0}\right) = b\left(\Phi^{-1}\left(TP^{1-3}_{T0+h}\right) - \Phi^{-1}\left(TP^{1-3}_{T0}\right)\right) \quad (6)$$

For $TP^{2\to1}$:

$$\Phi^{-1}\left(TP^{2-1}_{T0+h}\right) - \Phi^{-1}\left(TP^{2-1}_{T0}\right) = d\left(\Phi^{-1}\left(TP^{2-3}_{T0+h}\right) - \Phi^{-1}\left(TP^{2-3}_{T0}\right)\right) \quad (7)$$

Completing the transition matrix

Lastly, the scenario paths of the transition probabilities $TP^{1\to1}$ and $TP^{2\to2}$ are calculated as residuals to ensure that the probabilities in each row sum to one, with a floor at zero in accordance with equations (8) and (9).

$$TP^{1-1}_{T0+h} = \max\left(1 - TP^{1-2}_{T0+h} - TP^{1-3}_{T0+h}, 0\right) \quad (8)$$

$$TP^{2-2}_{T0+h} = \max\left(1 - TP^{2-1}_{T0+h} - TP^{2-3}_{T0+h}, 0\right) \quad (9)$$

Integration with lifetime ECL projections and beyond-horizon assumptions

Once scenario-conditional transition matrices are generated over the three-year MST horizon, under both the baseline and adverse scenarios, they are combined with stage-specific loss-given-default

(LGD) values and effective discount rates to produce stage-specific ECL projections, as detailed in FSR 2022. Beyond the three-year stress-test horizon, because the average residual maturity of loans exceeds the projection window, credit-risk parameters are extended to calculate IFRS 9 lifetime provisions. In line with the EBA approach, after 2028, these parameters are held constant under the baseline scenario, while under the adverse scenario, they gradually converge to their 2028 baseline values over a six-year period. Thus from 2034 onwards, all adverse-scenario credit-risk parameters are assumed to equal their 2028 baseline levels. In addition, supervisory minimum coverage expectations for NPEs are applied as an overlay to IFRS 9 provisions, ensuring that provisioning reflects not only model-based estimates but also prudential expectations linked to the age of the exposure, its classification as legacy or newly defaulted, and the presence of collateral as explained in FSR 2022.

Robustness check: Back testing results for 2025

The performance of the upgraded credit-risk module was assessed using an out-of-sample back-test, comparing projected transition matrices for 2025 with the corresponding observed outcomes, across the three main portfolios. For each portfolio and approach, the Root Mean Squared Error (RMSE) of the transition probabilities serves as an aggregate measure of deviation between estimated and observed migration patterns. This metric confirms that the new approach improves the overall fit for the most significant credit portfolios, notably reducing the error term from 14.9 to 7.5 for NFCs and from 8.0 to 1.8 for Mortgages (see Table 1).

The stage-level results help explain these aggregate patterns (see Table 2). For NFCs and mortgages, the new approach clearly outperforms the Z-factor benchmark across the main stages. In fact, the mean error in Stage 2 falls by 13.4 percentage points for NFCs and 10.4 percentage points for mortgages (see Table 2, column 2). This suggests that modelling default rates directly

Table 1
DIFFERENCE BETWEEN OBSERVED AND ESTIMATED TRANSITION MATRIX
RMSE

	New approach	Z-factor	Δ
NFCs	7.5	14.9	-7.4
Mortgages	1.8	8.0	-6.1
Consumer credit	8.4	6.3	2.1

Source: Central Bank of Malta.
Note: RMSE of one year transition probabilities between observed and model implied transition matrices for 2025. RMSE is expressed in percentage points. The "Δ" column represents the percentage point improvement of the new methodology over the previous Z-factor benchmark. Lower values indicate a better fit of the overall transition matrix.

Table 2
DIFFERENCES BY CREDIT PORTFOLIO AND STAGES
Average absolute deviation; percentage points

	Stage 1	Stage 2	Stage 3
NFCs	-0.39	-13.42	4.74
Mortgages	-1.35	-10.43	-0.21
Consumer credit	-1.48	2.85	1.74

Source: Central Bank of Malta.
Note: Difference in average absolute deviation (AAD) of stage specific transition probabilities in 2025 under the new framework relative to the Z factor benchmark, by credit portfolio and IFRS 9 stage. Values are expressed in percentage points. Negative numbers indicate an improvement (a smaller average deviation from observed transitions), and positive numbers indicate a deterioration.

as the macro-sensitive driver provides a more reliable and stable basis for identifying deteriorating exposures before they transition to non-performing status.

By contrast, the results for consumer credit are mixed. The bridge equation enhances Stage 1 modelling (-1.48 percentage points), but weaker results in Stages 2 and 3 offset this improvement, leading to an aggregate RMSE slightly higher than under the Z-factor benchmark. However, these results should be interpreted with some caution, as consumer credit is a relatively small portfolio, representing only 3.6% of the total credit as at December 2025.

In addition to the matrix-level diagnostics, a credit-weighted comparison was also conducted between the observed and estimated stage distributions. This analysis is particularly useful, as it scales the estimation error by the relative size of each portfolio segment, distinguishing between differences that are numerically large but economically less significant, as opposed to those more relevant from a portfolio perspective. The results show significant improvements in both Stages 1 and 2, where this new approach reduces the overall credit-weighted difference by 3.3 percentage points (see Table 3). This approach is particularly relevant for modelling the transition probabilities for Stage 1, not only improving the flow for new stages, but also reducing the error in the Stage 1 stock by 1.43 percentage points. Taken together, this suggests that the most relevant effect is concentrated in the largest segment, while the remaining differences are comparatively limited. The out-of-sample fit for Stage 3 exposures is relatively weaker; however, this is of limited significance in the stress-testing framework. First, under the adverse scenario, Stage 3 is treated as a fully absorbing state and therefore does not require further modelling of onward transitions. Second, movements in Stage 3 loans tend to be highly volatile and are less impacted by the macroeconomic variables included in the framework than by bank-specific factors such as balance-sheet dynamics, write-offs, cures, forbearance measures and other resolution actions.

Table 3
WEIGHTED DIFFERENCE BETWEEN OBSERVED AND ESTIMATED STAGES

Stages	S1	S2	S3
S1	-1.43%	-0.76%	-0.67%
S2	-0.14%	-0.29%	-0.04%
S3	0.05%	0.06%	0.14%

Source: Central Bank of Malta.

Note: Credit weighted difference between observed and model implied stage distributions at the end of 2025, by originating and destination IFRS 9 stage. Figures are expressed in percentage points of total exposure. Negative values indicate that the model slightly overestimates the corresponding stage share, while positive values indicate underestimation.

Given the weaker results for Stage 3, an additional comparison was conducted to assess how accurately each method replicates the PD ($TP^{1\to3}$ and $TP^{2\to3}$). The RMSE results show that this new method reduces error relative to the Z-factor benchmark across all three portfolios, with the largest improvement in mortgages, followed by consumer credit and NFCs (see Table 4, column 1). The standard deviation of the errors points in the same direction, suggesting that the bridge approach delivers a more stable fit across the two stage-to-default flows (see Table 4, column 2). Finally, the PD bias summarizes how model-implied probabilities of default compare to observed defaults, with negative values indicating a conservative (over-predicting) calibration. Both methods exhibit a small negative PD bias, but the deviation under this new approach remains closer to zero, implying a more balanced PD profile and more realistic results across all three credit segments (see Table 4, column 3). Overall, the evidence points to a more accurate, more balanced, and better-calibrated PD profile under this new framework.

Table 4
PD ANALYSIS

	Metrics		
	RMSE	Std. Dev.	PD Bias %
NFCs	-1.54	-2.96	-0.30
Mortgages	-12.01	-11.37	-0.94
Consumer credit	-4.23	-3.26	-0.36

Source: Central Bank of Malta.

Note: RMSE, standard deviation of errors and mean bias of model implied PD in 2025, by credit portfolio. Metrics are computed across the Stage 1 to Stage 3 and Stage 2 to Stage 3 transition flows. PD bias is defined as the percentage deviation between model implied and observed default flows, calculated as (estimated S1→S3 + estimated S2→S3)/(observed S1→S3 + observed S2→S3) - 1. Negative PD bias values indicate a conservative (over predicting) calibration on average.

Summary

This methodological upgrade significantly improves the bank's current credit risk module within the MST framework by delivering more realistic and detailed projections of baseline and adverse transition matrices. By replacing the current latent Z-factor modelling, with direct modelling of default rates and empirically grounded bridge equations, the new approach preserves information on stage-to-stage migration dynamics. The new methodology also offers stronger structural consistency and greater economic interpretability. The 2025 back-testing exercises indicate that the upgraded module provides a materially better fit for the main credit portfolios, particularly for transitions into default and for Stage 1 and Stage 2 loan stock projections, while also highlighting residual complexities in Stage 3 dynamics.

Looking ahead, the Bank intends to refine the credit risk module further by exploring potential extensions to the current framework. One area for further investigation is the development of more granular models for cure and write-off rates, which would enhance the precision of transition projections and better capture the interplay between credit migration and balance-sheet management. This ongoing work, combined with regular back-testing against realised outcomes and sensitivity analyses to alternative macro-financial scenarios, will ensure the framework's predictive performance and robustness remain fit for purpose in assessing systemic risks.

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3.1.3 Results

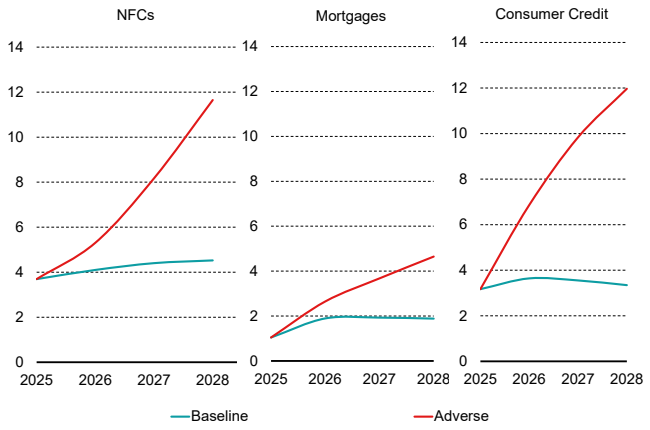
Credit risk module – Stage 3 loans projections

Chart 3.1 shows the projected Stage 3 loan ratios for the banks tested under the baseline and adverse scenarios. Under the baseline scenario, the projections point to only a limited deterioration in asset quality, in line with previous exercises. This reflects a slowdown in economic growth within an otherwise resilient macroeconomic environment and the inherently more conservative nature of the static balance sheet assumption. For NFCs, the Stage 3 loan ratio increases from 3.7% at end-2025 to 4.5% by end-2028. Over the same horizon, the ratio for mortgage lending rises from 1.0% to 1.9%, while that for consumer credit increases marginally from 3.2% to 3.3%.

Under the adverse scenario, the deterioration in credit quality is considerably more pronounced. The Stage 3 loan ratio for NFCs rises to 11.6% by end-2028, while the corresponding ratio for mortgages reaches 4.6%. Consumer credit records the sharpest increase, with the Stage 3 ratio climbing to 12.0% by the end of the projection horizon.

These results suggest that NFC and consumer loans are more sensitive to a severe and persistent deterioration in macro-financial conditions than mortgage lending. This is consistent with historical evidence indicating that NPLs in NFC and consumer credit portfolios tend to be more volatile and more reactive to macroeconomic developments, whereas mortgage portfolios have typically exhibited lower and more stable NPLs. As shown in Chart 3.1, these differences are already evident at the starting point, with Stage 3 loan ratios at end-2025 substantially higher for NFC and consumer loans than for mortgage lending.

Chart 3.1
PROJECTED SECTORAL RATIO OF STAGE 3 LOANS
(per cent)

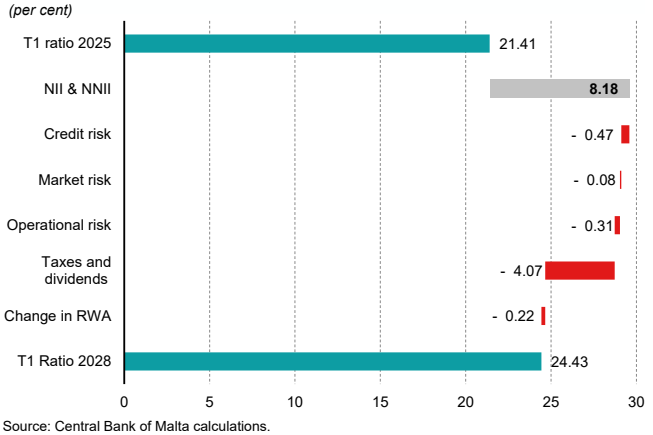


Source: Central Bank of Malta calculations.

Overall results – Impact on banks' capital position

Charts 3.2 and 3.3 illustrate the cumulative three-year effect of the different risk modules on the Tier 1 capital ratio of core and non-core domestic banks under the baseline scenario. At the starting point of the exercise, core domestic banks were in a relatively comfortable solvency position, with a Tier 1 capital ratio of 21.41% at end-2025, compared with 18.75% for non-core domestic banks. The lower aggregate ratio for non-core banks relative to the previous

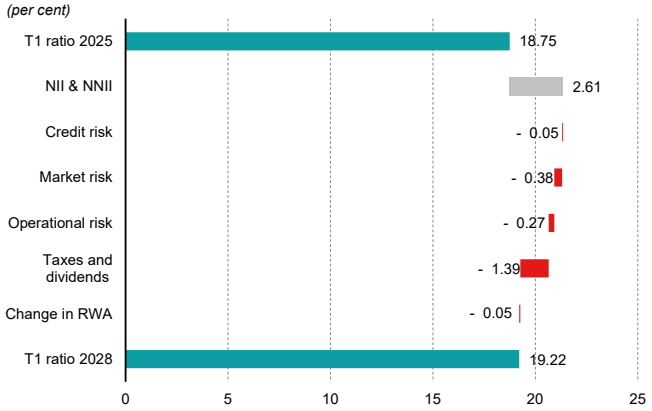
Chart 3.2
STRESS TEST RESULTS – MACRO STRESS TEST BASELINE SCENARIO – RELATIVE CONTRIBUTION OF THE IMPACT ON CORE DOMESTIC BANKS' TIER 1 CAPITAL RATIO
(per cent)



Source: Central Bank of Malta calculations.

year is largely explained by the impact of the exit of a credit institution within this category following termination of its operations at end-2025.

Chart 3.3
STRESS TEST RESULTS – MACRO STRESS TEST BASELINE SCENARIO – RELATIVE CONTRIBUTION OF THE IMPACT ON NON-CORE DOMESTIC BANKS' TIER 1 CAPITAL RATIO
(per cent)



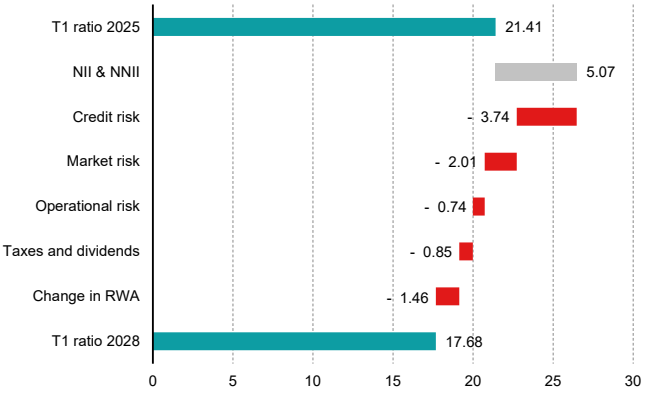
Source: Central Bank of Malta calculations.

Under the baseline scenario, NII and NNII remain the main drivers of capital generation, contributing 8.18 percentage points for core domestic banks and 2.61 percentage points for non-core domestic banks. For both groups of banks, NII makes a positive contribution, while NNII has a smaller negative effect, resulting in an overall still positive combined income contribution. Positive effects of NII are partly offset by deductions arising from credit risk, market risk, operational risk, taxes and dividends, and changes in RWAs. For both core and non-core banks, taxes and dividends are the main drivers of the decline in the Tier 1 capital ratio, reflecting the impact of profit generation under the baseline scenario. This reduces the Tier 1 capital ratio by 4.07 percentage points for core banks and by 1.39 percentage points for non-core banks.

Taken together, the income contribution more than offsets the losses from the other risk components, resulting in an overall improvement in capital positions through retained earnings after applying the 35% corporate tax rate and the assumed 30% dividend payout ratio. Accordingly, the Tier 1 capital ratio of core domestic banks rises by 3.02 percentage points from 21.41% in 2025 to 24.43% in 2028, whereas that of non-core domestic banks increases more modestly by 0.47 percentage points from 18.75% to 19.22%. The stronger increase in Tier 1 capital recorded for core banks is consistent with their higher profitability relative to non-core banks and reflects a business model more focused on traditional lending activities, particularly mortgage lending, which accounts for a substantially larger share of core banks' loan portfolios and supports higher NII.

Charts 3.4 and 3.5 present the corresponding results under the adverse scenario. Relative to the baseline, the stressed macro-financial environment leads to a weaker positive contribution from NII and NNII, amounting to 5.07 percentage points for core domestic banks and 1.21 percentage points for non-core domestic banks, while losses from credit risk, market risk and higher RWAs become more significant.

Chart 3.4
STRESS TEST RESULTS – MACRO STRESS TEST ADVERSE SCENARIO – RELATIVE CONTRIBUTION OF THE IMPACT ON CORE DOMESTIC BANKS' TIER 1 CAPITAL RATIO
(per cent)

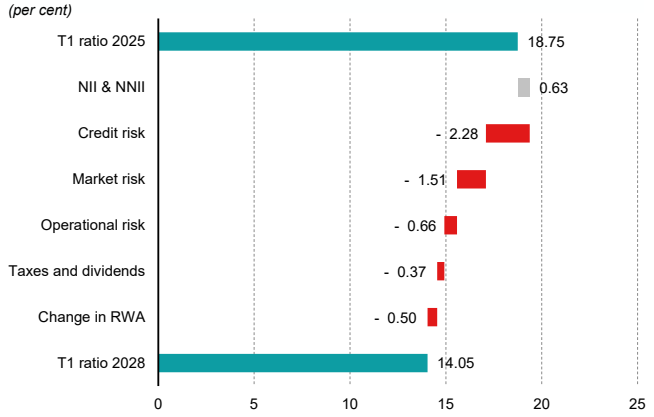


Source: Central Bank of Malta calculations.

Credit risk lowers the Tier 1 capital ratio by 3.74 percentage points for core banks and by 2.28 percentage points for non-core banks, while market risk accounts for a further reduction of 2.01 and 1.51

percentage points, respectively. For both groups of banks, the credit risk impact stems mainly from loans to NFCs, in line with the particularly severe effect of the adverse scenario on this segment and the pronounced increase in Stage 3 loan ratios shown in Chart 3.1. Consumer credit also adds to the deterioration, though to a lesser extent, given its smaller share in banks' loan portfolios. Additional negative contributions arise from operational risk, taxes and dividends, and changes in RWAs. As these effects outweigh the income contribution, the Tier 1 capital ratio of core domestic banks declines by 3.73 percentage points to 17.68%, while that of non-core domestic banks falls by 4.7 percentage points to 14.05%.

Chart 3.5
STRESS TEST RESULTS – MACRO STRESS TEST ADVERSE SCENARIO – RELATIVE CONTRIBUTION OF THE IMPACT ON NON-CORE DOMESTIC BANKS' TIER 1 CAPITAL RATIO
(per cent)



Source: Central Bank of Malta calculations.

MST results are subsequently benchmarked against banks' supervisory and regulatory capital requirements to assess the extent to which capital buffers are depleted under stress. On an aggregate basis, both core and non-core domestic banks remain above the regulatory minimum across both scenarios. At the individual bank level, all core domestic banks continue to pass the stress test, whereas one non-core domestic bank breaches the minimum required Tier 1 capital ratio in the final year of the adverse scenario. This mirrors the bank's loss-making position in the last year reported, which is further amplified over the projection horizon mainly by additional impairment charges and the materialization of market risk.

3.2. Sensitivity analyses

3.2.1. Credit quality deterioration

This sensitivity test aims to assess the vulnerability of portfolios of debt securities across core domestic, non-core domestic, and international banks to adverse shocks in credit-quality. In the context of rising geo-political tensions and heightened market volatility, deterioration in credit-quality has become a key risk factor for investment holdings, particularly for those with greater exposure to volatile or economically vulnerable markets. Accordingly, banks that do not hold debt securities are excluded from the analysis.

Under this framework, the MST's market risk module is slightly modified and applied in isolation to quantify the impact arising from credit quality deterioration using two different approaches. Bonds accounted at FV are repriced following a widening of credit spreads, as sourced from the EBA's EU-wide stress testing exercise for sovereign securities. For non-sovereign securities, shocks are quantified using the credit spread measured based on the iTraxx European Senior Financial Index 5y.[11,12] For bonds measured at AMC, impairment losses are recognised and quantified using higher probabilities of default associated with a three-notch downgrade in their official rating.

As of December 2025, banks continued to invest in debt securities considered as investment grade bonds,[13] with the share of such bonds in overall bond holdings at 100% in the case of core domestic banks', 97.4%

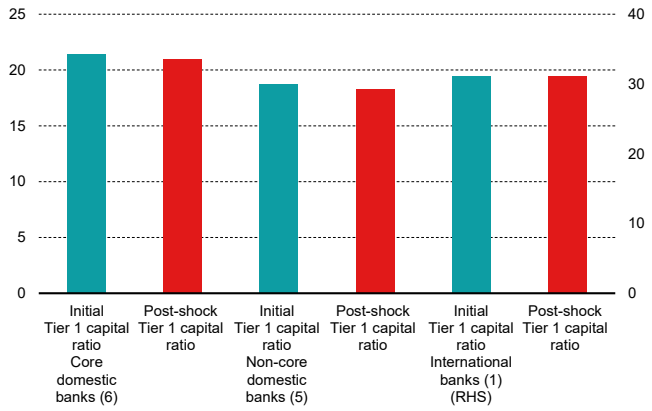
[11] The Credit spreads applied follow the 2025 EU-wide stress testing haircuts, calibrated by country of exposure and residual maturity of each instrument

[12] The applied shock corresponds to the closest 99th percentile of the right tail of the historical distribution of the iTraxx EU Senior Financial five-year index over the 2016-2025 period.

[13] The rating grades are based on an internal index capturing the second-best credit rating of the four major external credit assessment institutions (ECAIs): namely Fitch; Moody's; Standard & Poor's; and DBRS Morningstar. The investment-grade bonds are composed by those rated BBB- or higher by S&P and Fitch, and Baa3 or higher by Moody's. Entities and obligations under this category generally have relatively low to moderate credit risk of default on debt obligations, with stronger capacity to meet their financial commitments.

for non-core domestic banks', and 100% among international banks. In terms of bond accounting treatment classification, the share of total bond holdings measured at FV remained relatively low across banks, at 21% and 33% for core domestic and non-core domestic banks, respectively. Meanwhile, the share of total bonds at AMC accounted for 79%, 67% and 100% for core domestic, non-core domestic, and international banks, respectively. This reflects the banks' preference to insulate these holdings from market movements and to retain these instruments until maturity.

Chart 3.6
STRESS TEST RESULTS – IMPACT OF DETERIORATION IN DEBT SECURITIES PORTFOLIO ON TIER 1 CAPITAL RATIO
(per cent)



Source: Central Bank of Malta calculations.

As illustrated in Chart 3.6, the impact of credit quality deterioration in debt securities across bank categories is marginal, resulting in Tier 1 capital ratios of 21.09%, 19.28% and 31.07% for core domestic, non-core domestic and international banks, respectively. At the aggregated level, these results suggest that the direct capital impact from this specific shock remains limited for Maltese banks stemming from market adjustments such as downward repricing of instruments and assumed higher default probabilities. In addition, as USD-denominated debt securities are relatively small in aggregate, any further escalation of geopolitical tensions is unlikely to have a direct material impact due to a deterioration in the USD.

These results are similar to those reported at the end of December 2024. If such an extreme scenario were to materialise, all three categories of banks would have sufficient room to absorb potential capital losses relative to the minimum regulatory requirements. At the individual bank level, all banks in scope would be able to absorb this impact, with the resulting capital ratio exceeding their respective Total SREP Capital Requirements (TSCRs).

3.3. Interest Rate Risk in the Banking Book

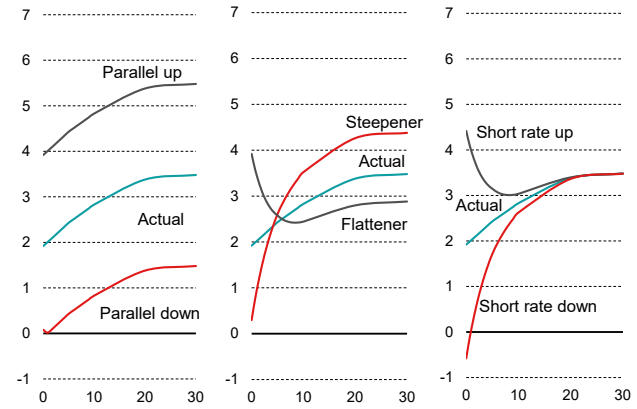
The Interest Rate Risk in the Banking Book (IRRBB) framework assesses the potential risk stemming from shocks that change the shape and slope of the yield curve and affect banks' business models. The stress framework assesses the immediate-term impact of changes in interest rates, which impacts banks' profitability via NII and the revaluation of bonds held by banks at FV in response to different shocks to the yield curve structure.

To capture all potential shifts in the yield curve, the assessment follows the scenarios prescribed in Annex 2 of the 2016 Basel Committee on Banking Supervision (BCBS) standards.[14] These scenarios are designed to capture a range of potential yield curve movements, including parallel upwards and downwards shocks, as well as non-parallel shifts affecting different segments of the curve. In particular, they comprise shocks to short-term rates (*short-rate up* and down scenarios) and slope scenarios, namely *steepener* and *flattener* shocks, which reflect opposite movements in short and long-term interest rates. Together, the six scenarios stress the term structure of the yield curve and are applied to the yield curve as at the December 2025 reference date. The scenarios also differ by currency denomination, resulting in different shocks for EUR, GBP, and USD-denominated instruments. Shocks applied to these currencies range from 100 to 250 basis points for EUR and from 150 to 300 for GBP and USD.

[14] These scenarios are also embedded in the European Banking Authority (EBA) Implementing Technical Standards (ITS) on IRRBB (EBA/ITS/2023/03) and corresponding templates as part of EBA reporting framework 3.4.

Chart 3.7 presents the shifts in the EUR term structure under the six tested scenarios as at December 2025.[15]

Chart 3.7
STRESS TEST SCENARIOS – CHANGE IN THE EUR TERM STRUCTURE OF INTEREST RATES UNDER THE 6 BCBS SCENARIOS
(per cent)



Sources: Central Bank of Malta calculations; BCBS.

The first component of this exercise assesses the impact of interest rate movements on NII over a 12-month period. A static balance sheet assumption is adopted, whereby instruments that mature within the one-year horizon are rolled over with similar instruments at the prevailing yield and characteristics under the respective scenario. As such, the composition of the loan portfolio is assumed to remain unchanged, with no effects arising from changes in credit demand or potential deterioration in asset quality due to higher debt servicing costs from additional NPLs. Within the IRRBB framework, interest rate shocks are applied directly to the reference rates of interest-bearing loans and deposits. For most banks, the loan reference rate is set internally, typically as a margin over deposit rates, while a smaller share of exposures, often linked to NFC lending, is tied to market rates. Consequently, as the vast majority of loans are set at variable rates, there will be an immediate impact on these income-earning instruments. In contrast, if deposits are of a longer and fixed-term nature, they may not be significantly affected by changes in the curve, as these instruments may not mature immediately and therefore are not replaced by instruments with different rates. The pass-through of changes in policy rates to lending and deposit rates in Malta is generally limited.

In the case of NII, the analysis focuses on EUR, GBP and USD, which represent the material currencies in which banks' banking book positions are denominated. Among non-Euro currencies, GBP and USD are the most relevant across the three banking categories. Overall, these three currencies account for 99%, 97% and 88% of the foreign currency banking book of core domestic, non-core domestic and international banks, respectively. The euro remains the dominant currency, representing 96%, 76% and 84% of the banking book across these three categories of banks.

Based on the revaluation analysis for December 2025, core domestic, non-core domestic, and international banks continue to hold relatively small shares of bonds measured at FV, representing 21%, 33% and 0% of their total bond holdings, respectively (see Table 3.4 in Section 3.4). Although core domestic banks retain the largest proportion of bonds measured at FV, accounting for 93% compared to 7% for non-core domestic banks, it is the latter that experience the biggest impact, particularly under both *parallel up* and *parallel down*. This is primarily driven by non-core domestic banks' significant reliance on long-term instruments, making them more vulnerable to changes in interest rates and roll-over risk.

As shown in Table 3.2, the IRRBB exercises have consistently shown that *short-rate-up* scenarios are net positive for capital, with higher NII more than offsetting re-valuation losses on bonds accounted for at FV. The scenarios featuring short-term increases in interest rates, namely, *parallel up*, *flattener* and *short rate up*, all yield positive results for the three bank categories. The most positive impact is observed under the *short-rate-up* scenario for core domestic and international banks, where the Tier 1 capital ratio increases by 2.1 and 1.68 percentage points, respectively. Non-core domestic banks experience the greatest positive impact under the *flattener*, with the Tier 1 capital ratio increasing by 1.93 percentage points. The least positive impact is observed under the *short-rate-down* scenario, in which interest rates decline over the near-term horizon of up to one year. Under this scenario, the Tier 1 capital ratios of the bank categories drop by 1.54, 1.64 and 1.51 percentage points for the respective categories of banks.

[15] The starting yield curve for GBP and USD differs by the respective currency; however, both curves experience similar shifts under the same scenarios.

Overall, non-core domestic banks are the most impacted across the three adverse scenarios: *parallel down*, steepener, and *short rate down*. Among these scenarios, the *short rate down* scenario has the largest effect, both in NII alone or when combined with debt securities revaluation effect. The results show that, under this scenario, Tier 1 capital for non-core domestic banks declines by 1.64 percentage points to reach 17.81%. This is primarily explained by a relatively higher exposure to USD-denominated assets and liabilities, compared with other banks segments, reflecting a higher shock on USD exposures compared with the EUR.

The magnitude of these results is in line with previous IRRBB exercises. Since 2022, the *short-rate-up* scenario has typically increased core domestic banks' Tier 1 capital ratio by around 2-3 percentage points and between 1.5-2.3 percentage points for noncore domestic and international banks, while *short-rate-down* scenarios have reduced Tier 1 ratios by about 1.4-2 percentage points across bank categories.

Table 3.2
STRESS TEST RESULTS – IRRBB FRAMEWORK – RELATIVE IMPACT OF CHANGES IN INTEREST RATES ON THE TIER 1 CAPITAL RATIO
(per cent)

		Core domestic banks	Non-core domestic banks	International banks
Initial Tier 1 capital ratio		21.41	19.45	31.07
Parallel up	*NII*	*2.13*	*1.80*	*1.38*
	Revaluations	*-0.91*	*-1.26*	*0.00*
	Post-shock Tier 1 capital ratio	22.63	19.99	32.45
Parallel down	*NII*	*-1.69*	*-1.71*	*-1.24*
	Revaluations	*1.24*	*3.56*	*0.00*
	Post-shock Tier 1 capital ratio	20.96	21.30	29.83
Flattener	*NII*	*2.01*	*1.59*	*1.34*
	Revaluations	*-0.12*	*0.33*	*0.00*
	Post-shock Tier 1 capital ratio	23.30	21.37	32.41
Steepener	*NII*	*-1.27*	*-1.24*	*-0.97*
	Revaluations	*-0.01*	*-0.40*	*0.00*
	Post-shock Tier 1 capital ratio	20.13	17.81	30.10
Short rate up	*NII*	*2.52*	*2.00*	*1.68*
	Revaluations	*-0.42*	*-0.27*	*0.00*
	Post-shock Tier 1 capital ratio	23.51	21.18	32.75
Short rate down	*NII*	*-1.97*	*-1.92*	*-1.51*
	Revaluations	*0.44*	*0.28*	*0.00*
	Post-shock Tier 1 capital ratio	19.88	17.81	29.56

Source: Central Bank of Malta calculations.

3.4 Liquidity stress tests

To assess the liquidity position of domestic banks and to identify potential vulnerabilities, the Bank employs three complementary frameworks in its stress-testing toolkit. The first framework is the persistent deposit withdrawals (PDW) framework, which evaluates banks' ability to meet their financial obligations in a bank-run type scenario over a four-week survival period. This framework includes a liquidity-to-solvency dimension whereby the impact of the bank run also translates into an impact on capital. The second framework studies the LCR, which assesses banks' ability to withstand adverse scenarios involving high outflows during a 30-day period. The third framework relates to the NSFR, which focuses on the longer-term liquidity position across four adverse scenarios by assessing the funding structure and relative stable funding availability.

The latter two frameworks play a pivotal role in evaluating the banking system, benchmarking their assessment against regulatory minimum requirements, while the PDW offers a broader assessment of a bank's liquidity performance.

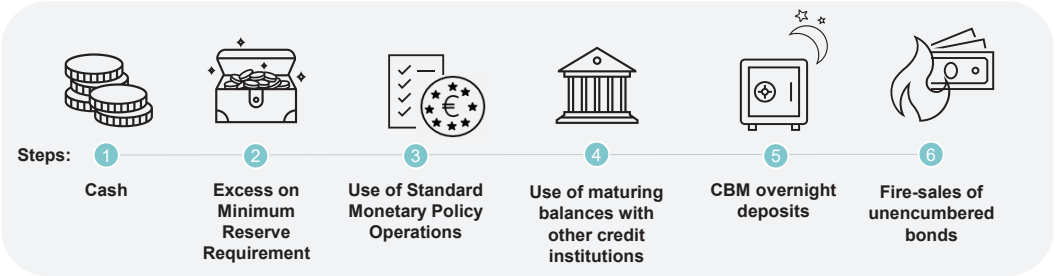
Over the past four FSR vintages, the three liquidity frameworks – PDW, LCR and NSFR – have consistently indicated that all banks operate with ample liquidity buffers, both in the short term, long term and from a structural funding perspective. While the 2023-2024 tightening cycle temporarily improved liquidity ratios via elevated central bank placements and higher corresponding remunerations, the latest results suggest that core domestic and non-core domestic banks continue to maintain sizeable buffers over regulatory minimum requirements, placing the system in a comfortable position to be able to absorb severe system-wide outflows.

3.4.1 PDW framework

The PDW framework assumes a bank-run type scenario where a persistent outflow of deposits, in order to assess a bank's ability to maintain sufficient liquidity buffers, defined as Counterbalancing Capacity (CBC), to meet liquidity needs arising from such outflows. Figure 3.1 presents the assumed hierarchy for the composition of CBC, which comprises liquidity assets such as cash, the use of bonds pledged as collateral for standard monetary policy operations, and the fire-sale of unencumbered and ESCB-ineligible bonds.[16] This hierarchy is based on the assumptions that banks primarily use the instruments that present the least costs e.g. cash, followed by excess on minimum reserve requirements, and then move on to those instruments that are more costly to use.

To assess the bank-run scenario, the framework features an instantaneous 100% withdrawal of all credit lines and deposits with the parent, subsidiaries, and other credit institutions, combined with steady, regular run-off from sight and fixedterm deposits maturing within the test horizon. These cumulative run-off rates are set at up to 10% for retail and corporate customer demand deposits, 25% for fixedterm deposits, and 30% for retail deposits sourced from online deposit platforms (ODPs). The higher outflows assumed for this latter category reflect the generally more rate-sensitive and less relationship-driven nature of deposits. As these funds can be transferred quickly and at low cost, they may exhibit greater volatility and be more prone to rapid withdrawals under stress conditions (see dynamics of ODPs for more details).

Figure 3.1
ASSUMED HIERARCHY FOR CBC



Source: Central Bank of Malta.

DYNAMICS OF ONLINE-DEPOSIT PLATFORMS (ODPs)

As of December 2025, ODP-funded deposits remained limited in core domestic banks but were more significant in non-core domestic and international banks. The share of deposits sourced from ODPs stood at 0.05% for core domestic banks, compared with 23% for non-core domestic banks and 31% for international banks (see Table. 3.3). Participation also differed across categories: two core domestic, four non-core domestic, and three international banks used digital platforms.

Despite a 14 percentage-point decline in ODP participation compared with December 2024, two bank categories continued to rely on this platform. While, ODP volumes remained stable for international banks, core domestic and non-core domestic banks reported substantial declines of 93% and 15%, respectively, in their total ODPs funding. An assessment of the composition indicates that these deposits

[16] Refer to Section 3.2.1 of the FSR 2023 where the list was introduced.

are predominantly fixed-term, accounting for 100%, 73% and 100% of total ODPs across the three categories. Indeed, international banks exhibit a longer maturity profile, maintaining the largest proportion of ODPs in the maturity bucket of more than three months up to two years, which accounts for 78% of their total funding sourced via ODPs (79% in the more than three months to five years bucket). Notably, these deposits offer easy access and an alternative source of flexible funding, but may also increase deposits' competition. Nevertheless, the associated risks arising from liquidity constraints and interest rate movements have so far remained relatively limited, as a large share of these liabilities are fixed-term deposits.

Table 3.3
COMPOSITION OF ONLINE DEPOSIT PLATFORMS (ODPs)

	Core domestic banks		Non-core domestic banks		International banks	
	Dec. 2024	Dec. 2025	Dec. 2024	Dec. 2025	Dec. 2024	Dec. 2025
ODPs as a share of total deposits	0.42%	0.05%	25%	23%	36%	31%
ODPs on Demand (% of total deposits)	0%	0%	10%	27%	1%	0%
ODPs on Fixed-term deposit (% of total deposits)	100%	100%	90%	73%	99%	100%
ODPs up to three months (% of total deposits)	76%	92%	74%	57%	9%	21%
ODPs more than three months (% of total deposits)	24%	8%	15%	17%	90%	79%

Source: Central Bank of Malta.

From a geographical perspective, ODPs are third-party providers primarily based in Germany that act as partners to various banks across Europe. Maltese banks are increasingly utilising these digital platforms to connect with a broader client base across Europe. In essence, core domestic and international banks are exclusively linked to German platforms, whereas non-core domestic banks reported 80% of exposures to German ODPs, with the remaining 20% to ODPs based in the UK.

Overview of composition of liquid assets

Bonds constitute an essential component of total assets, supporting the financial needs of both governments and corporations, and complementing traditional bank lending. Accordingly, Table 3.4 presents an assessment of the bond portfolio composition in terms of credit rating, valuation treatment and overall encumbrance and eligibility for ESCB standard monetary policy operations.

Table 3.4
ENCUMBRANCE AND ESCB ELIGIBILITY OF THE BOND PORTFOLIO

	Core domestic banks		Non-core domestic banks		International banks	
	Dec. 2024	Dec. 2025	Dec. 2024	Dec. 2025	Dec. 2024	Dec. 2025
Bonds as a share of total assets	33%	35%	19%	16%	0.1%	0.1%
Bonds at investment grade	100%	100%	96%	97%	100%	100%
Bonds held at AMC	80%	79%	69%	67%	100%	100%
Bonds held at FV[(1)]	20%	21%	31%	33%	0%	0%
Encumbered	11%	11%	45%	39%	0%	0%
Unencumbered and ESCB eligible	80%	84%	24%	28%	78%	100%
Unencumbered and ESCB ineligible	9%	5%	31%	33%	22%	0%

Source: Central Bank of Malta.

(1) Bonds at FV can be accounted at FVTPL or at FVOCI. In December 2025, practically all FV bonds were measured at FVOCI as the share of FVTPL amounted to 0.03%.

As of December 2025, debt securities represented 35%, 16% and 0.1% of total assets to core domestic, non-core domestic and international banks, respectively. From a valuation treatment perspective, the bonds are highly concentrated in AMC, followed by FV. The former represented 79%, 67% and 100% for the three categories, respectively, while the latter accounted for 21% of core domestic banks and 33% of non-core domestic banks. All banks hold investment-grade bonds (rated BBB- or better), at 100% for both core domestic and international banks, and 97% for non-core domestic banks.

In terms of encumbrance, core domestic and international banks hold a very low share of encumbered instruments, meaning that such instruments can be utilized to generate additional liquidity as needed. The higher share of ESCB-eligible bonds reinforces the prudent strategy followed by banks, which have been mainly investing in instruments eligible for standard monetary policy operations attracting lower haircuts, and thereby mitigating risks during a market stress episode.

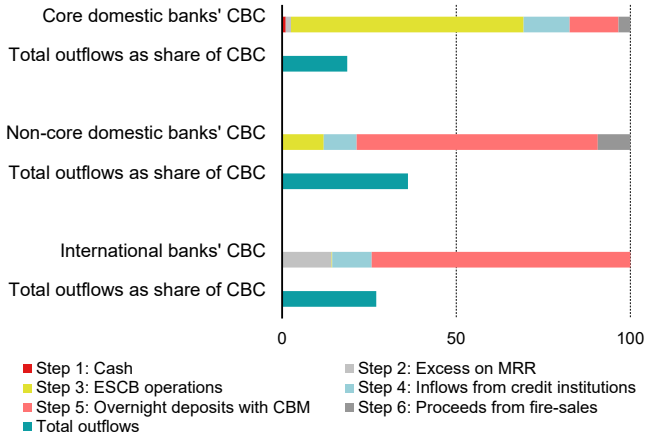
Simulating the liquidity outflows linked to the bank-run scenario

As of December 2025, the largest contributor to the CBC for core domestic banks remained the instruments available for standard monetary operations (step 3), which represents 67% of total CBC. This is followed by 13% of inflows from credit institutions (step 4) and a further 14% of placements held with the Central Bank of Malta (step 5). In contrast, for non-core domestic banks and international banks, the main contributor relates to the placements held with the Central Bank of Malta (step 5), accounting for 69% and 74%, respectively. The second-largest component of their CBC consist of inflows from credit institutions (step 4), which accounted for 9% and 11%, respectively. Overall, all bank categories maintain comparable and relatively small proportions of balances with credit institutions as a complementary source of liquidity, limiting concentration in this funding source (see Chart 3.8).

The PDW test results confirm the banking system's resilience to a severe bankrun. Banks' resistance to this adverse scenario has been broadly stable for core domestic banks but has improved for non-core domestic banks when compared with earlier exercises. Combined outflows over the four-week horizon have remained close to 19-20% of CBC for core domestic banks across the 2023-2025 vintages, leaving around four-fifths of their initial buffer intact even under the assumed instantaneous withdrawal of interbank funding. Over the same vintages, the share of CBC consumed by non-core domestic banks ranged from 36% to 43%, reflecting higher levels of central bank placements and unencumbered eligible securities held by these banks. In addition, at the aggregate level international banks had sufficient CBC to cover deposit withdrawals without resorting to the market for additional funding, even when considering that outflows for international banks increased in the test to 27% of CBC available, following a higher share of deposits on ODP platforms. For the remaining two bank categories, the extent of outflows remained relatively stable.

At the individual bank level, one non-core domestic and one international bank would exhaust the CBC before this four-week horizon. This is, however, reflective of the rather strict assumption of a full withdrawal of credit-institution placements, and higher reliance on interbank funding. Nevertheless, most institutions would retain an excess of CBC of at least 11%, allowing them to withstand further withdrawals beyond the four-week horizon considered.

Chart 3.8
COMPOSITION OF CBC AND TOTAL OUTFLOWS AS SHARE OF CBC
(per cent)



Source: Central Bank of Malta calculations.

All in all, the exercise results point to a banking system that has a sufficiently strong funding structure and enough liquidity to face a consistent and extreme deposit withdrawal scenario, even when considering that some banks are exposed to more volatile deposits via the ODP platforms.

3.4.2 LCR framework

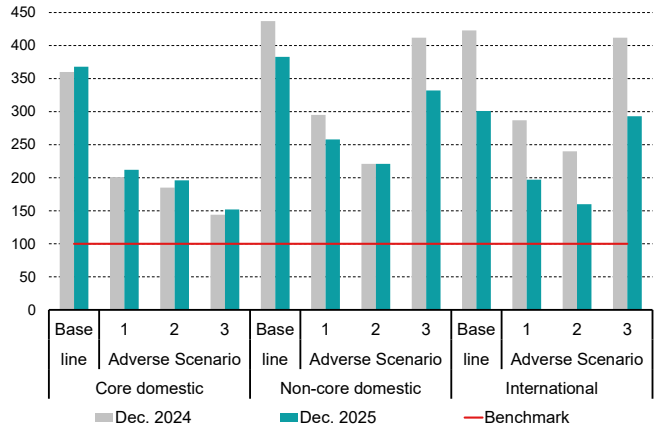
This framework assesses banks' resilience in withstanding periods of increased liquidity pressure relative to the 100% minimum LCR requirement. To assess banks' liquidity resilience, the framework considers a baseline and three adverse scenarios, by targeting banks' liquidity buffers of HQLA and net outflows occurring over a 30-day horizon. Detailed information on these scenarios is presented in Table 3.5.

As of December 2025, the LCR for core domestic banks stood at 367%, up from 359% in the previous year, whilst non-core domestic and international banks reported a decrease from 437% to 387% and from 422% to 300%, respectively. The decrease in the latter two categories stems mainly from lower HQLA volumes, which dropped by 14% and 9%, respectively. This decrease was mainly driven by cash and central bank reserves, reflecting the lower remuneration of these assets. The variation in net outflows differs between the two bank categories: non-core domestic banks show results similar to December 2024, while international banks show an increase of 28%. Chart 3.9 presents the results of the LCR framework for the three categories under the assumed scenarios for December 2024 and December 2025.

The LCR stress test framework continues to confirm that all bank categories can absorb substantial outflows. For core domestic banks, the largest impact was observed under adverse scenario 3; however, banks remain comfortably above the 140%-160% level across vintages, while non-core domestic and international banks continue to show higher buffers ranging from 250% to 350%.

Under adverse scenario 1, the LCR for core domestic, non-core domestic, and international banks declines by 156, 127, and 104 percentage points to 212%, 261% and 197%, respectively. All three bank categories show a significant drop in their LCR, demonstrating high sensitivity to outflow shocks. Notably, core domestic banks experience the smallest impact, given that retail deposits are their main

Chart 3.9
STRESS TEST RESULTS – LCR RESULTS FOR ALL BANKS
(per cent)



Source: Central Bank of Malta calculations.

Table 3.5
DESCRIPTION OF LCR FRAMEWORK'S BASELINE AND ADVERSE SCENARIOS

Scenario	Description
Baseline	Haircuts and outflow/inflow rates set out in the (EU) 2015/61
Adverse:	
Scenario 1	Higher outflows compared to the LCR Delegated Regulation
Scenario 2	Scenario 1 with additional withdrawals from both resident and non-resident time deposits
Scenario 3	Baseline scenario with full withdrawal of committed facilities to NFCs and households

Source: Central Bank of Malta.

source of funding, which are subject to the least severe shocks compared with other types of outflows. By contrast, non-core domestic banks and international banks appear more structurally exposed to wholesale funding shocks, as their funding structures are more concentrated in wholesale funding, which is subject to greater outflow assumptions.[17]

Under adverse scenario 2, which builds on scenario 1 but includes additional withdrawals from resident and non-resident time deposits exceeding 30 days, the LCR drops by 172, 164 and 141 percentage points to reach 196%, 224% and 160% for core domestic banks, non-core domestic banks and international banks, respectively.

Under adverse scenario 3, the LCR reaches 152%, 336% and 293% for the three categories, respectively, dropping by 216, 52, and 8 percentage points, respectively. The biggest impact is reflected on core domestic banks given their higher share of committed facilities, which represents 17% of total outflows, followed by 6% for non-core domestic banks and 1.3% for international banks.[18]

At the individual bank level, all banks meet the minimum requirement under the baseline scenario. However, four banks would not be able to remain above the 100% minimum requirement in at least one adverse scenario due to the magnitude of the applied shocks and their heavy reliance on the components associated. Three of four banks exhibit vulnerabilities related to their share of non-resident deposits, while two of four show vulnerabilities stemming from committed facilities. These risks are partially mitigated by the availability of HQLA and access to central bank facilities. As in previous exercises, these shortfalls are concentrated in a small group of banks, reflecting specific business models rather than a broad-based erosion of liquidity buffers.

3.4.3 Net Stable Funding Ratio

The NSFR stress test framework aims to ensure that banks maintain adequate and stable liquidity positions over a longer-term horizon. The framework comprises one baseline scenario and four adverse scenarios, targeting Available Stable Funding (ASF) and Required Stable Funding (RSF) components, as presented in Table 3.6.

The NSFR stress test framework shows stable or slightly improving outcomes for core domestic banks, with adverse-scenario results broadly remaining unchanged since 2021. By contrast, international banks' long-term liquidity buffers are lower but remain above regulatory minima in all scenarios.

As at December 2025, the NSFR for core domestic banks stood at 189% from 187%, while non-core domestic banks and international banks reported a decrease from 201% to 190% and from 150% to 138%, respectively.

Table 3.6
DESCRIPTION OF NSFR FRAMEWORK'S BASELINE AND ADVERSE SCENARIOS

Scenario	Description
Baseline	ASF and RSF factors as prescribed by the Regulation (EU) 2019/876
Adverse:	
Scenario 1	A higher run-off for retail and wholesale deposits impacting the availability of stable funding
Scenario 2	Adverse scenario 1 with some loans become non-performing requiring more stable funding to support them impacting the RSF
Scenario 3	Adverse scenario 2 with pressure in the market reducing the value of bonds and equities (Level 1, 2A and 2B HQLA and other securities) implying the need for further stable funding
Scenario 4	Baseline with full withdrawal of committed facilities to NFCs and households (Similar to LCR adverse scenario 3).

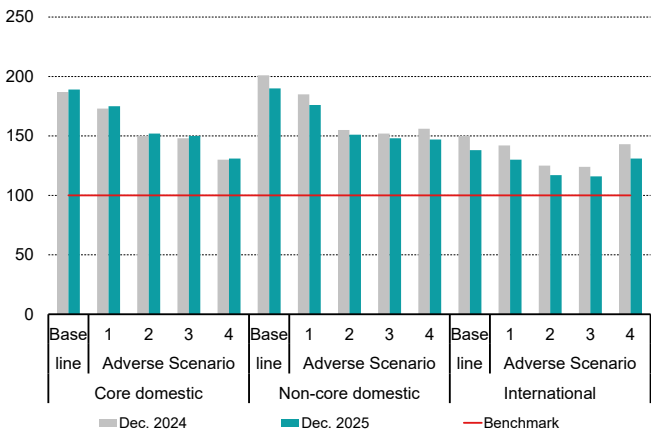
Source: Central Bank of Malta.

[17] Banks' deposit structure is divided into retail and wholesale funding. The former consists of deposits from individual consumers, while the latter is composed of operational and non-operational deposits, whose funds are held for day-to-day business operations and investment purposes, respectively.

[18] The available data does not allow a distinction between revocable and non-revocable committed facilities due data limitations. As a conservative assumption, all commitments are assumed to be withdrawn.

Considering a longer horizon, core domestic banks' NSFR ratios have risen from the mid170s in 2021 to around 190% in the baseline scenario, noncore banks have remained in the 180-200% range while international banks have consistently remained above 150% in all vintages.

Chart 3.10
STRESS TEST RESULTS – NSFR RESULTS FOR ALL BANKS
(per cent)



Source: Central Bank of Malta calculations.

Under adverse scenario 1, the NSFR for both core domestic and non-core domestic banks decline by 14 percentage points, reaching 175% and 176%, respectively. The international banks' NSFR declines by 8 percentage points to reach 130%. The overall impact is less significant, as banks continue to hold the largest proportions of their funding in retail deposits, which receive more favourable ASF treatment than wholesale deposits. Indeed, retail deposits account for 71.5%, 41% and 42% of total ASF for core domestic, non-core domestic, and international banks, respectively (see Chart 3.10).

Under adverse scenarios 2 and 3, which capture the effect of a deterioration in credit quality, some loans transition to non-performing status and consequently require more stable funding. Scenario 3 further incorporates market stress by reducing bond and equity values. Under these conditions, all three categories record the most significant declines in adverse scenario 3, falling by 38, 43, and 21 percentage points to reach 150%, 147% and 116%, respectively.

Under adverse scenario 4, which assumes a full withdrawal of committed facilities, the NSFR reaches 130%, 146% and 130%, respectively. This scenario generates one of the most significant impacts across banks, suggesting heightened sensitivity among those with higher exposure to committed facilities. However, it represents an extreme assumption, as the inability to distinguish between revocable and non-revocable committed facilities may further exacerbate the impact. At the category level, core domestic banks experience the largest decline, while non-core domestic banks also record a sizeable deterioration; by contrast, the impact on international banks is more limited. These results are also observed in the short term across the three bank categories of the LCR framework under adverse scenario 3.

Overall, core domestic banks continue to show more favourable results than last year across all stress scenarios, while non-core domestic and international banks record a slight deterioration. Under the adverse scenarios, the largest impact is observed for core domestic and non-core domestic banks in scenario 4, whereas the largest impact for international banks is observed in adverse scenario 3.

Scenario choice and severity are determined with the aim of identifying sources of vulnerability for individual banks. At the individual bank level, three banks would not meet the minimum requirement under adverse scenario 4 and, similarly, would fall short under adverse scenario 3 for the LCR, exhibiting vulnerabilities associated with committed facilities due to the potential drawdown of these liabilities under stress. Despite this, the impact is mitigated by available liquidity buffers. As in previous scenarios, these effects remain concentrated in a limited number of banks.

In conclusion, the findings generated by both the liquidity and solvency frameworks are submitted to the Financial Stability Committee and shared with the Malta Financial Services Authority (MFSA), after which follow-up engagement with individual banks may take place where warranted. This process strengthens the continuous surveillance of the financial system at both the system-wide and institution-specific levels, while contributing to the broader objective of safeguarding financial stability.

SPECIAL FEATURE: USING T2 TO ASSESS PAYMENT-SYSTEM FLOWS RELEVANT FOR CYBER STRESS TESTING IN MALTA[1]

In recent decades, the financial services sector has undergone a profound transformation driven by digitalisation and increasing interconnectedness. As a result, dependence on information and communications technology (ICT) infrastructure has become critical for the provision of essential economic functions, including customer services, risk management, and payment settlement. Against this backdrop, cyber incidents have become a growing source of operational disruption. In severe cases, such incidents could impair critical financial functions at increasing speed and scale, trigger second-round effects, and ultimately give rise to financial stability concerns.[2] Rising geopolitical tensions – increasingly manifesting as cyber threats – alongside greater reliance on ICT and a growing concentration among payment infrastructure providers have brought this issue to the forefront of the policy agenda. In response, several international institutions, including the Financial Stability Board (FSB), the European Systemic Risk Board (ESRB), the European Union Agency for Cybersecurity (ENISA), the World Economic Forum (WEF), and the International Monetary Fund (IMF), have developed policy recommendations and analytical frameworks to strengthen cyber resilience and assess cyber-related systemic risk.[3]

Payment infrastructures deserve particular attention in this context. Cyber incidents could result in their partial or complete freeze, preventing a targeted institution from sending and/or receiving payments. Such an event could spread rapidly to other institutions, accelerating the speed at which risks become systemic. In the euro area, these dynamics are especially relevant in the context of T2 (TARGET2), the Eurosystem's real-time gross settlement system, introduced in its current form in March 2023 as part of the TARGET Services consolidation project. By providing transaction-level information of payment flows, T2 offers a useful basis for analysing the financial stability implications of ICT disruptions affecting payment infrastructures and for assessing systemic risk arising from cyber events.

This document provides a first step towards a cyber stress-testing framework for Maltese payment systems. T2 transaction-level data is used to map payment network topologies, identify critical nodes and connections, and detect potential vulnerabilities that could be tested in future scenario-based exercises. The first section introduces T2 and its role in the domestic payment system. The second section uses transaction-level indicators to identify potential cyber vulnerabilities. The third section complements this evidence with a network-based analysis of domestic payment flows, highlighting the centrality and connectivity of key participants. The final section summarises the main findings and outlines the next steps towards a structural framework for assessing payments-related cyber risk and its implications for financial stability.

T2 and the Maltese payment system

T2 is the Eurosystem's real-time gross settlement (RTGS) system for euro payment transactions supporting monetary policy operations, bank-to-bank transfers, and commercial payments. In 2023, the EU's harmonised market infrastructure, TARGET Services, consolidated T2 with TARGET2-Securities (T2S) and a TARGET Instant Payment Settlement (TIPS). This led to a consolidated Eurosystem market infrastructure for transaction settlement in central bank money. T2 comprises two modules, a central liquidity management (CLM) platform and an RTGS service. The former supports the settlement of central bank operations and the management of participants' liquidity, while the RTGS platform handles payment transactions and

[1] Authored by Matteo Panfilo and Francesco Ricciutelli, Research Economists, and Pedro Polvora, Deputy Head within the Macroprudential Policy, Stress Testing and Research Department of the Central Bank of Malta. The authors would like to thank Alan Cassar, Christine Balzan, Wendy Zammit, Tiziana Grech, Francesca Bozza, Mariah Dimech, Edward Magro, Claudine Psaila, and Shaun Vella for their helpful inputs and suggestions.

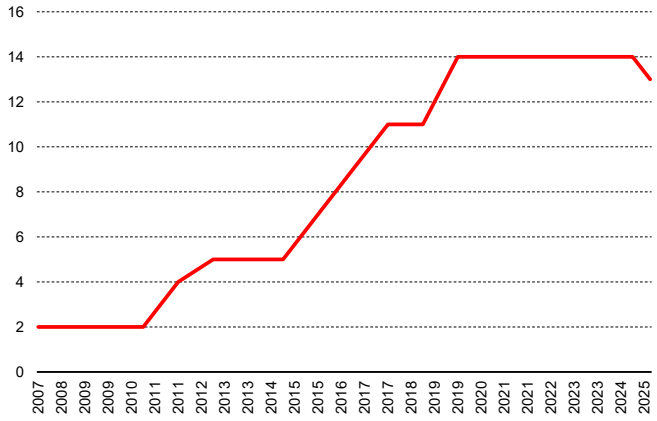
[2] According to the FSB Lexicon 2023, a cyber incident is defined as "cyber event that adversely affects the cyber security of an information system or the information the system processes, stores or transmits whether resulting from malicious activity or not".

[3] The main bibliographic references involve: ENISA Threat Landscape 2025 (ENISA, 2025), Systemic Cyber Risk (ESRB, 2020), Mitigating Systemic Cyber Risk (ESRB, 2022), Advancing Macroprudential Tools for Cyber Resilience (ESRB, 2023), Advancing Macroprudential Tools for Cyber Resilience – Operational Policy Tools (ESRB, 2024), Global Cybersecurity Outlook (WEF, 2025) and Global Financial Stability Report, April 2024 (IMF, 2024).

ancillary system (AS) settlement.[4] By recording the full sequence of payment events, T2 modules enable the detection of potential stress patterns consistent with disruption, such as rising levels of unsettled payments, abnormal delays, and network fragmentation. These patterns are particularly relevant in a small and highly interconnected banking system, where a limited number of participants account for a large share of overall transactions.

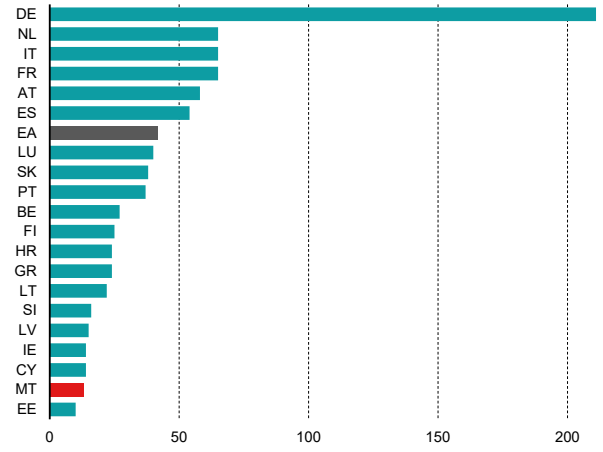
Operated by the Central Bank of Malta, the Maltese component of T2 (T2-Malta) provides Maltese participants with access to central bank money settlement. Since its adoption in 2007, the total number of direct participants in T2-Malta has increased, reaching 13 participants by the first quarter of 2025 (see Chart 1).[5] Despite being a small open economy, Malta's participation in T2 reflects the relative complexity and depth of its financial sector (see Chart 2).

Chart 1
NUMBER OF T2-MALTA DIRECT PARTICIPANTS OVER TIME



Source: ECB Statistical DataWarehouse (SDW).
Notes: Number of direct participants in the payments system (PSN), yearly and semiannual collection; the annual time-series has been augmented by integrating the semiannual observation from H1 2025.

Chart 2
NUMBER OF T2 DIRECT PARTICIPANTS IN THE EURO AREA IN 2025



Source: ECB Statistical Data Warehouse (SDW).

T2-Malta also identifies critical participants according to entities' activity. A T2 participant is usually considered critical if it meets at least one of two criteria related to the generated turnover in T2,[6] and the amount of unsettled T2 payments generated by simulating a technical failure of the credit institution, conditional on time dependence.[7]

From an aggregate perspective, both the average daily volume and value of transactions settled by critical participants in T2-Malta declined in the corresponding quarter over the last three years. This decline in transacted value was mainly driven by the four largest domestic banks, while the value transacted by

[4] Ancillary systems (AS) are systems in which payments and financial instruments are exchanged and cleared. In turn, resulting obligations are settled in TARGET. Examples of AS include retail payment systems, large-value payment systems, foreign exchange systems, money market systems, automated clearing houses, central counterparties (CCPs) and securities settlement systems.

[5] "A party owning an RTGS DCA or RTGS CB Account and having direct access to RTGS" as per T2 Glossary definition.

[6] The T2 turnover is computed as the sum of the traffic generated by each credit institution at the technical platform level, where generated means that transactions where the credit institution is debited but that are not initiated by the credit institution have to be filtered out. Notice that the average daily traffic includes customer, interbank and Continuous Linked Settlement (CLS) transactions, as well as liquidity transfers to T2S.

[7] The criteria for determining the criticality of participants are based on the information guides regularly published by the European Central Bank. As a general guideline, the Eurosystem considers a credit institution to be a critical TARGET (CLM and RTGS) participant if it consistently settles at least 1% of the value of the CLM and RTGS turnover as a daily average in the first quarter of the year (so-called Criterion 1). This includes interbank payments, customer payments, liquidity transfers and AS-related transactions where (i) the initiator is the debited participant and (ii) the debited and credited parties are not the same or do not belong to the same technical platform. In addition, criticality depends on the previous year's classification for both critical and non-critical participants. Further details are available at the following link, in the subsection T2 Participation/Registration, Information Guide for TARGET participants, Part 2 CLM and RTGS: T2 documents and links.

the remaining institutions increased significantly. Nevertheless, in 2025 Q4, around three-quarters of the daily average transacted value was accounted for by the four largest domestic banks, down from 85% and 80% in 2023 and 2024. By contrast, the daily average transacted value of the remaining credit institutions increased from 14% in 2023 to 20% in 2024 and further to 24% in 2025.

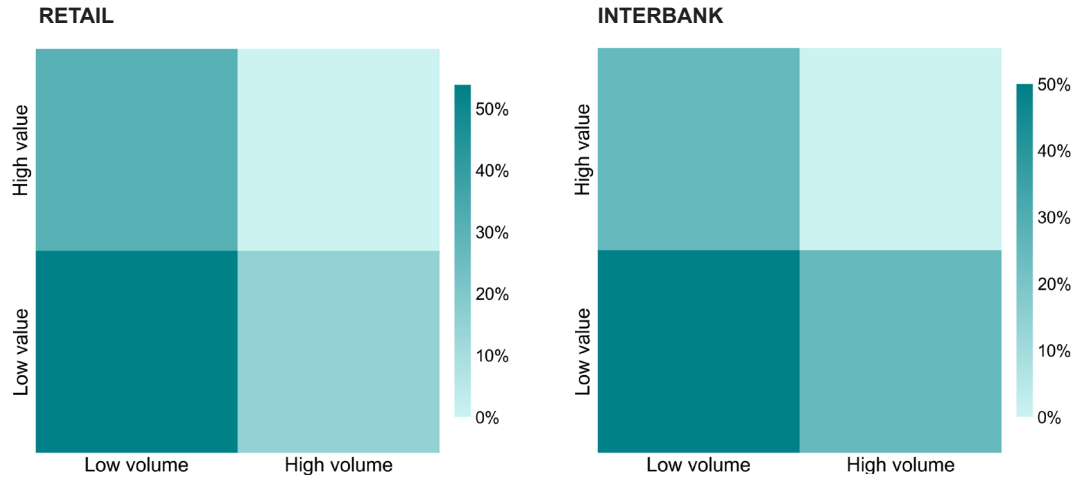
Determining cyber-risk systemic vulnerabilities from payment system activity

The identification of potential transaction-related systemic vulnerabilities involves assessing transactional configurations and financial structures that may trigger or amplify systemic losses due to a cyber threat targeting one or more financial institutions.[8] In the context of payment systems, this includes scenarios in which critical T2-based services are compromised and can no longer guarantee a minimum operational level or be restored within an appropriate recovery window. Such disruptions could generate material second-round effects on counterparties' liquidity and, more broadly, on the functioning of financial intermediation. The potential impact is likely to be greater in high value transactions, even if these are relatively less relevant in terms of volumes.

Chart 3 illustrates the share of participants across transaction-value and transaction-volume categories in 2025. It shows whether institutions are above or below the banking system average in terms of average transaction size and transaction volume, separately for the retail and interbank segments. The darker the colour gradient, the higher the share of participants – expressed as a percentage of the total population – in each quadrant of the matrixes. Most T2-Malta institutions are characterised by low transaction volumes and low average transaction values in both the retail and interbank segments, as illustrated in Chart 3.[9,10] However, a non-negligible share of observations falls within the low-volume, high-value cluster, particularly in the retail segment.

This configuration suggests that potential losses stemming from cyber incidents may be asymmetric. A subset of institutions appears particularly exposed to disruptions affecting low-frequency, high-value

Chart 3
TOPOLOGY OF TRANSACTIONS BY SWIFT MESSAGE CATEGORIES



Sources: T2 Data Warehouse and authors' calculations.

[8] T2 data can help identify operational and systemic vulnerabilities, but not all cyber-control vulnerabilities. It is suitable information for criticality, timing, concentration, substitutability, and contagion assessments. However, it is less appropriate for segmentation quality, threat detection maturity, backup immutability, forensics capability, or governance quality. Those require complementary evidence such as questionnaires, incident reports, DORA third-party information, or TLPT/TIBER-style testing.

[9] TRN stands for Transaction Report; this represents the core T2 data entity for cash transfer orders/cash transfers. See Data Warehouse User Handbook v. R2026.JUN for further details about T2 reporting.

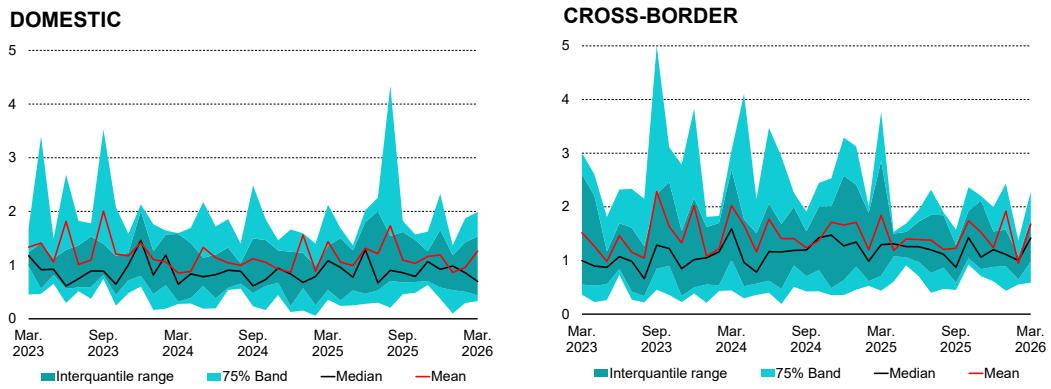
[10] The sample comprises settled 2025 transactions of T2-Malta participants active in 2025, involving Maltese banks and other T2 participants holding a Maltese T2 account; excluding transactions with monetary authorities, direct debit and internal transfers between accounts held by the same entity.

transactions in the retail segment, where even limited operational impairment in sending or receiving payments could generate disproportionately large operational and financial consequences. For instance, a temporary inability to send a small number of large corporate or customer payments could create sizeable liquidity shortfalls for counterparties, while a failure to receive high-value inflows could impair the affected institution's ability to fund subsequent payments. Similarly, in the interbank segment, disruptions to a participant that is mostly engaged in either fewer but larger-value transactions or, additionally, very frequent but low-value transactions could also interfere with liquidity redistribution. This highlights why transaction value, and not only frequency, is relevant for identifying cyber-related systemic vulnerabilities.

The outflow-to-inflow ratio shown in Chart 4 provides a complementary perspective by indicating whether, on average, a bank sends more funds to the financial system than it receives from it, or vice versa. The ratio may therefore signal short-term liquidity imbalances, contingent on the institution's broader funding position. Values above one indicate net outflows, while values below one reflect net inflows. Pronounced imbalances can be relevant in cyber stress scenarios because they help identify institutions or payment corridors where disruptions to outgoing or incoming payments could generate liquidity pressures.

At the domestic level, the outflow-to-inflow ratio remains broadly stable over time and close to one. This means that, on average, the value of payments sent by Maltese participants to other domestic participants is broadly matched by the value of payments received from them. In other words, domestic payment flows appear relatively balanced, with no persistent evidence of large net outflows or inflows at the system level. In contrast, the cross-border outflow-to-inflow ratio shows more volatile episodes and a mild upward trend, reflecting a gradual increase in net outflows abroad relative to the inflows received over the period. Overall, the median of the ratio remains close to unity, suggesting that payment flows are generally balanced on average. The mean, consistently above the median, indicates that the distribution is pulled upward by a relatively small number of high-value transactions from a subset of institutions with comparatively elevated ratios. The dispersion captured by the quantile bands highlights substantial heterogeneity across

Chart 4
DYNAMIC DISTRIBUTION OF OUTFLOW-TO-INFLOW RATIO



Sources: T2 Data Warehouse and authors' calculations.
Notes: Quantiles over time of the outflow-to-inflow ratio for T2-Malta participants spanning from March 2023 to March 2026. The ratio is calculated by dividing the total nominal outflow value (debited transactions) by the total nominal inflow value (credited transactions) of transactions excluding monetary authorities and internal transfers. A value equal to one indicates perfect matching between outgoing and incoming payment values; values above one indicate net outflows, while values below one indicate net inflows. Eligible transactions include domestic transactions and cross-border transactions, both excluding T2-relevant authorities, the Central Bank of Malta, and technical or operational transactions.[1]

[1] For the sake of filtering eligible transactions, this study prioritizes material financial transactions across entities, to represent the network of actual payments on a best effort basis, so as to focus on transactions not involving central bank core operations, technical transfers and operational tests, billing procedures and routing of funds across accounts owned by the same T2 participant. This approach excludes all the transactions involving the Central Bank of Malta and the ECB as main counterparty, EBA Clearing and other related operators, ASs and CCPs.

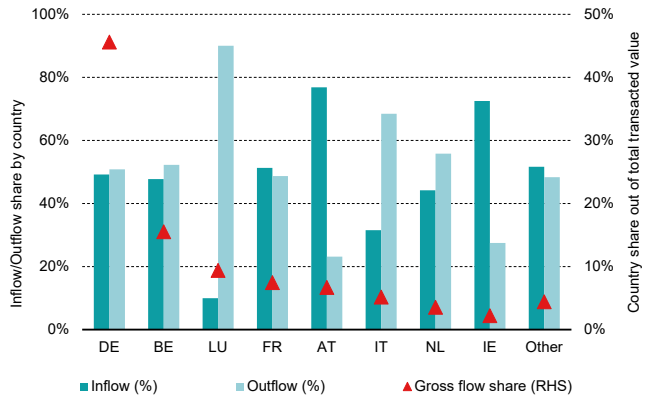
banks and over time, with occasional spikes in the upper tail. These episodes are notably more frequent in cross-border transactions.

From a Maltese financial stability perspective, however, one vulnerability of particular interest is banks' reliance on sizeable incoming cross-border payments from specific foreign jurisdictions. If a cyber incident were to impair the ability of a foreign counterparty or jurisdiction to execute outgoing payments towards Malta, Maltese recipient institutions could face liquidity pressures, especially where expected inflows are used to fund subsequent payments. In this sense, net inflow patterns are particularly informative for identifying foreign countries and payment corridors that should remain on the Bank's assessment radar. Jurisdictions that act as important sources of inflows for Maltese banks may therefore be especially relevant when designing cross-border variants of cyber stress-test scenarios.

Chart 5 depicts the extent to which the main T2 euro area partners contribute to total cross-border transacted value for the year 2025, by decomposing the total nominal flows exchanged with each country into inflow and outflow percentage shares. For instance, Germany is the most significant jurisdiction in this system, representing 46% of the overall transacted value, of which roughly 51% are outflows and 49% inflows. This deep dive into the geographical distribution of Maltese cross-border financial flows reveals a marked concentration of transacted value with a limited number of euro area jurisdictions, with fewer than five countries accounting for more than 80% of total cross-border activity. This points to a high degree of geographic concentration in payment flows. Moreover, the asymmetry between debited and credited transactions across countries highlights the presence of net-sender and net-receiver jurisdictions, reflecting directional dependencies in liquidity movements. Such a structure implies that ICT disruptions affecting key jurisdictions could have disproportionate systemic effects, particularly when payment activity is concentrated in a small number of systemically relevant institutions.

Malta appears to be strongly interconnected, particularly with a subset of large euro area economies that exhibit relatively high inflows and outflows. Exposure is also pronounced towards a smaller group of mainly unidirectional actors, whose monetary flows are either primarily absorbed by, or channelled outward from, the Maltese economy. However, given the small size of the Maltese payment system, these flows are unlikely to be material from the perspective of the recipient jurisdictions. For Malta, the more relevant vulnerability stems from countries that are important sources of inflows, such as Austria and Ireland. In this context, a payment disruption could propagate and impact the Maltese system as well, since cyber disruptions targeting institutions or payment infrastructure in these countries might critically reduce incoming payments to Maltese banks and cause liquidity pressures for domestic recipients. Overall, Malta's cross-border vulnerabilities appear concentrated along a limited number of critical payment corridors, which can help inform the design of cross-border cyber stress-test scenarios.

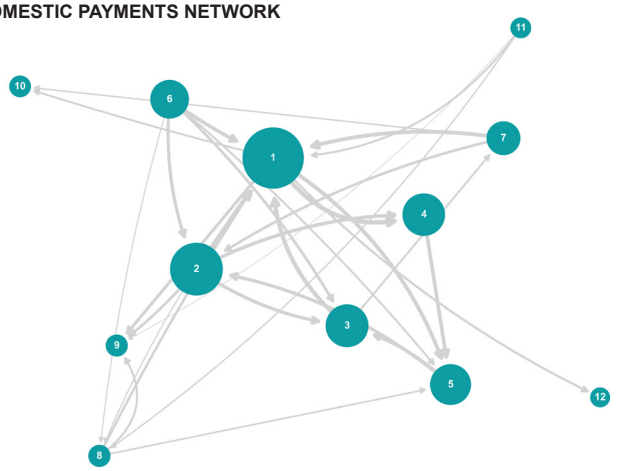
Chart 5
GEOGRAPHICAL DISTRIBUTION OF T2 MALTESE CROSS-BORDER TRANSACTIONS
(percentages)



Sources: T2 Data Warehouse and authors' calculations.

A bird's-eye view of the domestic payment network

Chart 6
DOMESTIC PAYMENTS NETWORK



Sources: T2 Data Warehouse and authors' calculations.

Network theory is used to complement the characterisation of T2-Malta and to provide a clearer understanding of its most relevant actors and interdependencies. Chart 6 provides a network perspective of this payment system.[11] Each node represents a bank, and node size is proportional to the total value transacted over the year, considering both sent and received payments.[12] The numbers displayed within the nodes rank institutions by node size, with 1 denoting the bank with the largest total transacted value. Directed edges represent bilateral payment relationships: edge thickness is proportional to the total transaction volume between each pair of institutions, while arrow direction indicates the direction of the bilateral net inflow, that is, towards the institution receiving the positive net balance of funds from its counterparty. Node positions are arranged to reflect the degree of weighted interconnectedness, with more strongly connected institutions placed closer to the centre and less connected institutions located towards the periphery.

The network displays an uneven, core-periphery structure. A relatively small group of institutions – comprising four banks – occupies a particularly prominent position within the network.[13] A further three institutions, identified by nodes 5 to 7, appear in an intermediate position, while the remaining five institutions, corresponding to nodes 8 to 12, are located in the periphery through fewer and thinner edges. Although the network appears broadly interconnected, payment activity is concentrated among a limited number of larger and more connected institutions. The direction of the arrows indicates that bilateral liquidity flows are asymmetric, with some institutions acting as net recipients (providers) in specific relationships.

Disruptions affecting the more central nodes could therefore have adverse implications for payment continuity, liquidity circulation, and the transmission of operational stress across the domestic network. From a systemic risk perspective, monitoring the evolution of this mapping and these connections over time can help assess the relative importance of individual banks and their activity within the system, and, therefore, the potential for heightened systemic risk.

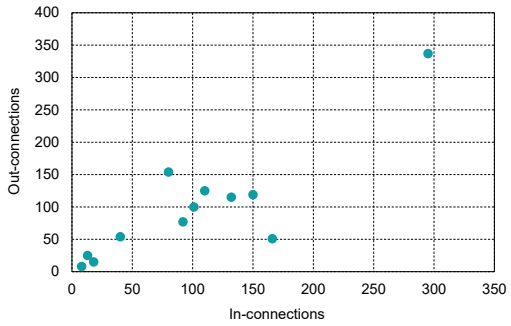
To assess the relative importance of individual banks in the domestic payment network, the analysis also relies on connectivity and centrality indicators, following Glowka et al. (2024). Chart 7 plots, for each institution, inflow against outflow unique nodes to quantify connectivity, where connectivity is measured as the number of unique counterparties from which an institution receives payments and to which it sends payments. It also reports the normalized in-degree and out-degree centrality measures, calculated for the domestic network only (i.e. excluding cross-border counterparties).

Chart 7 reinforces the uneven structure of the domestic payment network. One institution stands out as a dominant hub, displaying a markedly higher degree of centrality than all others, while most participants are clustered at substantially lower levels. The positive association between in and out-degree suggests that

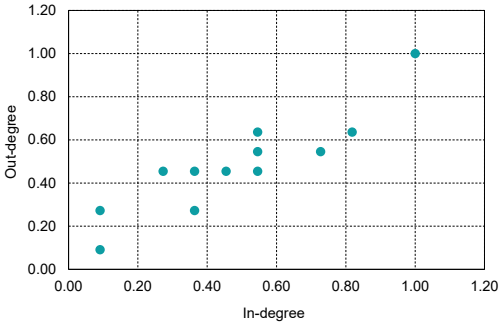
[11] The sample consists of T2-Malta participants active in 2025 and processing payments vs. other T2-Malta credit institutions.
[12] The sample comprises settled domestic transactions involving Maltese banks and other T2 participants holding a Maltese T2 account, excluding transactions with monetary authorities and internal transfers between accounts held by the same entity.
[13] Graph theory and network analysis provide tools to represent and analyse payment systems as networks, in which banks or other participants constitute the nodes, and payment flows the edges connecting them.

Chart 7
INTERCONNECTEDNESS OF T2-MALTA DIRECT PARTICIPANTS

TOTAL CONNECTIVITY



DEGREE CENTRALITY IN THE DOMESTIC PAYMENT NETWORK



Sources: T2 Data Warehouse and authors' calculations.

institutions that are more connected on the receiving side are also more connected on the sending side, although some asymmetries remain.

Taken together, the chart reinforces the evidence from the network map of a core-periphery configuration, in which a limited number of highly connected institutions coexist with a broader set of more peripheral participants. This concentration of connectivity points to a corresponding concentration of operational relevance, suggesting that disruptions affecting the most connected nodes could have disproportionate implications for payment continuity and the transmission of stress across the domestic payment network. This mapping also provides an empirical basis for designing plausible but severe cyber stress-test scenarios in the next phase of the analysis. In particular, the network indicators help identify which institutions could be selected as shock origins, focusing on participants that combine high connectivity, centrality, and transacted value.

At the same time, the analysis highlights which counterparties should be monitored for second-round vulnerabilities, especially those with strong bilateral exposures to the shocked node or with pronounced outflow-to-inflow imbalances. The cross-border evidence further supports the design of external variants of the shock by identifying the foreign jurisdictions and payment corridors through which disruptions could most strongly propagate to Maltese banks. In this sense, the descriptive indicators developed in this special feature are not only diagnostic but also provide the building blocks for calibrating institution-specific, network-based, and cross-border cyber stress scenarios.

Way forward and conclusions

The evidence presented in this document suggests that T2 data can serve as a useful operational and analytical tool for assessing potential cyber-related systemic risk in Malta. The Maltese component of T2 combines a manageable number of participants with sufficiently rich transaction-level information to identify critical actors, directional dependencies, concentration patterns, and potential channels of contagion.

Several findings emerge from this initial analysis. First, activity remains concentrated among a relatively small group of institutions. The share accounted for by the four largest domestic banks has decreased, but these institutions continue to represent a sizeable portion of overall transacted value. This justifies continued monitoring of the most active participants, while also recognising the growing relevance of the remaining institutions.

Second, the transaction topology for 2025 shows that most institutions are characterised by low transaction volumes and low average transaction values. However, a non-negligible share of activity is concentrated in low-volume, high-value transactions, especially in the retail segment. This suggests that the operational and financial consequences of a cyber incident may be highly asymmetric, since disruptions affecting a limited number of institutions may disproportionately impair large payment flows.

Third, the analysis of outflow-to-inflow ratios indicates that while domestic payment flows remain broadly balanced over time, cross-border positions display greater volatility and more frequent episodes of pronounced imbalances. This points to heterogeneity across institutions and payment corridors. From a Maltese financial stability perspective, particular attention should be given to sizeable incoming cross-border flows, as disruptions affecting key foreign counterparties or jurisdictions could reduce payments to Maltese institutions and generate liquidity pressures for domestic recipients.

Fourth, cross-border payment flows are geographically concentrated. A small number of euro area jurisdictions account for the bulk of transacted value, while cross-country asymmetries between credited and debited transactions reveal directional liquidity dependencies. This suggests that disruptions such as cyber incidents affecting key foreign jurisdictions could have a relatively large impact on Maltese participants through cross-border payment channels.

Finally, the domestic network analysis confirms that T2-Malta network exhibits a clear core-periphery structure. A limited number of institutions occupy central positions in the network, combining high transacted values with multiple bilateral links, while the remaining institutions are more peripheral. The connectivity and centrality indicators further reinforce this result, showing that one institution clearly acts as a dominant hub and that the most connected participants tend to be prominent on both the sending and receiving sides of payment flows. From a systemic risk perspective, this implies that operational relevance is concentrated in a narrow subset of participants, so that disruptions affecting the most central nodes could generate disproportionate effects, with implications for payment continuity, liquidity circulation, and the propagation of operational stress across the domestic network.

The indicators presented in this special feature provide a descriptive snapshot of payment-system structures that may be relevant under cyber-related disruption scenarios. They do not, on their own, measure all dimensions of cyber resilience, nor do they quantify the full systemic impact of a cyber incident. Rather, they provide a basis for further work by identifying potential shock sources, vulnerable counterparties, key bilateral links, and relevant cross-border corridors. The next phase of the analysis could develop a more structured framework to assess how payment-related operational disruption may translate into financial stability risk. This could include sensitivity analysis and scenario-based stress testing focused on selected critical participants, the transmission of stress through domestic payment links, and shocks originating from highly interconnected foreign jurisdictions. Such exercises could also support the development of dedicated Systemic Impact Tolerance Objectives (SITOs) for payments by linking severe-but-plausible disruption scenarios to measurable indicators such as affected payment values, liquidity shortfalls, unsettled transactions, recovery times and the number of institutions affected. In this way, T2 data could become an important empirical input into the broader assessment of cyber resilience in the Maltese financial system.

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4. INSURANCE COMPANIES AND INVESTMENT FUNDS

4.1 Domestic insurance companies

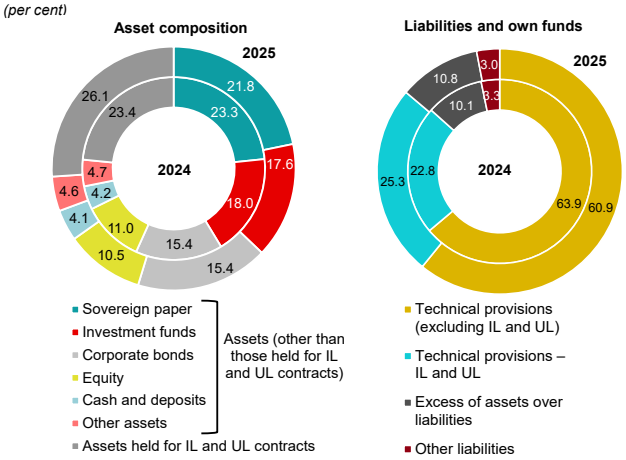
The number of licensed insurance companies operating in Malta increased to 69 by the end of 2025, following the licensing of a new entity. However, the number of domestically relevant insurers remained unchanged at ten, with their assets up by 3.5% to almost €4.0 billion, equivalent to 19.5% of GDP.[1] The expansion in assets was underpinned by improved performance across both life and non-life insurance undertakings, though this fell short of the rise in GDP.

Domestic insurance companies remained well capitalised and broadly resilient in 2025, supported by balance-sheet growth and improved performance across both life and non-life undertakings. Liquidity conditions were generally adequate, but uneven across firms, while the non-life segment's strong expansion was accompanied by higher claims volatility linked to property business written abroad and a continued high reliance on reinsurance.

4.1.1 Domestically relevant life insurance companies

The life insurance sector's balance sheet expanded by 2.1%, reaching €3.3 billion, equivalent to 16.1% of GDP. This growth was largely driven by IL and UL contracts, with the corresponding assets rising by 13.7% to €868 million.[2] In contrast, assets excluding IL and UL holdings declined by 1.2%, to stand at €2.5 billion as at December 2025. As a result, their share in the sector's total assets decreased (see Chart 4.1). This compositional shift reflected a greater pass-through of both investment risk and return to policyholders.

Chart 4.1
LIFE SECTOR BALANCE SHEET
(per cent)

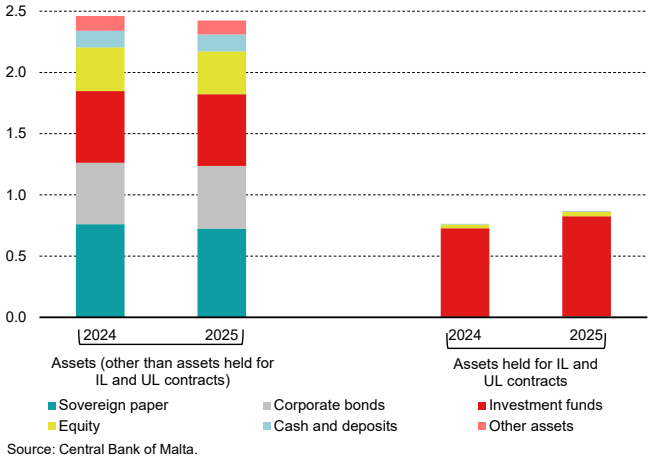


Source: Central Bank of Malta.

Asset composition – IL and UL policies

Assets backing IL and UL contracts remained predominantly focused on investment funds, which accounted for approximately 94% of the total. Although these funds span diverse investment strategies, exposures were concentrated mainly in equity, debt, and asset allocation funds. Overall fund holdings increased by 12.9%, driven largely by higher participations in asset allocation and euro-area debt funds, while investments in money market funds (MMFs) declined. The remaining IL and UL assets were mostly held in equities, with a smaller share in bonds (see Chart 4.2).

Chart 4.2
LIFE INSURANCE SECTOR ASSET COMPOSITION
(EUR billions)



Source: Central Bank of Malta.

[1] Of these, four specialise in life insurance and six in non-life. Three of the latter also writing a minor proportion of life business. However, this represents only 3.1% of their total gross written premia and are included within the non-life segment for analytical purposes.

[2] The performance of IL and UL contracts depends entirely on underlying investments, with investment risks borne by policyholders. By contrast, traditional life insurance products provide guarantees, with insurers retaining a share of market and balance sheet risk. Consequently, IL and UL contracts are assessed separately to reflect their distinct impact on the sector's financial position and stability.

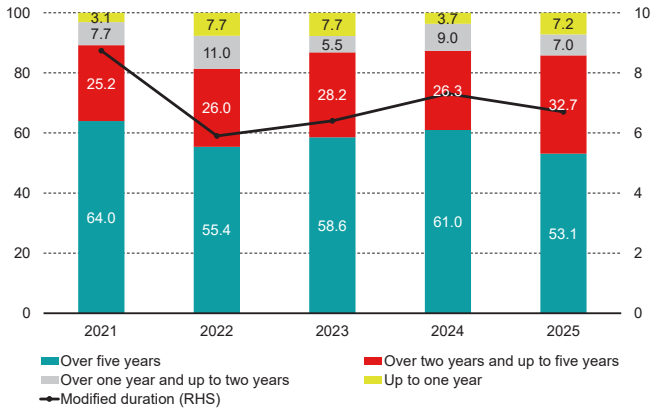
Asset composition – excluding IL and UL policies

Assets excluding IL and UL contracts comprise those backing other life insurance products, as well as assets held on insurers' own account. More than half of these assets remained invested in fixed-income securities, with an ongoing preference for sovereign debt (see Chart 4.2). Nevertheless, holdings of sovereign securities declined by 4.6% in 2025, driven by broad-based declines across jurisdictions, likely reflecting portfolio rebalancing in response to a lower interest rate environment. Conversely, corporate bond holdings increased by 1.9%, primarily due to higher exposures to NFCs in the euro area and the United States.

During 2025, the maturity profile of life insurers' bond portfolio shifted moderately, influenced by a combination of new purchases and the redemption of existing positions. Overall, the portfolio tilted towards shorter maturities (see Chart 4.3). Long-term bonds with residual maturities exceeding five years declined by 14.3%, although they continued to represent the largest segment at 53.1% of total holdings. Exposures in the two to five-year range rose by 22.0%, accounting for 32.7% of the portfolio, driven in part by new purchases. At shorter maturities, holdings of bonds between one and two-year tenors decreased by 23.6% to 7.0%, while securities maturing within one year nearly doubled to 7.2% of the total. In line with these developments, the modified duration of the bond portfolio declined by 0.6 percentage points to 6.7%, signalling a modest reduction in interest rate sensitivity.

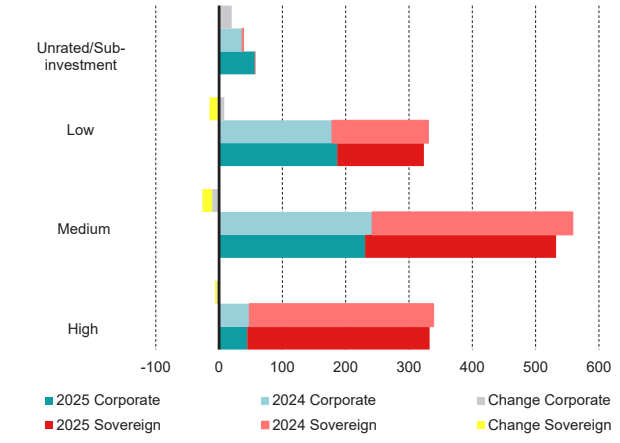
Life insurers' debt portfolios remained largely concentrated in medium and high-rated securities, which, despite a 3.6% decline, continued to account for around 70% of overall holdings (see Chart 4.4). Lower-rated debt increased by 3.2%, primarily driven by higher exposures to sub-investment grade instruments, although part of this increase reflected the growth of unrated securities, which are classified within this category. This shift may be consistent with a degree of search for yield. Sovereign exposures continued to exhibit strong credit quality, with over 80% of holdings rated medium or high. By contrast, the corporate bond portfolio displayed a more balanced distribution, with approximately 53% invested in medium and high-rated securities and the remainder allocated to lower-rated or sub-investment grade instruments.

Chart 4.3
LIFE – MATURITY STRUCTURE AND MODIFIED DURATION OF DEBT SECURITIES
(per cent of total debt securities holdings; per cent)



Source: Central Bank of Malta.

Chart 4.4
LIFE – DEBT SECURITIES PORTFOLIO – INVESTMENT RATINGS
(EUR millions)



Source: Central Bank of Malta.

Holdings in investment funds, excluding those related to IL and UL contracts, remained broadly unchanged and continued to account for around a quarter of overall assets in this segment. These investments were primarily allocated to euro area debt funds and MMFs.

Direct equity holdings declined by 2.3%, driven mainly by reductions in domestic and US exposures, especially securities issued by NFCs. Nevertheless, US exposure remained predominant, while domestic equity portfolios accounted for 20% of overall equity holdings. Around half of domestic holdings were in monetary financial institutions (MFIs), while approximately one-third were in NFCs.

Cash holdings rose by 1.9%, representing 5.6% of total assets. Meanwhile, life insurers' exposure to alternative investments such as collateralised securities, real estate, mortgages and loans remained limited, accounting for around 4.7% of the overall portfolio. This reflects insurers' continued preference for liquid and low-volatility instruments.

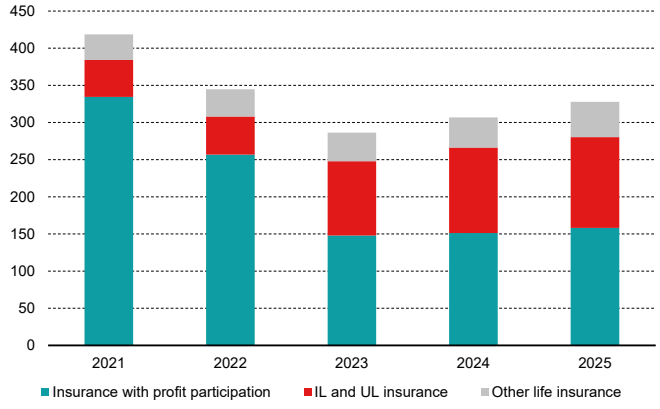
Liabilities and own funds

Developments in technical provisions broadly mirrored those observed on the assets side. Provisions related to IL and UL contracts increased by 13.5%, reaching around one quarter of the balance sheet (see Chart 4.1). Still, most of the provisions, amounting to 61% of the balance sheet, remained concentrated in other life insurance activities, although these declined by 2.6% in 2025. The excess of assets over liabilities increased by about 9%, outpacing overall balance-sheet growth, and rose to 10.8% of total assets. This surplus corresponds to eligible own funds under the Solvency II Directive and enhances life insurers' capacity to absorb unexpected losses and meet future obligations beyond the coverage provided by established technical provisions.[3]

Gross written premia and claims

Gross written premia (GWP) continued to recover in 2025, increasing by 6.8%, although levels remained below their historical average (see Chart 4.5).[4] 'Insurance with profit participation' products, while recording year-on-year growth of 4.7%, continued to show a comparatively slower recovery. They nonetheless remained the largest business line, accounting for 48.3% of total written premia. 'IL and UL' contracts similarly maintained positive momentum, with written premia rising by 6.0% and representing a further 37.2% of the total. This trend underscores the ongoing shift towards products that carry lower balance-sheet risk for insurers. Meanwhile, 'other life insurance' products recorded the strongest year-on-year expansion at 17.2%, accounting for 14.5% of total written premia, largely underpinned by the continued demand for mortgage-related life protection policies. Overall, the broad-based recovery across product lines points to stabilising demand conditions following previous years of subdued activity.

Chart 4.5
GWP OF THE DOMESTIC LIFE INSURANCE SECTOR BY LINE OF BUSINESS
(EUR millions)



Source: Central Bank of Malta.

Gross claims incurred declined by 8.8% over the same period, largely

[3] Total eligible own funds under the Solvency II Directive represent the excess of assets over liabilities as determined under regulatory rules, comprising primarily Tier 1 capital together with any eligible Tier 2 and Tier 3 capital items.

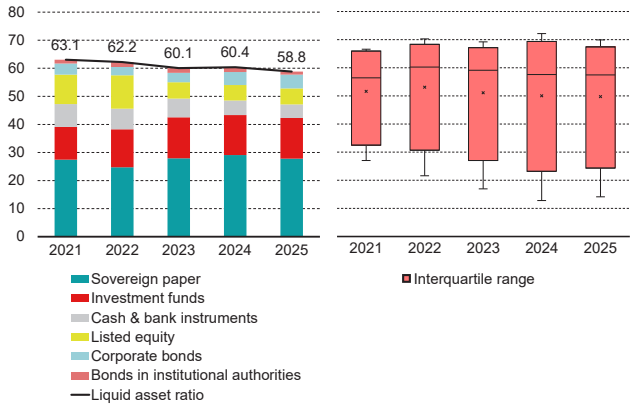
[4] Around 0.6% of premia are underwritten outside the domestic market, primarily within the euro area, and relate to IL and UL contracts as well as 'other life insurance' business.

driven by a reduction in claims related to 'insurance with profits participation' products, which nonetheless continued to account for the largest share of total claims. A similar downward trend was observed in claims arising from 'other life insurance' products. By contrast, claims associated with 'IL and UL' contracts increased by 4.6%.

Liquidity and capital

The liquid assets ratio for the life insurance sector declined by 1.6 percentage points to 58.8% (see Chart 4.6). This reduction reflected decreases in sovereign securities, bonds issued by institutional authorities, and equity holdings, all of which are key components of the liquid assets base. Despite the decline, overall liquidity remains broadly sound, supported by the predominance of high-quality fixed-income assets across most portfolios. The ratio continues to vary significantly across individual companies, underscoring the inherent heterogeneity in business models and investment strategies within the sector.

Chart 4.6
LIQUID ASSETS RATIO OF THE LIFE INSURANCE SECTOR
(per cent)



Source: Central Bank of Malta.
Note: The left panel shows the composition of liquid assets; the right shows the distribution of the indicator, where the box, horizontal line, and × denote the interquartile range, median and mean, respectively.

Life insurers maintained robust capital buffers throughout 2025, with the aggregate SCR coverage ratio rising by 22 percentage points to 271.5%. This elevated level of solvency coverage indicates substantial loss-absorbing capacity and provides insurers with a comfortable cushion against potential market or underwriting shocks. Furthermore, this strong position continues to be underpinned by the high quality of own funds, the majority of which comprise Tier 1 capital, the highest quality tier under the Solvency II framework.

Profitability

The profitability of the life insurance sector moderated in 2025, with profit before tax declining by 10.5% and the pre-tax ROA edging down to 0.8%. This moderation was driven by a deterioration in underwriting performance, which weighed on overall results. On the underwriting side, a marginal improvement in insurance revenue was more than offset by higher reinsurance costs, leading to a weaker insurance service result. By contrast, developments on the investment side were more supportive. Although gross investment returns declined, these were more than compensated for by a reduction in financing costs, resulting in a net improvement in the financial result. However, this recovery was insufficient to offset the decline in underwriting profitability.

Operational efficiency also weakened with the expense ratio rising by 1.9 percentage points to 17.6% by year-end.[5] This reinforces the upward trend observed over the past two years, pointing to a gradual but consistent increase in operating costs across the sector.

4.1.2 Domestically relevant non-life insurance companies

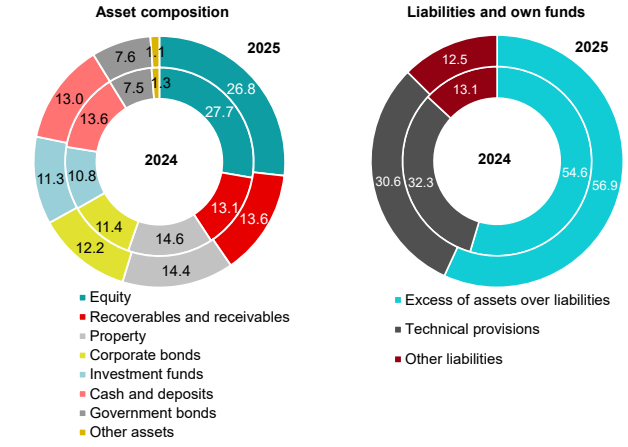
In 2025, domestically relevant non-life insurance companies recorded stronger asset growth than the life sector, with assets expanding by 10.6% to €694 million, equivalent to 3.4% of GDP.

[5] The expense ratio is defined as operating expenses, excluding claims, divided by net premia earned.

Asset composition

Growth was observed across most asset classes. Direct equity investments remained the largest asset class, accounting for more than one-quarter of non-life insurers' assets and increasing by 6.9% over the year (see Chart 4.7). A significant portion of these holdings consist of equity stakes in related insurance undertakings, highlighting a notable degree of interconnectedness through cross-ownership.

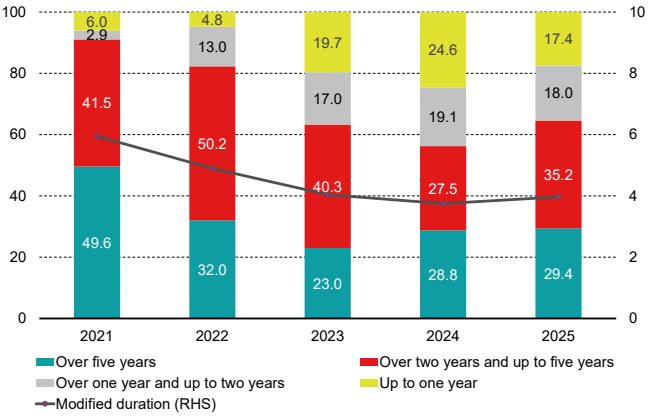
Chart 4.7
NON-LIFE SECTOR BALANCE SHEET
(per cent)



Source: Central Bank of Malta.

Fixed-income securities represented the second-largest asset category, rising by 16.2% to account for 19.8% of total assets. Within this segment, sovereign bond holdings increased by 12.6%, largely reflecting higher domestic exposures. Corporate bond holdings grew more strongly, rising by 18.6%, mainly driven by debt securities issued by financial institutions outside the euro area.

Chart 4.8
NON-LIFE – MATURITY STRUCTURE & MODIFIED DURATION OF DEBT SECURITIES PORTFOLIO
(per cent of total bond holdings; per cent)



Source: Central Bank of Malta.

During the year, the maturity profile of non-life insurers' debt securities portfolio shifted towards longer maturities, reflecting a reallocation across maturity buckets (see Chart 4.8). Short-term securities maturing within one year declined by 17.9%, likely reflecting the redemption of existing positions and proceeds being reinvested into longer-dated securities to take advantage of the relatively higher yields available at longer maturities. Holdings in the one to two-year segment increased by 9.4%. More pronounced increases were recorded at longer maturities, with securities in the two to five-year segment rising by 48.9%, while those exceeding five years rose by 18.6%, with both segments also supported by new purchases. In line with these developments, the modified duration of the bond portfolio increased by 0.3 percentage points to 4.0%, signalling a modest rise in interest rate sensitivity. This contrasts with developments in the life insurance sector, where the bond portfolio shifted towards shorter maturities over the same period, albeit remaining predominantly long-dated.

Growth in fixed-income investments was concentrated in medium and high-rated debt securities, contributing to a marked improvement in the overall portfolio quality. Within sovereign holdings, the share of medium and high-rated securities increased by 2.5 percentage points to nearly 96% of the total. An even more pronounced shift was observed in corporate bonds, where the proportion of medium and high-rated instruments rose by 5 percentage points to over 50% of the total.

Recoverables and receivables increased markedly by 15.4%, mainly reflecting higher outstanding premiums and commissions. Property holdings also rose, increasing by 8.6% to account for 14.4% of total assets. This increase was driven by properties held for own use, which represented around 55% of total property holdings, while the remainder was held for investment purposes.

Participation in investment funds grew by 15.8%, raising their share to 11.3% of total assets. Around 73% of these holdings were allocated to other euro area countries, while around 24% were invested domestically. These investments were predominantly concentrated in equity and debt funds. Finally, cash holdings increased by 5.5%, although their share of total assets edged down to 13.0%.

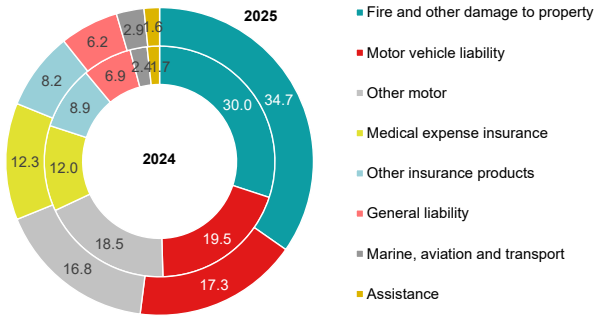
Liabilities and own funds

At the end of 2025, technical reserves increased by 4.8%, representing approximately 30.6% of the balance sheet, while other liabilities rose by 5.9%, accounting for 12.5% (see Chart 4.7). The largest portion of the balance sheet, more than half, remained as the excess of assets over liabilities, which grew by 15.2%, in line with the own funds' requirements under the Solvency II Directive.

Gross written premia and claims

In 2025, the non-life insurance sector recorded robust growth in GWP, which rose by 18.6% over the previous year. Motor, property, and health insurance remained the dominant segments, together accounting for over 80% of overall premia (see Chart 4.9). Growth was particularly pronounced in property insurance, which expanded by 36.9%, and in health insurance, which rose by 21.2%, while motor-related premia grew more moderately by 5.8%.[6]

Chart 4.9
GWP OF THE DOMESTIC NON-LIFE INSURANCE SECTOR BY LINE OF BUSINESS
(per cent)



Source: Central Bank of Malta.
Note: Solvency II Reporting. Other insurance products include workers' compensation, income protection, miscellaneous financial loss, other life insurance and profit participation, IL and UL insurance.

Gross claims incurred also rose sharply, up by 34.8%, driven almost entirely by property claims written abroad. This development highlights the risk implications associated with a growing and increasingly concentrated cross-border exposure. Cross-border underwriting accounts for around 30% of GWP and is concentrated among a small number of entities that have been actively expanding their international footprint, predominantly within the euro area. While cross-border business spans all major non-life products, property insurance alone accounts for nearly 70% of total premia written abroad, followed by miscellaneous financial loss and general liability, amplifying concentration risk at both the entity and sector level. Malta's Protected Cell Company (PCC) framework and the EU passporting regime, are central to this business model, enabling Maltese-licensed insurers to write business efficiently across member states under a single licence.

Non-life insurers continued to rely significantly on reinsurance for risk mitigation purposes, ceding 39.4% of GWP during the year. Reliance was especially pronounced in property insurance, where approximately three-quarters of written business was transferred to reinsurers. Such high cession rate implies that the sector's resilience is closely tied to the strength and pricing conditions of the global reinsurance market.

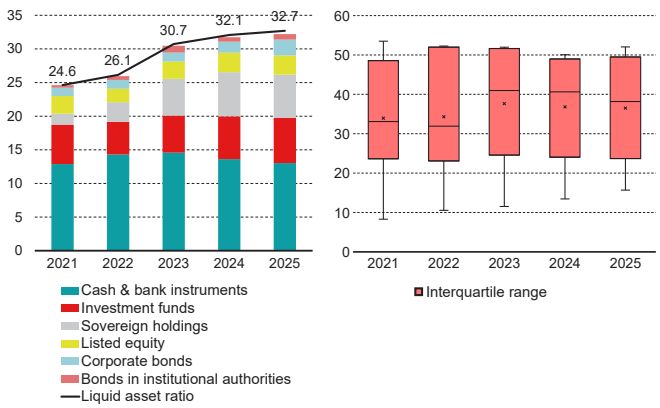
Liquidity and capital

The liquid assets ratio improved to 32.7% in 2025, strengthening insurers' capacity to meet short-term obligations. This improvement was broad-based, with investment fund holdings and corporate bonds making

[6] Motor vehicle liability insurance covers third-party liabilities arising from accidents, including bodily injury and property damage. In contrast, other motor insurance protects the insured vehicle against damage or loss but does not cover third-party liabilities.

the largest contributions (see Chart 4.10). Despite this overall strengthening, marked dispersion persisted across individual insurers, reflecting differences in liquidity management strategies. Notably, a subset of non-life insurers remained below the euro area benchmark range, indicating that liquidity risk persisted for some entities.[7]

Chart 4.10
LIQUID ASSETS RATIO OF THE NON-LIFE INSURANCE SECTOR
(per cent)



Source: Central Bank of Malta.
Note: The left panel shows the composition of liquid assets; the right shows the distribution of the indicator, where the box, horizontal line, and × denote the interquartile range, median and mean, respectively.

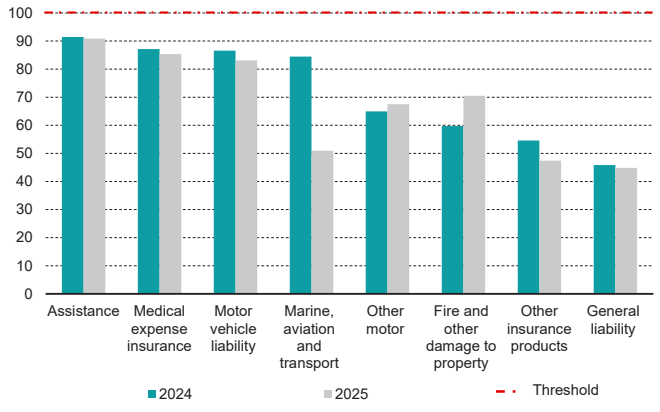
The non-life sector remained strongly capitalised in 2025, with a SCR coverage ratio of 238.3%, despite an 8.3 percentage points decline from the previous year. The decline primarily reflected the faster growth in SCR relative to eligible own funds. The expansion in the SCR was driven in part by robust balance sheet growth in 2025, which drove higher premium and reserve risk volumes and consequently raised capital requirements. Nevertheless, capitalisation levels continued to comfortably exceed the regulatory minimum, supported by a high-quality own funds base composed predominantly of Tier 1 capital.

Profitability

The non-life insurance sector recorded another year of strong profitability in 2025, with pre-tax ROA reaching 11.8%, up by one percentage point compared with the previous year. On the underwriting side, insurance expenses increased at a faster pace than revenue. However, a significant reduction in reinsurance costs more than offset this, contributing to an 8.6% improvement in the insurance service result. Reinsurance costs fell by 57.7%, the largest decline observed in recent years, suggesting that this may be largely one-off in nature.

This improvement was reflected in the net combined ratio, which declined marginally by 0.3 percentage points to 71.8%, supported by robust growth in net written premia, particularly in medical expense and in the marine, aviation, and transport lines of business (see Chart 4.11). Motor insurance also contributed positively, with an average 0.5 percentage point improvement in its combined ratio, driven by declining claims and stronger premium performance. By contrast, the property line experienced a deterioration in its combined ratio, as both claims and operating expenses outpaced premium growth. As discussed above, this

Chart 4.11
NET COMBINED RATIO BY LINE OF BUSINESS
(per cent)



Source: Central Bank of Malta.
Note: Solvency II reporting. Other products include income protection, miscellaneous financial loss and workers' compensation insurance. Bars are ranked by 2024 net combined ratio, from highest to lowest.

[7] See Insurance Risk Dashboard, January 2026.

deterioration was largely driven by higher claims associated with property business written outside the domestic market.

Profitability was further strengthened by a robust investment performance, with investment returns increasing by 17.2%, resulting in a 44% rise in the net financial result. Collectively, these developments contributed to an 18.9% increase in pre-tax profits.

4.1.3 Risk outlook

Both the life and non-life sectors started 2026 from a position of strength, underpinned by robust premium growth, balance-sheet expansion, and capital ratios that remain comfortably above regulatory requirements. Nevertheless, the environment is expected to remain challenging, shaped by persistent geopolitical tensions, international macro-financial uncertainty, and ongoing technological, regulatory, and climate-related developments. These factors may adversely affect insurers, with potential implications for margins, capital strength, and long-term business sustainability.

On the demand side, the macroeconomic outlook points to a possible moderation in premium growth across both sectors. As real GDP growth eased from its previously elevated pace, model-based estimates point to a softening in real premium growth particularly for the life insurance segment, where premium dynamics are historically more sensitive to changes in overall economic conditions.[8,9] For non-life insurance, the adjustment is expected to be more gradual, reflecting the more structural and less discretionary nature of demand in that segment. Beyond GDP developments, possible changes in interest rate conditions in response to the latest energy shock could dampen demand for investment-linked products. This would operate through the substitution effect in favour of higher-yielding alternative instruments, with impact on premium growth likely to materialise with a lag.

For life insurers, these macroeconomic headwinds are reinforced by sector-specific dynamics. The shift towards shorter-dated assets could gradually weigh on investment income. Additionally, the growing share of IL and UL products, while reducing balance-sheet risk for insurers, implies a greater pass-through of market risk to policyholders, heightening their exposure to financial market volatility.

Non-life insurers, while well-capitalised, face a distinct but equally challenging risk landscape. Exposure to a potential resurgence in claims, driven by renewed geopolitical tensions and increasingly frequent and severe climate-related loss events, could place pressure on underwriting margins and reinsurance costs, testing the adequacy of current pricing and risk transfer strategies.

Beyond sector-specific risks, insurers face a common set of structural challenges cutting across both segments. Cyber threats and supply-chain disruptions require sustained investment in data capabilities, modelling techniques, and operational resilience frameworks. From a financial aspect, while diversification across asset classes and geographies remains an important risk-management tool, it may also give rise to cross-sectoral exposures that may warrant continued monitoring and robust governance.

Overall, the sector's strong solvency position provides a solid foundation to navigate these challenges and adapt to evolving market conditions.

4.2 Domestically relevant investment funds

In 2025, 38 sub-funds were identified as domestically relevant, representing a net decrease of two sub-funds from the 40 assessed in this FSR for 2024.[10] The sector's combined assets grew by 2.0%, reaching €1.7 billion, equivalent to 7.0% of GDP, supported by favourable market conditions. At the same time, the sector

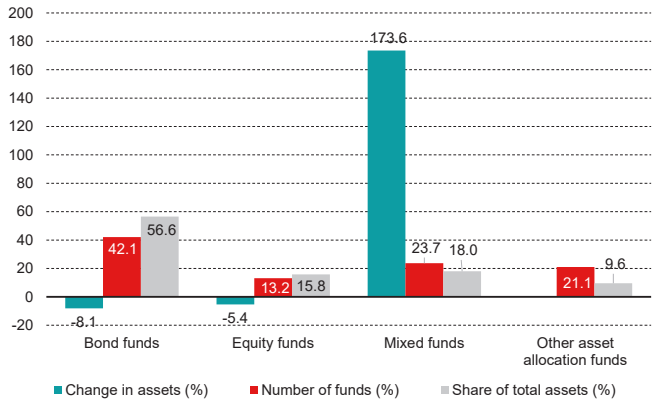
[8] Central Bank of Malta, Outlook for the Maltese Economy 2026:1.
[9] Camilleri, L., Macroeconomic Drivers of Insurance Premia in Malta, Central Bank of Malta.
[10] Compared with the previous FSR, three additional sub-funds were identified as domestically relevant in 2024. Accordingly, the number of sub-funds for 2024 has been revised to 40, from the previously considered 37. These newly identified sub-funds have also been included in earlier periods' data.

recorded notable shifts in portfolio composition and investment strategy, including higher exposure to equities and investment fund units, lower liquidity buffers, and some reallocation within bond portfolios. Despite a gradual rebalancing in the investor base, households remained the largest investors, while liquidity and leverage indicators continued to suggest that the sector remained broadly resilient.

Developments by fund strategy

Investment funds are generally classified according to their investment mandate, namely the types of assets to which they are primarily exposed. While some funds pursue relatively focused strategies concentrated in a single asset class, others allocate their investments across a range of asset classes (mixed funds). Over the course of the year, several funds updated their investment strategies. As a result, mixed funds accounted for almost one quarter of the domestically relevant sub-funds, and 18% of the sector's assets (see Chart 4.12). Bond funds nevertheless remained the dominant investment category, holding 56.6% of total assets, although this share declined by 6.2 percentage points when compared to 2024. Equity funds accounted for 15.8% of total assets, reflecting a decrease of 1.2 percentage points. The share of other asset allocation funds also declined, falling by 3.9 percentage points to 9.6% of total assets.

Chart 4.12
DOMESTICALLY RELEVANT SUB-FUNDS BY MAIN STRATEGY
(per cent)



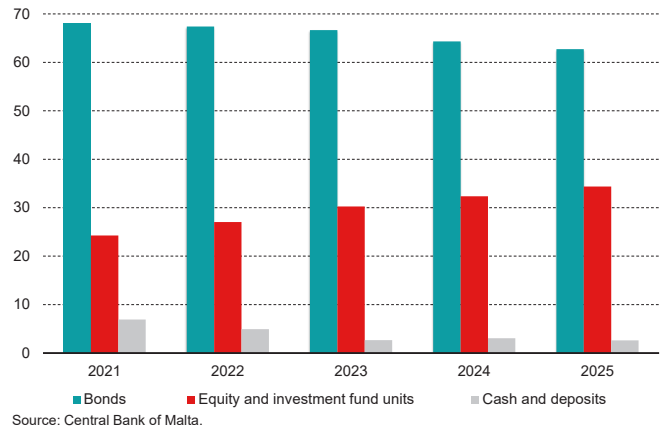
Source: Central Bank of Malta.
Note: Teal indicates the change in assets compared with 2024. Red represents the share by number of funds, while grey denotes the share of total assets.

4.2.1 Asset composition and investment strategies

The shift in asset allocation continued across all domestically relevant sub-funds in 2025. Holdings of equities and investment fund units increased by 8.3%, reflecting both higher portfolio allocations towards this segment and favourable market performance. As a result, their share in total assets rose by 1.4 percentage points to 34.2% (see Chart 4.13). By contrast, debt securities declined marginally by 0.5%, reducing their portfolio weight by 2.8 percentage points, although at 62.7%, they remained the dominant asset class.

Increased investment activity was accompanied by a reduction in liquidity buffers, with cash and deposits falling by almost 13% to a modest 2.6% of the overall portfolio, while other assets remained marginal at 0.7%.

Chart 4.13
ASSETS COMPOSITION OF THE DOMESTICALLY RELEVANT INVESTMENT FUNDS
(per cent)

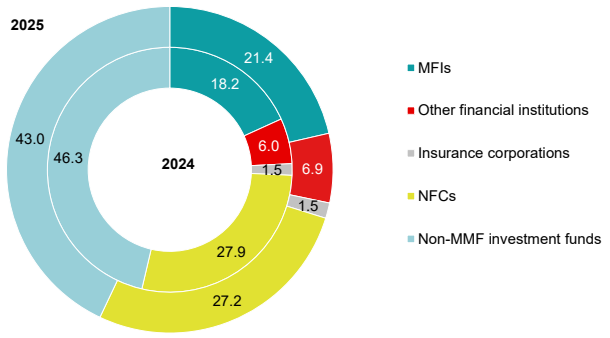


Source: Central Bank of Malta.

Equities and participations in investment funds

The overall increase in these funds' holdings of equities and investment fund units was driven almost entirely by direct equity exposures. This expansion was primarily attributable to a sharp rise in holdings of bank equities, which increased by 27.4% and accounted for nearly 60% of the absolute growth in the combined equity and investment fund units. Holdings of equities issued by other non-bank financial institutions also rose markedly, bringing the overall share of these entities and credit institutions to almost 30% of the overall holdings in equities and investment fund units (see Chart 4.14). Similarly, investments in NFCs rose by 5.6% and accounted for 27.2% of overall equities and investment funds units.

Chart 4.14
EQUITY HOLDINGS COMPOSITION OF DOMESTICALLY RELEVANT INVESTMENT FUNDS
(per cent)



Source: Central Bank of Malta.
Note: Other financial institutions includes other financial intermediaries (OFIs), financial auxiliaries and captive financial institutions and money lenders.

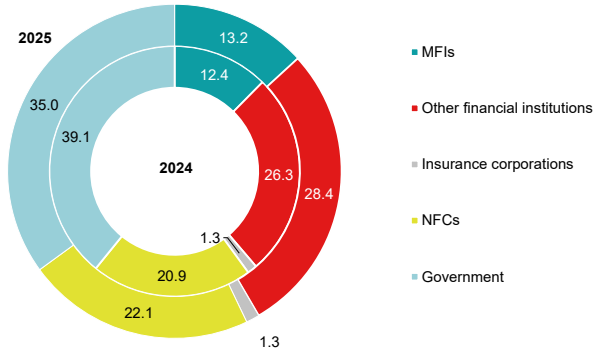
By contrast, the share of investment fund units declined to 43.0% in 2025, as holdings increased only marginally in absolute terms. Of these holdings, 61.4% were allocated to exchange-traded funds (ETFs), potentially indicating a preference for more passive, cost-effective and liquid investment vehicles.

From a geographical perspective, growth was driven primarily by domestic exposures, mainly through bank equities which increased by 13.2%, and represented over 37% of the combined equity and investment fund units. Strong growth was also recorded in non-euro area holdings. In particular, exposures to the United States increased by 12.1%, while holdings in the rest of the world rose by 23.9%. By contrast, growth in euro area holdings was more moderate, rising by 2.3%, although at 44.5%, they continued to account for the largest share of the combined category. Exposure to emerging market economies declined further and remained marginal, accounting for just 0.2% of overall holdings.

Bond holdings

The decline in bond holdings was mainly driven by a sharp contraction in sovereign securities. The latter fell by 11.0% and accounted for 35.0% of total bond holdings (see Chart 4.15). This decline primarily reflected reduced exposures to domestic sovereign paper, which fell by 9.6%, although lower holdings were also reported across most other geographical areas. It was followed by lower euro area sovereign holdings, which fell by 26.8%. Bond holdings from emerging markets and the rest of the world also fell by 21.8% and 18.0%, respectively. On the contrary, US sovereign holdings rose

Chart 4.15
BOND HOLDINGS COMPOSITION OF DOMESTICALLY RELEVANT INVESTMENT FUNDS
(per cent)



Source: Central Bank of Malta.
Note: Other financial institutions includes other OFIs, financial auxiliaries and CFIML.

markedly, by almost 40%, although they continued to account for a limited share of total sovereign bond holdings at 4.1%. Notwithstanding the overall decrease, domestic sovereign securities continued to represent the largest sub-category of sovereign holdings, accounting for nearly 78% of all sovereign bond holdings. This reallocation may partly reflect changes in the yield curve environment, particularly periods of steepening at the longer end, which may have reduced the attractiveness of longer-duration sovereign exposures and encouraged a shift in portfolios towards shorter maturities or alternative assets.

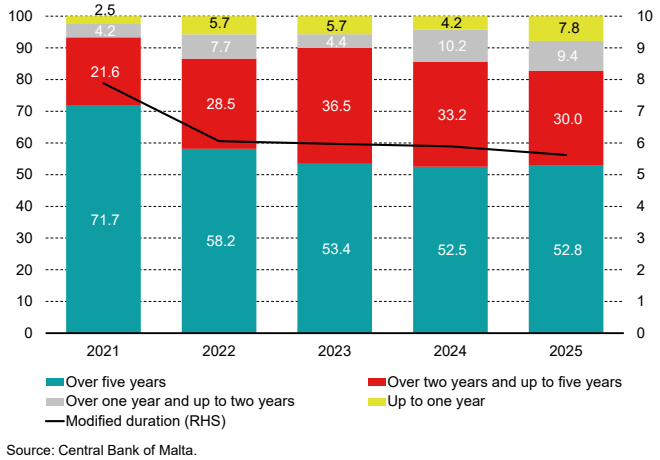
In contrast, most of the other bond categories recorded growth. The largest increase was observed in bonds issued by other financial institutions, which rose by 7.3%, raising their share to 28.4%. Bank bonds also recorded robust growth of 6.0%, with their share increasing to 13.2%. Meanwhile, holdings of bonds issued by insurance companies and investment funds remained limited.[11] Taken together, debt securities issued by financial corporations accounted for 42.9% of total bond holdings. Debt issued by NFCs also expanded, growing by 5.3% to account for the remaining 22.1%.

Despite the contraction, overall bond holdings remained heavily skewed towards domestic issuers. These accounted for 52.5% of total holdings, pointing to a persistent degree of home bias. However, such increase was partly offset by a notable increase in euro area bonds, driven mainly by higher holdings of debt issued by NFCs. As a result, the share of euro area bond holdings increased by 2 percentage points to 22.6%. Conversely, the allocation to US securities declined by 0.3 percentage points to 8.4%, as the increase in US Treasuries was more than offset by reduced holdings of debt issued by financial institutions. Exposures to emerging market securities also decreased, falling by 0.8 percentage points to 3.3%.

In 2025, some changes were observed in the maturity profile of bond portfolios. At 52.8%, long-term bonds[12] continued to represent the largest share of the portfolio (see Chart 4.16). By contrast, medium-term bonds decreased to 39.4% of overall holdings, while shorter-dated bonds increased to 7.8%. As a result, the portfolio's estimated modified duration edged down slightly to 5.6%. These developments suggest that investment managers are repositioning the portfolio to be less affected by potential increases in interest rates, by adopting a more defensive stance amid heightened volatility.

Asset quality weakened slightly in 2025. The share of investment-grade fixed-income securities fell by 5 percentage points to 59.0% of the portfolio, as these holdings declined in absolute terms. Within the investment-grade segment, holdings of high-rated bonds decreased to 5.5%, mid-rated bonds fell to 37.1%, and low-rated bonds declined to 16.4%.[13] While the share of speculative-grade securities also decreased marginally, down by 0.3 percentage points to 13.2% of the overall bond portfolio. The share of unrated holdings increased to around a quarter of the portfolio by the end of 2025. Taken together, these developments may point to a modest search-for-yield behaviour, reflected

Chart 4.16
OUTSTANDING MATURITY STRUCTURE AND MODIFIED DURATION
(per cent of total bond holdings; per cent)



Source: Central Bank of Malta.

[11] Bonds issued by Investment funds are very limited, accounting for just 0.02% of total bond holdings, and are therefore not plotted in Chart 4.15.

[12] Short-dated bonds are defined as those with maturities of up to one year; medium-term bonds as those with maturities between one and five years; and long-term bonds as those with maturities exceeding five years.

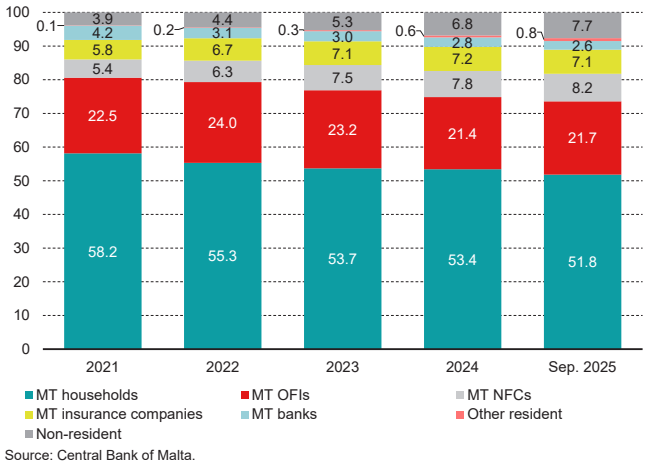
[13] Investment-grade bonds carrying a rating of AA- or above are considered as 'high-rated bonds'. 'Medium-rated bonds' are those rated between A- and A+, whereas 'low-rated bonds' are those rated between BBB- and BBB+.

in the increased shift towards higher credit risk, in response to evolving market conditions.

4.2.2 Investors

Maltese households remained the largest investors in domestically relevant sub-funds, although their share declined marginally by 1.6 percentage points to 51.8% of NAV as at September 2025 (see Chart 4.17).[14] In contrast, participation by domestic OFIs and NFCs increased to 21.7% and 8.2%, respectively, consolidating their positions as the second and third-largest investor groups.

Chart 4.17
DOMESTIC INVESTMENT FUND'S NAV BY COUNTERPART
(per cent)



Source: Central Bank of Malta.

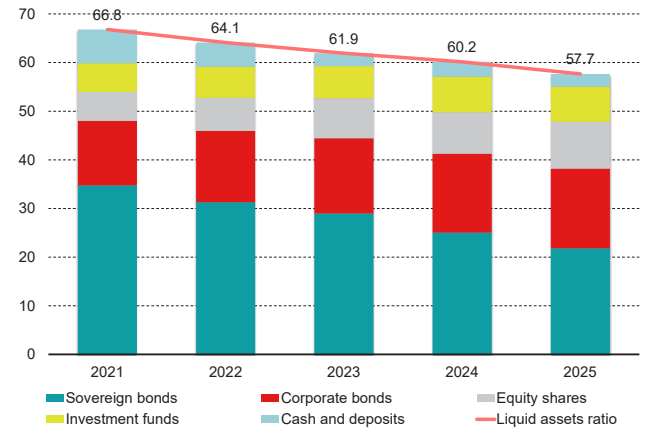
Participation by insurance companies also increased marginally in absolute terms over the period, although their share declined to 7.1% of NAV. In contrast, holdings by domestic banks continued to decrease, accounting for just 2.6% of NAV. Participation by other resident investors increased during the year, driven by pension funds, although these remained limited. Meanwhile, participation by non-resident investors, largely originating from outside the euro area, rose further to account for 7.7% of total NAV.

Overall, these developments suggest a continued gradual rebalancing of fund ownership towards institutional and corporate investors with generally higher risk-bearing capacity and longer investment horizons. At the same time, the continued predominance of households as investors implies that developments in fund valuations remain an important channel for the transmission of market risk to the household sector. Systemic risks to households are, however, mitigated by ample liquidity, with around half of their financial assets held in cash and deposits.

4.2.3 Liquidity and leverage

In 2025, the liquid assets ratio of domestically relevant investment funds stood at 57.7%, down from 60.2% in December 2024 (see Chart 4.18). This decline mainly reflected lower exposure to sovereign bonds, which carry a higher liquidity factor. Although exposures to corporate bonds increased, their lower liquidity factor weighed on the overall ratio. Cash and deposits also fell and continued to account for only a limited share of assets.

Chart 4.18
LIQUIDITY RATIO
(per cent)



Source: Central Bank of Malta.

The Redemption Coverage Ratio (RCR), calibrated using the worst-case quarterly outflows, decreased slightly to 6.3 times from 6.5 in

[14] Investor composition is reported as at September 2025 to ensure consistency of classification, given the implementation of revised reporting templates towards the end of the year.

2024.[15] This reflected both a modest reduction in HQLA and a slight increase in the estimated worst-case outflows. Notwithstanding, the ratio remained robust, indicating coverage of worst-case redemptions for more than a year and a half on average across sub-funds.

Leverage within domestically relevant sub-funds decreased slightly, with the AUM-to-NAV ratio declining to 100.2% by end-2025 from 100.6% in 2024. This level of leverage remained very low, reflecting a conservative approach to risk-taking. This is consistent with the regulatory framework, as most of these funds are licensed and supervised under the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive.[16]

4.2.4 Interconnectedness

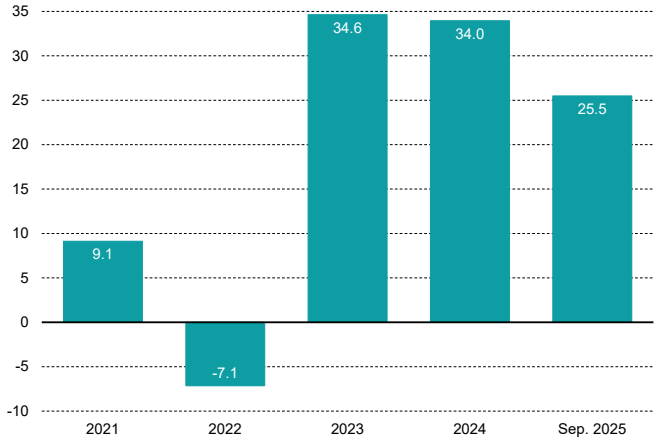
Domestically relevant investment funds remain closely interconnected with other segments of the domestic financial system. On the assets side, investments in bonds and equities issued by key domestic financial institutions accounted for 12.7% of total assets, with exposures to banks representing the largest component. In parallel, these funds continued to play a consistent role in financing the domestic financial and non-financial corporate sector, holding around 8.2% of the outstanding market capitalisation of corporate bonds listed on the Malta Stock Exchange. At the same time, the domestic financial sector remained the main investor on the liabilities side, accounting for 10.6% of NAV, with insurance companies representing approximately two-thirds of these holdings.

Although these exposures remain contained at present, the interconnectedness between investment funds and the broader financial system could amplify the transmission of shocks, particularly under conditions of heightened market volatility and sharp asset price movements. These vulnerabilities are compounded by group-level linkages, as a number of funds, while operating as separate legal entities, are affiliated with financial groups that include systemically-important banking institutions. In this context, step-in risk remains relevant, as reputational considerations or strategic incentives may prompt intra-group support during periods of financial stress.

4.2.5 Profitability

Profitability weakened somewhat in the four quarters ending September 2025, relative to the year ending December 2024, with the net profit margin declining to 25.5% (see Chart 4.19).[17] Although revenue increased by 10.0%, expenses rose by a considerably faster rate of 24.1%, resulting in a 17.4% decline in net profit. As a result, profitability came under pressure, with the growth in income insufficient to offset the broad-based increase in costs. Changes in income were driven mainly by developments in dividend and other income, while the higher expenses are mainly due to an increase in other expenses.

Chart 4.19
NET PROFIT MARGIN
(per cent)



Source: Central Bank of Malta.

[15] The RCR is defined as the ratio of HQLA to the estimated worst-case quarterly outflows observed since 2016.
[16] Article 83 of the UCITS Directive restricts borrowing by retail funds to up to 10% of their assets and only on a temporary basis (as found in Directive 2009/65/EC).
[17] Profitability is assessed using data up to September 2025 to ensure consistency in the analysis, given the implementation of revised reporting templates towards the end of the year.

4.2.6 Risk outlook

Overall, domestically relevant investment funds recorded a resilient performance in 2025, supported by favourable market conditions. Looking ahead, however, the outlook remains subject to downside risks stemming from persistent global uncertainty, heightened market volatility, and the possibility of renewed repricing across financial markets, including from resurgence of inflationary pressures.

In this context, the increase in equity exposures, together with lower modified duration and lower liquidity buffers, suggests continued portfolio rebalancing in response to evolving risk-return conditions. Elevated bond yields have continued to shape fixed-income market performance, with the observed reduction in modified duration consistent with a shift towards shorter to medium-term debt securities. This adjustment helps limit sensitivity to interest-rate shocks while preserving flexibility in responding to future changes in the interest-rate outlook.

Liquidity and leverage indicators continue to point to an overall resilient sector, supported by Malta's stable macroeconomic conditions, strong government support, and the generally conservative nature of the domestic financial services sector. Nonetheless, the more challenging global environment implies that effective risk management remains essential. Persistent volatility in international markets could weigh on the valuation and liquidity of foreign asset holdings. In this context, fund managers should continue to monitor downside risks closely, maintain adequate liquidity buffers, and pursue portfolio diversification to mitigate the potential impact of adverse market developments.

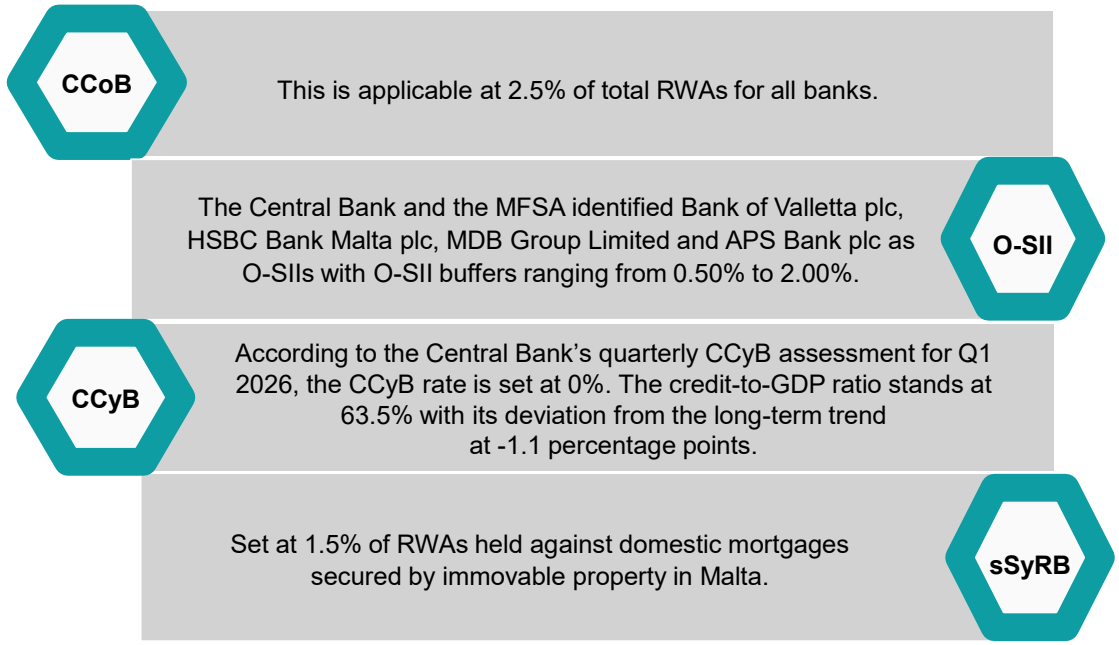
5. MACROPRUDENTIAL POLICY RESPONSE

During 2025, the Bank continued to pursue further its financial stability mandate by maintaining sufficient macroprudential policy space to strengthen the resilience of the financial system. This chapter provides an overview of the macroprudential measures in force during the year and highlights other significant developments at both the domestic and European levels.

5.1 Capital-based macroprudential measures

Capital-based macroprudential measures are an important component of the regulatory framework aimed at safeguarding financial stability. These tools enhance the resilience of financial institutions by mitigating systemic risks and helping banks absorb losses in case adverse shocks materialise. Figure 5.1 presents the capital buffer requirements applicable to domestic banks in 2025. The sSyRB is set to remain at 1.5% but will be applicable to all loans secured by immovable property. Consequently, both RRE and CRE will fall within the scope of the buffer, including loans to both legal and natural persons. This decision came into effect in July 2026.[1]

Figure 5.1
CAPITAL-BASED MEASURES IN MALTA IN 2025



Source: Central Bank of Malta.

5.1.1 O-SII Buffers

The Central Bank of Malta, in collaboration with the MFSA, conducts an annual assessment to identify domestic institutions classified as other systemically important institutions (O-SIIs) and determine their applicable capital buffer. The methodology used for this assessment is outlined in the CBM-MFSA O-SII Policy Document. The Bank also evaluates the suitability and effectiveness of the applied O-SII buffers by monitoring developments in banking sector activity, cumulative O-SII scores, and how these buffers contribute to the resilience of the domestic banking sector. The buffer is designed to internalize part of the potential costs

[1] The statement of decision on the sSyRB can be accessed using the following link: Statement-of-decision-2026.pdf while the policy case to extend the sSyRB can be accessed through this link: Box-6.pdf.

Table 5.1
LIST OF IDENTIFIED O-SIIs AND CORRESPONDING O-SII BUFFER RATES FOR 2026

Institution	O-SII score (bps)	2026 O-SII rate
Bank of Valletta plc	2,848	2.00%
HSBC Bank Malta plc	1,431	1.25%
MDB Group Limited	1,264	1.00%
APS Bank plc	796	0.50%

Source: Central Bank of Malta.

associated with the failure of an O-SII and serves as a first line of defence against possible losses. Table 5.1 above shows the O-SII scores of the four credit institutions designated as O-SIIs for the period under review, along with their respective buffer rates.

These rates remain unchanged for the period under review. The buffers are determined in line with the current calibration methodology, with expert judgement applied whenever appropriate. Further details are provided in the latest published Statement of Decision.[2] Bank of Valletta plc, HSBC Bank Malta plc, and MDB Group Limited are all meeting their respective fully loaded O-SII buffer requirements and have not recorded any changes to their buffer rates following this year's O-SII assessment.[3] APS Bank plc has also reached a fully loaded O-SII buffer rate of 0.50% from 1 January 2026.[4] Accordingly, these institutions are requested to continue maintaining their respective fully loaded O-SII buffer rates throughout 2026.

5.1.2 Countercyclical Capital Buffer (CCyB)

The CCyB is a Basel III capital-based macroprudential instrument that operates as a time-varying capital requirement. It requires banks to hold additional CET1 capital, typically ranging from 0% to 2.5% of RWAs, and is activated 12 months following its announcement, and can be released immediately in downturns. Introduced under Basel III and transposed into EU law via the Capital Requirements Directive (CRD), the CCyB complements the capital conservation buffer (CCoB), by addressing procyclicality in the financial system.

The buffer serves a dual macroprudential objective. Its primary purpose is to protect the banking sector from periods of excessive aggregate credit growth that are often linked to the build-up of system-wide risk. As cyclical systemic risks rise, banks should build capital to strengthen resilience ahead of potential losses. When conditions deteriorate, releasing the buffer helps limit the risk that capital requirements constrain credit supply, thereby supporting lending to the real economy and reducing the likelihood of procyclical deleveraging.

The CCyB may also help moderate the financial cycle during the build-up phase. However, this "leaning against the wind" effect is considered a secondary benefit rather than the main aim. This reflects the international consensus that macroprudential buffers are primarily designed to enhance resilience rather than to directly stabilise the economy, distinguishing them from monetary policy tools (ECB/ESRB, 2025).

The Central Bank of Malta, under Directive No. 11, is the national competent authority responsible for setting the CCyB rate. This tool was adopted in 2016 and has remained at 0%, reflecting persistently negative Basel credit-to-GDP gaps and quarterly assessments that have not indicated an accumulation of cyclical systemic risk. The Bank is further developing its CCyB framework by combining the standard Basel indicators with additional domestic risk metrics and forward-looking analyses, while retaining a guided-discretion approach. In line with the responsibilities assigned by Directive No. 11 and the CRD

[2] The 2026 statement of decision on the Identification of O-SIIs and the related capital buffer calibration.
[3] When a bank is newly designated as an O-SII, or where its buffer rate increases following a move to a higher bucket, a transitional period is applied to allow for the gradual build-up of the applicable buffer requirement. This is then deemed to be fully phased-in upon completion of the transition period.
[4] The buffer rate for the year 2025 amounted to 0.4375%.

framework to regularly assess macroprudential instruments and buffer settings, the framework is currently being reviewed and strengthened, with a focus on more tailored cyclical indicators and sector-specific credit gaps to better inform future decisions on the use and level of the buffer.

5.2 Borrower-based measures

As highlighted in the Interim FSR 2025, banks were required, for the second time since the introduction of Directive 16 in July 2019, to submit their external audit reports. Overall, external auditors noted that banks continued to comply with the Directive's requirements, which supports the supervisory and internal assessments underpinning the framework.

On 23 January 2026, the Bank launched a public consultation proposing to replace the current 40% stressed Debt Service to Income (sDSTI) limit, which applies to both legal and natural persons, with a 1.3x stressed Debt Service Coverage Ratio (sDSCR) for legal persons engaged in RRE lending, including buy-to-let (BTL).[5] This change recognizes that, for legal persons, repayment capacity is better captured by a debt service coverage ratio (DSCR) based on business cash flows than by a debt service to income (DSTI) limit based on gross income. In this case, debt service is assessed against earnings before interest, tax, depreciation and amortisation (EBITDA), which excludes non-cash charges, whereas households continue to be assessed on gross income without such adjustments. The measure further applies a stressed interest rate of 1.5% and conservative haircuts to projected income streams to ensure prudent risk management.

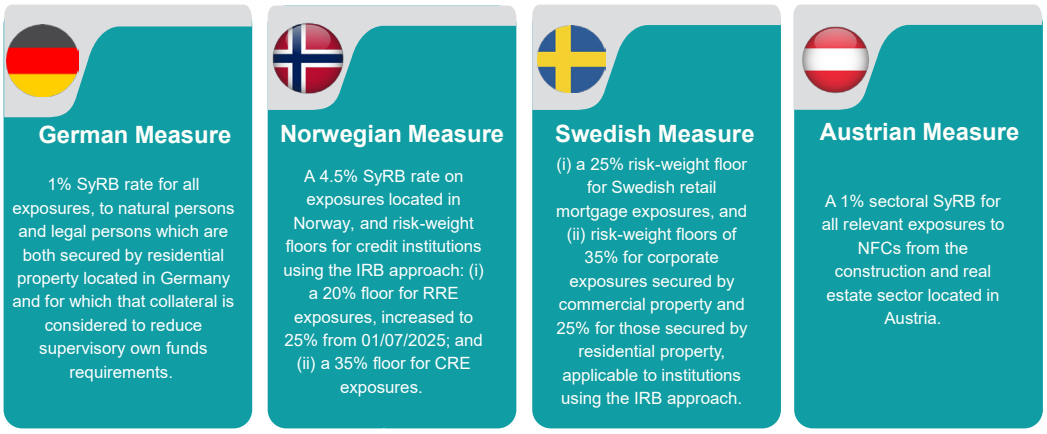
On 26 March 2026, the Bank published a feedback statement with its response to the comments received during the consultation. The amended Directive 16, which came into effect on the same date, seeks to align further the regulatory framework with prevailing best practices, while maintaining an appropriate balance between safeguarding financial stability and preserving adequate market flexibility.

5.3 Other domestic measures

5.3.1 Voluntary reciprocation

In line with the ESRB Recommendation on the assessment of cross-border effects and voluntary reciprocity for macroprudential measures (ESRB/2015/2), the Bank reviews policy measures recommended for reciprocation by other EU Member States. During 2025, four countries issued recommendations for reciprocation, which are summarised in Figure 5.2. The Bank conducted internal assessments to determine its stance on

Figure 5.2
RECIPROCATION REQUESTS ANALYSED DURING 2025



Source: Central Bank of Malta.

[5] The DSCR is the reciprocal of the DSTI.

these measures and concluded that it would not reciprocate. This decision was based on the immateriality of exposures within the domestic banking sector and/or the inapplicability of the proposed measures to the local financial system. The Bank also kept its stance unchanged with respect to previously activated measures recommended by other Member States.[6]

5.3.2 Material third countries

The materiality assessment of third countries is determined based on three criteria outlined in Article 4 of the ESRB Decision on the assessment of materiality of third countries (ESRB/2015/3): (i) risk-weighted exposures, (ii) original exposures, and (iii) defaulted exposures. The Bank kept its list of material third countries for the period Q2 2026-Q2 2027 unchanged, namely the United Kingdom and the United Arab Emirates. The Bank has informed both the ESRB and domestic banks of its determination that the CCyB rates set by the respective authorities in these jurisdictions remain appropriate. Consequently, no additional macroprudential capital buffer top-ups are deemed necessary.

5.3.3 CBM Directive 11

Following the publication of the amended CRD and CRR, the Bank transposed the relevant provisions into Central Bank of Malta Directive No. 11 on Macroprudential Policy. To this end, on 5 May 2025, the Bank launched a four-week public consultation to present the proposed amendments. The amendments to Directive No. 11 primarily clarify the shared responsibility between the Bank and the MFSA in assessing property related risk weights. They also explicitly reference the option of using the SyRB to address climate-related risks. In addition, the amendments specify that Commission approval is not required when capital buffer rates remain unchanged or are reduced. The amendments also introduce the European Single Access Point (ESAP), which is an EU-wide information platform, where O-SII data must now be uploaded, with MFSA acting as Malta's single collection body.

In July 2025, the Bank issued a feedback statement addressing the points raised by stakeholders. In line with CRD VI implementation timelines, the amendments to Directive No. 11 became applicable on 19 December 2025, following publication of the revised Directive, while the updated CRR provisions have been in force since 1 January 2025.

[6] Central Bank of Malta: Reciprocity.

5.4 European regulatory developments

Capital Requirements Regulation	The revised CRRIII, which transposes the final Basel III standards into EU law, has been applicable since 1 January 2025. While the majority of the new prudential requirements entered into force as scheduled, the implementation of the revised market risk framework under the Fundamental Review of the Trading Book (FRTB) has been formally deferred through Commission delegated acts, reflecting concerns about international alignment and the global level playing field. Alongside the application of CRRIII and the transposition of the accompanying CRDVI, regulatory work remains ongoing. Throughout 2025, the EBA continued to operationalise the new framework through a substantial programme of regulatory technical standards, ITS and guidelines – covering areas such as supervisory reporting, disclosures, operational risk, the output floor, internal governance and third country branches – to promote consistent and effective implementation across Member States.
Governing Council proposes simplification of EU banking rules	On 11 December 2025, the ECB published the recommendations of the Governing Council's High-Level Task Force (HLTF) on Simplification, which examined how to reduce unnecessary complexity in the EU's regulatory, supervisory and reporting framework for banks. The HLTF's work focused on identifying rules that may impose excessive burdens, limit banks' competitiveness, or hinder their ability to support the real economy. To address these issues, the Task Force put forward a set of high-level policy recommendations aimed at simplifying the framework while ensuring that the resilience of the European banking system is fully preserved and that Microprudential, Macroprudential and Resolution competent authorities remain able to meet their objectives effectively. The recommendations are built on four core principles: i) maintaining current levels of resilience; ii) preserving the effectiveness of prudential oversight; iii) encouraging greater EU wide harmonization in areas where diverging national rules create complexity; and iv) upholding international cooperation, including the full and consistent implementation of Basel III. The ECB has submitted these proposals to the European Commission, which is preparing a report on the overall state of the EU banking system for publication by the end of 2026. The CBM is actively contributing to these discussions and supports the overarching goal of simplifying the EU banking framework.
European Commission launches the Savings and Investment Union strategy	On 19 March 2025, the European Commission adopted its strategy for the Savings and Investments Union (SIU), a major initiative aimed at improving how the EU's financial system channels household savings into productive investments. The goal is to give EU citizens wider access to capital markets and provide companies with better financing opportunities. This, in turn, can help increase citizens' wealth, support economic growth, and strengthen the EU's competitiveness. By developing more integrated capital markets, alongside a unified banking system, the SIU aims to better match savings with investment demands. Additionally, this initiative builds on and brings together the objectives of the Capital Markets Union (CMU) and the Banking Union (BU), with the ambition of creating a more competitive and resilient EU financial system. These matters were extensively discussed during a meeting at the Bank with the European Commissioner for Financial Stability, Financial Services and the CMU, Ms Maria Luís Albuquerque, who visited the CBM as part of her broader outreach to key national stakeholders during her visit to Malta.
EU Crisis Management and Deposit Insurance framework	On 25 June 2025, the European Parliament and the Council reached an agreement on the Commission's proposal to review the bank crisis management and deposit insurance (CMDI) framework. This reform represents a significant milestone in advancing the BU. It aims to strengthen financial stability while reducing the likelihood that taxpayer funds are used to rescue failing banks. The revised framework enhances the capacity of resolution authorities to manage the failure of small and medium-sized banks by broadening the scope of resolution where this is in the public interest. As a result, more banks will be able to exit the market in an orderly manner, for example through a sale to another institution, rather than being liquidated, thereby limiting economic disruption in the event of bank failures. The reform also reinforces depositor protection across the European Union, while recognising the specific characteristics of national banking sectors and ensuring a level playing field. On 20 April 2026, the legal texts were published in the Official Journal of the European Union.[1]

[1] BRRD: Directive (EU) 2026/806 of the European Parliament and of the Council of 30 March 2026 amending Directive 2014/59/EU as regards early intervention measures, conditions for resolution and funding of resolution action and Directive 2014/24/EU as regards valuation services in resolution.

SRMR: Regulation (EU) 2026/808 of the European Parliament and of the Council of 30 March 2026 amending Regulation (EU) No 806/2014 as regards early intervention measures, conditions for resolution and funding of resolution action.

DGSD: Directive (EU) 2026/804 of the European Parliament and of the Council of 30 March 2026 amending Directive 2014/49/EU as regards the scope of deposit protection, the use of deposit guarantee schemes funds, cross-border cooperation, and transparency.

APPENDICES

Appendix A
IMPLEMENTED POLICY MEASURES[1]

CAPITAL-BASED MEASURES

Capital Buffer for O-SIIs	2022	2023	2024	2025	2026	Implementation date
MDB Group Limited	0.625%	0.750%	0.875%	1.000%	1.000%	1 Jan. 2016 Revised 1 Jan. 2020
HSBC Bank Malta plc*	1.500%	1.250%	1.250%	1.250%	1.250%	
Bank of Valletta plc	2.000%	2.000%	2.000%	2.000%	2.000%	
APS Bank plc**	0.125%	0.250%	0.375%	0.437%	0.500%	

* HSBC Bank Malta plc still qualifies for the provisions of Article 131(8) of CRD, which results in the capping of its O-SII buffer rate from 1.50% to 1.25%.

**APS Bank plc reached the fully loaded O-SII buffer rates in Q1 2026.

Sectoral Systemic Risk Buffer (sSyRB)	2023	2024	2025	2026	Implementation date
All credit institutions involved in mortgage lending	1.000%	1.500%	1.500%	1.500%	1% as from end Sep. 2023 1.5% as from end Mar. 2024 1.5% from June 2026 extended to cover all mortgages secured by immovable property

Countercyclical Capital Buffer (CCyB)	2022				2023				2024				2025				2026	Implementation date
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	
All credit institutions	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	1 Jan. 2016

BORROWER-BASED MEASURES

	2022	2023	2024	2025	2026	Implementation date
BBMs	No changes occurred	No changes occurred	No changes occurred	No changes occurred	40% sDSTI for legal persons replaced with 1.3x sDSCR	1 July 2019 (amended 29 November 2021 and 26 March 2026)

OTHER POLICY MEASURES

Material Third Countries	2022	2023	2024	2025	2026	Implementation date
Identification of Material Third Countries	United States of America, United Kingdom, United Arab Emirates	United States of America, United Kingdom, United Arab Emirates	United Kingdom, United Arab Emirates	United Kingdom, United Arab Emirates	United Kingdom, United Arab Emirates	June 2016

[1] List of implemented policy measures up to 2026 Q1.

Appendix B – Table 1
FINANCIAL SOUNDNESS INDICATORS – BANKING SECTOR

	Core Domestic Banks					Non-Core Domestic Banks					International Banks					Total Banks				
	2021	2022	2023	2024	2025	2021	2022	2023	2024	2025	2021	2022	2023	2024	2025	2021	2022	2023	2024	2025
Capital[1]																				
Regulatory capital to RWAs	22.7	23.0	24.7	25.3	27.6	20.3	18.7	20.8	23.2	22.0	46.3	41.1	38.7	37.6	33.3	25.6	24.6	26.0	26.7	27.8
Regulatory Tier 1 capital to RWAs	19.5	19.6	21.0	21.1	21.5	20.0	17.6	19.7	22.1	19.8	46.3	40.7	38.5	36.3	31.1	23.1	21.9	23.0	23.2	22.7
Leverage ratio	7.3	7.2	7.9	8.2	8.0	10.0	8.9	9.5	10.6	10.4	34.2	32.3	28.8	28.9	23.1	9.6	8.9	9.5	9.8	9.5
Large exposures to total own funds	66.1	83.3	60.6	58.3	56.6	173.0	194.4	133.5	104.2	99.7	67.9	75.6	65.4	64.6	80.4	76.4	91.8	68.3	63.8	64.4
RWAs to total assets	39.1	38.0	38.8	39.8	38.8	50.9	51.7	49.5	52.8	57.5	74.9	70.8	67.3	71.9	76.0	43.0	41.6	42.1	43.5	43.5
Profitability																				
ROA[2]	0.4	0.4	1.0	1.1	0.8	0.2	-0.4	0.6	0.4	0.2	1.5	2.6	2.5	-0.3	0.9	0.7	0.9	1.3	0.7	0.8
ROE[1,2]	4.3	5.4	12.0	11.6	8.7	2.4	-3.4	5.7	4.2	1.5	11.6	6.0	11.3	8.7	8.7	6.0	4.5	11.2	10.3	8.0
Operational cost-to-income ratio	75.2	82.3	51.0	52.4	58.4	82.2	81.0	66.6	73.3	82.9	47.3	44.6	55.8	69.9	45.0	61.8	62.9	53.8	56.9	56.4
NII to gross income	72.1	71.8	78.8	78.8	77.3	40.9	54.0	66.2	71.2	68.5	56.4	49.2	36.0	46.3	62.7	62.7	59.3	60.0	70.7	72.4
Non-interest income to gross income	27.9	28.2	21.3	21.2	22.7	59.1	46.0	33.8	28.8	31.5	43.6	50.8	64.0	53.7	37.4	37.3	40.7	40.0	29.4	27.6
Non-interest expense to gross income	77.0	83.2	51.5	52.8	58.7	83.4	81.3	67.4	73.8	83.3	47.3	44.5	55.8	80.0	52.6	62.7	63.3	54.2	60.7	58.4
Personnel expenses to non-interest expenses	41.2	36.4	46.6	47.5	46.1	48.5	47.3	49.1	49.8	44.6	10.8	10.0	9.2	9.0	15.9	30.3	27.6	30.4	29.9	37.9
Net impairment charges to gross income	-3.4	-11.5	0.4	-4.8	-1.2	6.3	35.2	5.8	6.6	1.1	18.9	14.5	5.5	29.1	23.2	8.1	4.2	2.9	3.9	6.2
Asset Quality																				
NPLs to total own funds[1]	29.4	21.5	17.9	14.2	10.4	34.2	30.0	8.0	6.8	5.5	12.1	11.5	11.8	15.2	14.1	25.7	20.3	15.8	13.7	10.6
NPLs to total gross loans	3.5	2.7	2.5	2.3	1.8	5.1	4.3	1.2	1.1	0.9	1.4	1.3	1.5	1.7	1.5	3.1	2.5	2.2	2.0	1.7
Overall NPL ratio excluding CBM placements	5.3	3.7	3.3	2.7	2.1	8.5	6.4	2.0	2.0	1.6	1.9	1.6	1.9	2.7	2.4	4.6	3.4	2.9	2.7	2.1
NPEs to total gross exposures	2.7	2.0	1.8	1.5	1.2	3.8	3.1	0.9	0.9	0.7	1.0	0.9	0.9	0.9	1.3	2.4	1.8	1.5	1.3	1.2
Total coverage ratio	44.3	46.5	43.5	39.5	46.3	59.8	72.7	60.1	71.2	77.0	147.5	189.6	125.3	107.4	101.2	57.9	66.1	55.7	54.8	60.5
Unsecured loans to total lending	20.1	18.7	18.0	17.4	17.1	71.9	55.3	47.5	49.6	51.7	21.5	23.6	27.9	33.1	39.5	23.8	22.4	22.1	22.5	23.6
Share of Stage 3 provisions to total provisions	70.2	69.6	67.3	70.8	72.2	90.2	88.4	56.6	54.8	51.3	27.9	26.5	45.3	55.1	49.3	60.5	58.5	59.9	63.6	62.1
Forborne loans to gross loans	4.5	3.5	2.5	2.3	2.0	0.8	0.6	1.1	1.4	1.6	7.4	7.4	1.3	1.4	2.3	4.9	4.1	2.2	2.0	2.0
Liquidity																				
LCR[1]	359.9	380.0	366.4	362.0	374.4	356.8	316.0	405.2	438.3	387.2	2,469.6	383.7	566.9	422.6	300.3	379.0	373.8	379.4	371.9	370.4
Liquid assets to total assets[1,3]	35.6	36.3	35.0	36.7	39.1	33.2	31.1	36.1	41.3	37.4	27.3	26.9	30.5	30.6	24.1	34.7	35.1	34.7	36.6	37.7
Customer loans to customer deposits	55.2	56.0	58.9	59.1	60.2	52.2	54.4	49.5	49.0	51.5	267.0	230.6	184.6	179.3	174.8	67.5	67.2	67.0	66.9	68.4
CBC on net cash outflows	189.3	251.0	287.2	331.0	336.9	300.8	240.7	272.0	315.7	297.3	601.9	58.6	189.1	131.0	140.2	204.0	239.8	281.2	318.0	320.6
NSFR[1]	174.0	187.1	175.8	183.9	186.5	178.4	172.9	191.3	180.9	172.7	155.3	118.4	137.7	144.5	130.5	172.8	180.3	173.8	180.3	179.7
Balance Sheet																				
Assets-to-GDP	166.5	158.1	140.4	132.8	134.9	20.3	19.0	17.2	14.5	13.0	68.5	56.2	47.5	56.2	46.4	255.3	233.3	205.0	203.5	194.2
Domestic debt securities to total assets	8.8	9.4	8.9	10.3	10.5	7.9	7.9	6.0	5.2	5.1	0.2	0.2	0.0	0.0	0.0	6.4	7.1	6.6	7.1	7.6
Foreign debt securities to total assets	12.4	16.5	19.2	22.4	22.7	15.9	18.0	17.0	13.6	14.5	24.0	29.8	35.9	39.5	27.5	15.8	19.8	22.9	26.5	23.3
Customer loans to total assets	45.4	47.2	48.8	49.6	50.2	34.5	38.2	36.9	37.9	39.9	36.9	41.7	38.4	30.4	38.5	42.3	45.1	45.4	43.5	46.7
Interbank exposures to total assets	4.9	4.9	3.9	3.9	3.7	9.4	7.2	6.4	5.9	5.4	17.8	10.0	7.7	4.7	8.2	8.7	6.3	5.0	4.3	4.9

(1) Data for international banks excludes the branches of foreign banks.
(2) Based on profits after tax.
(3) Liquid assets defined in line with the EBA Liquidity Coverage Ratio (LCR DA) Methodology.

Appendix B – Table 2
FINANCIAL SOUNDNESS INDICATORS – NON-BANK FINANCIAL INSTITUTIONS

Domestically relevant Insurance Companies	Life Insurance Firms					Non-life Insurance Firms					Overall Insurance Firms				
	2021	2022	2023	2024	2025	2021	2022	2023	2024	2025	2021	2022	2023	2024	2025
SCR coverage ratio	218.0	180.2	219.7	249.5	271.5	240.1	233.6	242.9	246.6	238.3	227.0	200.2	230.1	248.0	253.8
Excess of assets over liabilities as a share of total assets[1]	9.5	10.1	10.1	10.1	10.8	48.1	44.3	53.1	54.6	56.9	14.7	15.4	16.6	17.4	18.8
Technical provisions as a share of net written premia	754.8	788.5	983.2	954.6	907.8	131.4	124.7	86.2	81.6	76.6	573.9	541.4	573.7	539.5	507.2
Liquid assets ratio[2]	63.1	62.2	60.1	60.4	58.8	24.6	26.1	30.7	32.1	32.7	57.0	55.7	54.7	54.6	53.0
Modified duration	8.7	5.9	6.4	7.3	6.7	5.9	4.9	4.0	3.7	4.0	8.6	5.8	6.2	7.0	6.4
ROA[3]	0.3	1.0	0.8	0.9	0.8	6.3	2.5	10.0	10.8	11.8	1.1	1.3	2.2	2.5	2.7
Assets-to-GDP	21.8	18.6	17.0	16.4	16.1	3.4	3.4	3.0	3.2	3.4	25.1	21.9	20.0	19.6	19.5
Growth in premia	17.9	-17.7	-16.9	7.2	6.8	9.5	15.8	16.8	14.1	18.6	14.7	-5.2	-1.6	10.9	13.3
Growth in claims	25.8	-10.7	-8.5	-0.5	-8.8	-9.8	41.2	-26.7	40.5	34.8	17.4	-0.9	-13.4	8.8	4.0
Bond holdings as a share of total assets	36.7	33.7	37.5	38.9	37.4	11.1	12.9	16.8	18.9	19.8	33.3	30.5	34.4	35.7	34.4
Equity holdings as a share of total assets	18.2	16.8	14.7	11.9	11.6	30.5	24.1	27.9	27.7	26.8	19.8	17.9	16.7	14.4	14.2
Investment fund units as a share of total assets	31.6	34.5	38.1	40.2	42.1	10.0	8.2	9.4	10.8	11.3	28.7	30.4	33.7	35.4	36.8

Domestically relevant Investment Funds	Bond Funds					Equity Funds					Mixed Funds					Other Asset Allocation Funds					Overall Funds				
	2021	2022	2023	2024	2025[7]	2021	2022	2023	2024	2025[7]	2021	2022	2023	2024	2025[7]	2021	2022	2023	2024	2025[7]	2021	2022	2023	2024	2025[7]
Leverage ratio	100.7	100.3	100.2	100.6	100.4	100.3	100.2	100.2	100.7	100.2	100.4	100.4	100.3	100.7	100.2	100.2	100.2	100.7	100.6	100.2	100.6	100.3	100.3	100.6	100.3
Liquid assets ratio[2]	72.0	68.6	66.3	63.6	60.6	51.0	51.8	50.6	57.0	55.1	58.8	58.3	57.3	57.0	55.1	58.0	56.7	56.5	57.5	54.3	66.8	64.1	61.9	60.2	57.7
RCR[4]	8.2	7.3	7.0	6.7	6.4	5.8	5.7	6.8	5.4	5.2	8.4	6.4	6.0	5.4	5.2	8.4	6.4	6.0	5.4	5.2	8.2	7.1	6.8	6.5	6.3
Modified duration	7.5	5.9	5.8	5.7	5.4	8.1	4.0	3.0	8.9	7.0	10.8	8.5	8.6	8.9	7.0	11.9	7.0	7.1	6.6	7.4	7.9	6.1	6.0	5.9	5.6
Net profit margin[5][6]	9.1	-2.5	37.4	38.7	32.6	8.2	-20.1	26.7	59.6	63.4	51.1	47.8	54.8	59.6	63.4	4.5	-17.3	30.5	16.2	12.9	9.1	-7.1	34.6	34.0	25.5
Assets-to-GDP	7.8	5.7	4.9	4.6	4.0	1.1	1.0	1.1	0.5	1.3	0.7	0.6	0.6	0.5	1.3	1.3	1.1	1.0	1.0	0.7	11.0	8.3	7.5	7.3	7.0
Growth in NAV[4]	-0.8	-20.8	-0.4	3.9	-7.9	23.6	-3.2	26.8	-1.9	175.1	5.1	-14.2	15.0	-1.9	175.1	10.3	-14.3	8.2	10.1	-27.0	3.0	-17.7	5.1	7.2	2.3
Share of NAV by resident households[6]	59.9	56.7	55.2	56.2	55.0	33.6	32.1	31.3	69.1	66.8	72.5	71.7	72.6	69.1	66.8	61.6	61.6	61.0	59.4	56.5	58.2	55.3	53.7	53.4	51.8
Share of NAV by other resident sectors[6]	35.3	38.1	38.2	35.1	35.2	63.7	64.0	65.4	26.4	28.2	26.0	24.7	24.6	26.4	28.2	37.7	37.1	36.4	37.0	38.3	38.0	40.2	41.0	39.7	40.5
Bond holdings as a share of total assets	86.3	88.2	90.4	89.3	92.6	0.3	0.9	7.2	45.9	30.3	51.7	52.3	47.9	45.9	30.3	28.1	27.6	26.9	30.6	28.8	68.1	67.4	66.7	64.3	62.7
Equity holdings as a share of total assets	2.4	2.5	2.4	2.0	0.7	59.2	60.2	63.2	43.8	40.5	38.1	38.1	44.4	43.8	40.5	15.0	16.7	19.3	17.9	4.3	12.1	13.9	16.7	17.4	19.7
Investment fund units as a share of total assets	3.6	4.2	4.4	5.5	4.0	36.5	33.0	27.1	5.9	18.3	4.4	4.8	5.1	5.9	18.3	45.5	46.2	48.1	47.5	64.3	12.1	13.1	13.5	15.0	14.7

[1] The excess of assets over liabilities is the difference between total assets and liabilities, representing the solvency margin under Solvency II.
[2] For info on the methodology refer to FSR 2023 Box 4.
[3] Based on profit before tax. Figures from 2023 onwards are based on IFRS 17. Earlier data reflect IFRS 4 and are not directly comparable.
[4] The RCR compares the stock of HQLA to the largest quarterly outflow recorded since the inception of the time series in December 2016.
[5] Defined as the funds' net profit as a share of total revenue.
[6] Data as at 2025 refers to September 2025.
[7] As from Q4 2025, five sub-funds changed strategy, comprising of two bond funds, two classified as 'other funds', and one equity fund that were reclassified as mixed funds.