BOX 1: IMPACT OF CRR3 ON MALTESE BANKS' RISK WEIGHTS[1]

Introduction

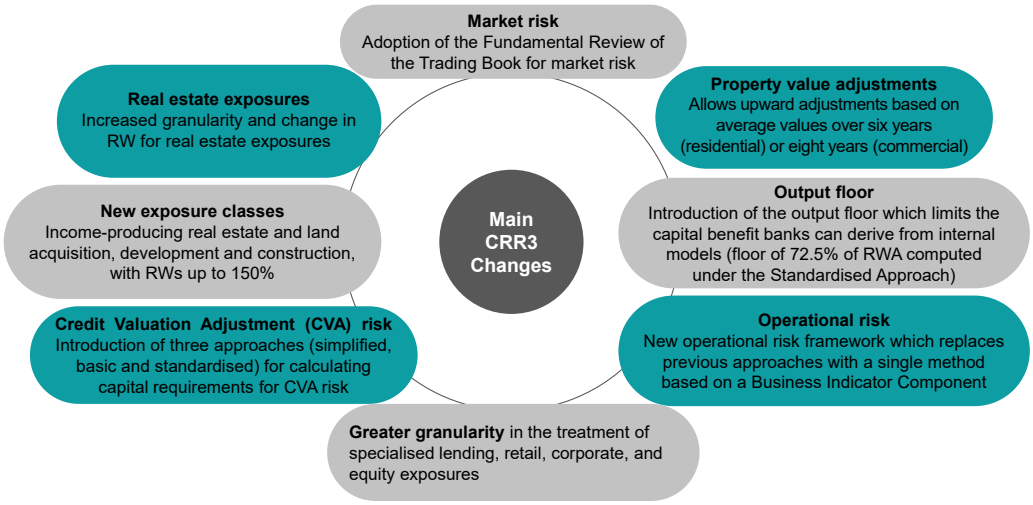
On 1 January 2025, the revised CRR3 came into effect as part of the EU legislative landscape, marking a pivotal step in finalising the Basel III reforms. These changes aim to strengthen the resilience of the banking sector via, *inter alia*, updates in supervisory reporting requirements, revised approaches to market and operational risk, as well as refinements on how banks quantify their capital requirements, particularly for credit risk.

Against this backdrop, the purpose of this boxed article is to explore in greater depth the changes in RWA reported by banks in the calculation of capital requirements, focusing on credit and operational risk. The analysis evaluates differences in impact across banks attributed to the new rules. In particular, the analysis aims to evaluate the impact on the overall capital position by measuring the extent to which risk weights (RWs) have shifted relative to total assets.[2] A key focus is to determine whether these updates have materially affected banks' capital levels. This examination is especially relevant in the context of macroprudential policy space, and in light of potential refinements or the introduction of new macroprudential tools.

Overview

Figure 1a below outlines the key changes to the revised Regulation, in particular those of direct relevance to the revised quantification of capital. For the purposes of this summary, the focus is limited to selected regulatory changes with direct implications for financial stability. Broader reforms, such as those concerning Environmental, Social and Governance (ESG) risk, data architecture, and reporting frameworks, are not addressed here but remain critical components of the overall CRR3 package.

Figure 1a
MAIN CHANGES EMANATING FROM CRR3



[1] Prepared by Ms Dominique Tanti, Principal Economist within Macroprudential Policy, Stress Testing and Research Department. The author would like to thank Ms Christine Balzan, Head; Mr David Stephen Law; Mr Pedro Polvora, Principal Economist and Mr Alan Cassar, Chief Officer Financial Stability and Statistics Division, for their valuable suggestions.

[2] The impact on RWs is calculated as a ratio of RWA to Total Assets of the total domestic banking system and is referred to as the effective RW or risk density.

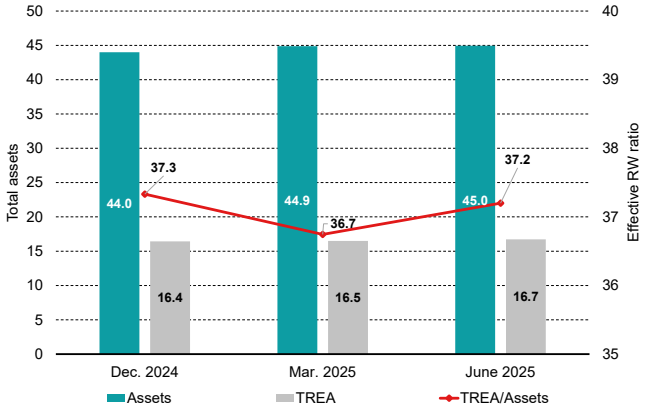
Credit risk remains the main source of risk for domestic banks in Malta and consequently, the majority of their RWA are held against such risk. In light of this, the following section will underscore this development by outlining quantitatively the impact of CRR3 comparing data for December 2024 (CRR2) with June 2025 (CRR3). Furthermore, the analysis is conducted at the consolidated level (rather than solo level) to ensure consistency with capital ratio calculations.

Deep dive into changes to the effective RWs

Overall effective RW decreased slightly with a heterogeneous impact across risk classes.

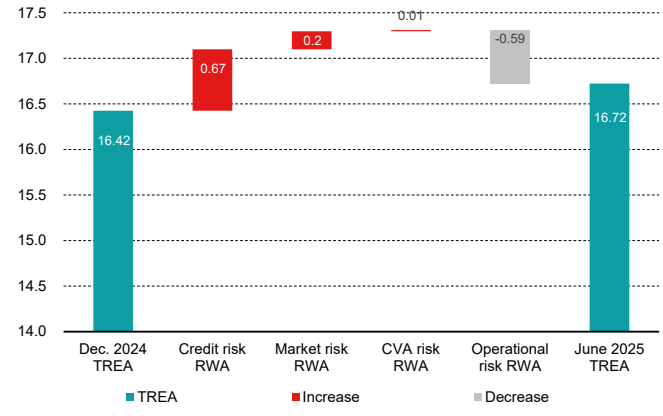
Chart 1a illustrates a consistent upward trend in both Total Assets and the Total Risk Exposure Amount (TREA); also referred to as RWA, for Maltese banks over the observed period. This reflects continued expansion in the sector's balance sheet and associated risk exposures. Concurrently, the RWA-to-Assets ratio – depicted by the line graph – declined modestly from 37.3% in December 2024 to 36.7% in March 2025, before stabilizing at 37.2% in June 2025. This marginal decrease in the ratio suggests a slight reduction in overall risk density, primarily attributable to asset growth marginally outpacing the increase in risk-weighted exposures. Indeed, upon further investigating the evolution in TREA specifically within key risk categories, this overall movement is the result of offsetting shifts across the risk classes as seen in Chart 1b. The composition of these changes highlights a rebalancing of risk (given by changes in corresponding RWs) within the sector, with rising credit and market exposures partially offset by reduced operational risk.

Chart 1a
DEC. 2024 TO JUNE 2025 – EVOLUTION OF BANK ASSETS AND RISK EXPOSURE RATIO
(EUR billions; per cent)



Source: Central Bank of Malta

Chart 1b
DECOMPOSITION OF TREA CHANGES BY RISK CLASS – TOTAL BANKING SECTOR
(Eur billions)

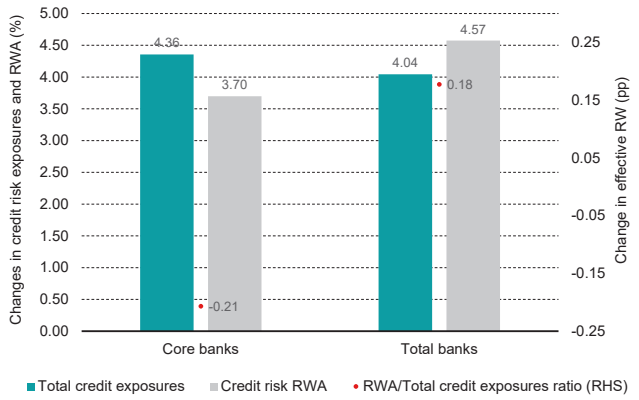


Source: Central Bank of Malta.

Change in RWA for credit risk

Given that credit risk and operational risk are the principal drivers of changes in TREA, a more granular analysis of the underlying factors for both core and total banks, is warranted. In this context, Chart 1c provides a breakdown of the evolution in Credit Risk RWA by examining the changes in total credit exposures, RWA held against Credit Risk, and the resulting effective RW. This comparative view helps to isolate to the extent possible, the impact of portfolio shifts and regulatory adjustments on credit risk metrics from other developments.

Chart 1c
DEC. 2024 TO JUNE 2025 CHANGES IN CREDIT RISK EXPOSURES AND RWA, AND THEIR RATIO
(per cent; percentage points)



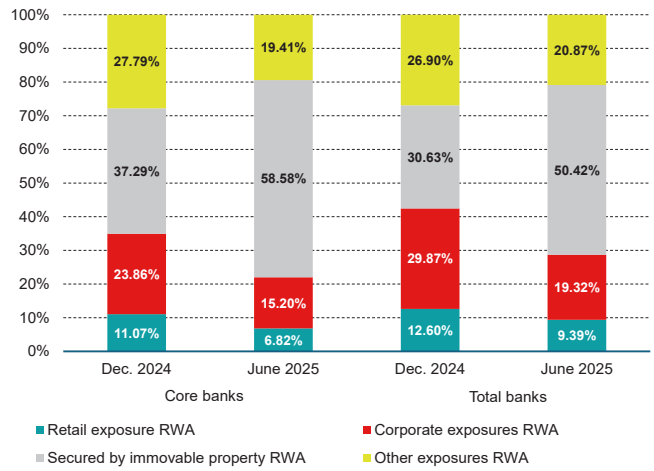
Source: Central Bank of Malta.

As outlined in Chart 1c, while core banks registered a drop of 0.21 percentage points in the effective RW, total banks recorded an increase in 0.18 percentage points.

Figure 1b below goes a step further and provides a detailed breakdown of the evolution in the composition of credit risk across key exposure classes for domestic banks, comparing the regulatory periods prior to and following the implementation of CRR3 (i.e. December 2024 vs. June 2025). This

Figure 1b
DEEP DIVE IN THE EVOLUTION OF CREDIT RISK ACROSS KEY EXPOSURE CLASSES

DEC. 2024-JUNE 2025 SHARES OF CREDIT RWA, BY EXPOSURE TYPE



Core banks
Secured by Immovable property exposure class –

- ⬆ Eur 2.58bln in RWA

Decomposed into:

- ⬆ Eur 1.57bln via assets
- ⬆ Eur 1.01bln via effective RW

Total banks
Secured by Immovable property exposure class –

- ⬆ Eur 3.00bln in RWA

Decomposed into:

- ⬆ Eur 1.79bln via assets
- ⬆ Eur 1.20bln via effective RW

breakdown aims to identify shifts within these exposure classes and uncover the underlying factors driving changes in RWA held against credit risk.[3]

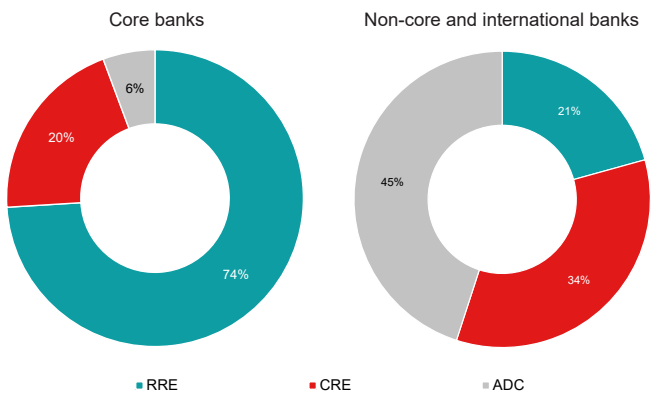
A notable development is the significant increase in the share of risk-weighted exposures classified as *secured by immovable property* (SIP), observed across both core and total banks. This shift is primarily attributable to two factors:

1. **Reclassification of exposures:** The enhanced granularity introduced under CRR3 has led to the reclassification of certain exposures which are now classified under SIP. This includes the classification of exposures previously reported under the *retail and corporate* categories, as well as items classified under the *SIP* new sub-classification of *Land Acquisition, Development, and Construction* (ADC).

2. **Changes in RWs:** CRR3 has also introduced revised RWs for RRE and CRE exposures, as well as a new classification for ADC. For core banks, this has resulted in a higher effective RW for loans secured by immovable property. This is mainly because a significant portion of RRE loans, have loan-to-value (LTV) ratios between 55% and 70%, which now attract RWs of 75% or 100%, (depending on the counterparty), compared to the previous uniform weight of 35%. Similarly, CRE loans with LTVs below 50% now carry a RW of 60%, up from 50%. Moreover, CRR3 has introduced a new exposure category – income producing real estate (IPRE) – which carries significantly higher RWs. Under this classification, RRE exposures may attract RWs of up to 105%, while CRE exposures may be subject to RWs of up to 110%.

   These changes have collectively contributed to an increase in the RWA for the SIP exposure class for core banks by €2.58 billion (see Chart 1d). When considering the entire banking system, this increase rises slightly to €3.00 billion. As illustrated in the pie charts below, the primary factor driving the increase in RWA for non-core and international banks differs from that of core banks. For the former institutions, the inclusion of ADC exposures, which carry a RW of up to 150%, is the main contributor. ADC exposures now account for approximately 45% of total exposures within this class for non-core and international banks. This shift has resulted in a reclassification from the previously assigned exposure class, *'items associated with particularly high risk'*.

Chart 1d
SHARE OF SECURED BY IMMOVABLE PROPERTY EXPOSURES
(per cent)



Source: Central Bank of Malta.

[3] The relative contributions to changes in the effective RW were estimated using a Fisher decomposition which attributes the relative change in RW density to the proportional contributions of changes in RWAs and total assets. This is done by expressing the density as a multiplicative function and isolating each component's effect through log-differentiation.

Table 1a summarises the impact of reclassification of exposures and changes in RWs on the overall RWA pertaining to credit risk for core banks.

Between December 2024, and June 2025, total RWA for credit risk increased modestly from €11.01 billion to €11.41 billion, a net rise of €0.4 billion. This increase was primarily driven by a €0.48 billion positive contribution from asset growth, which more than offset a €0.07 billion negative contribution from declining effective RWs.

A notable shift occurred within the SIP category, where RWA rose significantly from €4.10 billion to €6.69 billion. This increase was supported by both a reallocation of exposures from the retail and corporate segments and a rise in the effective RW for the SIP class. The SIP category alone contributed €1.01 billion via RWs and €1.57 billion via asset growth.

Conversely, the retail and corporate exposure classes experienced declines in RWA, largely due to the above-mentioned asset reallocation. While both categories showed small positive contributions from RWs (+€0.02 billion and +€0.26 billion, respectively), these were outweighed by substantial negative contributions from asset reductions (−€0.46 billion and −€1.15 billion, respectively).

The “Others” category, which accounts for over half of total credit exposures, also saw a decline in RWA – from €3.06 billion to €2.22 billion. This was primarily driven by a significant drop in effective RW (−€0.83 billion), as a result of the shift of ADC exposures (carrying a 150% RW) from the ‘others’ exposure class to the SIP, offsetting the positive contribution of the effective RW in the retail, corporate, and SIP on their corresponding RWA class.

Overall, the observed changes in RWA reflect a combination of compositional shifts and asset reclassifications, particularly the contraction in the ‘others’ category (which consists of over 50% of total credit exposures) and which thus played a key role in the observed change in the system’s aggregate credit risk profile over the period.

Table 1a
EXPOSURE COMPOSITION AND RWA ANALYSIS FOR CORE BANKS – DEC. 2024 VS JUNE 2025

Per cent; EUR billions

	Dec. 2024	June 2025	Dec. 2024	June 2025		
Exposure Class	Share of total credit exposures	Share of total credit exposures	RWA	RWA	Relative contribution from RW[2]	Relative contribution from total assets[2]
Retail	5.0%	3.0%	1.22	0.78	0.02	-0.46
Corporate	9.7%	5.4%	2.63	1.73	0.26	-1.15
SIP[1]	30.3%	39.1%	4.10	6.69	1.01	1.57
Others[3]	55.0%	52.5%	3.06	2.22	-0.83	-0.01
Overall	100.0%	100.0%	11.01	11.41	-0.07	0.48

Source: Central bank of Malta.

[1] SIP is referring to Secured by Immovable Property Exposures

[2] RW Effect and Asset Effect represent the relative contributions (in billions) to the change in RWA based on the Fisher decomposition. Positive values indicate a positive contribution towards the RWA change.

[3] The largely dominant factor in the reduction of effective RW is the reclassification of ADC exposures from the high-risk class (under the 'others' category) to SIP. These carry a 150% RW and in Dec. 2024 had accounted for 28% of the 'others' RWA albeit accounting for only 3% of 'others' assets. Excluding this reclassification, the 'others' category (consisting of over 70% of its exposures with central government and institutions) would have remained with very similar RWA and total assets (given that RWs remained similar) between December 2024 and June 2025.

RWA held against operational risk

As observed above, a decline in RWA for operational risk was observed between December 2024 and June 2025. As outlined earlier, the implementation of CRR3 introduced a new methodology which replaces all previously used approaches.[4]

Under CRR3, a single Standardised Approach is applicable to all institutions. This new framework is based on the Business Indicator Component (BIC), which is computed from financial statement data including interest income, fee income, and trading income.[5] The BIC is then mapped to one of three regulatory buckets, each with a corresponding coefficient:

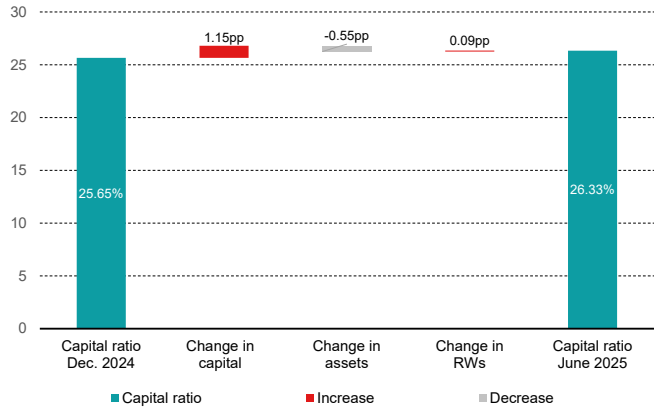
- 12% for BIC ≤ €1 billion
- 15% for BIC between €1 billion and €30 billion
- 18% for BIC > €30 billion

A comparative analysis of data from December 2024 to June 2025 reveals that, despite a 6.28% increase in the sector-wide BIC, the own funds requirement for operational risk fell by 27% over the period. This reflects a dual effect: an 8% increase in RWAs due to the higher indicator base component, offset by a 35% reduction resulting from the lower regulatory coefficient. The majority of banks fell within scope of the 12% bucket, as opposed to their previous position falling within the 15% category. As a result of these developments, operational risk RWAs registered a net decline.

An analysis into the banks' capital ratio

Chart 1e decomposes the sources of change in the capital ratio following the introduction of the new CRR3 provision. This decomposition therefore reflects changes in capital, total assets, and RWs.[6] The biggest contribution stems from the increase in capital, which led to a 1.15 percentage points rise in the capital ratio.[7] Conversely, the growth in total assets exerted downward pressure on the ratio, resulting in a negative contribution of -0.55 percentage points. Lastly, when isolating the effect of changes in RWs – excluding other balance

Chart 1e
CHANGE IN CAPITAL, ASSETS AND RWs IMPACTING BANKS' CAPITAL RATIO – TOTAL BANKING SECTOR
(per cent; percentage points)



Source: Central Bank of Malta.

[4] The previous approaches include: the Basic Indicator Approach (BIA), which applied a flat 15% regulatory coefficient, the Standardised Approach, which segmented activities by business lines with coefficients ranging from 12% to 18%, depending on the associated risk level; the Advanced Measurement Approach (AMA). In Malta, the majority of banks had adopted the BIA, whilst only a few followed the Standardised Approach. To note that under the BIA approach, the relevant indicator comprises of the sum of NII, net fee and commission income, trading result, and other operating income.

[5] Under the BIC approach, the relevant indicator comprises of the three-year average of Interest, lease, and dividend income, Services income and Financial income.

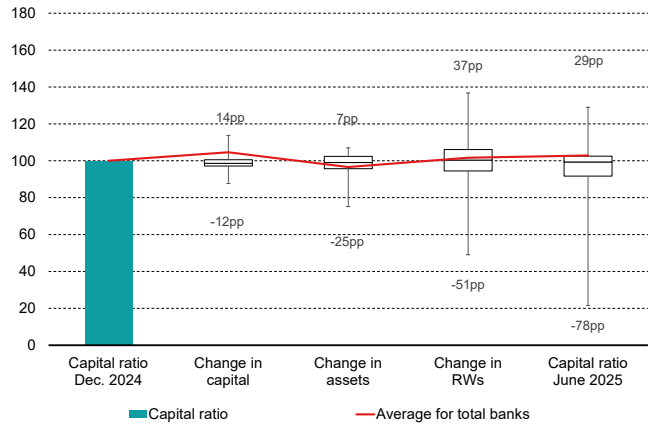
[6] The relative contributions to changes in the capital ratio were estimated using a first-order Taylor expansion, which linearly approximates the capital ratio as a function of capital, total assets, and RWs by computing the partial derivatives with respect to each variable and multiplying them by their respective changes.

[7] Main driver behind the increase in capital is issuance of Tier 2 instruments (in the form of bonds, tier 2 notes and subordinated loan) amounting to 195 million, registering an increase of 36% over December 2024.

sheet movements – these declined slightly, thereby contributing positively to the capital ratio by 0.09 percentage points.

The impact on domestic banks has been heterogenous. As illustrated in Chart 1f, on average, changes in capital contributed positively, with quite a narrow dispersion among banks; however, the impact on RWs was quite varied, indicating substantial differences in risk profile recalibrations. This divergence helps explain the overall neutral impact on RWs for total banks.

Chart 1f
BOX PLOT OF CHANGES TO BANKS' CAPITAL RATIO
(Index: Capital Ratio Dec. 2024=100, percentage points)



Source: Central Bank of Malta.

Banks remain with solid capital buffers

Banks' voluntary capital buffers remained robust, increasing on average by 0.87 percentage points – from 5.90% to 6.77%. This improvement reflects two key drivers: an increase in banks' capital levels and a reduction in overall RWs stemming from changes introduced under CRR3.

Concluding remarks

The implementation of CRR3 has introduced a more granular and risk-sensitive framework for calculating capital requirements, particularly under the Standardised Approach for credit risk, among other topical developments. These refinements are expected to enhance the responsiveness of capital metrics to underlying risk changes and improve comparability across institutions.

The impact of CRR3 has been heterogeneous across banks, reflecting differences in portfolio composition, business models, and exposure to ADC-type lending. Credit risk exposures, particularly exposures under SIP exposure class have nonetheless increased considerably, driven by: (i) reclassification of exposures from the retail and corporate categories to the SIP class; (ii) the introduction of the ADC exposure class, now included within the immovable property category and subject to higher RWs (up to 150%).

This shift, together with the revised RW treatment for real estate exposures under CRR3, has significantly elevated the RWA for the immovable property class, particularly among non-core banks. These developments are relevant for the upcoming extension of the sSyRB, which will be targeting this newly classified category for immovable property.

Even though the RWs within the SIP class have increased and contributed positively to the increase in RWA for its own class, its impact on overall credit risk effective RW has been partly offset by the reclassification of exposures from higher RW exposure classes (namely retail and corporate classes) to those attracting lower RWs. Furthermore, the drop in the effective RW for the "Others" category, which accounts for over half of total credit exposures, helped in offsetting the positive contribution of the effective RW in the retail, corporate, and SIP on their corresponding RWA class, thus leading to a negative effective RW for total credit risk.

Nonetheless, while the overall effective credit RW has declined for core banks and increased slightly for total banks, the overall impact on Maltese banks' capital ratios and voluntary buffers has been muted, with voluntary buffers remaining strong.

From a strategic perspective, the CRR3 amendments are expected to support banks in continuing to maintain adequate capital levels, particularly in the face of emerging sectoral or niche risks. The enhanced risk sensitivity of the framework should enable more timely and targeted supervisory responses, thereby contributing to the overall resilience of the financial system.