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INTERIM FINANCIAL STABILITY REPORT 2018

The *Interim Report* covers the first six months of 2018 and evaluates developments which may impact the resilience of the domestic financial system since the publication of the *Financial Stability Report* 2017. It also analyses whether any new risks have emerged.[1] The *Interim Financial Stability Report* is prepared by the Financial Stability Department and is subsequently reviewed and endorsed by the Financial Stability Committee of the Central Bank of Malta.

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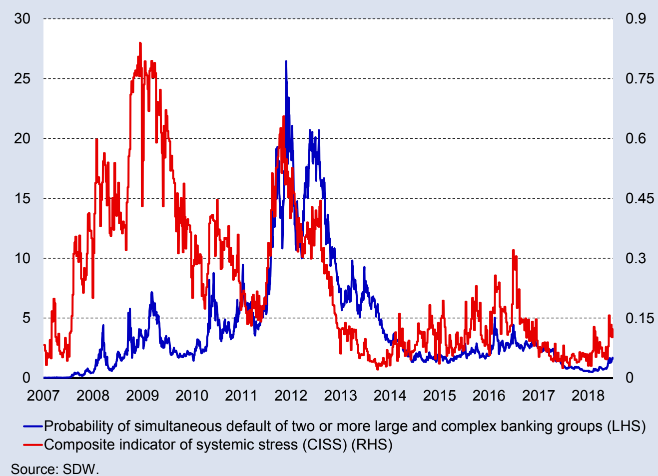
Introduction

Risks to the euro area financial system have remained broadly unchanged during the first half of 2018, as the more broad-based economic expansion supported financial stability. Headline inflation picked up pace, and as a result the European Central Bank (ECB) continued to reduce its monthly net purchases under the Asset Purchase Programme (APP), which is planned to be phased out by the end of the year. Still, the ECB is expected to maintain its key policy interest rates unchanged at least through the summer of 2019. The persistently-low interest rate environment coupled with improved economic developments have aided in lowering financing costs, though sovereign and private debt levels are still elevated for some euro area countries, raising sustainability concerns.

Geopolitical uncertainties stemming from a potential disruptive hard Brexit, concerns on weak fundamentals of the Italian economy and stress in emerging markets gathered momentum. Furthermore, rising interest rates in the United States and an appreciating US dollar coupled with trade tensions could potentially affect market sentiment and trigger an abrupt reassessment of global risk premia. Indeed, episodes of heightened market volatility were reflected in the Composite Indicator of Systemic Stress (CISS), but still remained somewhat relatively contained compared to earlier periods of stress (see Chart 1).

Chart 1
SYSTEMIC RISK INDICATORS



Source: SDW.

On the domestic front, potential risks from a disruptive hard Brexit have been assessed to be manageable.[2] Direct exposures to emerging market economies are concentrated in a small number of international banks, which apart from having no links with the domestic economy, also took measures to mitigate any undue risk. Exposures to Italy amounted to just 0.7% of the banking sector's assets, limiting any direct contagion effect

[1] The cut-off date for the analysis is 6 September 2018.

[2] Estimates by the Central Bank of Malta indicate that under a scenario akin to a hard Brexit the loss in output is projected to be of just over half a percentage point. https://www.centralbankmalta.org/file.aspx?f=51540

from possible adverse developments. Favourable economic developments contributed to improvements in debt sustainability. Public debt as a share of gross domestic product (GDP) declined to 49.6% by June 2018, while the general government balance remained in surplus at 3.9% of GDP.[3] Furthermore, private sector debt stood at about 120% of GDP in June 2018, significantly lower than the euro area average of about 140%.

The Maltese financial system has reinforced further its resilience, supported by continued robust economic growth. Core domestic banks, which cater mostly for the local economy, have continued with their de-risking process and concurrently strengthened further their capital buffers. These banks continued to operate with ample liquidity, while remaining profitable, in line with their European peers. Systemic risks arising from non-core domestic and international banks remained contained, also on the back of strong capital and liquidity levels. The domestically-relevant insurance companies continued to report positive underwriting performance and maintained capital levels well-above the regulatory minima. Risks stemming from the domestically-focused investment funds remained in-check reflecting their conservative investment strategies.

Credit growth continued to gradually gather momentum as loans to resident non-financial corporates (NFC) rose for the first time since 2014 whilst corporates continued to tap the local capital market for funding and also used internal funds. At the same time, growth in mortgages slowed down slightly to 7.8% in June 2018 from 8.2% in December 2017, but remained the main driver of credit growth.

Compared to a year ago, house prices decelerated while dwelling construction permits continued to rise. Results from the Real Estate Market Survey conducted by the Central Bank of Malta covering the first half of the year indicated that around three-fourths of real estate agents perceived property prices to be correctly-priced. Furthermore, the positive labour market developments have supported borrowers' repayment capabilities, which coupled with the banks' conservative lending practices continued to attenuate any potential risks to the domestic banking sector.

On balance, risks to financial stability in Malta remained broadly unchanged. Table 1 presents the key vulnerabilities of the domestic financial sector highlighting the changes in risk levels since the *Financial Stability Report* 2017 and provides an outlook for the second half of 2018.

Table 1
SUMMARY OF RISKS

Main vulnerabilities and risks for the financial system	Type of risk	Nature of risk	Change in risk level since FSR 2017	Risk assessment for 2018 H2
Vulnerabilities within the financial system				
The level of non-performing loans	Credit	Cyclical/ Structural	↔ (Medium)	↓ (Moderate)
Concentration in bank lending	Credit	Structural	↔ (Moderate)	↔ (Moderate)
Subdued credit developments	Profitability	Structural	↓ (Medium)	↔ (Medium)
Interlinkages between banks and the non-bank financial sector	Contagion	Structural	↔ (Moderate)	↔ (Moderate)
Vulnerabilities outside the financial system				
Domestic macroeconomic developments	Credit/Profitability	Cyclical	↔ (Moderate)	↔ (Moderate)
Performance of key economic sectors reliant on bank credit	Credit	Cyclical/ Structural	↓ (Moderate)	↔ (Moderate)
Real estate market developments	Credit/Contagion	Cyclical	↔ (Moderate)	↔ (Moderate)
Exposures of the financial sector to domestic sovereign securities	Profitability	Structural	↔ (Moderate)	↔ (Moderate)
Economic conditions in the euro area and public debt sustainability	Credit/Profitability	Cyclical	↔ (Medium)	↑ (Medium)
Geopolitical uncertainties	Contagion	Structural	↑ (Medium)	↑ (Medium)
Prolonged low interest rate environment	Profitability	Cyclical	↔ (Moderate)	↔ (Moderate)

Risk position		Direction of risk	
Moderate	(yellow)	Increased risk	↑
Medium	(orange)	Stable risk	↔
Elevated	(red)	Decreased risk	↓

[3] Government balance is estimated on the basis of a four-quarter moving sum.

Domestic Regulatory Developments

Countercyclical Capital Buffer (CCyB)

Cyclical risks remained under control with the credit-to-GDP gap remaining in negative territory supporting the Macroprudential Authority's decision to maintain the CCyB rate at 0%.[4] The relevant credit-to-GDP gap ratio and the deviation from its long-term trend stood at 77.1% and -23.7pp, respectively for the first half of 2018.[5] The qualitative and quantitative assessments carried out by the Bank do not indicate signs of excessive credit growth and the CCyB rate of zero was retained.

Public consultation on borrower-based measures

On the initiative of the Joint Financial Stability Board, during the first half of the year, the Central Bank of Malta in consultation with the Malta Financial Services Authority undertook analysis and drafted a policy on borrower-based measures. This work culminated in the launch of a public consultation on a proposed Directive on borrower-based measures.[6,7] The draft Directive refers to the deployment of macroprudential limits on mortgages in the form of borrower-based measures given that these will enhance the resilience of banks and household balance sheets to possible house price corrections and interest rate reversals.

Identification of material third countries

As per ESRB Recommendation 2015/1, the Central Bank of Malta identifies annually the third countries which are material to the domestic banking system.[8] In line with the methodology specified in Article 4 of the ESRB Decision 2015/3, for the period Q2 2018 till Q2 2019, the Central Bank of Malta identified United Arab Emirates, Russia, Turkey and the United States of America as material third countries for the Maltese banking system.

MIFID II and MIFIR

The legislative texts of Directive 2014/65/EU3 (MiFID II) and Regulation (EU) No 600/2014 (MiFIR) were approved by the European Parliament on 15 April 2014 and by the European Council on 13 May 2014. MIFIR became binding from 3 January 2017 whilst MIFID II has been transposed in national legislation, where the effective date was 3 January 2018.

The changes introduced by MIFID II and MIFIR include transparency requirements for a broader range of asset classes; the obligation to trade derivatives on-exchange; requirements on algorithmic and high-frequency-trading and new supervisory tools for commodity derivatives. Protection for retail investors is also strengthened through limits on the use of commissions; conditions for the provision of independent investment advice; stricter organisational requirements for product design and distribution; product intervention powers and the disclosure of costs and charges.

Amendments to the domestic insolvency hierarchy

In 2017, the EU has adopted Directive (EU) 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy ('the Directive'). Member States are required to transpose the Directive by 29 December 2018. In view of this, the MFSA initiated the necessary process to amend Article 29A of the Banking Act (CAP. 371) by means of a public consultation process that was concluded on 16 March 2018. The proposed amendments to Article 29A of the Banking Act (CAP. 371) include the following:

- Priority ranking of the Resolution Fund with respect to any contributions not paid by a credit institution which has been declared insolvent
- A new sub-article to Article 29A introducing the new class of unsecured claims arising from debt instruments having specific features.

[4] Refer to: https://www.centralbankmalta.org/countercyclical-capital-buffer

[5] Central Bank of Malta. Source: https://www.centralbankmalta.org/countercyclical-capital-buffer

[6] Financial Stability Notifications and Consultations: https://www.centralbankmalta.org/notifications

[7] The closing date of the consultation was 24 October 2018.

[8] Recommendation of the ESRB of 11 December 2015 on recognising and setting countercyclical buffer rates for exposures to third countries (ESRB/2015/1). Source: https://www.esrb.europa.eu/pub/pdf/recommendations/2016/Recommendation_ESRB_2015_1.pdf

Virtual Financial Assets Framework

The Virtual Financial Assets (VFA) Framework, which has been published for consultation in the first half of 2018, is made up of four pillars: i) VFA Act, ii) VFA Regulations, iii) VFA Rulebook and iv) Guidelines. The Virtual Financial Assets (VFA) Act (Cap 590) was enacted by an Act of Parliament on 4 July 2018. The Act entered into force on 1 November 2018. The Act will only apply to distributed ledger technology (DLT) assets qualifying as virtual financial assets.[9] As per the Act, a Virtual Financial Asset is defined as any form of digital medium recordation that is used as a digital medium of exchange, unit of account, or store of value and that is not i) electronic money ii) a financial instrument and iii) a virtual token. Whilst the Act sets out the high level principles for the regulation of Initial VFA Offerings and Virtual Financial Assets, the Regulations are aimed at providing more granularity, particularly with respect to exemptions, fees, control of assets and administrative penalties and appeals. On the other hand the VFA Rulebook will provide detailed regulation applicable to VFA Agents, Issuers of VFA and VFA Service Providers.

National International Monetary Fund (IMF) Financial Sector Assessment Program (FSAP)

Following a request by the Maltese Government, the IMF initiated Malta's FSAP procedure with a Scoping Mission starting on the 20 March 2018 and lasting for three days.[10] The FSAP is an exercise conducted by the IMF to comprehensively analyse a country's financial sector and the findings ultimately contribute to a broader analysis in Article IV consultations. A number of public and private sector stakeholders were involved in the exercise. The IMF FSAP on-site mission ended on 26 September 2018 and the assessment is expected to be concluded early next year.

Prevention of money laundering

In December 2017, Malta enacted legislation to fully transpose the European Union's Fourth Anti-Money Laundering Directive into national legislation. The Fourth Anti-Money Laundering Directive, which came into force on 1 January 2018, revises and improves upon the Third Anti-Money Laundering Directive and incorporates the latest Financial Action Task Force (FATF) Recommendations in the field of anti-money laundering and counter-terrorist financing.[11,12] This Directive has been transposed into Maltese law by virtue of amendments to the Prevention of Money Laundering Act (PMLA), the enactment of new regulations under said Act, and through the publication of various regulations intended to set up beneficial ownership registers for companies, trusts, associations, foundations and other legal entities. These legislative enactments aim to further strengthen the Maltese legal regime for combating money laundering and funding of terrorism through a number of concrete measures. Among these, the PMLA provides for the setting up of the National Coordinating Committee on Combating Money Laundering and Funding of Terrorism (NCC) to be in charge of defining, overseeing and coordinating the implementation of the national AML/CFT strategy. The national AML/CFT strategy was published in April 2018 with the objective to strengthen Malta's AML/CFT framework including the national institutional framework to prevent, detect and deter money laundering and terrorism financing. This strategy is based on the findings of an update of the National Risk Assessment (NRA) of 2015 including a rigorous gap assessment of Malta's AML/CFT framework. It is composed of seven key initiatives, broken down into approximately 50 actions, to be implemented by 2020.[13]

International Regulatory Developments

ESRB Recommendation 2017/6 on liquidity and leverage risks in investment funds

In February 2018, the ESRB issued Recommendation 2017/6 to promote a common framework for addressing systemic risks associated with liquidity mismatches and the use of leverage in investment funds.[14] This Recommendation is addressed to European Securities and Markets Authority (ESMA) and the European

[9] There are four different categories of distributed ledger technology (DLT) assets – also known as crypto assets: (a) a financial instrument (b) electronic money (c) a virtual token and (d) a virtual financial asset.

[10] Malta undertook its first FSAP exercise in 2003.

[11] The FATF Recommendations are considered as the global anti-money laundering and counter terrorist financing standard.

[12] More recently, on 19 June 2018, the 5th Anti-Money Laundering Directive, which amends the 4th Anti-Money Laundering Directive, was published in the Official Journal of the European Union. Member States must transpose this Directive by 10 January 2020.

[13] National AML/CFT Strategy, Republic of Malta – April 2018 https://mfin.gov.mt/en/Library/Documents/National%20AML-CFT%20Strategy/National%20AML-CFT%20Strategy.pdf

[14] Recommendation of the ESRB of 7 December 2017 on liquidity and leverage risks in investment funds (ESRB/2017/6). Source: https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation180214_ESRB_2017_6.en.pdf?3e0fcb8ecf8e862140408bea5af7261f

Commission. Specifically, the Recommendation discusses risks arising from inadequate liquidity management tools, promotes liquidity stress testing practices, establishes a reporting framework for the Undertakings for the Collective Investment of Transferable Securities (UCITS) and introduces a macroprudential tool to limit leverage in Alternative Investment Funds (AIFs).

Non-performing loans (NPL)

On 18 March 2018, the ECB published an Addendum to its guidelines to banks on NPLs by specifying its supervisory expectations while assessing the treatment of new NPLs by adopting a mechanism where the unsecured portion of loans classified as NPLs from 1 April 2018 onwards, are fully provisioned after 2 years and after seven years at the latest for the secured portion of new NPLs classified as such from 1 April 2018 onwards with a linear path starting from year three onwards.[15] The addendum is non-binding and will serve as the basis for supervisory dialogue between the significant banks and the ECB.

On 14 March 2018, the EU Commission issued a proposal for a regulation on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures.[16,17] This proposal provides for a statutory prudential backstop against any excessive future build-up of NPLs without sufficient loss coverage on banks' balance sheets. These backstops are intended to protect banks' profitability and strengthen their capital base and funding costs in times of stress whilst reducing unnecessary differences in banks' practices and ensuring less pro-cyclical financing is available to households and businesses. The proposed backstop would only apply to exposures originated after 14 March 2018.

European Commission proposed regulation on Sovereign Bond-Backed Securities (SBBS)

On 24 May 2018, the European Commission presented a legislative proposal to enable a framework for the development of SBBS. The main objective of this proposal is to develop a new class of low-risk securities backed by a diversified pool of national government bonds (in proportion to the ECB's capital keys of each Member State's in the euro area economic and financial system). The Commission opened a public consultation that ran till 24 August 2018 to gather the views of stakeholders.

The Commission undertook an impact assessment on this proposal. The costs for the public sector are expected to be limited whilst the costs for the issuers mainly arising from arranging the product (including buying sovereign bonds and warehousing the bonds) have been estimated by the High Level Task Force at €3.26 million per year for a €6 billion SBBS programme.[18]

BOX 1: MREL: REDUCING THE COST OF BANK FAILURE ON THE ECONOMY[1]

The 2007 financial crisis and the resultant widespread bank failures brought about a major change in the banks' regulatory landscape, as size, complexity, and interconnectedness of the banking systems were identified as major amplifiers of this event. The complexity of the financial system impeded banks that were facing severe financial difficulties from following regular insolvency procedures. Ultimately, the final backstop fell on the governments which had to bailout the banks on an unprecedented scale and at a high cost to the taxpayer. Since then, monetary authorities have equipped themselves with an enhanced toolkit and the necessary regulatory powers, enabling them to take the necessary precautionary measures at a sufficiently early stage. This early intervention mitigates against the most damaging effects of a crisis, such as the interruption of core financial services, contagion to other market players and steep fiscal costs.

[1] Prepared by Denise Camilleri, Senior Economist at the Financial Stability Department of the Central Bank of Malta and Brendon Cassar, Financial Analyst at the Financial Stability Department of the Central Bank of Malta.

[15] 'Addendum to the ECB Guidance to banks on nonperforming loans: supervisory expectations for prudential provisioning of non-performing exposures' – https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.npl_addendum_201803.en.pdf

[16] Regulation 575/2013 deals with prudential requirements for credit institutions and investment firms.

[17] 'Proposal for a regulation of the European Parliament and of the Council on amending Regulation No 575/2013 as regards minimum loss coverage for non-performing exposures' – http://ec.europa.eu/finance/docs/policy/180314-proposal-regulation-non-performing-loans_en.pdf

[18] European Commission staff working document: Impact Assessment 'An enabling regulatory framework for the development of sovereign bond-backed securities (SBBS)'.

In this light, one of the main objectives of the new regulatory initiatives was to ensure that possible bank resolutions in the future would be feasible and realistic, thus limiting taxpayers' involvement to cover losses, regardless of the size of an institution.

Indeed, the introduction of the Bank Recovery and Resolution Directive (BRRD) in 2014 was a milestone in addressing the problem of banks being 'too big to fail'. The aim of the recovery and resolution framework is to increase banks' resilience to future financial downturns. A new "bail-in" tool was introduced to enable resolution authorities to write-down equity and debt instruments in order to absorb losses by converting debt instruments into new equity thereby recapitalising banks by means of internally generated funding. This new regime implies that the costs of bank failures would primarily be borne by bank's shareholders and creditors, rather than taxpayers. As a corollary, banks are required to issue sufficient instruments that are eligible to be bailed-in effectively in an event of failure. In this regard, the BRRD requires resolution authorities to determine a Minimum Requirement for own Funds and Eligible Liabilities for bail-in, known as MREL.

MREL fosters financial stability on the one hand by reducing ex-ante incentives of banks to take excessive risk as well as by increasing their capacity for both loss absorption and recapitalisation. In turn, financial stability will also be strengthened by reducing the banks' overall probability of default and minimizing banks' losses given default.

Banks can meet their MREL requirements either by:
1. reducing asset size
2. cutting down lending to risky borrowers
3. raise debt and/or equity
4. a combination of the three above.

Naturally, these strategies have different financial implications both in terms of costs and benefits on banks' operations and economic growth. Empirical evidence shows that banks tend to downsize their balance sheets by cutting down on their lending to address higher capital requirements. Furthermore, banks also tend to exhibit "flight to quality" behaviour when faced with higher capital requirements by reducing their lending to risky borrowers. This implies that corporates, including SMEs that are reliant on bank funding, may face capital and liquidity constraints. In turn, the contraction in bank lending may lead to a decline in real economic activity in the short-term.

Another option that banks could consider to meet their MREL requirement is that of issuing equity, debt or a combination thereof, though this is likely to raise the cost of funding. A study conducted by the EBA indicates that at an aggregate level across the EU, the incremental cost of funding ranges between €2.9 billion and €5.8 billion, depending on the MREL calibration adopted.[2,3] Generally, these costs are transmitted to the borrowers through higher interest rate charges. Furthermore, the EBA study indicates that an increase in MREL costs may lead to a widening in the lending spreads by approximately 1.3 and 2.6 basis points and may in turn dampen the demand for credit.

Alternatively, credit institutions may also consider recouping higher MREL-related funding costs by increasing their lending rates. According to a study conducted by the European Commission, the estimated impact on long-term GDP could range between -0.03% and -0.06%. In terms of funding costs, the impact on the banks would range between 1.38 bps and 2.71 bps.[4]

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[2] Source: https://www.eba.europa.eu/documents/10180/1695288/EBA+Final+MREL+Report+%28EBA-Op-2016-21%29.pdf

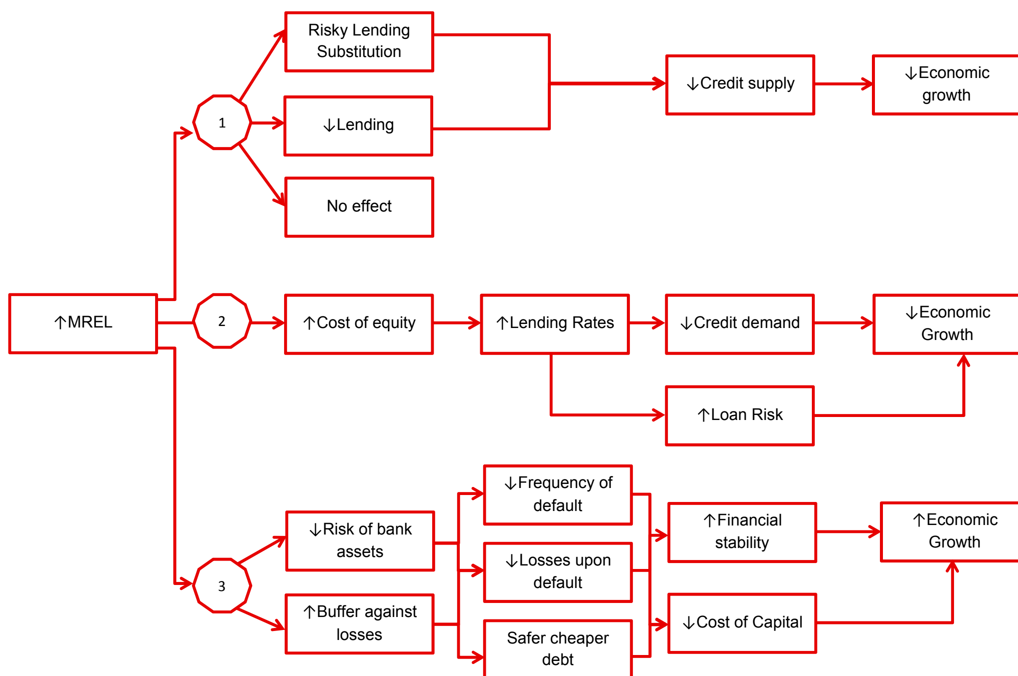
[3] The EBA adopted two approaches to MREL calibration as at the time of publication, the policy approach that resolution authorities in the EU will adopt when implementing the MREL requirement had only been partially clarified and no MREL decisions have been taken. The MREL Calibration Scenarios are: i) An LA buffer scenario – Twice capital requirements + CBR, i.e. [2 x (P1 + P2) + CBR]. Buffers are not included in the RCA. No market confidence layer is considered and ii) A buffer/8% scenario – Higher of twice capital requirements including the CBR, and 8% of TLOF, i.e. [max {2 x (P1 + P2 + CBR); 8% of TLOF}].

[4] Source: https://ec.europa.eu/info/system/files/161123-impact-assessment_en.pdf

From a longer term perspective, the implementation of MREL is expected to have an overall positive impact on the banks' balance sheets and may lead to higher and more stable economic growth. In addition, MREL mitigates risk-taking behaviour as it lowers the likelihood of a bail-out by the government, thereby reducing moral hazard and ultimately leading to a lower probability of failure, as well as dampening the severity of a financial crisis. Recent studies conducted by the Bank of England and the US Federal Reserve suggest that with the introduction of MREL, systemic banks are 33% less likely to fail.[5,6] Furthermore, governments can utilise taxpayer money more efficiently and effectively to boost the economy in times of crisis. Studies show that MREL can reduce crisis-related bail-outs costs by 3.8% of annual GDP.

The following diagram provides an overview of the short to long-term impact of MREL on economic growth based on the option adopted by banks.

Figure 1
EFFECTS OF DIFFERENT BANK RESPONSES TO MEET MREL



Source: Martynova, N. (2015). Effect of bank capital requirements on economic growth: A survey. DNB Working Paper Series (No. 467), page 17.

The ultimate results from MREL depend on the aggregate effect of banks' preferred approaches to meet these new requirements. In general, an approach which foresees a reduction in riskiness of bank assets, coupled with increased buffers against losses will lead to a lower probability of default and loss given default, thereby leading to cheaper cost of funding in the medium term. Hence, in the long run, besides an expected strengthening in financial stability, the resulting lower cost of capital is expected to lead to an overall improvement in economic growth.

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[5] Brooke, M. et al. (2015), "Measuring the macroeconomic costs and benefits of higher UK bank capital requirements", Bank of England Financial Stability Paper No. 35. https://www.bankofengland.co.uk/financial-stability-paper/2015/measuring-the-macro-economic-costs-and-benefits-of-higher-uk-bank-capital-requirements

[6] Firestone, Simon, Amy Lorenc and Ben Ranish (2017). "An empirical economic assessment of the costs and benefits of bank capital in the US," Finance and Economics Discussion Series 2017-034. Washington: Board of Governors of the Federal Reserve System, https://www.federalreserve.gov/econres/feds/files/2017034pap.pdf.

Core domestic banks remained supportive of domestic financing needs, with growth in lending to NFCs turning positive, for the first time in four years. Funding remained primarily through deposits. Banks strengthened further their capital buffers, remained profitable and liquid.

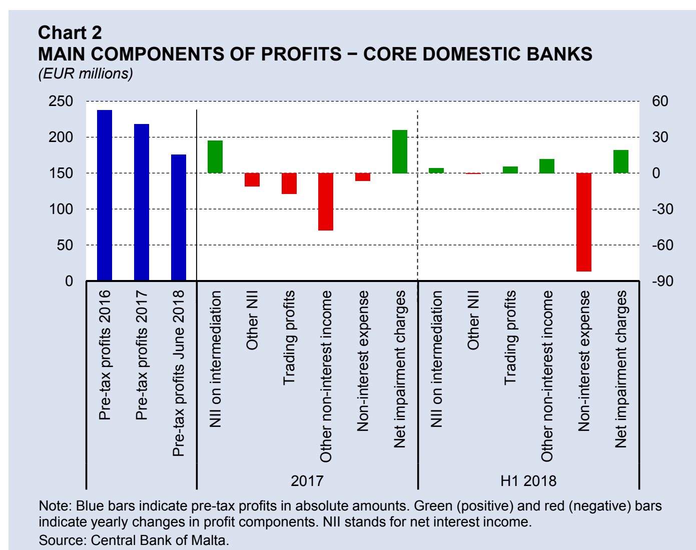
The profitability of core domestic banks weakened somewhat during the first half of 2018 owing to one bank which stepped up its provisioning to address potential legal risks. As a result, pre-tax profits contracted by around 19% to €175.7 million in June 2018 (see Chart 2). The post-tax return on equity (ROE) and the return on assets (ROA) declined to 7.6% and 0.6%, respectively in June 2018, from 9.2% and 0.7% in December 2017. Notwithstanding the core domestic banks' profitability is in line with that of their European peers.[19] Should pre-tax profits be adjusted to exclude one-off events, profits would have risen by about 12% to around €251 million in June 2018, surpassing the levels reported in recent years.[20] The adjusted pre-tax ROE and ROA would also increase to 13.6% and 1.1%, respectively from 13.0% and 1.0% in December 2017.

Non-interest expenses rose by a significant 26.0% to reach €398.2 million in June 2018 owing to the one-off costs reported above. Adjusting for such costs would result in non-interest expenses to increase at a more moderate rate of 4.2%, reflecting higher operating expenses and staff wages, to a lesser extent. In contrast, net impairment charges dropped by €19.2 million, reflecting lower bad debts written-off as well as specific and collective provisions. Such developments contributed positively to the banks' profitability.

Gross income increased by 3.8% owing to higher non-interest income (+€17.3 million) and net interest income (NII) (+€3.4 million), though the latter remained the core domestic banks' primary income stream. Non-interest income grew on the back of higher fees and commissions, dividends and trading profits. Fees and commission income rose by 7.7% to €112.4 million in June 2018, accounting for about two-thirds of non-interest income. The increase in NII continued to be driven by intermediation activities which increased by 1.3% to account for about 88% of NII. In contrast, other NII which largely captured income from securities holdings dropped by 1.6%.

The cost efficiency of core domestic banks deteriorated with the overall cost-to-income ratio increasing by 12.6 percentage points to 69.6% in June 2018, reflecting the one-off provisioning cost mentioned earlier. Adjusted for this exceptional event, the cost-to-income ratio would remain stable at around 56%, with core domestic banks still outperforming their euro area peers.[21]

Chart 2
MAIN COMPONENTS OF PROFITS – CORE DOMESTIC BANKS
(EUR millions)



Note: Blue bars indicate pre-tax profits in absolute amounts. Green (positive) and red (negative) bars indicate yearly changes in profit components. NII stands for net interest income.
Source: Central Bank of Malta.

In the first half of 2018, core domestic banks continued to expand their balance sheet with assets growing by 1.5% to €23.3 billion, equivalent to 201.5% of GDP. This was mainly driven by customer loans which

[19] The euro area small domestic banks ROE and ROA as at June 2018 are estimated to stand at approximately 7.2% and 0.7%, respectively. Source: ECB Consolidated Banking Data, Central Bank of Malta workings.

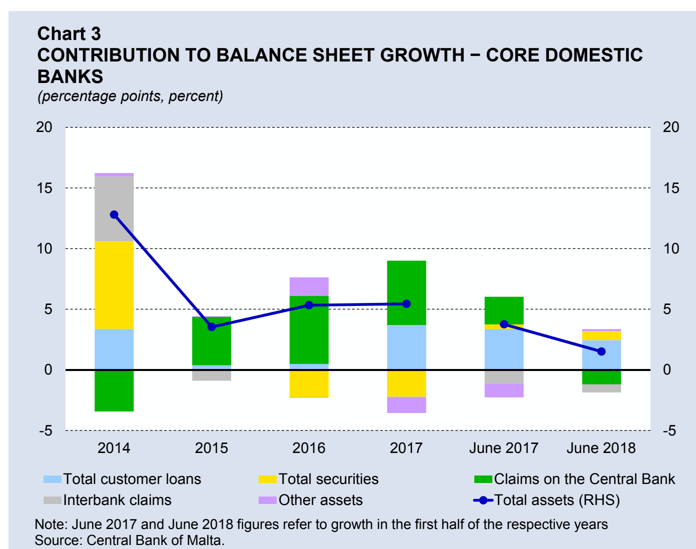
[20] Other one-off events considered also include increased provisioning for brokerage remediation and collective agreement benefits by one bank reported in 2017.

[21] Small domestic euro area banks reported a cost-to-income ratio of about 69%.

grew by 5.2% and accounted for almost half of their balance sheet (see Chart 3). Resident credit growth accelerated by 3.5% to about €9.8 billion, driven by higher lending to resident corporates. After a four-year span of contraction, lending to resident NFCs grew by 5.6% mainly reflecting higher credit to professional activities, real estate, energy, accommodation and food services, and manufacturing. Lending to resident households also rose, up by 3.1% in the first six months of 2018. This reflected the increased lending for house purchases which went up by 3.6%. Conversely, resident consumer credit and other household lending contracted by 1.4%. By June 2018 non-resident lending increased by 17.9% to €1.5 billion due to further participation in syndicated loans.

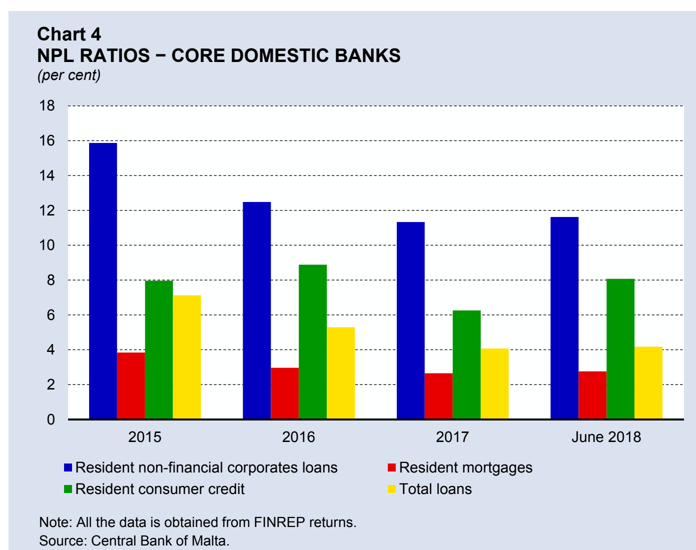
In terms of asset quality the non-performing loans (NPL) ratio stood at 4.2% as at June 2018, just 0.1 percentage point higher when compared to December 2017 (see Chart 4). This marginal increase was driven by higher non-resident NPLs which represented 9.5% of total NPLs held by the core domestic banks. Meanwhile resident NPLs dropped somewhat, but as resident loans and advances also decreased, the resident NPL ratio remained unchanged at 4.7%.

Chart 3
CONTRIBUTION TO BALANCE SHEET GROWTH – CORE DOMESTIC BANKS
(percentage points, percent)



Note: June 2017 and June 2018 figures refer to growth in the first half of the respective years
Source: Central Bank of Malta.

Chart 4
NPL RATIOS – CORE DOMESTIC BANKS
(per cent)



Note: All the data is obtained from FINREP returns.
Source: Central Bank of Malta.

Resident corporate NPLs declined by 5.6%, mainly reflecting continued progress in the construction and real estate sector, with related NPLs declining by 6.6% in the first half of 2018. Nonetheless, a reclassification of some loans and advances from the non-financial sector to the financial sector led to the resident NFC NPL ratio to increase by 0.3 percentage point to 11.6%. In the absence of such reclassification, the resident NFC NPL ratio would have declined further.

Resident household NPLs rose both for mortgages and consumer lending, in part attributable to the introduction of IFRS9. Notwithstanding, the mortgages NPL ratio remained contained at 2.8%, up by just 0.1 percentage point over December 2017, driven by one bank and primarily reflecting the impact of IFRS9. Conversely, the resident consumer credit NPL ratio increased to 8.1% from 6.3% in December 2017, also largely reflecting the impact of IFRS9. However, this ratio is still lower than the 8.9% reported in December 2016.

Total provisions including the Reserve for General Banking Risks as specified in the BR/09/2016, remained generally unchanged during the first half of 2018. Owing to the marginal increase in NPLs, the total coverage ratio narrowed to 43.5% in June 2018 from 45.2% in December 2017. Collateral continues to be another important credit risk mitigating factor, which as at June 2018 backed almost two-thirds of NPLs. In this regard, taking into consideration collateral backing the loans and total provisions, NPLs are more than covered, equivalent to around 107% of NPLs.

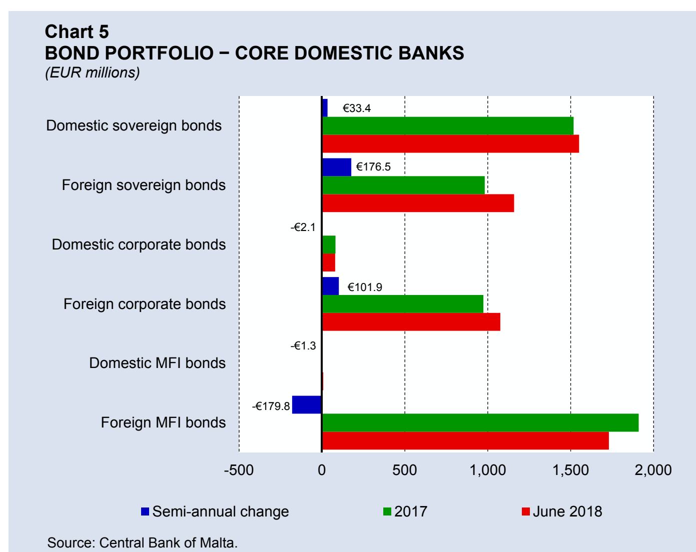
Core domestic banks' holdings of securities increased by 2.9% to €6.1 billion and account for more than a quarter of their total assets. Equity holdings remained contained at about 7.7% of their total portfolio. Debt securities holdings which represented the bulk of their portfolio rose by 2.4% largely due to higher holdings of foreign sovereign and corporate bonds, which represented 20.7% and 19.2% of the total debt securities portfolio, respectively (see Chart 5). Holdings of domestic bonds remained mainly in the form of sovereign paper with the latter increasing by 2.2% since December 2017, to account for around 28% of their bond portfolio. In contrast, holdings of bank bonds declined, mainly due to lower foreign holdings. While domestic MFI bond holdings are limited, foreign MFI bonds remained significant amounting to around 31% of their total debt securities.

The expansion in the debt securities portfolio consisted mainly of bonds booked as 'held-to-maturity' which rose by 15.7% and accounted for about 68% of the total bonds held. Almost half of the debt securities portfolio consisted of medium-rated investment grade bonds, followed by high-rated investment grade bonds which accounted for 34.1% of bond holdings, 5.0 percentage points higher than in December 2017. Low-rated bonds consisted only of 4.2% of total holdings while the remaining 13.0% consisted of unlisted or unrated bonds. The share of low-rated and unlisted/unrated bonds declined by 3.1 percentage points compared to six months earlier.[22]

Interbank placements dropped by 8.2% in the first half of 2018 to account for just 7.2% of total assets. Furthermore, for the first time in three years, placements with the Central Bank of Malta declined by 7.8%. As a result, the Liquidity Coverage Ratio (LCR) fell by 4.5 percentage points, which however remained healthy at almost 184%. Indeed, such placements continued to account for 14% of assets. Given that short-term liabilities increased by 1.4%, the liquid assets-to-short-term liabilities ratio decreased by 1.7 percentage points to 41.8% in June 2018. This, however, stands at almost double the euro area average of about 22% as at June 2018.[23]

Core domestic banks continued to fund most of their assets through customer deposits, which grew by 1.5% in the first half of 2018. As loans rose at a faster pace than deposits, the customer loan-to-deposit ratio increased to 61.1% in June 2018 from 58.9% in December 2017, but remained significantly below the euro area average of around 104%.[24,25] Similar to December 2017, the weighted average deposit rate was 0.32% in June 2018. Customers' preference for highly-liquid instruments persisted as demand deposits rose by 1.6%, accounting for 76.6% of

Chart 5
BOND PORTFOLIO – CORE DOMESTIC BANKS
(EUR millions)



Source: Central Bank of Malta.

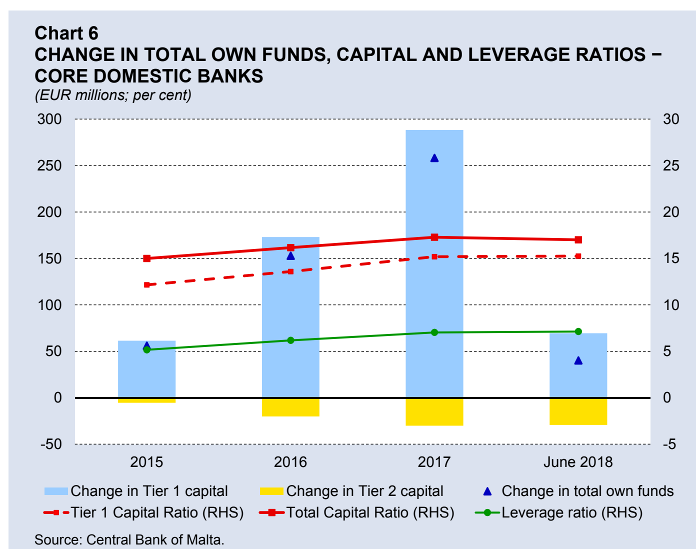
[22] Investment-grade bonds carrying a rating of AA- or above are regarded as 'high-rated bonds'. 'Medium-rated bonds' are those rated between A- and A+, whereas 'low-rated bonds' are those rated between BBB- and BBB+.

[23] Source: http://sdw.ecb.europa.eu/

[24] Source: http://sdw.ecb.europa.eu/

[25] This was mainly influenced by the increase in non-resident syndicated loans which were funded through interbank placements from one particular core domestic bank. If such bank is excluded, the increase in the customer loan-to-deposit ratio would be more contained at 55.8% in June 2018 from 54.8% six months earlier.

total deposits. Short-term deposits with maturity of less than one year declined by 1.6% and represented about 16% of total deposits. In contrast, deposits with long-term maturity remained the least preferred by customers accounting for just 7.0% of total deposits, although these increased by 8.3% in the first half of 2018.



The core domestic banks have throughout the first half of the year strengthened further their Common Equity Tier 1 (CET1) capital, up by 4.2%, mainly reflecting higher paid-up capital instruments financed through retained earnings and capital injections (see Chart 6). This led to a 0.1 percentage point increase in the Tier 1 capital ratio to 15.2% in June 2018.[26] The risk appetite of core domestic banks increased somewhat, as the expansion of 3.8% in Risk Weighted Assets (RWA) outpaced growth in total assets. The ratio of RWA to total assets rose by 1.1 percentage points to 49.3%. At the same time, Tier 2 capital instruments and subordinated loans declined, which caused the total capital ratio to drop by 0.3 percentage point to 17.0% in June 2018.

The fully phased-in leverage ratio governed by the CRR improved by 0.1 percentage point to 7.1% in June 2018, with all core domestic banks exceeding the 3% minimum regulatory requirement.

Non-core domestic and international banks remained focused on non-resident business, though some tapped further the domestic market. Such banks maintained adequate capital levels and, ample liquidity buffers.

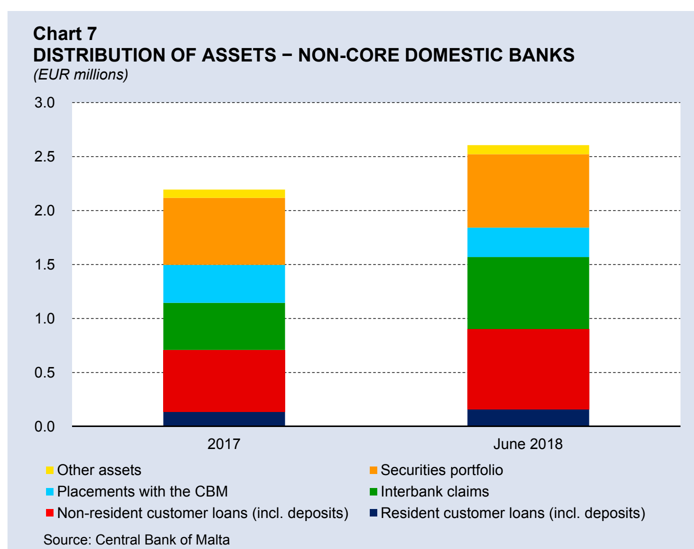
Non-core domestic banks

The balance sheet of the five banks classified in this category expanded by 18.8% to €2.6 billion, equivalent to 22.5% of GDP. The increase was driven by the largest bank in this category which engaged in higher interbank activity and retail lending.

The profitability of non-core domestic banks deteriorated in the first six months of 2018, predominantly due to higher impairment recognition on customer loans following the implementation of IFRS9. Non-interest expenses also increased owing to higher staff costs. Meanwhile, gross operating income improved reflecting higher non-interest income and to a lesser extent, NII. Although trading profits decreased, these were offset by higher fees and commissions, pushing the share of non-interest income in gross income by 1.2 percentage points to 70.1%. Similarly, NII also rose by 8.6% over December 2017 owing to higher interest income earned on intermediation, coupled with a reduction in interest expense. As a result, the after-tax ROE and ROA fell by 1.0 and 0.1 percentage points, respectively to 1.9% and 0.2% in June 2018. Yet, the non-core domestic banks' cost-efficiency improved further with the cost-to-income ratio declining by 4.9 percentage points, though still remaining relatively high at 71.4%.

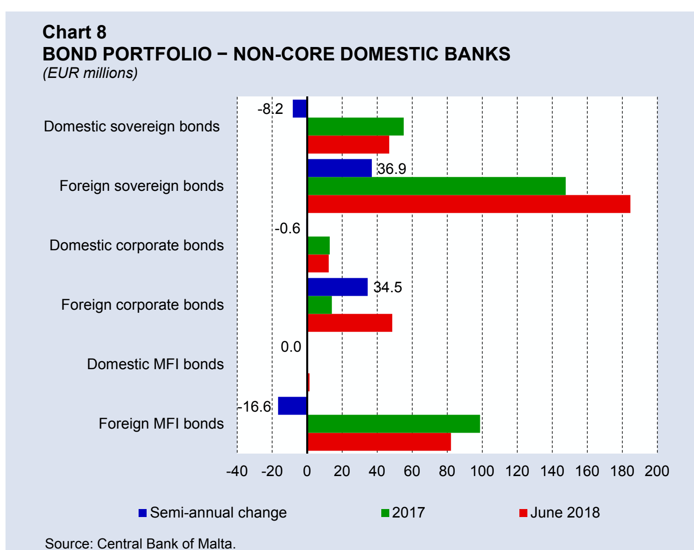
[26] Following prudential requirements under the Capital Requirement Directive (CRD) IV, the gradual phasing-in of the capital conservation buffer stood at 1.875 percentage points on the CET1 ratio for 2018. All the banks met the required capital add-ons, including the three domestic significant institutions which are also subject to an Other Systemically Important Institutions (O-SII) buffer and Pillar II requirements under the Supervisory Review and Evaluation Process (SREP). The CCyB has remained unchanged at 0% due to the subdued credit developments. As at June 2018, the credit-to-GDP gap stood at 77.1%, with the deviation from the long-term trend standing at -23.7 percentage points. Refer to https://centralbankmalta.org/tools

On the assets side, this category of banks reported a significant increase in interbank placements, which rose by more than half since December 2017 to represent just over a quarter of total assets (see Chart 7).[27] Such deals were largely with foreign unrelated credit institutions mainly located in EU countries. Deposits placed with resident MFIs also increased but their share in total assets remained stable at 2.8% in June 2018. Placements with the Central Bank of Malta contracted by 22.7% to 10.4% of total assets as these banks resorted to higher-yielding investment opportunities.



Customer loans increased by 27.4% in the first six months of 2018, accounting for just over a third of total assets. This was largely attributed to higher non-resident loans to corporates predominantly in the financial and insurance sector, wholesale and retail trade, manufacturing, mining and quarrying. Resident lending also increased but remained contained at 1.6% of overall resident customer lending by the banking system in Malta. Such lending was mainly directed towards the financial and insurance sector, construction, wholesale and retail trade activities. Lending to resident households rose by around a third, but remained contained at just 3.0% of total customer loans by the non-core domestic banks. The asset quality of their lending portfolio improved further during the first half of 2018, with the NPL ratio declining by 0.2 percentage point to 2.0%. Such improvement resulted from a larger lending base which surpassed the increase in NPLs. Total provisions rose on the back of the implementation of IFRS9, significantly pushing the coverage ratio to 83.1% from 65.9% as at end 2017. Taking into consideration collateral backing NPLs, outstanding NPLs are almost fully covered.

The securities portfolio of the non-core domestic banks grew by 9.7% in June 2018, representing just over a quarter of their total assets. These were mainly composed of bonds which rose by 13.9% in the first half of 2018 to account for around 55% of their securities portfolio. The increase was largely driven by holdings of foreign sovereign paper predominately in EU countries (see Chart 8). These accounted for 49.1% of their debt securities portfolio, equivalent to 7.1% of total assets. Meanwhile, investments in domestic sovereign paper fell over the six-month period to 6.9% of the total securities portfolio, and just 1.8% of total balance sheet size. Holdings of foreign bank bonds fell by 16.8% over December 2017, while investment in foreign cor-



[27] Interbank placements include placements in the form of deposits placed with other credit institutions which are reported on the asset side of the balance sheet.

porate bonds more than tripled by mid-2018. The overall quality of the bond portfolio remained high, with the non-performing securities ratio standing at just 0.1%. Meanwhile, equities increased by fewer than 5% to account for the remaining 44.8% of the total securities portfolio. These mainly related to one bank's equity in subsidiaries.

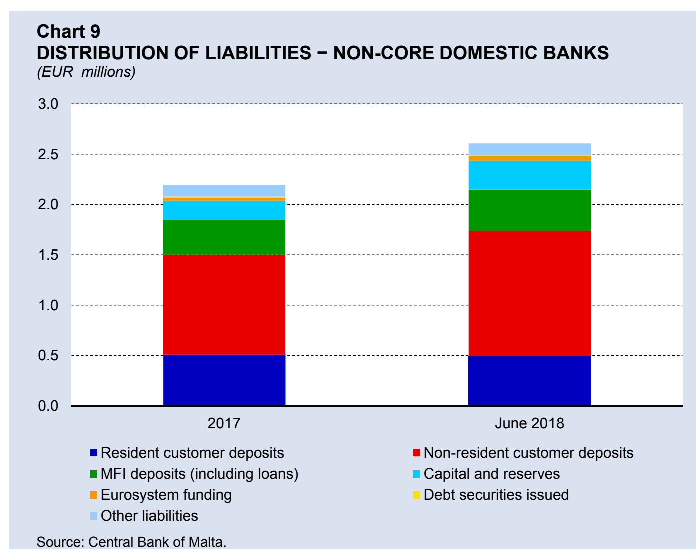


Chart 9
DISTRIBUTION OF LIABILITIES – NON-CORE DOMESTIC BANKS
(EUR millions)

Source: Central Bank of Malta.

The expansion in the balance sheet was funded predominantly by a 15.7% increase in customer deposits, largely non-residents. These financed around two thirds of total assets as at June 2018 (see Chart 9). Deposits from non-resident other financial intermediaries (OFI) increased by 14.5%, while deposits from non-resident NFCs declined by 8.9%. Resident customer deposits which accounted for 19.0% of assets fell by 3.1%, owing to higher outflows from resident OFIs and to a lower extent, non-MMF investment funds. On the other hand, deposits of resident households rose by 16.9%. Customer deposits were largely of a short-term nature, with demand deposits and short-term deposits up to one year accounting for 93.1% of total customer deposits.

Interbank funding (excluding repos) gained momentum, rising by around 18% to finance almost 16% of total assets.[28] These placements, largely deposits, were mostly from foreign unrelated credit institutions. Placements of resident banks meanwhile fell by a quarter accounting for 0.5% of all liabilities by mid-2018. Reliance on Eurosystem funding remained low, with only one bank tapping US dollar operations.

The capital position of this category of banks improved, largely driven by a capital injection by one bank, which outweighed its increase in RWA. As a result, the total capital ratio of non-core domestic banks strengthened by 0.6 percentage point to 17.3% in June 2018. Similarly, the CET1 ratio rose by 3.6 percentage points to 16.9% in June 2018. The leverage ratio also improved by 2.7 percentage points over 2017, reaching 9.9% by mid-2018. This group of banks continued to operate with ample liquidity, as demonstrated by their aggregate LCR ratio of 415.5%, with liquid assets mainly consisting of central bank reserves and sovereign paper.

The Bank's stress test exercises reaffirm the robustness of core and non-core domestic banks' solvency and liquidity buffers.

During the first half of the year, banks continued to increase their capital positions mainly via capital injections. The univariate stress tests carried out to assess the resilience of the core and non-core domestic banks for (i) credit quality deterioration in their securities portfolio (ii) persistent deposit withdrawals (iii) a drop in property prices and (iv) interest rate risk in the banking book, remained similar to those presented in the *Financial Stability Report* 2017, both in terms of methodology and underlying assumptions.[29] The post-shock Tier 1 capital ratios of the core and non-core domestic banks remained comfortably above the regulatory threshold of 6%. With regards to test (i) a minor shift from marketable towards non-marketable assets could be noted for some of the banks. Securities held at amortised cost (AMC), formerly known as held-to-maturity, increased from 57.6% in December 2017 to 64% as at June 2018 at an aggregate portfolio level for banks within the scope of the test. By way of assumption of the liquidity stress test, Eurosystem ineligible securities held at AMC cannot be sold on the market in order to increase counterbalancing capacity. Thus,

[28] Interbank deposits include placements in the form of loans placed with unrelated credit institutions which are reported on the liabilities side of the balance sheet.

[29] One bank is excluded from the non-core domestic banks' tests, in line with the tests reported in *Financial Stability Report* 2017.

this change in accounting treatment was also reflected in the results of the liquidity test as these banks had a lower marked-to-market asset base to convert into liquid assets. The shift in accounting treatment for banks' securities and the slight drop in counterbalancing capacity did not affect the core and non-core domestic banks' liquidity stance, as the system remained amply liquid even under the extreme scenario for the whole one-month survival period.

International banks

During the first half of 2018, the number of international banks operating from Malta remained unchanged at 14.[30] These banks which deal almost exclusively with non-residents, have consolidated further their operations with total assets as a share of GDP contracting by 28 percentage points to 177.1%. This drop was mainly driven by the three branches of foreign banks, whose assets fell by 11.7% to €17.3 billion.[31] The other 11 banks also downsized their balance sheet by just over 1% to €3.2 billion. These are either subsidiaries of foreign banks or stand-alone banks with diverse business models, ranging from trade financing and factoring, payments and settlements, wealth management and lending towards non-resident private NFCs.

Branches of foreign banks

Profitability of the three branches of foreign banks deteriorated in the first half of 2018, with the post-tax ROA falling to 0.8% in June 2018 from 1.5% in December 2017. This mainly reflected foreign exchange losses by one branch owing to the strengthening of the dollar. Interest income declined, as these branches continued to shed Turkish sovereign bonds and bank bonds, with a view to mitigate country risks. This however remained the main income stream for these branches. At 6.4%, the cost efficiency of these branches deteriorated by 3.7 percentage points from end 2017, on the back of higher non-interest expenses.

Customer loans remained relatively stable at €4.9 billion, accounting for 28.1% of total assets. These branches continued to target non-resident NFCs operating in the transport and storage, wholesale and retail trade, construction and in the energy sectors. Lending to the financial and insurance sector is also sizeable. Asset quality remained sound with a NPL ratio of just 0.5%.[32] At the same time placements with foreign unrelated credit institutions dropped by 4.1% to €2.8 billion, accounting for around 16% of total assets.

Branches of foreign banks continued to finance their operations mainly from wholesale funding, amounting to almost 63% of their assets. Nonetheless, such deals contracted by almost a fifth mainly from lower placements from their head-office, and unrelated credit institutions, but to a lesser degree. However, such funding needs declined as customer deposits increased by almost 10% to €5.1 billion, financing almost 30% of their activities. These largely consisted of non-bank financial institutions and corporates in the wholesale and retail trade and manufacturing sectors mainly located in Europe, UAE and USA. These branches virtually do not tap the domestic retail market as total resident customer deposits remained negligible at just under €2 million.

Subsidiaries of foreign banks and stand-alone foreign banks

During the first six months of 2018, this group of banks posted a drop in their pre-tax profits of about 22%. As a result, the post-tax ROE and ROA decreased by 1.0 and 0.4 percentage points to 3.9% and 1.2%, respectively. The contraction in profits is mainly attributed to higher impairment charges by one bank owing to higher specific provisions and an increase in operating expenses by two other banks. Such increase in expenses was partly offset by higher gross income, which reflected an increase in both NII and non-interest income. The latter, predominantly in the form of fees and commissions, presently accounts for around half of gross operating income, reflecting increased business of acquiring and processing payments on behalf of merchants.

[30] In October 2018 a competent person was put in charge of one bank's assets whereas in November 2018, one bank had its licence withdrawn. In terms of GDP, these two banks accounted for 4.8% as at June 2018.

[31] Out of the three branches licenced in Malta, one is a third-country branch, while the other two branches have their parent company located within the euro area.

[32] NPLs of non-EU branches are transferred on the books of their respective head office banks.

Holdings of debt securities fell by almost a fifth to 7.1% of their balance sheet (see Chart 10). This drop largely stemmed from lower sovereign securities, predominately issued by European governments. Investment in Malta Government Stock (MGS) also dropped further to account for just 0.7% of these banks' total assets. On the other hand, bank bonds and corporate debt securities holdings increased, though the latter by a lower extent. More than four-fifths of these bond holdings are medium to high investment-grade bonds, with only 0.1% of total debt securities listed as non-performing. Equity holdings decreased to just 0.3% of total assets. These were mainly equities of corporates domiciled in the United States.

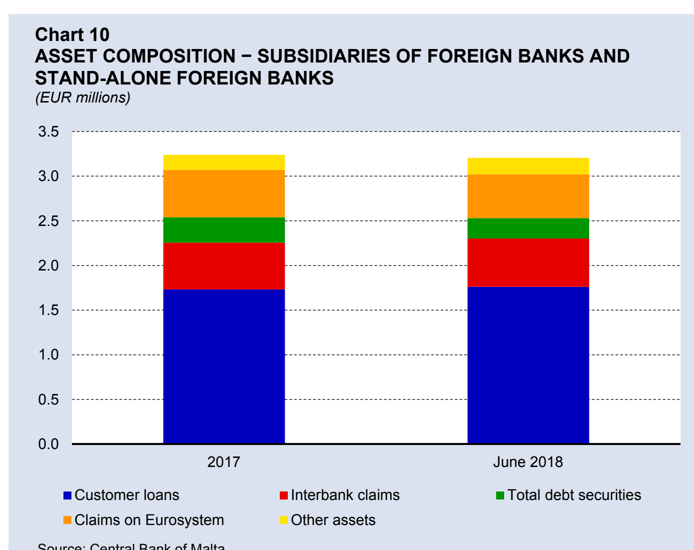


Chart 10
ASSET COMPOSITION – SUBSIDIARIES OF FOREIGN BANKS AND STAND-ALONE FOREIGN BANKS
(EUR millions)

Source: Central Bank of Malta.

Customer loans edged higher to represent 55.0% of total assets. These loans were mainly granted to non-resident NFCs in manufacturing, transportation, and in construction and real estate sectors. Around a fifth of total customer loans are granted to OFIs and households, the latter being mostly bank-specific. Resident customer loans increased but remained minimal at 0.8% of total assets, or 0.2% of total resident customer loans granted by the entire banking system. The increase was attributable to one bank's lending to the transportation and storage sector. In terms of asset quality, the NPL ratio increased marginally by 0.3 percentage point to 5.6%.

On the other hand, interbank placements rose by just 3.3% to 16.9% of the total balance sheet. These largely consisted of placements with unrelated European credit institutions. Placements with related credit institutions decreased by 8.6% to 44.3% of total interbank placements, as some banks opted to place their excess funding with related credit institutions. Claims on the Eurosystem meanwhile contracted by 7.5% to 15.3% of total assets.

Retail funding remained the most preferred source of funding for this group of banks, financing almost 38% of total business activities. Yet total customer deposits dropped by 8.5% to €1.2 billion on account of lower non-resident customer deposits in the wholesale and retail trade, professional, scientific and technical activities and other services sectors (see Chart 11). Deposits continued to originate mostly from non-resident non-bank financial corporates and households. Resident customer deposits which are largely corporates, represented just 1.6% of total resident customer deposits in the banking system. These remained fairly stable in the first half of the year.

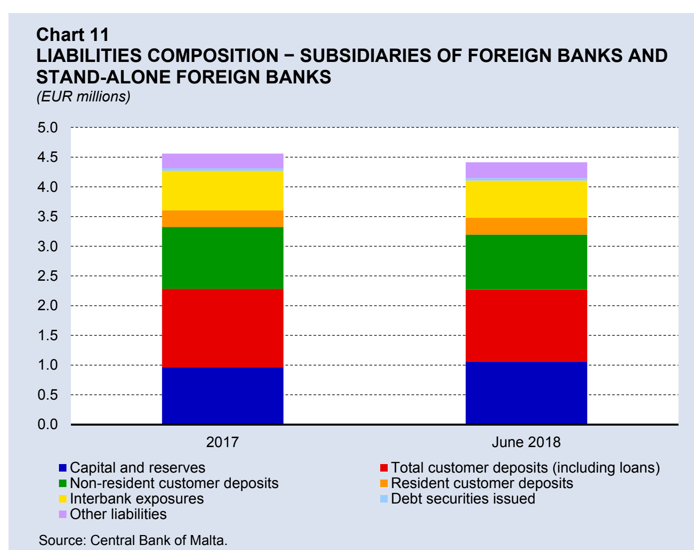


Chart 11
LIABILITIES COMPOSITION – SUBSIDIARIES OF FOREIGN BANKS AND STAND-ALONE FOREIGN BANKS
(EUR millions)

Source: Central Bank of Malta.

Interbank funding contracted by almost 6% to finance around 20% of total assets. Such funding was mostly from related institutions, although smaller banks also relied on foreign unrelated credit institutions to partly finance their operations. Debt securities issued remained a minor share of total liabilities standing at a mere 1.3% of total funding.

These banks hold ample liquidity buffers. At 234.5% their aggregate LCR significantly exceeded the minimum regulatory requirement. Capital and reserves increased by almost €100 million to account for a third of their balance sheet pushing the total capital ratio of over 50% and a leverage ratio of 29.5%. Such a strong capital position enables these banks to be well-placed to absorb unforeseen shocks should these materialise.

Risks stemming from the domestically-relevant insurance companies and investment funds remained contained, despite rising global uncertainties that could affect market sentiment.

Domestic insurance companies

In the first half of the year, two new insurance companies were set up, bringing the total number of insurance and reinsurance companies to 65. The total assets of the industry stood at €11.3 billion, equivalent to 97.8% of GDP, edging up slightly since December 2017. Of these, only eight companies underwrite risks situated in Malta as their main line of business, consisting of three life insurance companies, four non-life insurance companies and one non-life protected cell company (PCC).[33] The assets of these eight companies totalled €3.9 billion in June 2018, up by 0.4% since end 2017 and equivalent to 33.6% of GDP. Given their systemic relevance, the analysis that follows relates to these companies' performance.

These insurance companies held 10.3% of their assets in the form of deposits with domestic banks. They also held 8.0% of outstanding Maltese Government debt, representing 12.2% of assets. A further 11.8% of their total assets were held in the form of common equity and bonds in foreign non-financial corporates (NFC). Life and non-life domestic insurers also protect their underwriting business through reinsuring with other companies both in Europe and in the rest of the world. As at June 2018, the median reinsurance part of their premia stood at 14.1%, up by 0.6 p.p. in December 2017.[34]

The funding of the domestic insurance companies is largely generated through premia paid by resident households. On the other hand, insurance products sold by these eight companies accounted for around 14% of the Maltese households' net financial wealth and only 0.3% of the financial assets of domestic NFCs in June 2018.[35]

The domestic insurance sector remained resilient to the risks stemming from a very low interest rate environment and there is lack of evidence of search-for-yield behaviour. Their profitability could however be affected by risks stemming from reinvestment. Vulnerability to a low-yield environment is also mitigated by the fact that these companies do not offer guaranteed-return products.[36] Overall, the outlook for the domestically-focused insurance sector remains positive, buttressed by a robust macroeconomic environment, as well as healthy capital and liquidity buffers.

The domestic life insurance companies

In June 2018, the domestic life insurance sector held €3.4 billion in assets, up by 0.1% in the first six months of the year and equivalent to 29.8% of GDP. These assets remained concentrated in two companies which held 96.8% of gross premia written by the life segment.

[33] A protected cell company is a single legal entity comprising a core business activity and a number of activities, which are segregated from the main business, called "cells". The undertakings of one cell have no bearing on the other cells, with each cell identified by a unique name. The assets, liabilities and activities of each cell are also ring-fenced from other cells.

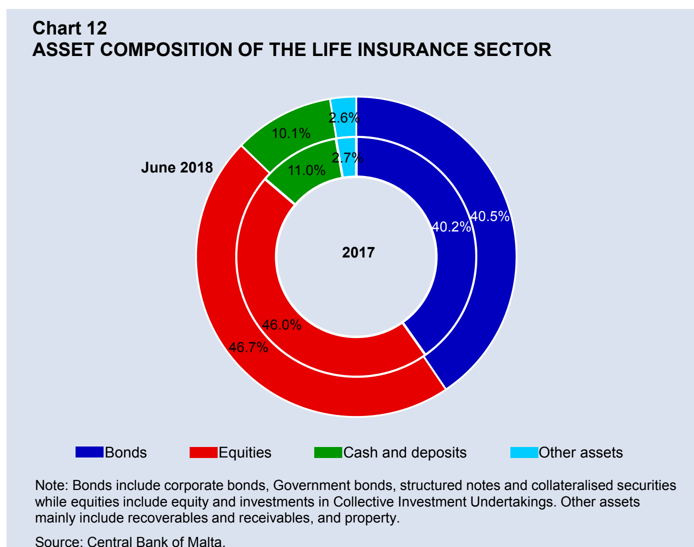
[34] The median reinsurance part of premia for the life and non-life sectors in June 2018 stood at 4.9% and 28.0% respectively.

[35] These percentages include insurance, pension and standardised guarantees. Source: Central Bank of Malta.

[36] The trend in the euro area is to decrease the guarantees offered in new insurance contracts and/or restrict their contractual maturity.

The asset composition of the domestic life insurance companies remained stable during the first half of the year, with equity and bonds forming 46.7% and 40.5%, respectively of their total assets (see Chart 12). The rest mainly comprised cash and deposits.

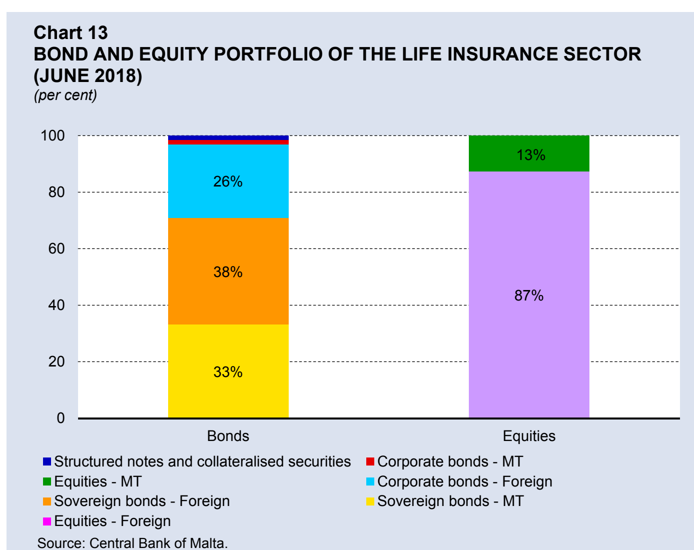
Chart 12
ASSET COMPOSITION OF THE LIFE INSURANCE SECTOR



Note: Bonds include corporate bonds, Government bonds, structured notes and collateralised securities while equities include equity and investments in Collective Investment Undertakings. Other assets mainly include recoverables and receivables, and property.
Source: Central Bank of Malta.

Life insurance companies invested a large part of their equity portfolio in equity funds, predominantly in the euro area, followed by common equity issued in Malta, the US and in euro area countries, and units in debt funds, mainly in Malta and other eurozone countries (see Chart 13). Equity issued in Malta corresponded to 12.7% of their equity holdings and mainly consisted of common equity, participations in debt funds and equity in real estate-related corporations.

Chart 13
BOND AND EQUITY PORTFOLIO OF THE LIFE INSURANCE SECTOR (JUNE 2018)
(per cent)



Source: Central Bank of Malta.

Sovereign debt accounted for around 70% of their bond portfolio, with MGS representing almost half of their sovereign bond portfolio. The rest of the sovereign debt holdings were diversified across a large number of eurozone countries. The overall quality of the life sector's sovereign bond portfolio remained of medium investment-grade.[37]

Over half of the corporate bond portfolio was issued in the euro area (excluding Malta), with the main holdings in OFIs, NFCs and banks in EU countries. Another 42.7% were issued outside the euro area, with the majority of holdings in NFCs, banks and OFIs in the US. Holdings of domestic corporate bonds, which made up 5.5% of the corporate bond portfolio, were mainly issued by OFIs, banks and NFCs. Around three-fourths of the corporate bond portfolio was held in the form of plain vanilla bonds, followed by subordinated and hybrid bonds, each representing around 9% of corporate bond holdings.[38]

Domestic life insurers decreased their index- and unit-linked business from 32.1% of technical reserves in 2017 to 30.1% in June 2018.[39] The latter move was mainly due to surrenders, maturities and death claims incurred in the first half of 2018.

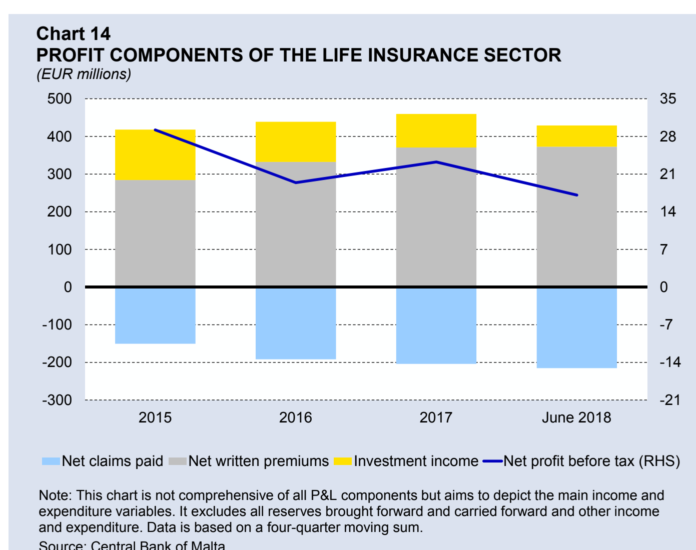
Credit risk is also very limited since the only loans granted by the life insurance sector are related-party loans, and accounted for only 0.2% of their total assets.[40] Life insurance companies remained exposed to

[37] High-rated bonds range from AAA to AA-, medium-rated bonds range from A- to A+ and low-rated bonds range from BBB+ to NR (S&P).
[38] Hybrid bonds contain bonds with debt and equity-like features.
[39] For unit-linked policies, part of the premium paid is utilised to provide insurance cover to the policy holders, while the rest is invested on behalf of the policyholder. For index-linked policies, the returns are linked to the performance of one or more indices.
[40] Non-traditional non-insurance activities refer to bank-like activities such as credit intermediation.

market risk particularly in anticipation of potential interest rate reversals, though domestic insurers are somewhat shielded from this event as they do not offer guaranteed-return products.

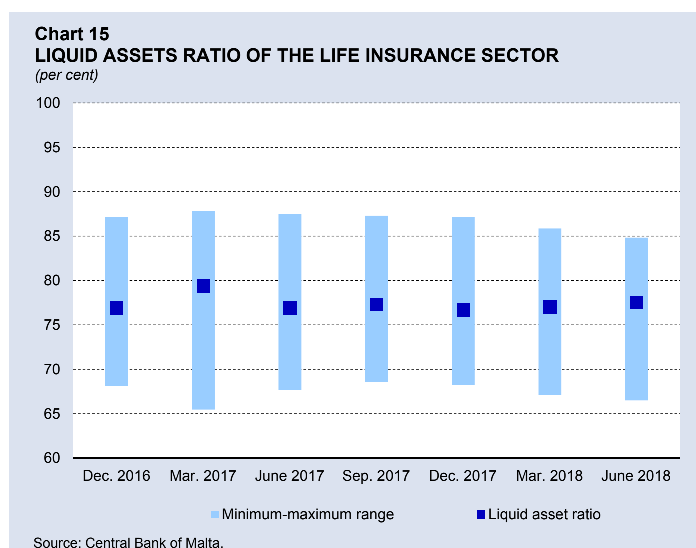
The first half of 2018 was characterised by uncertainty and market volatility in international markets, political developments and geopolitical events, as well as interest rate hikes by the US. Against this background, adverse exchange rate movements and revaluation adjustments impinged upon the life insurers' net profit before tax, which dropped by 26.4% to €17.1 million as at end-June 2018 (see Chart 14). Otherwise, the underwriting performance remained positive with net written premia rising by 0.6% to €372.7 million.[41] Net claims paid increased by 5.5% during the same months. The post-tax return on net premia stood at 3.0% for domestic life companies in June 2018, down from 4.6% in 2017. The post-tax profits as a share of the excess of assets over liabilities, which is a proxy to the ROE, fell from 6.0% in 2017 to 4.0% in June 2018, below the EU median of about 7%. The post-tax ROA dropped from 0.5% in 2017 to 0.3% in June 2018.[42]

Chart 14
PROFIT COMPONENTS OF THE LIFE INSURANCE SECTOR
(EUR millions)



Note: This chart is not comprehensive of all P&L components but aims to depict the main income and expenditure variables. It excludes all reserves brought forward and carried forward and other income and expenditure. Data is based on a four-quarter moving sum.
Source: Central Bank of Malta.

Chart 15
LIQUID ASSETS RATIO OF THE LIFE INSURANCE SECTOR
(per cent)



Source: Central Bank of Malta.

The life sector remained highly liquid. At 77.5%, the liquid asset ratio edged up when compared to the 76.7% as at the end of 2017 (see Chart 15).[43,44]

The domestic life insurers remained adequately capitalised with a median Solvency Capital Requirement (SCR) of 258.3% in June 2018. This dropped from 286.5% in 2017, due to a stronger increase in SCR than own funds, but remained well-above the 100% minimum threshold and exceeded the EU median

[41] Gross written premia grew by an annual 4.8%, exceeding the median year-on-year growth of 2.6% reported across EU life companies in June 2018. Source: EIOPA Risk Dashboard October 2018.

[42] Source: EIOPA Risk Dashboard October 2018.

[43] The assets having a liquidity weighting of 100% are cash and cash equivalents, Government bonds and listed equities. Corporate bonds and deposits other than cash equivalents have a liquidity weighting of 80%. Assets having a weighting of 30% include collateralised securities, structured notes, units in Collective Investments Undertakings, derivatives, unlisted equities, other investments, property (other than for own use), own shares (held directly) and pension benefit surplus. Amounts due in respect of own fund items or initial fund called up but not yet paid in have a liquidity weighting of 4%. Source: EIOPA.

[44] For both the EU life and non-life sectors, at a median level, liquid assets represented around 68% of total assets in June 2018. Source: EIOPA Risk Dashboard – October 2018.

of around 187% in June 2018 (see Chart 16).[45] The capital composition of the life segment remained of very high quality, almost all in Tier 1 own funds.

The domestic non-life insurance companies

Assets held by the domestic non-life insurance sector increased by 3.0% to €431.7 million, equivalent to 3.7% of GDP. Bond holdings accounted for 11.7% of the non-life insurers' assets, with the rest consisting of recoverables and receivables, as well as cash, deposits and fixed assets.

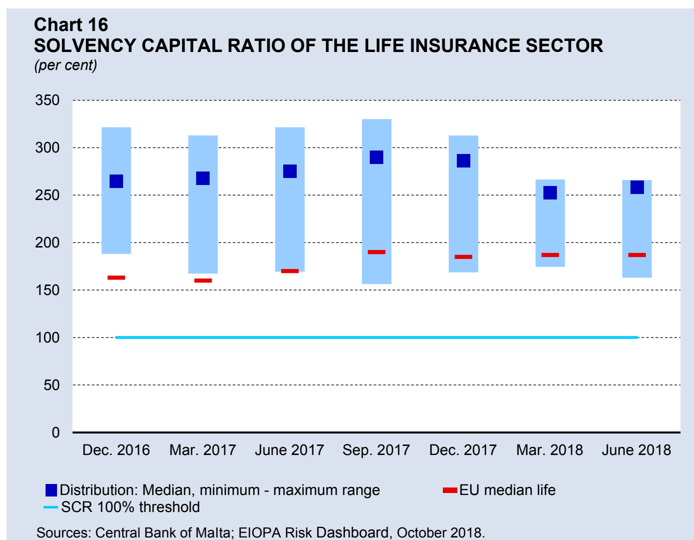
At 37.9%, equity holdings remained the largest component of assets, reflecting one company's investment in a related company. These dropped by 2.5% during the first six months of the year (see Charts 17 and 18). Holdings of foreign equities which accounted for 23% of equities were largely issued in euro area countries, mostly as common equity in NFCs and as units in investment funds.

Half of the bond portfolio was composed of foreign corporate bonds, mainly issued in the United States, and in other EU countries, while another 17.0% were corporate bonds issued in Malta.

Foreign sovereign bonds accounted for 13.2% of their bond portfolio while another 19.9% were MGS. The sovereign bond portfolio is also of medium investment grade. Credit risk is also limited given that non-life insurance companies only lend to related group companies and is contained at 0.8% of their assets.

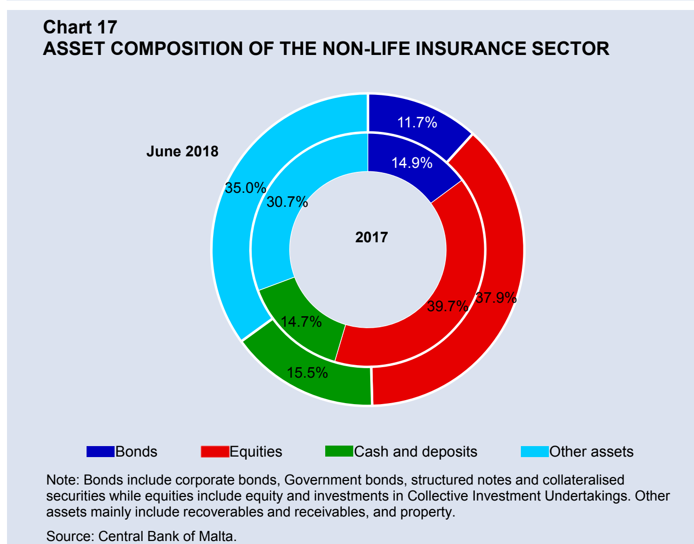
Profitability among the domestic non-life companies remained positive, with a net profit before

Chart 16
SOLVENCY CAPITAL RATIO OF THE LIFE INSURANCE SECTOR
(per cent)



Sources: Central Bank of Malta; EIOPA Risk Dashboard, October 2018.

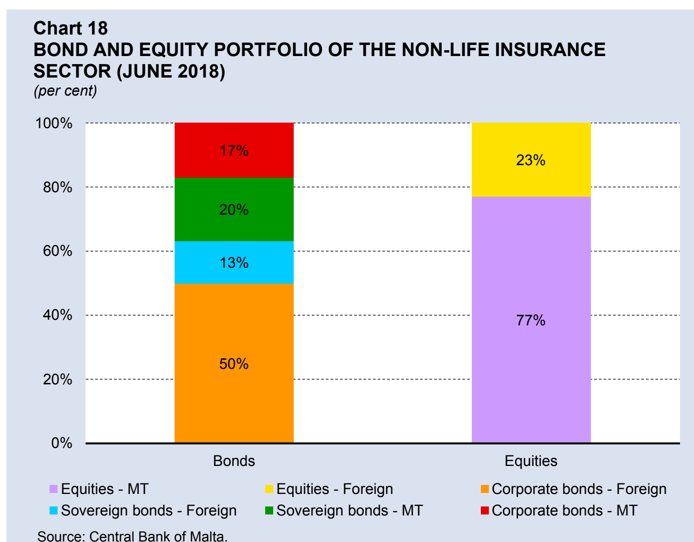
Chart 17
ASSET COMPOSITION OF THE NON-LIFE INSURANCE SECTOR



Note: Bonds include corporate bonds, Government bonds, structured notes and collateralised securities while equities include equity and investments in Collective Investment Undertakings. Other assets mainly include recoverables and receivables, and property.

Source: Central Bank of Malta.

Chart 18
BOND AND EQUITY PORTFOLIO OF THE NON-LIFE INSURANCE SECTOR (JUNE 2018)
(per cent)

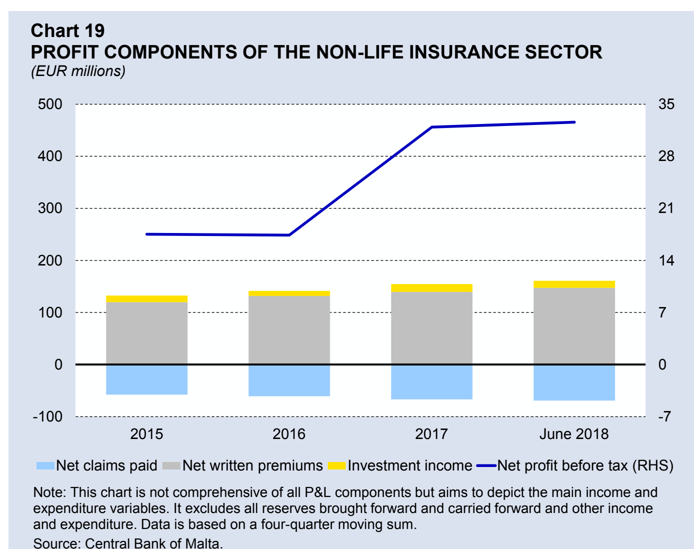


Source: Central Bank of Malta.

[45] The SCR reflects the amount of capital required to meet all obligations over one year, taking into account underwriting risk, pricing risk, provisional risk, market risk, credit risk, liquidity risk and operational risk, and is measured at a 99.5% VaR confidence level. Breach of an adequate level of capital commensurate with the risks faced by the individual insurers will compromise the protection of policyholders and beneficiaries, and result in supervisory consequences. The MCR reflects the minimum level of security below which the amount of financial resources should not fall. If the level of eligible basic own funds falls below the MCR, the authorisation of the insurer would be withdrawn. Source for EU median: EIOPA Risk Dashboard – October 2018.

tax of €32.6 million in June 2018, increasing by 2.1% during the first half of the year (see Chart 19). This was spurred by a rise in net written premia which rose by 5.5% and was in part outweighed by a 3.5% increase in net claims paid. Investment returns dropped by 9.8% on the back of adverse market movements. By the first half of 2018, the post-tax return on premia stood at 13.9%, down from 17.0% at the end of 2017.[46]

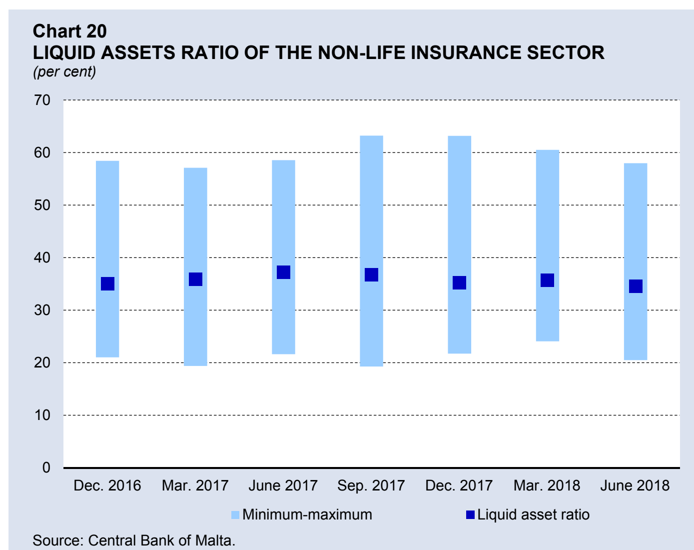
Chart 19
PROFIT COMPONENTS OF THE NON-LIFE INSURANCE SECTOR
(EUR millions)



Note: This chart is not comprehensive of all P&L components but aims to depict the main income and expenditure variables. It excludes all reserves brought forward and carried forward and other income and expenditure. Data is based on a four-quarter moving sum.
Source: Central Bank of Malta.

The combined ratio stood at 84.6% in June 2018 down from 85.6% in 2017, remaining significantly below the 100% threshold.[47] This ratio indicated better underwriting performance than in the rest of the EU countries with a median of around 97% in June 2018.[48] The return on excess of assets over liabilities of the non-life segment rose to 12.1% from 11.8% in 2017, whereas the ROA after tax dropped from 5.9% in 2017 to 5.6% in June 2018, owing to a faster growth in assets than profits.

Chart 20
LIQUID ASSETS RATIO OF THE NON-LIFE INSURANCE SECTOR
(per cent)



Source: Central Bank of Malta.

The liquidity level of the non-life insurance sector was lower than that for the life sector, with a liquid assets ratio of 34.6% in June 2018, falling by 0.7p.p. from December 2017. The lower liquidity levels reflected the intragroup equity holdings and recoverables and receivables which are deemed less liquid asset classes (see Chart 20).[49]

The median SCR of the domestic non-life sector stood at 224.2%, down from 254.0% in December 2017. Such drop was driven by a stronger increase in SCR than in own funds, the latter largely Tier 1. However,

[46] Return to premium is calculated as profit after tax as a proportion of net premium.

[47] The combined ratio is measured as the sum of net claims incurred and the net operating expenses as a proportion of net earned premia. A combined ratio of less than 100% portrays underwriting profit as insurers are taking in more in premia than paying out in claims and other expenses. Net claims incurred are reported when an insured event has happened and against which the insurer may be liable if a claim is made. Conversely, net claims paid are triggered at the time a claim is paid, rather than at the time a claim is first reported or at the time the injury or damage occurs.

[48] Source: EIOPA Risk Dashboard October 2018.

[49] Intragroup equity holdings account for 22.5% of assets and receivables and recoverables represent another 14% of assets. These carry a zero weighting when determining the extent of liquidity.

this indicator remained higher than the EU median of around 207% in June 2018 (see Chart 21).[50]

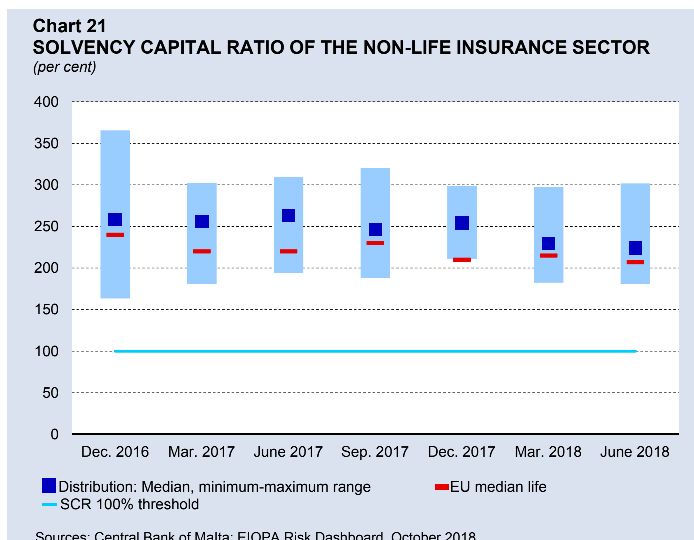
The domestic investment funds maintained an overall stable investment strategy.

Domestic investment funds

By the end of June 2018, 60 sub-funds were considered as the most domestically-relevant given that their main investors are residents of Malta.[51] The total assets of these funds stood at €2.2 billion in June 2018, up by 6.4% during the first half of the year. In terms of GDP, total assets of these funds stood at 18.7%. Overall, the domestic investment funds sector consisted of 35 retail Undertakings for the Collective Investment in Transferable Securities (UCITS) (62.9% of the domestic funds' total assets), followed by seven Alternative Investment Funds (AIF) (24.4%), 15 Professional Investor Funds (PIF) (12.5%) and three retail non-UCITS (0.2%).

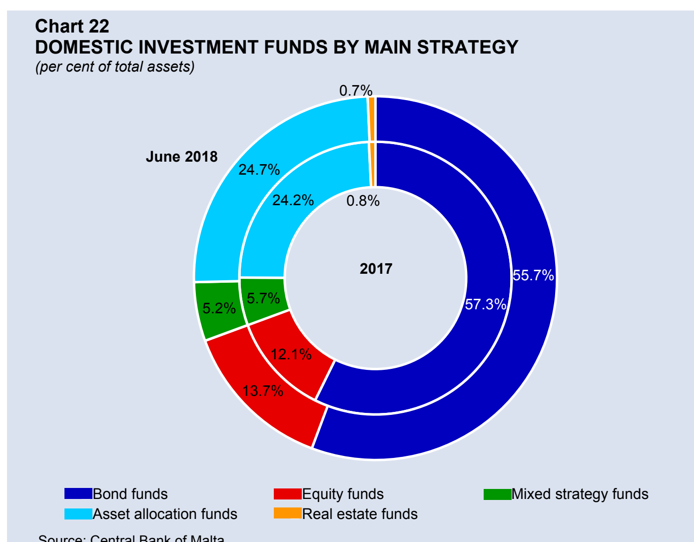
In terms of their main investment strategy, the majority of domestic investment funds were bond funds, with the rest mainly split among asset allocation funds, equity funds, mixed strategy and real estate funds (see Chart 22). Overall, the funds' strategies remained fairly stable in the first half of the year, with the share of bond funds decreasing from 57.3% in 2017 to 55.7% in June 2018 and equity funds increasing by 1.6 percentage points since December 2017. During the period under review deposits and cash rose at the expense of bond and equity holdings (see Chart 23). One AIF provided loans mainly outside the EU and accounted for 3.4% of the overall funds' assets, which dropped by 0.7p.p. since December 2017.

Chart 21
SOLVENCY CAPITAL RATIO OF THE NON-LIFE INSURANCE SECTOR
(per cent)



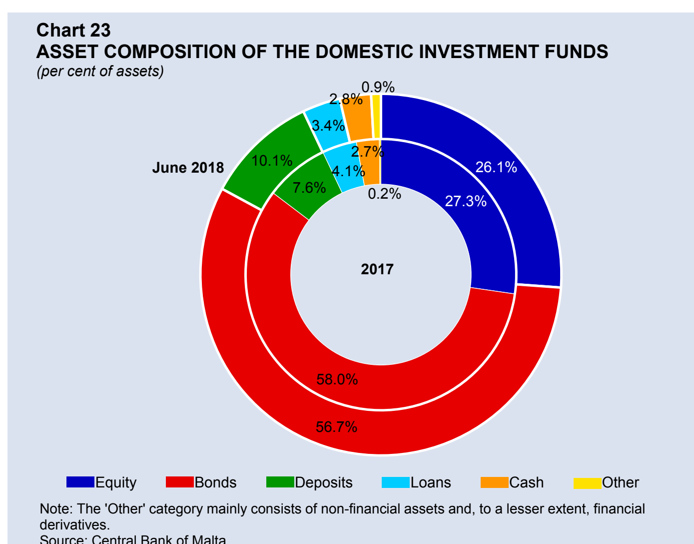
Sources: Central Bank of Malta; EIOPA Risk Dashboard, October 2018.

Chart 22
DOMESTIC INVESTMENT FUNDS BY MAIN STRATEGY
(per cent of total assets)



Source: Central Bank of Malta.

Chart 23
ASSET COMPOSITION OF THE DOMESTIC INVESTMENT FUNDS
(per cent of assets)



Note: The 'Other' category mainly consists of non-financial assets and, to a lesser extent, financial derivatives.
Source: Central Bank of Malta.

[50] Source: EIOPA Risk Dashboard, October 2018.

[51] Due to revisions the total number of domestically-relevant sub-funds stood at 55 as at December 2017 with total assets equivalent to €2.1 billion.

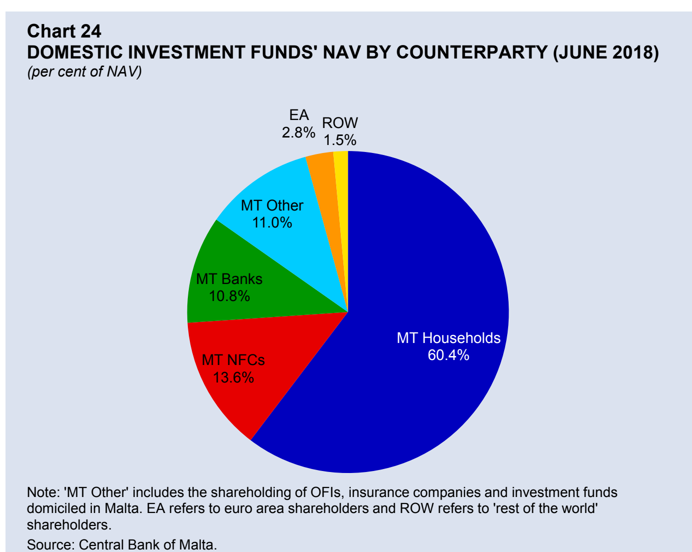
Since December 2017, the bond portfolio expanded by 4% to €1.2 billion, half of which in MGS. Around 35% of the bond portfolio was in corporate bonds and another 10% in bank bonds issued in Malta, the United States and in the United Kingdom. Corporate bonds amounted to around €434 million in June 2018 and were largely issued by 'captive financial institutions and money lenders' situated in Malta and in other Eurozone countries and by non-financial corporations (NFC) based in Malta, the United States, and in other European countries.

Equity holdings rose by 2.0% to €566.4 million in June 2018, predominantly due to higher units in investment funds domiciled in Malta, other European countries and in the United States. Holdings of equities issued by OFIs in the United States also rose.

Most of the domestic investment funds do not use leverage as 98.3% of funding is sourced from investors' money. Leverage among funds is also limited by regulation.[52] Overall, investors in domestic investment funds are predominantly resident households (60.4%), NFCs (13.6%) and local banks (10.8%) (see Chart 24).[53] Maltese households largely invested in retail UCITS, followed by AIFs, non-UCITS and PIFs, but to a lesser extent. Resident NFCs largely invested in PIFs and retail UCITS but also have limited exposures towards AIFs and PIFs. Domestic banks are largely invested in AIFs with limited exposures in retail UCITS and PIFs. Domestic insurers are largely invested in retail non-UCITS and AIFs. In June 2018, units in investment funds accounted for 5.1% of households' financial assets whereas those held by NFCs represented just 1.2% of their balance sheet. This reflected the limited exposure of both the household and NFC sectors to these investments.

Potential financial stability risks stemming from the domestically-relevant investment funds are deemed to be low reflecting their conservative investment strategies. Furthermore investment funds are set up as separate legal entities subject to the provisions in the Maltese companies' law and the Investment Services Act with embedded tools such as gating mechanisms and liquidity fees to limit any potential runs. However, this does not rule out reputational risk to banks as well as step-in risk, whereby entities may provide financial aid to related companies.[54] The key risk exposure of the domestic funds is potential reassessment of risk premia owing to heightened uncertainty driven by geopolitical events which could lead to higher redemption rates and interest rate reversals predominantly in view of the fixed-income portfolio of these funds.

Chart 24
DOMESTIC INVESTMENT FUNDS' NAV BY COUNTERPARTY (JUNE 2018)
(per cent of NAV)



Note: 'MT Other' includes the shareholding of OFIs, insurance companies and investment funds domiciled in Malta. EA refers to euro area shareholders and ROW refers to 'rest of the world' shareholders.
Source: Central Bank of Malta.

[52] UCITS are allowed to use borrowing facilities only provided that such borrowing is on a temporary basis and not exceeding 15% of total assets. Moreover, global exposure through the use of financial derivative instruments should not exceed the total net value of their portfolio. Experienced PIF are allowed to borrow for investment purposes and use leverage via the use of derivatives. Leverage is restricted to 100% of NAV. There are no leverage restrictions for Extraordinary and Qualifying PIF.
[53] There is no split by counterparty for Rest of the World (ROW).
[54] 24 sub-funds (63.6% of the domestic sub-funds' NAV) are managed by the core domestic banks.

APPENDIX

Appendix:
Financial Soundness Indicators

	Core Domestic Banks					Non-Core Domestic Banks					International Banks					Total Banks				
	2014	2015	2016	2017	June 2018	2014	2015	2016	2017	June 2018	2014	2015	2016	2017	June 2018	2014	2015	2016	2017	June 2018
Core FSIs																				
Regulatory capital to risk-weighted assets[1]	14.44	15.00	16.16	17.28	17.01	17.44	22.11	15.48	16.66	17.30	69.15	56.34	49.20	47.16	50.82	25.65	21.75	21.17	21.63	21.80
Regulatory Tier 1 capital to risk-weighted assets[1]	11.53	12.15	13.58	15.19	15.25	17.05	18.59	12.27	13.29	16.91	69.14	56.19	46.41	44.54	48.24	23.58	19.19	17.50	19.34	20.07
Non-performing loans net of specific provisions and interest in suspense to total own funds[1]	41.03	44.17	20.44	22.37	24.68	7.71	7.86	11.97	6.88	4.61	2.96	5.72	9.25	12.60	10.48	18.24	25.00	19.10	18.17	18.31
Non-performing loans to total gross loans[1]	7.56	7.22	5.35	4.11	4.18	4.37	4.04	3.45	2.26	2.05	0.69	1.18	2.15	1.66	1.80	3.99	4.68	4.13	3.05	3.13
Sectoral distribution of resident loans to total loans																				
Agriculture	0.24	0.23	0.19	0.16	0.14	0.00	0.00	1.99	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.14	0.14	0.12	0.09	0.08
Fishing	0.09	0.10	0.07	0.35	0.22	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.05	0.06	0.05	0.20	0.13
Mining and quarrying	0.06	0.09	0.07	0.02	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.04	0.05	0.04	0.01	0.01
Manufacturing	2.73	2.75	2.57	2.59	2.70	0.55	0.57	0.31	0.43	0.34	0.00	0.09	0.01	0.01	0.01	1.67	1.68	1.60	1.52	1.62
Electricity, gas, steam and air conditioning supply	2.93	2.15	2.30	1.18	1.53	5.14	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	2.04	1.30	1.41	0.68	0.90
Water supply; sewerage waste management and remediation activities	0.63	0.54	0.46	0.43	0.40	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.38	0.33	0.28	0.25	0.24
Construction	7.32	5.24	4.88	4.63	4.42	0.00	0.00	0.03	2.51	2.72	0.00	0.00	0.00	0.00	0.00	4.39	3.15	2.99	2.79	2.75
Wholesale and retail trade; Repair of motor vehicles and motor cycles	8.27	8.19	7.80	7.14	6.60	0.67	1.11	0.42	2.23	2.13	0.00	0.17	0.00	0.00	0.00	5.00	4.99	4.80	4.23	4.02
Transportation and storage	2.82	2.80	2.30	1.98	1.78	0.80	0.00	0.00	0.00	0.00	0.11	0.00	0.15	0.16	0.21	0.04	1.76	1.46	1.21	1.13
Accomodation and food service activities	3.78	4.12	3.47	2.79	3.02	0.03	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	2.27	2.48	2.12	1.62	1.78
Information and communication	0.93	0.83	0.67	0.48	0.55	0.11	0.11	0.02	0.07	0.02	0.00	0.02	0.00	0.00	0.00	0.56	0.50	0.41	0.28	0.33
Financial and insurance activities	4.79	5.86	6.79	6.64	6.09	0.74	0.90	2.59	3.71	3.99	0.02	0.14	1.31	0.06	0.08	2.92	3.58	4.74	4.03	3.84
Real estate activities [includes inputed rents of owner-occupied dwellings]	6.63	6.70	7.26	7.09	7.32	3.55	3.50	4.18	4.36	3.57	0.00	0.53	0.03	0.00	0.00	4.17	4.37	4.70	4.29	4.52
Professional, scientific and technical activities	0.87	1.12	1.26	0.98	1.66	0.00	0.00	0.00	0.86	0.62	0.00	0.00	0.00	0.00	0.00	0.52	0.68	0.77	0.61	1.02
Administrative and support service activities	1.37	1.22	1.02	1.00	0.65	0.08	0.11	0.69	1.09	0.24	0.01	0.02	0.01	0.03	0.03	0.83	0.74	0.67	0.64	0.40
Public administration and defence; Compulsory social security	1.54	1.58	1.13	1.30	1.26	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.92	0.95	0.69	0.76	0.75
Education	0.36	0.44	0.33	0.30	0.27	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.21	0.27	0.21	0.17	0.16
Human health and social work activities	0.67	0.73	0.71	0.75	0.72	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.01	0.40	0.44	0.44	0.44	0.43
Arts, entertainment and recreation	0.52	0.47	0.38	0.33	0.31	0.39	0.00	0.00	0.00	0.00	0.00	0.00	0.02	0.00	0.00	0.33	0.29	0.24	0.19	0.18
Other services activities	0.28	0.27	0.21	0.18	0.20	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.17	0.16	0.13	0.11	0.12
Households and individuals (excl. Sole Proprietors)	43.60	46.18	48.26	47.51	46.51	0.11	0.14	0.14	2.62	2.70	0.01	0.02	0.01	0.00	0.01	26.15	27.78	29.56	27.66	27.66
Mortgages	36.87	39.77	42.28	42.37	41.70	0.01	0.01	0.01	0.00	0.00	0.01	0.01	0.01	0.00	0.00	22.11	23.91	25.89	24.57	24.67
Activities of extraterritorial organisations and bodies	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Non-resident loans to total loans	9.60	8.37	7.84	12.19	13.63	87.82	93.57	89.61	82.10	83.67	99.86	99.02	98.46	99.73	99.65	46.80	44.31	42.57	48.24	47.94
Return on assets[2]	0.71	0.71	0.76	0.70	0.61	-1.32	0.18	0.30	0.25	0.18	0.86	1.01	0.96	1.48	0.88	0.71	0.85	0.84	1.04	0.71
Return on equity[2]	9.82	9.84	10.06	9.20	7.62	-6.42	1.44	3.38	2.94	1.91	2.38	3.38	3.65	4.91	3.92	3.62	5.87	6.72	7.33	6.03
Interest margin to gross income	64.84	64.48	62.25	70.79	68.85	46.31	43.54	31.24	31.06	29.90	201.85	137.81	92.57	78.82	87.56	115.13	92.96	72.99	73.28	75.48
Non-interest expense to gross income	51.23	54.15	52.21	58.80	71.23	56.14	73.39	66.52	78.25	71.95	11.87	24.78	31.89	28.13	37.39	36.76	43.31	44.70	44.04	55.93
Non-interest income to gross income	35.16	35.52	37.75	29.21	31.15	53.69	56.46	68.76	68.94	70.10	-101.85	-37.81	7.43	21.18	12.44	-15.13	7.04	27.01	26.72	24.52
Liquid assets to total assets	28.31	31.77	36.52	38.56	28.20	31.68	36.34	31.55	38.82	23.46	19.67	22.72	30.14	33.13	28.84	27.28	31.19	35.39	37.96	27.85
Liquid assets-to-short-term liabilities[3]	50.42	50.24	55.80	43.49	41.80	77.92	63.26	62.69	37.36	27.94	84.73	83.59	96.31	43.69	65.54	53.89	52.61	58.34	42.96	41.95
Other FSIs																				
Total coverage ratio[4]	40.40	43.52	45.91	45.16	43.47	77.11	65.24	53.86	65.89	83.06	40.45	50.37	54.81	42.26	61.27	37.54	39.98	47.96	45.32	49.01
Liquidity Coverage Ratio		165.10	164.43	188.29	183.79		100.17	194.89	263.87	415.49		188.27	357.63	280.69	234.51		159.65	173.87	198.28	195.54
Domestic debt securities to total assets	9.63	9.30	7.90	7.01	7.03	4.56	7.74	4.86	3.16	2.32	0.00	0.17	0.09	0.15	0.12	3.86	4.54	4.02	3.57	3.71
Foreign debt securities to total assets	23.25	21.80	20.62	16.84	17.01	19.48	12.45	14.96	11.87	12.10	52.44	50.39	46.91	42.65	34.37	39.93	35.99	32.83	28.89	24.40
Unsecured loans to total lending	28.97	27.41	25.36	27.70	29.38	65.23	70.87	65.39	67.16	72.16	48.44	30.69	26.69	16.23	15.89	37.70	30.83	28.18	24.97	26.77
Assets to total capital and reserves	14.05	13.72	13.33	11.99	12.16	8.41	8.42	12.12	11.49	8.97	1.67	1.96	2.91	3.36	3.02	6.43	7.98	9.56	9.25	8.90
Large exposure to total own funds[1]	103.40	96.48	110.84	87.83	103.63	339.94	157.63	268.57	275.75	274.30	45.31	129.94	129.91	133.01	93.04	88.86	115.83	130.45	115.60	114.73
Gross asset position in financial derivatives to total own funds[1]	1.08	1.27	1.65	0.87	0.90	0.84	0.33	0.61	0.29	0.71	15.74	67.23	104.36	131.23	174.30	8.93	25.85	41.02	42.69	57.77
Gross liability position in financial derivatives to total own funds[1]	4.49	2.02	2.04	1.03	1.12	2.24	0.27	3.60	0.29	0.11	10.43	15.86	69.19	80.23	111.66	10.43	15.34	22.57	26.41	37.30
Personnel expenses to non-interest expenses	50.81	51.18	48.76	48.05	38.78	44.98	42.46	49.74	45.61	48.85	27.40	23.18	19.88	16.22	14.93	47.40	43.95	40.52	37.58	32.17
Customer loans to customer deposits	63.98	58.22	55.95	58.87	61.07	75.69	60.68	46.51	47.14	51.91	93.05	104.08	108.14	111.55	105.76	71.79	67.89	65.66	70.35	71.02
Net open position in equities to total own funds[1]	14.43	15.44	14.01	13.10	12.68	44.97	81.83	146.79	138.95	109.68	0.26	2.74	1.45	3.39	0.93	8.98	18.10	21.87	18.58	17.11
Loan-to-value:																				
Residential	74.18	75.25	75.10	73.53	72.85															
Commercial[5]	69.00	62.99	67.50	65.14	43.73															

[1] Capital data based on the COREP returns from 2014. Large exposures is based on COREP returns from 2015. NPL data based on FINREP returns from 2014. Specific provisions for June 18 refer to stage 3 allowances.
[2] Based on profit after tax.
[3] The liquid assets-to-short-term liabilities ratios for 2017 and June 2018 are based on COREP returns.
[4] For the core domestic banks the ratio includes 'Reserve for General Banking Risks' as per the revised Banking Rule 09/2016.
[5] The market share of the banks was adjusted to cater solely for the banks that provided commercial real estate loans. Also, the limited volume transactions of such loans reflects the volatility in the weighted indicators.