4. INSURANCE COMPANIES AND INVESTMENT FUNDS

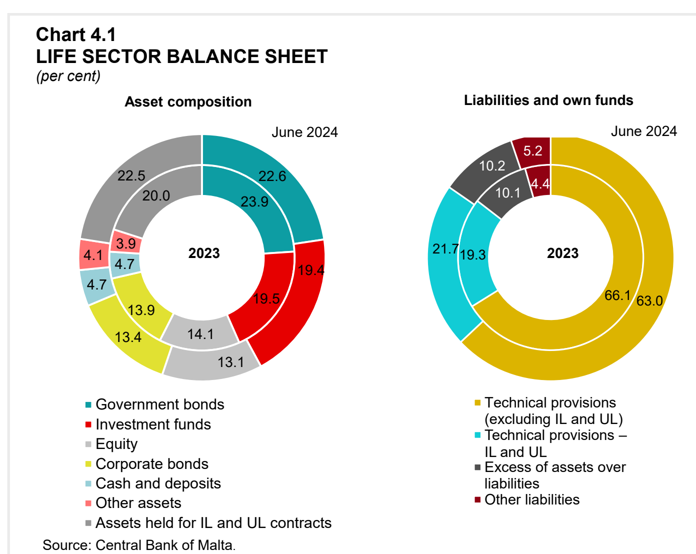
4.1 The domestic insurance companies

In the first half of 2024, the insurance sector experienced little change in terms of licensing, with the number of licensed companies remaining at 68. The number of domestically-relevant insurers remained unchanged at ten, with their assets expanding by 2.2%, reaching €3.8 billion, or 17.5% of GDP.[1]

4.1.1 Domestically-relevant life insurance companies

The life insurance sector's balance sheet grew by 1.0%, reaching €3.2 billion, which is equivalent to 14.7% of GDP. This growth was driven by index-linked (IL) and unit-linked (UL) contracts, with assets held on behalf of these contracts rising by 13.6% to €715 million.[2] Meanwhile, assets excluding IL and UL holdings totalled €2.5 billion, representing a 2.1% decrease compared to December 2023 (see Chart 4.1).

Chart 4.1
LIFE SECTOR BALANCE SHEET
(per cent)



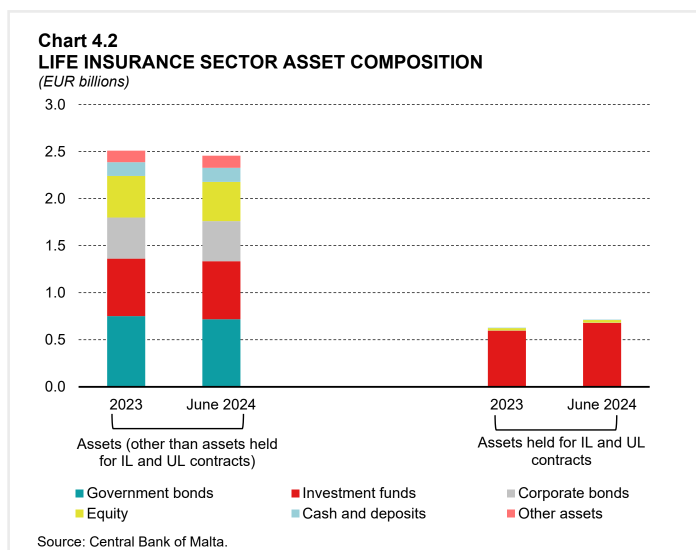
Source: Central Bank of Malta.

Asset composition

Most assets allocated to IL and UL contracts were primarily invested in investment funds, which constituted 95% of their holdings (see Chart 4.2). The remaining investments were allocated in equities and, to a lesser extent, in bond holdings. While all asset classes have grown compared to December 2023, the value of the participations in investment funds for these contracts increased by 13.7%. This increase was largely driven by domestic debt funds and equity funds from outside the euro area.

Assets excluding IL and UL contracts consisted of holdings for other classes of life insurance, and assets held on behalf of the insurers themselves. Approximately 47% of such assets are invested in fixed-income securities (see Chart 4.2). However, in the first half of 2024, holdings in government bonds declined by 4.5%, driven primarily by a significant 19.5% drop in Malta Government Stocks (MGS). Similarly, corporate bond holdings fell by 2.2%, particularly in non-euro area markets.

Chart 4.2
LIFE INSURANCE SECTOR ASSET COMPOSITION
(EUR billions)



Source: Central Bank of Malta.

[1] Four specialise in life insurance, four in non-life insurance, and two are composite insurers, meaning they offer both life and non-life insurance products. However, for the composite insurers, life insurance operations account for less than 4% of their total gross written premiums.

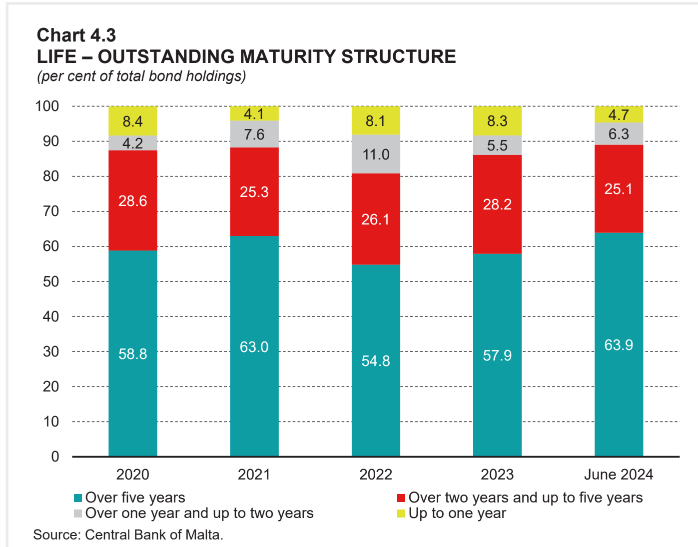
[2] The performance of linked contracts fluctuates with underlying investments, placing all investment risk on policyholders, while traditional life insurance offers guarantees, with insurers absorbing some market risk. For this reason, these contracts are analysed separately when assessing the sector's financial position and stability risks.

Looking at bond maturities, holdings of bonds maturing in over five years grew by 6.4% (see Chart 4.3). In contrast, bonds maturing in two to five years fell by 14.1%, while shorter-dated bonds experienced the steepest decline, dropping by 23.7%. These changes resulted in the modified duration to increase by 0.8 percentage points to 7.0% by June 2024 (see Chart 4.4). This development aligns with the life insurance business model; due to the long-term nature of life insurance contracts where insurers tend to favour long-term bonds to match their liabilities. At the same time, this increase in longer-term bonds likely reflected the insurers' effort to lock in higher yields that were available before interest rates started to decline and to benefit from potential price appreciation of longer-dated bonds as rates fall further.

The quality of the life insurers' bond portfolios has changed minimally since December 2023, with medium and high-rated bonds accounting for about two-thirds of the total portfolio (see Chart 4.5). The corporate bond portfolio is nearly evenly split, with about half invested in high and medium-rated bonds and the remainder in low-rated and unrated/sub-investment grade bonds. In contrast, the sovereign bond portfolio is more concentrated in higher quality bonds, with more than three-quarters allocated to high and medium-rated bonds.

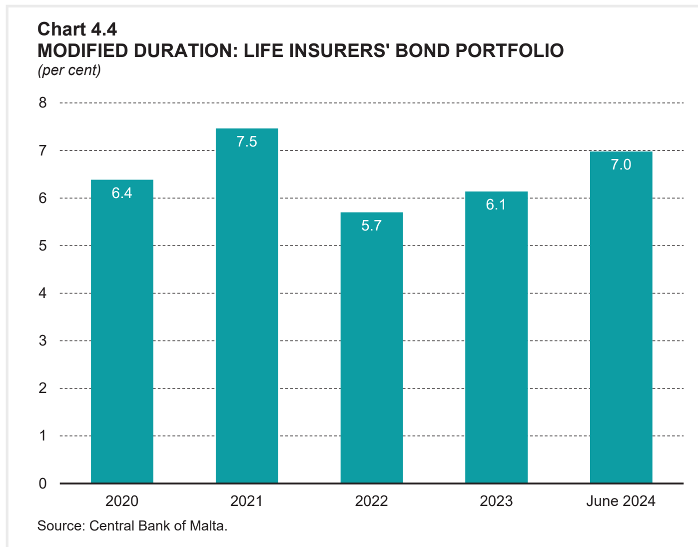
Excluding those pertaining to UL and IL contracts, participation in investment funds increased by 1.0% during the first half of 2024, accounting for about one-quarter of total assets. This growth was largely due to higher allocations to euro area equity funds, reflecting optimism in regional equity markets, as lower interest rates often

Chart 4.3
LIFE – OUTSTANDING MATURITY STRUCTURE
(per cent of total bond holdings)



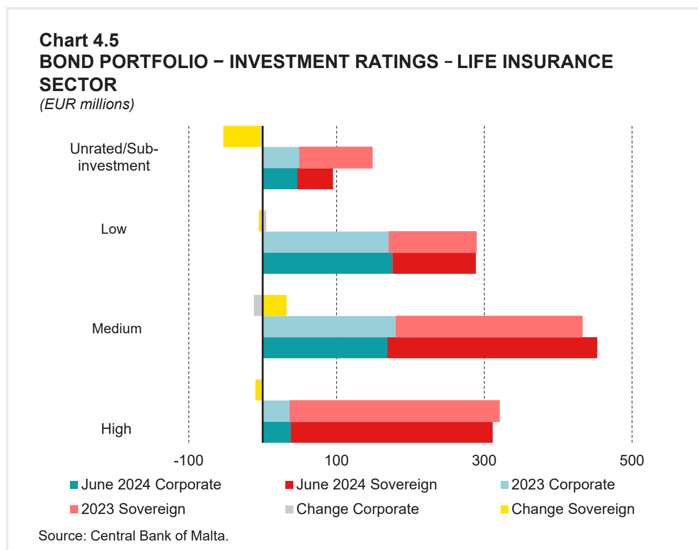
Source: Central Bank of Malta.

Chart 4.4
MODIFIED DURATION: LIFE INSURERS' BOND PORTFOLIO
(per cent)



Source: Central Bank of Malta.

Chart 4.5
BOND PORTFOLIO – INVESTMENT RATINGS – LIFE INSURANCE SECTOR
(EUR millions)



Source: Central Bank of Malta.

support equity valuations. On the other hand, direct equity holdings fell by 5.8%, reflecting a more cautious approach, likely driven by concerns over volatility and a preference for diversified exposure through investment funds rather than direct equity positions.

Excluding UL and IL contracts, cash holdings rose by 2.5% during the same period, reaching approximately 6% of total assets. This increase enhances life insurers' flexibility in navigating uncertain market conditions, allowing them to respond swiftly to new investment opportunities. At the same time, life insurers maintained a modest allocation to alternative assets, including collateralised securities, real estate, mortgages, and loans, which collectively accounted for 5.2% of their overall portfolio.

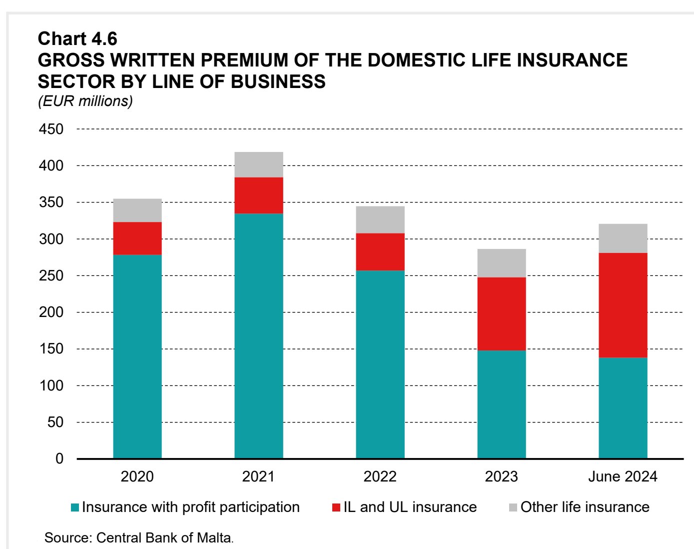
Liabilities and own funds

By June 2024, technical provisions for IL and UL contracts rose by 13.3%, making up over one-fifth of total liabilities (see Chart 4.1). However, most provisions remained allocated to other life insurance activities, which fell by around 3.8% to 63% of overall liabilities. The excess of assets over liabilities remained stable, representing about one-tenth of liabilities, and forming the regulatory own funds under the Solvency II Directive.[3] This financial buffer acts as a safety net for life insurers in event of having to absorb unexpected losses or pay future claims beyond what it has set aside in reserves.

Gross written premium and claims

Gross written premiums rebounded in the first half of the year, increasing by 12.0%. This growth was largely driven by IL and UL products, which experienced a substantial rise of 43.2% and have now become the primary line of business, representing 44.7% of the overall life insurance premiums (see Chart 4.6). In contrast, 'insurance with profit participation' products declined further by 6.7% to account for 43.0% of total premiums, as demand shifted toward higher-yielding alternatives, diverting interest from traditional life insurance offerings. Meanwhile, 'other life insurance products', including mortgage life insurance, saw an increase of 2.7% reflecting the still robust developments in the property market.

Chart 4.6
GROSS WRITTEN PREMIUM OF THE DOMESTIC LIFE INSURANCE SECTOR BY LINE OF BUSINESS
(EUR millions)



Source: Central Bank of Malta.

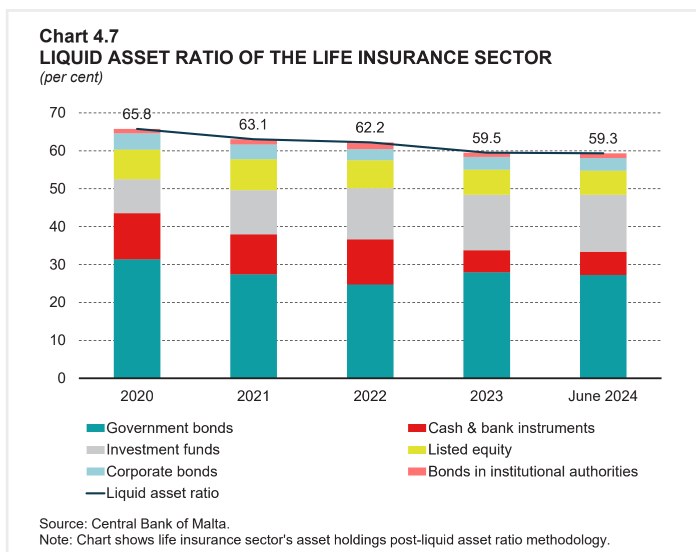
In the first half of the year, gross claims incurred rose by 5.2%, totalling €357 million. While most claims were attributed to 'insurance with profit participation' products, the increase was driven by claims related to IL and UL products and 'other life insurance products'.

Liquidity and capital

The liquid asset ratio of the life insurance sector decreased slightly by 0.2 percentage points, reaching 59.3% (see Chart 4.7). This decline is primarily attributable to the reduction in government bond holdings, which are considered highly liquid, although they still make up the largest share of liquid assets. The ratio continued to exhibit considerable variability among individual companies, reflecting the inherent heterogeneity within the sector.

[3] Total eligible own funds under the Solvency II directive include the excess of assets over liabilities, along with other funds that meet the requirements for Tier 2 and Tier 3 capital.

Life insurers continued to uphold strong capital buffers, boasting an overall Solvency Capital Requirement (SCR) coverage ratio of 267.5%, representing a notable increase of nearly 50 percentage points since December 2023. Moreover, the quality of own funds remained robust, predominantly composed of Tier 1 capital, the highest-quality category.[4]



Profitability

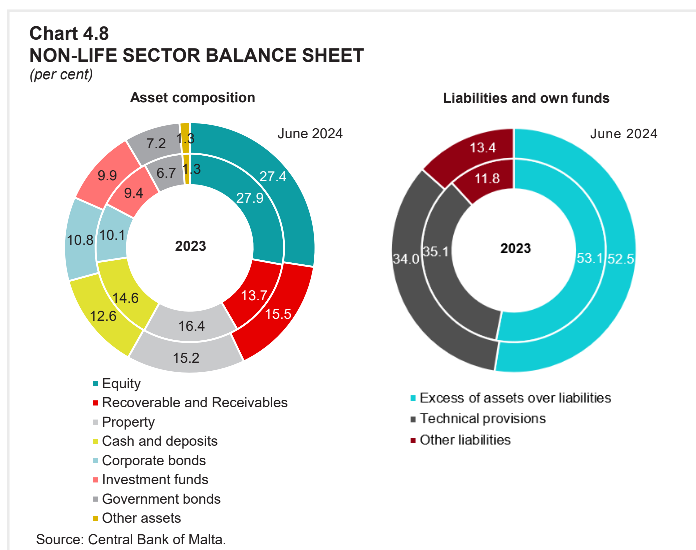
The life insurance sector remained profitable, with a pre-tax ROA of 0.8%, slightly higher than in December 2023, although performance varied among companies.[5] From an underwriting standpoint, the sector experienced a decrease in insurance revenue and an increase in insurance expenses. However, this negative performance was offset by a significant reduction in net reinsurance expenses, resulting in overall positive returns from the insurance business. While investment returns declined, they remained substantial. This decline was largely offset by significantly lower financial expenses. As a result, the sector achieved a modest positive net financial result, ultimately contributing to an improvement in the sector's profit after tax.

4.1.2 Domestically-relevant non-life insurance companies

The mild contraction experienced in 2023 was more than offset during the first half of 2024, as the aggregate balance sheet of domestically-relevant non-life insurance companies expanded by 9.0%, reaching €612 million, equivalent to 2.8% of GDP.

Asset composition

Changes in asset composition were generally modest, though some asset classes experienced varying trends. Favourable stock market performance drove a 7.3% increase in equity holdings, which continued to represent a significant 27.4% of total assets (see Chart 4.8). These remained mainly concentrated in related insurance companies, underscoring a high level of interconnectedness through cross-ownership.

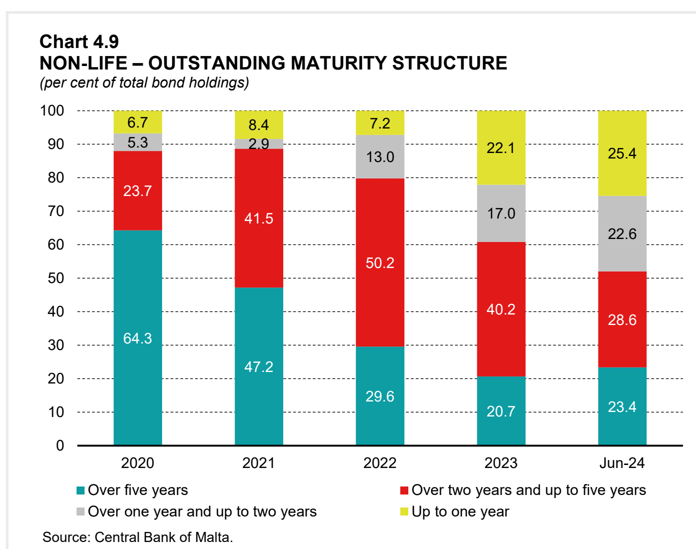


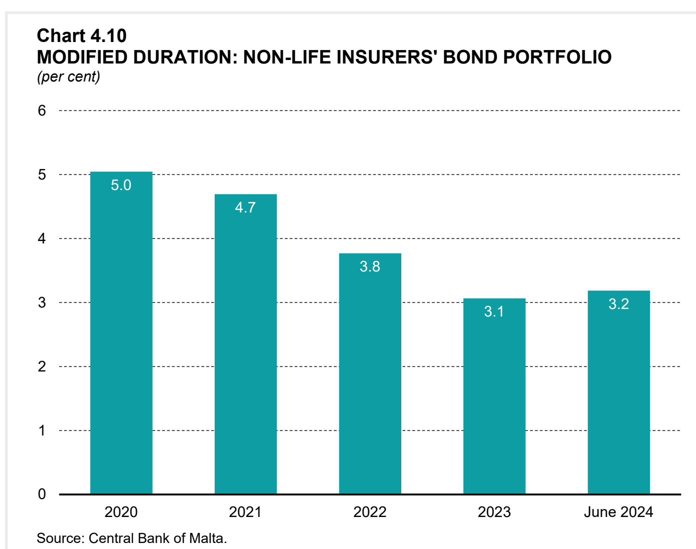
Unlike the life insurance sector, non-life insurers adopted a more proactive strategy in the fixed-debt securities market, reporting a

[4] Total eligible own funds under Solvency II consist of the excess of assets over liabilities, along with other qualifying forms of capital that meet the criteria for Tier 2 and Tier 3 capital definitions.

[5] This profitability analysis excludes one life insurance company that did not submit its June 2024 IFRS 17 returns in time for inclusion in this Report.

17.2% increase in their total bond holdings, which now constituted about 18% of total assets. Government bond holdings increased by 18.3%, primarily of euro area sovereigns, while holdings of domestic government bonds decreased. Corporate bonds grew by 16.4%, primarily related to firms in the euro area but they also invested in financial bonds issued in the United Kingdom and the United States.





Given the prospect of further interest rate cuts, which would make long-dated bonds more attractive, non-life insurers took a balanced approach by increasing both their short-term and long-dated bond exposures. Short-term bonds, maturing within two years, rose sharply by 43.5%, constituting 48.0% of holdings, a significant increase from the 12.0% in 2020 (see Chart 4.9). This development is in line with the non-life insurance business model, where the short-term nature of contracts prompts insurers to favour short-term bonds to better align with their liabilities. At the same time, holdings in long-term bonds with a maturity of over five years, increased by 32.6% to 23.4% of total holdings, indicating a recognition of the potential for capital gains as interest rates fall further. Meanwhile, bonds maturing between two and five years decreased by 16.5% to account for the remaining share. This dual increase in both short-term and long-term bonds indicated a deliberate effort to balance immediate liquidity needs with long-term investment opportunities. The rise in long-term holdings has contributed to a slight increase in the overall modified duration to 3.2% as of June 2024 (see Chart 4.10).

The rise in fixed-income investments was largely driven by medium and high-rated bonds, significantly enhancing the quality of the portfolio. Medium and high-rated corporate bonds accounted for 52.7% of these holdings, representing a 12-percentage point increase, while similarly rated sovereign bonds made up a substantial 90%, reflecting a 30.4 percentage point rise.

Additionally, non-life insurers have increased their participation in investment funds by 15%, bringing their share to almost 10% of total assets. This diversification is likely with the aim to spread risk across a wider range of asset classes, with non-life insurers investing primarily in debt and equity funds. Recoverables and receivables have risen by 23.0% to account for 15.5% of total assets, with a significant portion being reinsurance recoverables.

In contrast, cash and deposit holdings decreased by 5.8% as of June 2024, accounting for 12.6% of total assets. This could reflect a reallocation towards higher-yielding investments, most likely to take advantage of shifting bond market conditions. While property investments rose marginally, their overall share of total assets has fallen to around 15%.

Liabilities and own funds

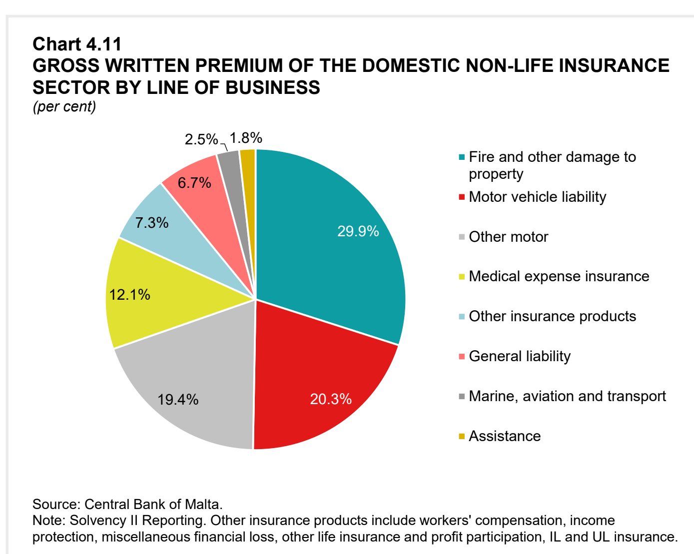
As of June 2024, technical reserves rose by 5.6%, making up approximately a third of the balance sheet, while other liabilities grew by 24.4%, representing 13.4% (see Chart 4.8). The excess of assets over liabilities increased by 7.8%, comprising more than half of the balance sheet, which corresponds to the regulatory own funds as defined by the Solvency II Directive.

Gross written premium and claims

In the first half of the year, the non-life insurance sector sustained its growth momentum, with gross written premiums growing by 6.8% compared to December 2023, reaching €374.9 million. Growth was noted in nearly all business lines, particularly in property damage insurance, which increased by 8.8% to account for almost 30% of the sector's total premiums (see Chart 4.11). This segment has consistently increased over the past six years, largely driven by sustained interest in the property market. Motor-related categories also grew by 5.4%, maintaining their position as the largest business line, with 39.7% of gross written premiums.[6]

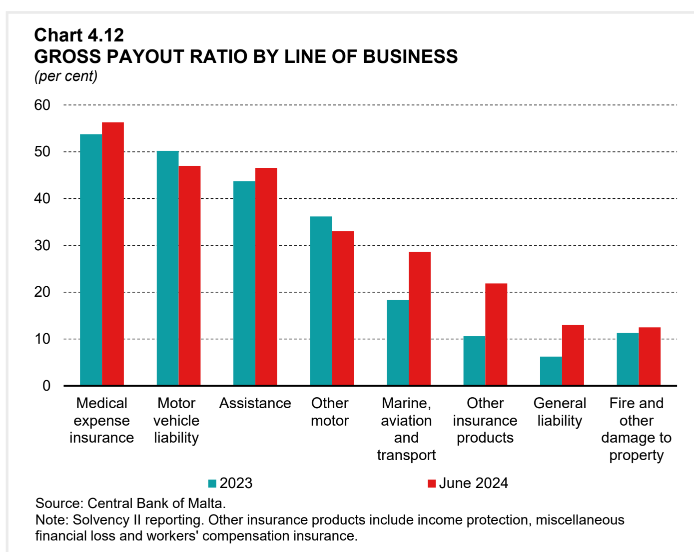
Conversely, gross claims incurred rose by nearly 13%, causing a slight uptick in the payout ratio to 30.7%. The most notable increase in the payout ratio was seen in marine aviation and transport insurance, as well as in the miscellaneous financial loss line of business within the other insurance products category (see Chart 4.12). In contrast, the average payout ratio for the two-motor related business declined by 3.3 percentage points to 40.2% during the review period, indicating that recent pricing adjustments are starting to have an effect.

Chart 4.11
GROSS WRITTEN PREMIUM 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.

Chart 4.12
GROSS PAYOUT RATIO BY LINE OF BUSINESS
(per cent)



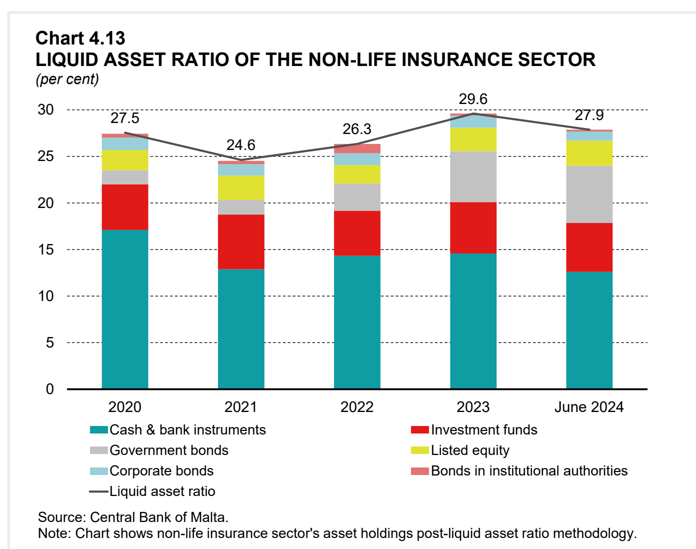
Source: Central Bank of Malta.
Note: Solvency II reporting. Other insurance products include income protection, miscellaneous financial loss and workers' compensation insurance.

[6] The difference between motor vehicle liability insurance and other motor insurance lies in their coverage. "Motor vehicle liability insurance" covers liabilities arising from motor vehicle accidents, encompassing bodily injury and property damage to third parties. In contrast, "Other motor insurance" focuses on protecting the vehicle itself, covering damages or loss incurred, but does not cover liability for accidents caused to others.

Liquidity and capital

In June 2024, the liquid assets ratio for the non-life insurance sector decreased by 1.7 percentage points to 27.9%, driven by a slower increase in liquid assets compared to the growth in the overall balance sheet. This reflected a reduction in cash holdings, as other assets, including sovereign bonds, equities, and fund investments, increased. All these assets have a stricter factor (see Chart 4.13). Notably, there remains significant variability in the liquid asset ratios across individual companies.

Chart 4.13
LIQUID ASSET RATIO OF THE NON-LIFE INSURANCE SECTOR
(per cent)



Source: Central Bank of Malta.
Note: Chart shows non-life insurance sector's asset holdings post-liquid asset ratio methodology.

Non-life insurers continued to maintain a robust capital position, with an SCR coverage ratio of 242%, reflecting a slight decrease of 0.9 percentage points since December 2023. This ratio remained well above regulatory requirements, highlighting the high quality of eligible own funds, predominantly held in Tier 1 capital.

Profitability

The non-life insurance sector maintained strong profitability despite some variability in insurers' performance, with a pre-tax ROA increasing to around 11%.[7] This solid performance was mainly driven by robust underwriting results, highlighted by substantial growth in insurance revenue, which combined with lower reinsurance costs, more than compensated for the increased underwriting expenses. As a result, overall underwriting performance improved significantly compared to December 2023. Furthermore, the sector benefited from improved investment returns, which further bolstered profitability.

4.1.3 Risk outlook

In the first half of the year, both life and non-life insurance sectors experienced balance sheet growth and strong capital positions. Life insurers benefited from a recovery in gross written premiums driven by IL and UL products, despite pressures stemming from with-profit products. In contrast, the non-life sector faced declining liquidity but maintained strong profitability through solid underwriting performance and favourable investment returns. Looking ahead, the ongoing macro-financial and geopolitical uncertainty may weigh on the sector's earnings growth potential. In this environment, diversification across asset classes and regions will be crucial for managing risk and seizing growth opportunities. Additionally, evolving customer needs and behaviours are intensifying competition across traditional industry lines. In this context, insurers that adopt purposeful and differentiated strategies, such as climate insurance, will be better positioned to enhance customer engagement and address emerging risks. Indeed, as climate-related shocks become more frequent and severe, the risk of economic and financial losses is bound to rise. Climate insurance is essential in mitigating these risks by addressing immediate threats and fostering adaptation.

4.2 Domestically-relevant investment funds

In the first half of 2024, the overall assets of domestically-relevant sub funds rose by 2.8%, marking the highest growth recorded in the past five years. Standing at €1.6 billion, assets were equivalent to 7.4% of GDP. The number of domestically-relevant sub funds remained unchanged at 36, of which 35 were licensed as retail Undertakings for the Collective Investment in Transferable Securities (UCITS) and one as a Professional Investor Fund.

[7] This profitability analysis excludes one non-life insurance company that failed to submit its June 2024 IRSR 17 returns in time for inclusion in this *Report*.

The expectation of interest rate cuts by major central banks, along with a more stable macroeconomic environment, contributed to the strong performance of the domestically-relevant investment funds. Markets experienced significant gains, including a notable recovery in the bond market, which recovered the losses incurred in previous years.

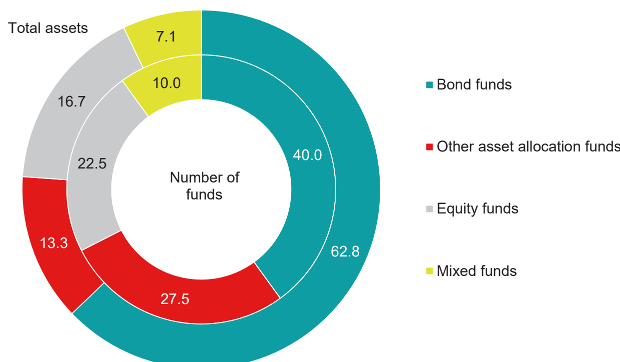
Developments by fund strategy

The robust performance of equity markets led to an expansion in the assets of sub-funds with greater exposure to these instruments. Equity funds registered the highest growth, surging by 15.4%, with their share increasing by 1.8 percentage points to 16.7% of total assets. Similarly, other allocation sub-funds reported a positive trend, rising by 3.2% to represent 7.1% of the overall portfolio (see Charts 4.14 and 4.15). Units in bond funds increased marginally by 0.3%, making up just under 63% of the overall assets.

4.2.1 Asset composition and investment strategies

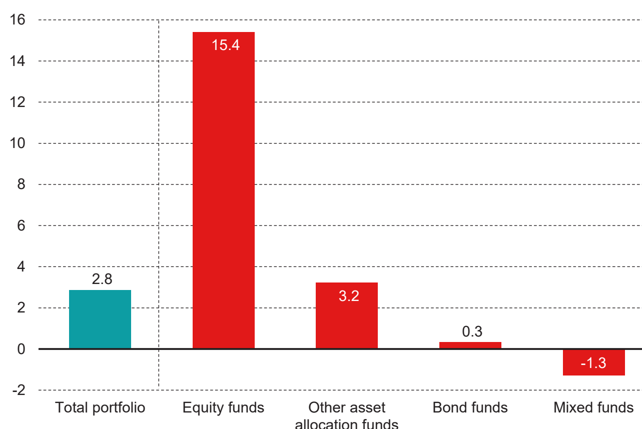
By June 2024, the value of bond holdings grew by a marginal 1.1%, mainly reflecting the modest rise in bond prices in the first quarter of the year. However, such growth was slower than for other assets, with the share in overall assets decreasing by 1.1 percentage points to 65.2% (see Chart 4.16). Concurrently, exposure towards equities continued to rise steadily to represent 31.8% of the overall share in assets. At 2.6% of overall assets, cash and deposits stood relatively stable, following declines reported in previous years.

Chart 4.14
DOMESTICALLY-RELEVANT INVESTMENT FUNDS BY MAIN STRATEGY AS AT JUNE 2024
(per cent)



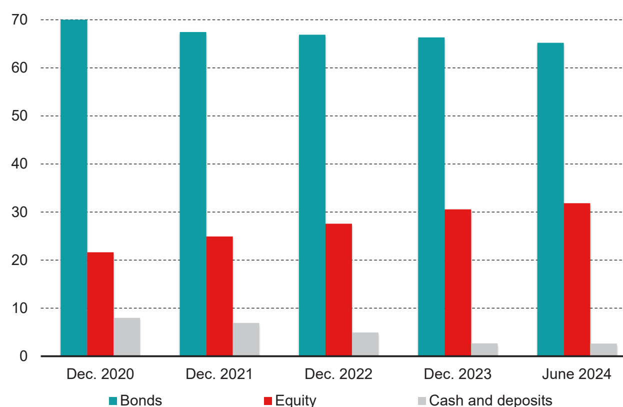
Source: Central Bank of Malta.

Chart 4.15
CHANGES IN OVERALL ASSETS BY MAIN STRATEGY
(per cent)



Source: Central Bank of Malta.

Chart 4.16
ASSETS COMPOSITION OF THE DOMESTICALLY-RELEVANT INVESTMENT FUNDS
(per cent)

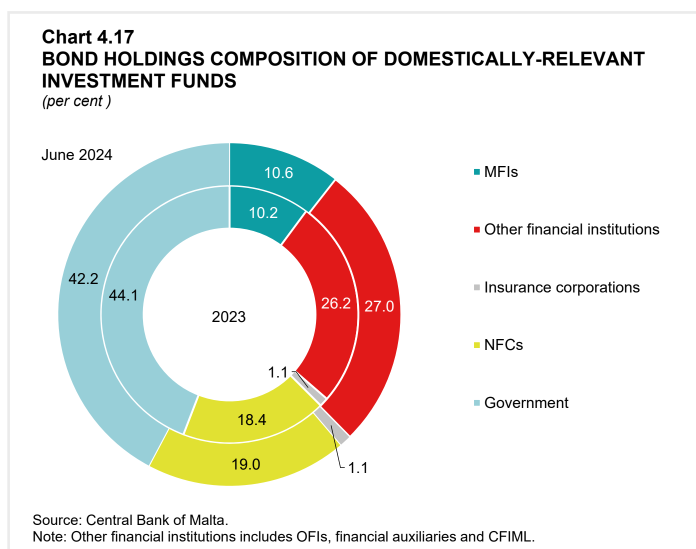


Source: Central Bank of Malta.

Bond holdings

The increase in the overall bond holdings was mainly driven by financial corporate[8] bonds, which rose by 4.4% to account for 38.5% of the overall bond portfolio (see Chart 4.17). Specifically, holdings of bank bonds rose by 5.1%, with more than 60% of these holdings relating to Maltese banks. The increase in bonds issued by OFIs was more modest, at 4.2%. Bonds of insurance companies, mainly foreign, remained limited, making up just around 1% of the bond portfolio. Holdings of NFC bonds also increased, up by 4.5% to reach 19.0% of the overall bond portfolio. A large part of the corporate bonds related to firms in other euro area countries and the United States, while domestic corporate bonds accounted for just over a quarter of the corporate bond portfolio.

Chart 4.17
BOND HOLDINGS COMPOSITION OF DOMESTICALLY-RELEVANT INVESTMENT FUNDS
(per cent)

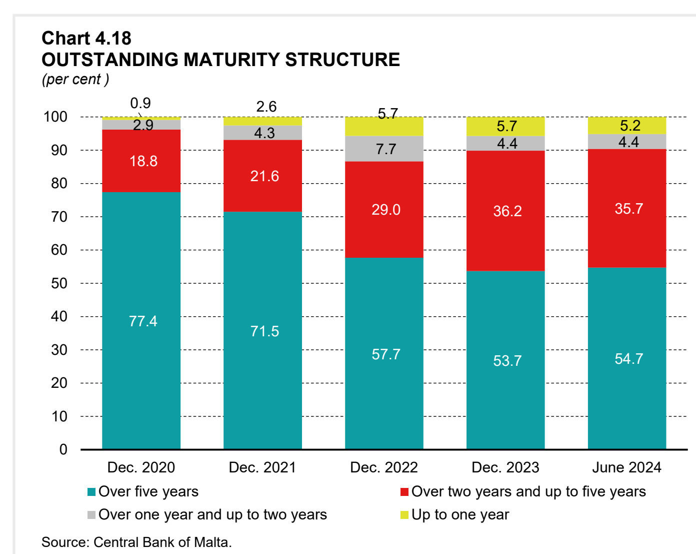


Source: Central Bank of Malta.
Note: Other financial institutions includes OFIs, financial auxiliaries and CFIML.

Meanwhile, sovereign bond holdings decreased by 3.4%, with their share in the overall bond portfolio dropping by 1.9 percentage points to 42.2%. Although this decline was largely attributed to holdings of domestic sovereign bonds, the portfolio remained heavily concentrated in domestic assets, with MGS accounting for nearly 80% of sovereign bond holdings. Meanwhile, foreign sovereign bond holdings grew, with bonds issued by euro area countries increasing by a fifth, while those outside the euro area, including the United States, rose by 15.5%.

Focusing on geographical exposure, despite remaining predominantly exposed to domestic debt securities, overall bond holdings saw a 2.2 percentage-point drop in the share of domestic holdings, representing 57.5% of the fixed-income assets. The reduction aligns with the trend observed in the last five years, where fund managers gradually shifted their exposures mostly towards euro area, which accounted for 19.4% of the debt portfolios as of June 2024. The remaining of the portfolio consisted of bonds issued outside the euro area, with a significant concentration in US bonds.

Chart 4.18
OUTSTANDING MATURITY STRUCTURE
(per cent)



Source: Central Bank of Malta.

In anticipation of interest rate cuts, investment managers chose to pause the reduction of longer-dated bonds. Consequently, the share of bonds maturing over five years increased by 1.0 percentage point to 54.7% of the portfolio (see Chart 4.18). In contrast, both medium

[8] Financial Corporate Bonds comprise securities issued by OFIs, MFIs, and insurance companies.

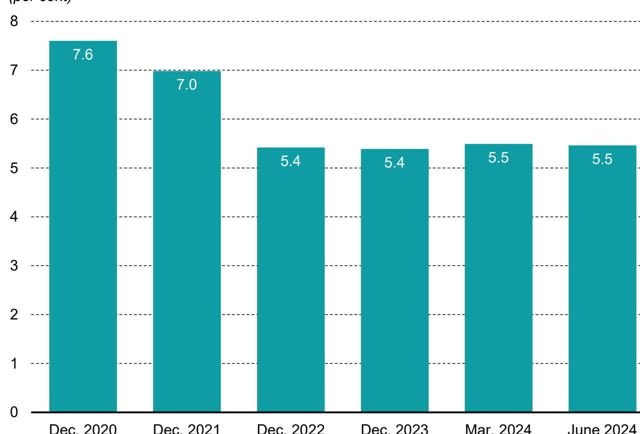
and short-dated bonds, maturing between two and five years, and under two years, respectively, saw their shares drop by 0.5 percentage points each, to 35.7% and 9.6%, respectively. Despite these changes in the bond maturity distribution, estimates for the modified duration remained stable at 5.5%, largely consistent with December 2023 (see Chart 4.19).

Equity holdings[9]

The strong performance of the equity market contributed to a 7.1 % increase in equity holdings. This growth was primarily driven by a 7.8% rise in NFC equities, maintaining their share at around 30% (see Chart 4.20). Increases were also reported for equities issued by other financial institutions and insurance corporations, although they continued to represent a limited portion of the overall holdings, at 6.3% and 1.8%, respectively. In contrast, bank equities fell by 0.6%, with their share declining by 1.0 percentage point to 16.6%.

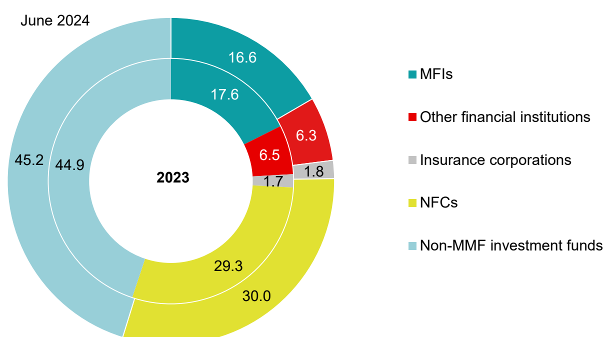
Concurrently, exposures to non-money market funds (MMF) investment funds also surged, with holdings rising by 6.0% to reach 45.2% of the overall equity portfolio.

Chart 4.19
MODIFIED DURATION OF THE PORTFOLIO
(per cent)



Source: Central Bank of Malta.

Chart 4.20
EQUITY HOLDINGS COMPOSITION OF DOMESTICALLY-RELEVANT INVESTMENT FUNDS
(per cent)



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

Focusing on geographical exposure, value of investment in domestic equities continued to decline, with holdings falling by 2.5%, primarily driven by the lower exposure to Maltese banks. As a result, the overall domestic share fell by 3.0 percentage points to 37.0% of the equity portfolio. Meanwhile, securities issued by other euro area entities grew by 6.4%, raising their overall share by 0.5 percentage points to 46.2%. Holdings of equities issued by US firms surged by 40.0%, reaching 11.3% of the total equity portfolio, the highest level recorded since 2016. The exposure to other countries remained limited to 5.5% of the overall holdings.

4.2.2 Investors

Maltese households remained the largest investors in domestically-relevant investment sub-funds, holding almost 55% of the net asset value (NAV). This represented an increase of 0.6 percentage points, while participation by domestic OFIs contracted by 1.2 percentage points to 22.2% (see Chart 4.21). Participations by other investors remained relatively contained, with domestic NFCs, insurance companies and banks accounting for

[9] Equity holdings include investment in other non-MMF investment funds.

8.0%, 7.2% and 3.2% of the overall NAV, respectively. The remaining 4.5% pertains to other investors, largely foreigners.

4.2.3 Liquidity and leverage

By June 2024, the overall liquidity ratio for domestically-relevant investment funds declined by 1.9 percentage to 61.2% of total assets (see Chart 4.22). This decline was primarily attributed to a larger allocation towards equities, for which a 50% factor is applied. Nevertheless, a substantial portion of the portfolios remained invested in high-rated corporate bonds and stocks. The level of cash and deposits remained contained at 2.6% of total assets, somewhat below the average since 2016.

During the first half of the year, redemptions increased by 0.5 percentage points to approximately 3.1% of the NAV, close to average levels since 2016. This was largely driven by a large outflow from one bond fund.

Meanwhile, leverage of domestically-relevant sub-funds remained limited with the AUM-to-NAV ratio standing at 100.6%, in line with previous years. This is partly because most of them are licensed and regulated under the UCITS Directive.[10]

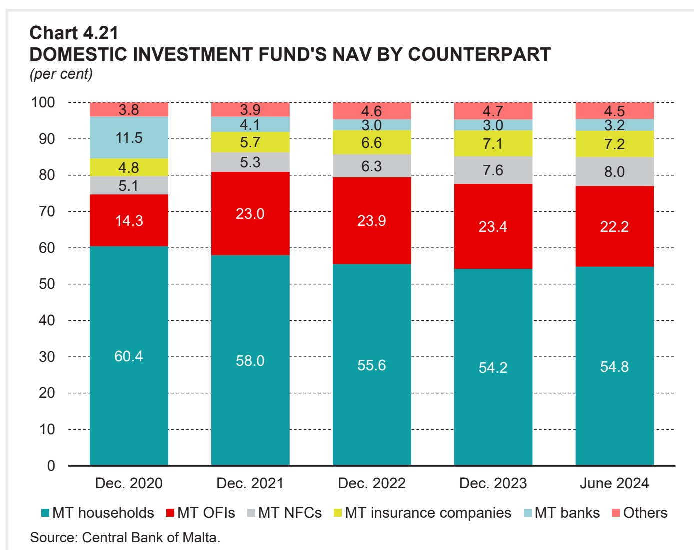


Chart 4.21
DOMESTIC INVESTMENT FUND'S NAV BY COUNTERPART
(per cent)
Source: Central Bank of Malta.

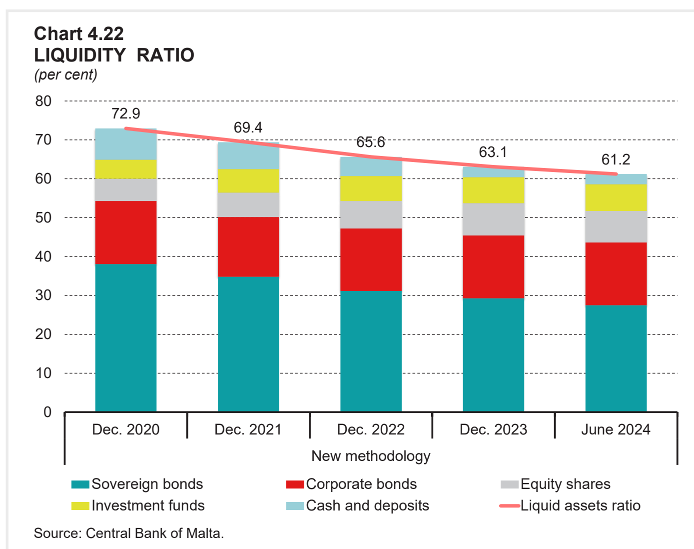


Chart 4.22
LIQUIDITY RATIO
(per cent)
Source: Central Bank of Malta.

4.2.4 Risk outlook

The market performance in the first half of 2024, with gains reported across both equity and bond markets, played a significant role in consolidating the recovery of domestically-relevant investment funds. Liquidity risks remained relatively contained, as entities maintained a large share of HQLA and continued to operate with low leverage levels. However, this sector is experiencing lower levels of cash and deposits. Some sub-funds have begun to adjust their allocations, reverting to levels closer to historical averages. Systemic risks are somewhat mitigated by the availability of liquidity management tools, such as redemption gates and fees. If in the short-term, fund managers gradually shift their strategies, to potentially increase both the modified duration and the share of longer-dated fixed-income securities, such a scenario would result in the funds becoming more exposed to interest rate volatility. Another potential risk could arise if the sub-funds continue to increase exposure to foreign equities, driven by expectations of positive performance despite ongoing economic uncertainties. This is likely to increase further risks driven by volatility and should the expected positive performance fail to materialise, sub-funds could face significant losses.

[10] UCITS Directive Article 83 restricts borrowing for retail to up to 10% of their assets and only on a temporary basis (as found in Directive 2009/65/EC of the European Parliament and of the Council).

The structural connection between most sub-funds and core domestic banks persists, as asset management companies are owned by these banks. However, these companies operate as distinct legal entities. Moreover, approximately 10% of the overall assets consist of investments in domestic financial companies, largely bonds and equities issued by core domestic banks. Domestic banks and insurance companies also hold investments in these sub-funds, with exposure of around 10% of the NAV. As a result, any potential losses incurred by domestically-relevant sub-funds could impact the banks' profitability, although such effects are not expected to be systemic.

BOX 3: AN INTRODUCTION TO PENSION FUNDS REGISTERED IN MALTA[1]

Introduction

Pension funds play an important role in ensuring financial security for households during retirement while contributing to the stability of the financial system. They also facilitate the efficient allocation of long-term capital across firms. As the population ages, pension funds are becoming increasingly important domestically, emphasising the need for sustainable retirement income. Pension funds pool contributions from individuals, employers or any other participants, and invest them in a diversified portfolio of assets with the aim to generate long-term returns. This approach provides retirees with a steady income stream, while simultaneously supporting economic growth, influencing capital markets, and contributing to financial market resilience.

The turbulence in the UK Gilt Market in late September 2022 underscored the significant role pension funds play as active market participants, demonstrating how the sector's development can potentially trigger and amplify market volatility during periods of financial stress. While the private pension system in Malta is still evolving, estimates from financial accounts data shows that these remained very limited at just 0.11% of overall financial assets.[2]

This Box aims to discuss the growth of Malta-registered pension funds, shedding some light on their potential financial stability implications.

Overview of the pension funds sector

Between 2019 (when pension funds data first became available) and 2024, the number of domestically registered pension funds remained roughly stable, amounting to 48 as at June.[3] Of these, 45 were classified as non-occupational schemes, which are set up independently with voluntary contributions that are not tied to any specific employment. The remaining three were categorized as occupational pension funds, which are provided by employers, with contributions made by both parties of the employment relationship. In terms of size, non-occupational pension funds hold most of the assets managed by the sector, standing at around 98.7% of the overall assets. All these funds are defined contribution (DC) pension schemes, where members contribute to a fixed amount or percentage of income to an individual account and the final benefit depends on the contributions made and the overall investment performance.[4]

Despite the limited developments in the number of pension funds registered, these still expanded their presence, both in terms of overall assets as well as participation.

Between 2019 and 2023, the sector registered over 25% increase in the number of members enrolled (see Chart 1). Growth, however, diverged among the composition of such members. Active individual members grew by 88.5%, to account for 46.0% of overall membership, from 30.7% in 2019. Retired members, being those receiving regular pension payments from the fund, also grew, up by 51.1% and accounted for 30.2% of overall members. In contrast, deferred members, who are those that stopped contributing but are yet to draw their pension benefits fell to account for around 23.8% of the overall members, compared to 44.3% in 2019.

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[1] Prepared by Mr Renan Dos Santos Carinha, Analyst, from the Financial Stability Surveillance Office. The author would like to express his gratitude to Mr Andrew Spiteri, Manager within the same office, and Ms Wendy Zammit, Head of the Financial Stability Surveillance and Research Department, for their invaluable suggestions.

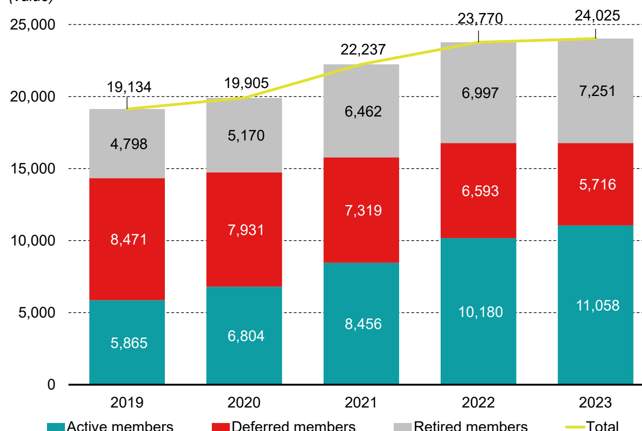
[2] Source: ECB.

[3] Out of these 48 pension funds, 46 are licenced as Retirement Schemes, with the remaining two licenced as Retirement Funds.

[4] Another type of fund commonly found in other EA countries is the defined benefit plan, which guarantees a specific retirement benefit, based on factors other than the investment performance. Nevertheless, there are no pension funds currently registered in Malta operating under this scheme.

The change in the composition of the members resulted in the active-to-retired members ratio rising from 1.22 in 2019 to 1.53 in 2023, suggesting the pension funds' increased ability to sustain payouts with ongoing contributions. Concurrently, the active-to-deferred ratio stood at 1.9, growing steadily since 2019. This also indicates that pension funds are increasingly reporting higher inflows of contributions compared to their future liabilities, which is the deferred pensions. By the end of 2023, about 85% of overall members were non-resident. Despite the limited domestic participation, since 2019, the number of domestic members has grown exponentially, up by more than eightfold. As a result, their share of the total membership has risen by 12.7 percentage points compared to 2019. This increase is driven by the growing interest in pension plans by domestic households, possibly also driven by the tax benefit schemes on offer.[5] The rise in domestic members was almost exclusively among active members, where just over a third are resident. In contrast, non-resident beneficiaries accounted for all the retired members and represented 98.1% of the total deferred policyholders. Nonetheless, it is worth noting that resident members are entirely concentrated in four pension funds, which currently have no retired members.

Chart 1
AMOUNT OF PENSION FUNDS MEMBERS BY TYPE
(value)

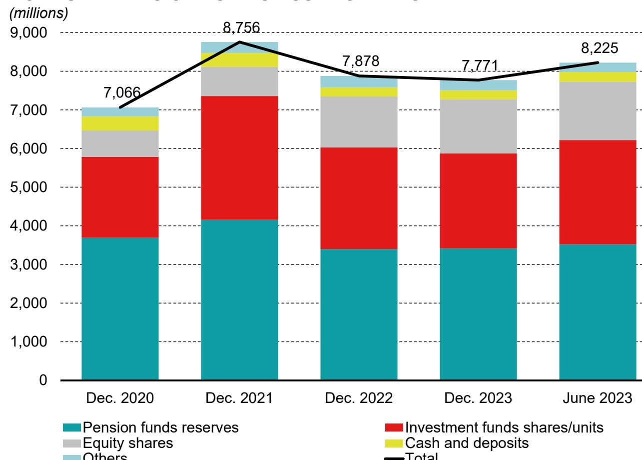


Source: Central Bank of Malta.

Assets and liabilities composition

The increased interest in pension funds in the last few years meant that their overall assets grew by nearly 20% between end 2019 and June 2024. Total assets under management (AUM) by the domestic pension funds reached over €8.2 billion in mid-2024, equivalent to around 38% of GDP (see Chart 2). Overall assets held by pension funds peaked in 2021 at €8.8 billion. In the subsequent two years the assets held by pension schemes declined owing to

Chart 2
DOMESTIC PENSION FUND'S ASSET SHARES
(millions)



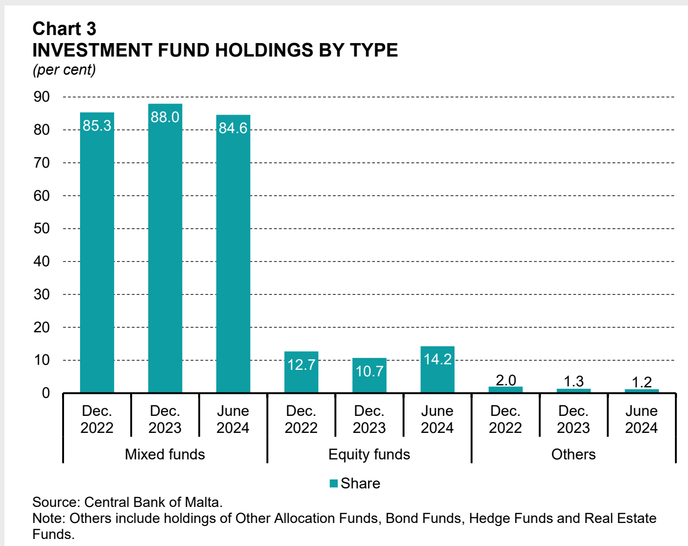
Source: Central Bank of Malta.

[5] An annual tax credit of 25% on a contribution ceiling of a maximum of €3,000 is available. This means that a maximum annual tax credit of €750 can be obtained. Source: Buying private pension retirement products.

the monetary tightening and the decline in financial markets. Nevertheless, recent results have demonstrated robust growth with the aim of recovering from the losses registered. As a result, the overall value of total assets expanded by 5.8% during the first half of 2024.

The composition of the overall assets remained relatively stable during the period assessed. Pension funds' reserves were consistently the main asset component, standing at 42.8% of overall assets by June 2024. These consist of a pool of assets which reflect the contributions, the investment returns and any adjustments due to market performance which are set aside to ensure that pension funds can meet their future obligations to retirees and other beneficiaries. Such reserves act as a safety net to manage the risk of underfunding, which could happen if contributions and investment returns are insufficient to cover future pension liabilities. These are followed by holdings of investment funds units which accounted for 32.8% of the balance sheet by June 2024. The vast majority were allocated towards non-MMFs categorized as mixed funds (see Chart 3). Equity sub funds followed with 14.2% as the remaining were limited to just 1.2% of the share.

Chart 3
INVESTMENT FUND HOLDINGS BY TYPE
(per cent)



Source: Central Bank of Malta.
Note: Others include holdings of Other Allocation Funds, Bond Funds, Hedge Funds and Real Estate Funds.

Meanwhile, direct equity exposures stood at 18.4% of the overall asset holdings as of June 2024. Cash and deposits represented just 3.0% of the total assets, while on aggregate, other assets such as loans granted, debt securities held, and non-financial assets remained together limited to around 3.0%.

Nonetheless, it is worth noting that although the direct holdings of debt securities were limited, the exposure of the pension fund sector to the fixed-income market remained present largely through the holdings of mixed investment funds units.

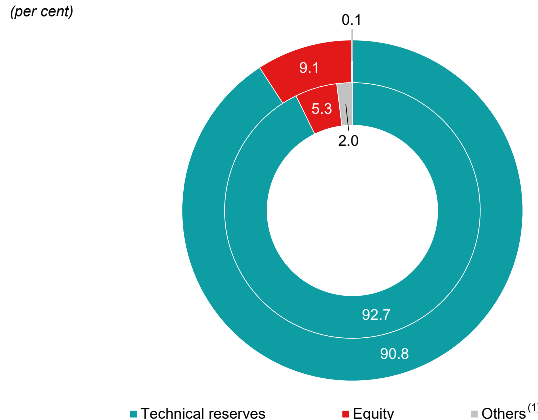
In terms of geographical exposure, the largest share of assets were securities issued by entities based in countries other than the euro area, the vast majority situated in British Crown Dependency territories, the United States and the United Kingdom, representing around 63% of the total assets by mid-2024. Parallel to that, euro area accounted for 25.4% of the overall assets. Meanwhile, domestic assets were limited to 12.0% of the overall portfolios, largely in equities.

Pension funds' technical reserves, which are the estimated present value amount required to cover future pension obligations to policyholders, account for most of the liabilities (see Chart 4). In line with the balance sheet developments, following the decline reported in 2022 and 2023, such reserves rose by 5.4% during the first half of 2024, accounting for 90.8% of total liabilities. The remaining 9.2% of liabilities consisted almost entirely of equities, which share increased during the period assessed.

Geographically, the largest part of technical reserves' entitlements was towards beneficiaries based in the euro area, which accounted for 40.0% of the total share. Entitlements from the rest of the

world represented 39.2% of all technical reserves, most notably with policyholders predominantly based in the United Kingdom. Concurrently, US residents represented 20.1% of the total technical reserves. Maltese beneficiaries were limited to 0.7% of the total entitlements.

Chart 4
COMPOSITION OF PENSION FUNDS LIABILITIES
(per cent)



Source: Central Bank of Malta.
(1) Loans, other payable.

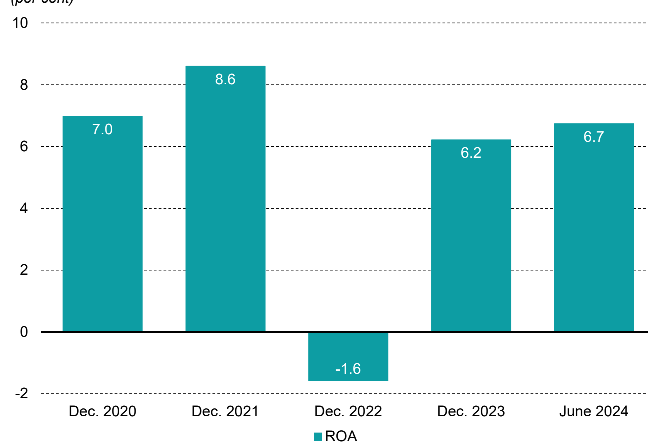
Key financial metrics for pension funds

This section introduces a number of metrics which are key for evaluating the financial health and performance of pension funds in meeting their long-term obligations to beneficiaries. These include the funded ratio, which compares the fund's total amount of assets to its liabilities. It indicates the fund's ability to meet its pension obligations. A ratio above 100% indicates that pension funds have a solid position to meet current and future obligations to their members. During the period assessed the funded ratio remained relatively stable, reaching 110% in June 2024. In comparison, pension funds in the euro area reported a higher funded ratio of 123%[6] for the same period.

When looking at the contribution-to-benefit ratio, which measures the balance between the contributions made into the fund by its active members to the benefits being paid out to its retired members, data for 2023 indicates a healthy ratio standing at 1.4. This ratio indicates that the flow of contributions significantly exceeded the benefits currently being paid out. During the first six months of 2024, the contribution-to-benefit ratio registered a slight increase to 1.5. These high ratios, however, also point to the fact that pension funds are still in their infancy, reflective of the fact that they have limited retirees.

Data available from 2020 shows that pension funds were generally profitable, as highlighted by the ROA, which is measured as the four-quarter moving sum of profits or losses as a share of the average AUM (see Chart 5). The only exception was in 2022. However, profitability quickly recovered

Chart 5
RETURN ON ASSET
(per cent)



Source: Central Bank of Malta.

6 Source: ECB.

along with the gains observed across financial markets by the end of the third quarter of 2023. By mid-2024 the ROA stood at 6.7%.

Meanwhile, the expense ratio,[7] which measures the evolution and performance of operating and management costs of pension funds as a proportion to their total assets, increased marginally since 2020, standing at 0.58% in June 2024. Such a level generally points towards moderate expenses.

The rate of return for pension funds is defined as:

$$Rate\ of\ Return = \frac{Net\ Return}{Beginning\ Value\ of\ Fund}\ x\ 100$$

Where: Net Return = Ending Value of Fund - (Beginning Value of Fund + Contributions – Withdrawals)

Using this metric, pension funds recorded a negative return of 2.8% for 2023, mainly reflecting lower valuations of overall assets coupled with net withdrawals. However, the positive performance of financial markets prompted a significant expansion in assets with the rate of return rising to 4.6% in the first half of the year.

Liquidity

The primary liquidity risk for pension funds arises from the potential inability to meet short-term obligations, particularly benefit payments, without the risk of selling assets at a loss due to insufficient liquidity. However, in June 2024, the aggregate indicators such as the active-to-retired members and the contributions-to-benefits ratio support a positive outlook for the sector in the medium term. In addition, assets are primarily composed of relatively liquid assets, including technical reserves, investment funds units, and shares.

Outlook

The consistent growth in membership and assets of domestically-registered pension funds underscores the sector's resilience and its potential for further development. While most members were non-residents, the share of resident members has been steadily increasing throughout the years. This presents a promising opportunity for ensuring financial security in retirement, particularly in the face of an ageing population and increasing demand for sustainable income solutions, serving as another important component for the broader social safety net.

Positive metrics, such as the funded ratio and contribution-to-benefit ratio, indicate that the funds are well-positioned to meet their obligations. The challenges posed by market volatility, as seen in recent years, highlight the necessity for prudent investment strategies and regulatory analysis. With units in investment funds comprising more than a third of total assets, pension funds need to keep watch for potential exposures to risks and vulnerabilities originating from the funds industry, such as liquidity mismatches and leveraged portfolios. The profitability and the rate of return has started increasing again, consolidating the rebound of the sector from the losses experienced in previous periods.

As the private pension system continues to mature, accompanied by increased domestic participation, ongoing monitoring of the key indicators is essential in assessing this sector long-term stability and sustainability in Malta.

[7] The expense ratio includes expenditures listed as administration expenses, investment advisory fees, investment management expenses, legal and professional fees, bank charges, custodian fees, and trustee expenses. It does not include disbursements listed as taxation and other expenses.