



# BANK ĊENTRALI TA' MALTA

EUROSISTEMA

# CENTRAL BANK OF MALTA

## INTERIM FINANCIAL STABILITY REPORT 2017

This *Interim Report* covers the first six months of 2017 and evaluates developments which may impact the resilience of the domestic financial system since the publication of the *Financial Stability Report 2016*. It also analyses whether any new risks have emerged.<sup>1</sup> The *Interim 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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***The Maltese financial sector remained sound and resilient, evidenced by healthy capital levels and ample liquidity buffers. Financial institutions remained prudent limiting excessive risk-taking despite a challenging environment of low interest rates coupled with pressing external challenges. The outlook for the rest of the year is positive but financial institutions are encouraged to actively mitigate any emerging vulnerabilities.***

During the first six months of 2017 profitability weakened further but still remained at healthy levels. Slow credit growth compounded with further accumulation of liquidity continued to affect banks' profitability, largely due to rollovers of maturing paper in lower yielding financial instruments. However, in case of income from financial intermediation, core domestic banks continued to largely weather the effects of low interest rates by maintaining stable margins. Over the years, credit demand decelerated steadily, buoyed solely by mortgage lending, as otherwise consumer credit and lending to resident non-financial corporates (NFC) contracted. The latter mirrors changes in the economic landscape with the economy becoming more services-oriented and less capital-intensive. However it also reflects the fact that NFCs are increasingly retreating from bank funding and tapping either internal funds or accessing the capital market. Looking ahead, the persistence of these factors, together with upcoming regulatory changes which may require higher loan-loss provisions and possibly higher funding costs will continue to pose challenges for banks' profitability.

Risks from the residential real estate market have attenuated. Banks have not engaged in excessive risk-taking, with lending policies remaining conservative. Credit standards remained relatively tight as evidenced by the weighted average loan-to-value and debt service-to-income ratios for residential real estate loans which stood at 72.7% and 23.8%, respectively. Also loans channelled to the domestic construction and real estate sector by core domestic banks declined further to 11.6% of their overall loan portfolio.

Loan quality continued to improve during the first half of 2017 as indicated by a further decline in the non-performing loans (NPL) ratio. The outstanding value of NPLs contracted owing to write-offs and improved creditworthiness supported by a growing economy, favourable labour market developments and rising incomes. From a policy perspective, the enforcement of Banking Rule 09/2016 as from January 2017 is bound to lead to further declines in the NPL ratio, freeing up capital which can be allocated for other income-generating activities.

Potential systemic implications stemming from the non-core domestic and international banks remained low owing to limited links with the Maltese economy. While their business model varied considerably, both groups of banks continued to operate prudently with high capital buffers and ample liquidity. Furthermore, following

<sup>1</sup> The cut-off date for the analysis is 6 September 2017.

periods of relatively weak performance by a few banks, efforts have been made to alter their business focus and operating structure to boost efficiency and overall profitability. Similarly, no systemic implications were identified from the domestically-relevant insurance and investment fund sectors.

On balance, the overall level of risk to financial stability in Malta attenuated further as indicated by most of the financial soundness indicators which remained stable or improved. The favourable economic background continued to buttress the financial sector though there are areas that warrant vigilance.

While lending to NFC remained subdued, lending to mortgages maintained its strong momentum, in line with economic growth. In light of these developments banks need to preserve conservative lending policies. While, the overall level of NPLs declined, more effort needs to be employed by banks to reduce further their stock of legacy NPLs.

Regulatory and supervisory measures call for banks to strengthen further their capital buffers. Furthermore, owing to the increasing sophistication and intensification of cyber-attacks and unauthorised data leakages, banks need to continue to increase their resilience against the crippling effects of such attacks.

Table 1 presents the key vulnerabilities of the domestic financial sector highlighting the changes in risk levels since the *Financial Stability Review 2016* and provides an outlook for the second half of 2017.

<b>Table 1 SUMMARY OF RISKS</b>				
<b>Main vulnerabilities and risks for the financial system</b>	<b>Type of risk</b>	<b>Nature of risk</b>	<b>Change in risk level since FSR 2016</b>	<b>Risk outlook for H2 2017</b>
<b>Vulnerabilities within the financial system</b>				
The level of non-performing loans	Credit	Cyclical/ Structural	↓	↔
Concentration in bank lending	Credit	Structural	↔	↔
Subdued credit developments	Profitability	Structural	↔	↔
Interlinkages between banks and the non-bank financial sector	Contagion	Structural	↔	↔
<b>Vulnerabilities outside the financial system</b>				
Domestic macroeconomic developments	Credit, Profitability	Cyclical	↓	↔
Performance of key economic sectors reliant on bank credit	Credit	Cyclical/ Structural	↓	↔
Real estate market developments	Credit/Contagion	Cyclical	↔	↔
Exposures of the financial sector to domestic sovereign securities	Profitability	Structural	↓	↓
Economic conditions in the euro area and public debt sustainability	Credit, Profitability	Cyclical	↓	↔
Geopolitical uncertainties	Contagion	Structural	↑	↔
Prolonged low interest rate environment	Profitability	Cyclical	↔	↔
<b>Risk position</b>		<b>Direction of risk</b>		
Moderate		Increased risk	↑	
Medium		Stable risk	↔	
Elevated		Decreased risk	↓	

**The Maltese economy continued to support the soundness of financial institutions, weathering headwinds from geopolitical uncertainties.**

The global economic recovery initiated in the second half of 2016 was maintained throughout the first half of this year, with world economic growth expected to reach 3.6%, driven by both advanced and emerging economies.<sup>2</sup> The recovery is still on-going with some countries still experiencing weak growth and below-target inflation amid geopolitical tensions.

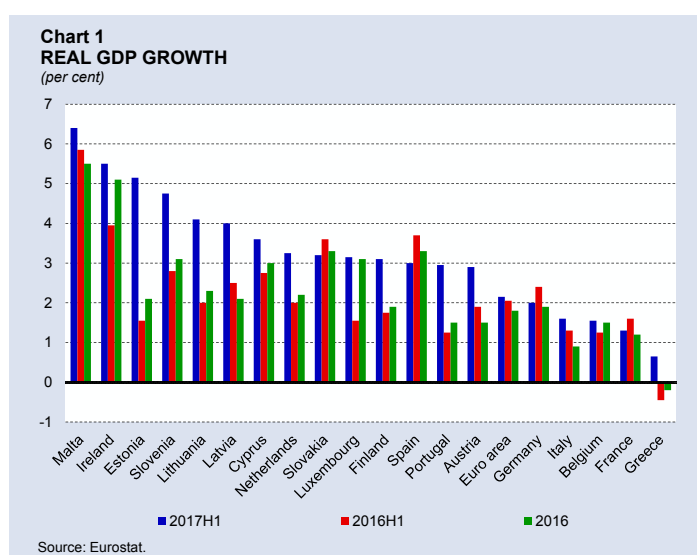
In the euro area, growth was driven primarily by higher private consumption spurred by favourable labour market developments. Albeit remaining higher than in pre-crisis levels, the unemployment rate in the euro area dropped to 9.1% in June 2017, with persistently wide divergences across countries. Investment continued to grow in 2017 and is expected to rise moderately, on the back of low financing costs and improving global economic prospects. However, the level of investment remained below pre-crisis levels casting some doubts on the sustainability of the euro area economic recovery and potential growth. Looking ahead, the euro area economy is anticipated to expand by 1.6% in real terms in 2017 and 1.8% in 2018, respectively. However, geopolitical uncertainties, elevated sovereign debt levels, high unemployment rates, uncertain US policies and Brexit negotiations could all adversely impact economic growth.<sup>3</sup>

Concerns on the euro area sovereign debt sustainability persisted as public debt to GDP is expected to remain elevated at 90.4% in 2017, with public deficit falling to 1.4%.<sup>4</sup>

While economic recovery in the euro area is underway, inflation remained subdued at 1.3% in June 2017, remaining short of the 2% ECB target.<sup>5</sup> In this regard, the ECB maintained its official policy rates unchanged, with the main refinancing rate and the marginal lending facility rate standing at 0% and 0.25%, respectively whereas the overnight deposit facility rate remained in negative territory at -0.4%. In October 2017, the ECB reduced the monthly asset purchases from €60 billion to €30 billion, but extended the programme until September 2018 or until such a time that there is evidence of a sustainable adjustment in inflation.

The low interest rate environment exerted some pressures on banks' profitability, which could be attenuated with the steepening of the yield curve. However, evidence suggests that the current monetary policy stance is not impinging on banks' profitability, as banks are benefiting from the monetary stimulus. Although banks continued to improve their performance and capital positions, some structural impediments remained in some countries owing to the high stock of legacy non-performing loans (NPL), the overcapacity in specific markets, and business models prone to low income diversification and cost inefficiencies.

The Maltese economy continued to grow steadily posting one of the highest growth rates across the euro area, with real GDP rising by an annual 6.4% in the first half of 2017 and is anticipated to grow further in 2017 (see Chart 1).<sup>6</sup> Growth was mainly fuelled by external demand. Government finances improved



<sup>2</sup> Source: IMF World Economic Outlook, October 2017; ECB Financial Stability Review, November 2017.

<sup>3</sup> Source: European Economic Forecast, Winter 2017, European Commission.

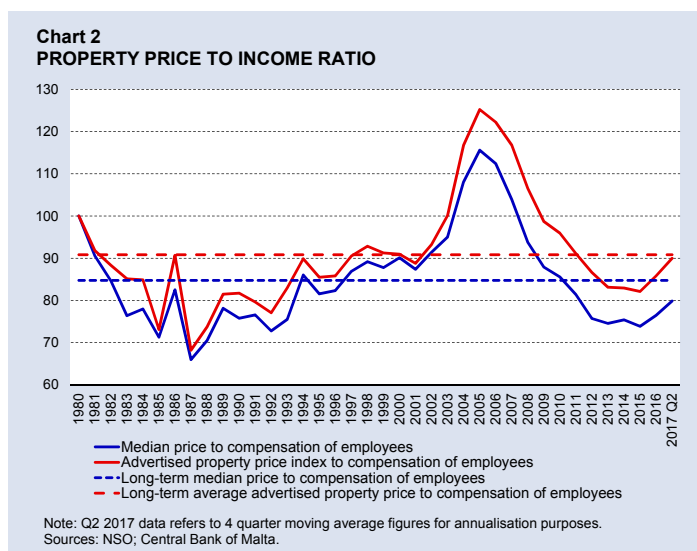
<sup>4</sup> Source: European Economic Forecast, Winter 2017, European Commission.

<sup>5</sup> At 2% in the second quarter of 2017, wage growth remained suppressed even though there was a marginal pick up when compared to 1.6% in the last quarter of 2016.

<sup>6</sup> Source: NSO News Release 141/2017.

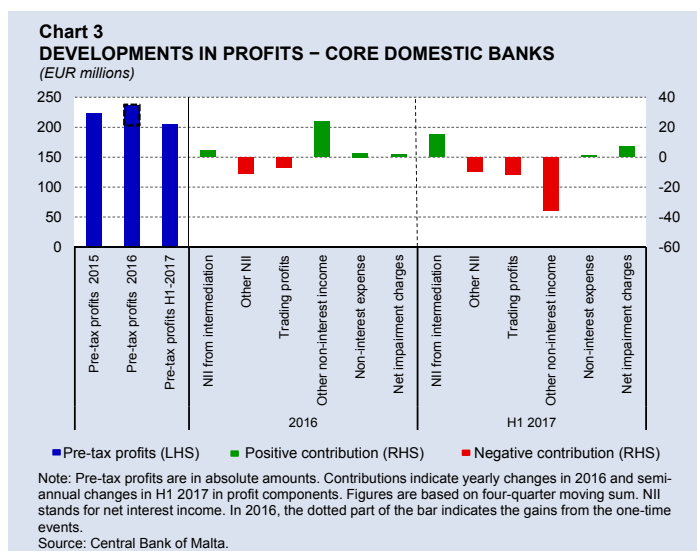
with the Government balance turning to a surplus of 2.0% of GDP in the second quarter of the year, with the debt-to-GDP ratio concurrently falling further to 56.8%.<sup>7</sup> The labour market has been improving on the back of robust growth, with the unemployment rate reaching a historical low of 4.1% by mid-2017. Inflation picked up marginally to 1.0% in June 2017, up from 0.9% in 2016 and remained below euro area inflation.<sup>8</sup>

In the first half of 2017 transacted property prices grew by 5.3% over the same period a year earlier. Prices grew at a slower pace than nominal GDP and lost some momentum compared with the same period a year earlier, easing somewhat the potential build-up of risks stemming from the real estate market. Although the median advertised property price-to-income ratio has been rising in recent quarters, it still remained below the long-term average (see Chart 2).<sup>9</sup> Households continued to accumulate financial wealth, in line with the rise in compensation for employees, though household debt largely through mortgages increased.<sup>10</sup>



**Credit risk abated further and profitability of the core domestic banks remained healthy. Customer deposits continued to flow in, further enhancing their liquidity levels, while capital buffers remained adequate.**

The profitability of the core domestic banks deteriorated in the first half of 2017 but they still fared comparatively better than their euro area peers.<sup>11</sup> Profits before tax contracted by around 14% to €203.9 million pushing down the return on equity (ROE) and return on assets (ROA) to 8.5% and 0.6%, respectively in June 2017 from 10.2% and 0.7% in December 2016 (see Chart 3).<sup>12</sup> This weakening was mainly affected by a number of one-off events reported in the previous year, including the realisation of profits from the sale of Visa Inc.<sup>13</sup>



<sup>7</sup> Source: *Quarterly Review 2017:4*, Central Bank of Malta.

<sup>8</sup> Source: *Quarterly Review 2017:4*, Central Bank of Malta.

<sup>9</sup> Advertised property prices are generally higher and rise at a faster pace than actual transacted property prices, reflecting the sellers' expectations.

<sup>10</sup> Source: NSO *News Release 141/2017*.

<sup>11</sup> The euro area ROE and ROA as at June 2017 are estimated to stand at approximately 4.2% and 0.3%, respectively. Source: ECB Consolidated Banking Data, Central Bank of Malta workings.

<sup>12</sup> Both ROE and ROA are based on four-quarter moving sum figures, on profits after tax. ROE before tax stood at 12.9%, down from 15.5% in December 2016. Likewise, ROA declined from 1.1% in the end of 2016 to 0.9% by mid-2017.

<sup>13</sup> Moreover, one particular bank reported one-time provision costs due to the winding-down of a business operation.

Should profits be adjusted to exclude such events, pre-tax profits would have improved marginally in the first half of 2017.<sup>14</sup>

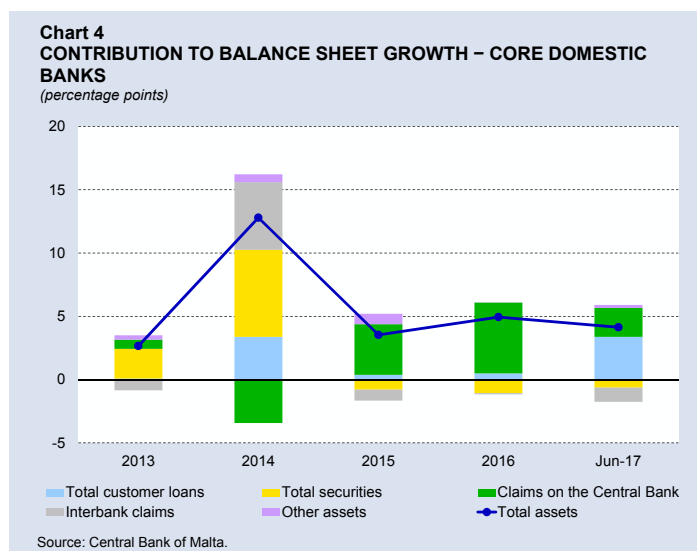
Given the one-time gains in the first half of 2016, non-interest income fell by 21.4% in June 2017 (see Chart 3). Trading profits also dropped mainly due to lower gains from fair value movements in financial assets held for trading. While fees and commissions remained the main source of non-interest income, this decreased marginally during the period under review. Over the past years, the contribution of fees and commissions in total operating income gained more relevance, mirroring the banks' efforts to structurally change their business model via income diversification to address pressures on profitability.

Core domestic banks continued to expand their balance sheets with assets growing by 4.1% in the first half of the year, reaching €22.6 billion and equivalent to 218% of GDP. This increase was largely driven by the loan portfolio which expanded by 7.2%, predominantly fuelled by participations in non-resident syndicate loans – a business stream which is specific to one bank (see Chart 4).<sup>15</sup> Developments in resident credit remained generally subdued, increasing by just 1.5% driven by higher lending for house purchases. Lending for consumer credit continued to contract, whereas lending to resident NFCs was weak turning positive in the first six months of the year, up by merely 0.4%. This turnaround reflected higher lending towards real estate, public administration and defence, manufacturing, and wholesale and retail trade sectors. Such rise in credit was partly offset by lower lending to accommodation and food services activities, information and communications, and professional, scientific and technical activities.

Asset growth continued to be funded through customer deposits, which grew by 2.3% in the first six months of the year. Higher intra-group funding gained relevance in total liabilities, financing the growth in non-resident syndicate loans. Other types of funding sources remained rather stable, with no significant changes.

Net interest income (NII) from intermediation activities remained the core domestic banks' prime income stream, accounting for more than half of gross income. Such NII rose by 5.0%, benefiting from the faster growth in loans than deposits. This is evidenced by the increase in the customer loan-to-deposit ratio to 58.7% in June 2017 from 56% in December 2016, remaining well below the euro area average of around 100%. Apart from the volume effect, the pricing effect also contributed to the improvement in NII as the weighted average deposit rate declined further, also reflecting the persistent shift towards demand deposits.<sup>16</sup>

Despite registering higher income from financial intermediation, the prolonged episode of low interest rates remained challenging for banks. Interest rates on deposits have approached the lower bound limiting further potential declines, possibly hampering NII. This concern is particularly amplified should credit channelled to the domestic economy remains subdued.



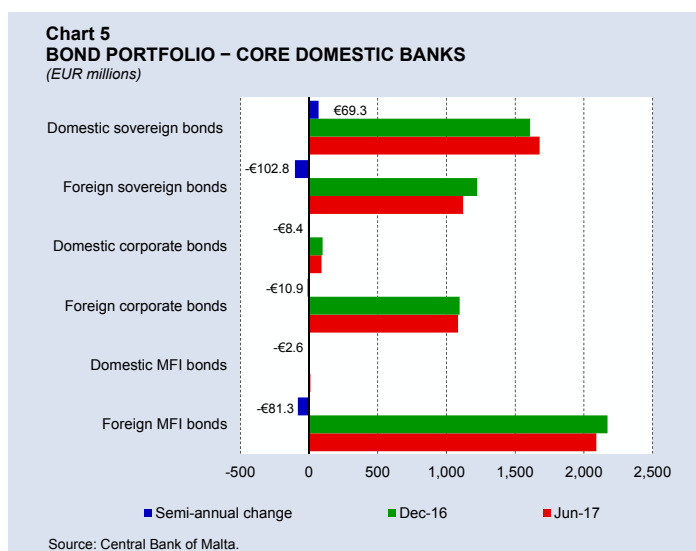
<sup>14</sup> The pre-tax ROE and ROA would however still decline marginally to 13.2% and 1%, respectively, as a result of the larger growth in equity and assets than in profits before tax.

<sup>15</sup> As a result, the share of non-resident lending to total lending increased from 7.8% in December 2016 to 12.8% in June 2017. However resident lending remain the main form of lending, accounting for around 87% of total loans.

<sup>16</sup> The weighted average rate of deposits fell by 0.05 percentage point in the first six months of the year to 0.34% in June 2017.

In spite of the negative interest rate, placements with the Central Bank of Malta expanded further, impinging on banks' profitability. This liquidity has been building up owing to the continuous flow of deposits, which in part are placed overnight with the Central Bank of Malta. Such reserves drove the increase in the high-quality liquid assets (HQLA), boosting the Liquidity Coverage Ratio (LCR) to 172.6% in June 2017, comfortably surpassing the regulatory minimum of 80% for 2017.<sup>17,18</sup> Central bank reserves accounted for 43.0% of HQLA, whereas sovereign paper holdings accounted for almost a third. The latter increased by 4.3%

in the first half of 2017, albeit the proportion in total assets remained unchanged at 7.4% (see Chart 5). This rise was more than offset by the contraction in foreign sovereign and MFI bond holdings, with the overall bond portfolio contracting by 2.2%.



As a result of a smaller bond portfolio NII from activities other than financial intermediation fell by 16.1%. This was however also impacted by the rolling-over of bonds into lower-yielding bonds. The drop in income was partially restored through a reduction in expenses, driven by lower net impairment charges which declined by 17.7%. Non-interest expenses fell marginally by 0.4% owing to lower staff costs and 'other' expenses. On the other hand, operating expenses largely administration and technology-related costs rose. Despite the minor improvement in non-interest expenses, the banks' efficiency weakened somewhat as reflected in the cost-to-income ratio which increased by almost four percentage points to 54.7% in the six months to June 2017.<sup>19</sup> This however still compares well with the euro area average of about 66%.<sup>20</sup>

The asset quality of core domestic banks continued to improve in the first half of 2017. Furthermore the revised Banking Rule 09/2016 has partly motivated banks to clean up their balance sheets. As a result, the outstanding level of NPLs contracted by 6.8% pushing down the NPL ratio by 0.7 percentage point to 4.6% in June 2017, below the euro area average. The growth in loans and advances has also contributed to push down the NPL ratio. NPLs remained largely related to the resident loan portfolio, with the total resident NPL ratio falling to 5.1%. In contrast non-resident NPLs increased by more than a fourth, but the NPL ratio remained limited to 2.2%.

From a sectoral perspective, the contraction in NPLs resulted from the resident corporate sector, with related NPLs dropping by almost 11%, largely concentrated in construction, and wholesale and retail trade sectors, which reduced the NPL ratio of resident NFCs by 1.3 percentage points to 11.2% (see Chart 6). This drop reflected the amount of legacy NPLs that were written off but also due to improved creditworthiness underpinned by robust economic growth. While credit quality of loans towards small and medium-sized enterprises (SME) improved, the related NPL ratio stood somewhat higher compared to that of large enterprises, at 11.7% and 9.3%, respectively.

<sup>17</sup> The LCR ratio is progressively being implemented in accordance with the CRR as follows: 60% from 1 October 2015, 70% from 1 January 2016, 80% from 1 January 2017, and 100% from 1 January 2018. The LCR will be fully phased in by 2018, one year earlier than required under Basel requirements.

<sup>18</sup> The ample liquidity by core domestic banks is also evidenced through the high liquid assets-to-short term liabilities ratio, which stood at 55.2%, above the 30% minimum requirement. Refer to Banking Rule 05/2007.

<sup>19</sup> In 2016, the cost-to-income ratio would stand at 53.5% if the one-time events had not occurred.

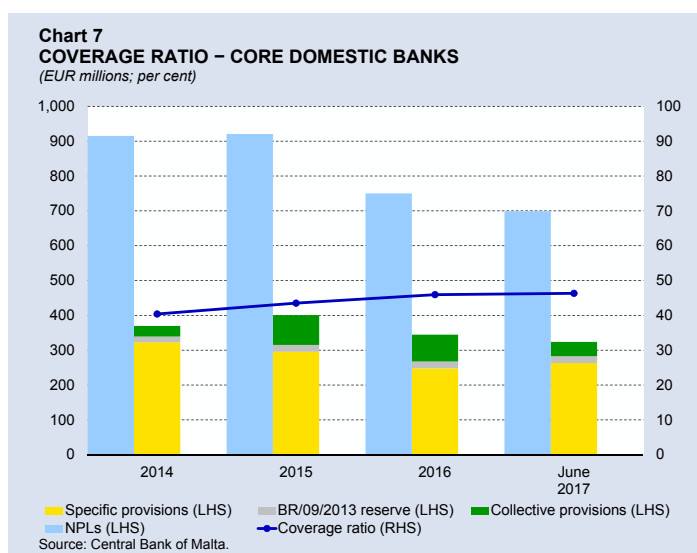
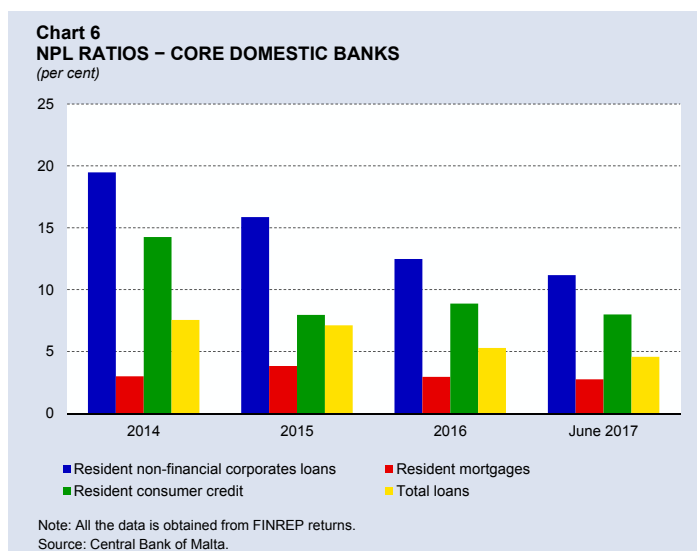
<sup>20</sup> Source: ECB Consolidated Banking Data. Figure refers to the first quarter of 2017.

Resident household NPLs contracted by 5.6% bringing down the resident household NPL ratio to 3.7% in June 2017, slightly lower than the level in December 2016. The mortgage NPL ratio stood at 2.8%, while that of consumer credit dropped to 8.0%.

The fall in NPLs led to a 6.0% decline in outstanding loan loss provisions, largely due to lower specific provisions. However, the faster drop in NPLs than provisions raised the coverage ratio by 0.4 percentage point to 46.3% (see Chart 7).<sup>21</sup> Apart from loan loss provisions, core domestic banks remained highly reliant on collateral, predominantly in the form of real estate. Banks applied conservative haircuts in the range of 10% to 30% on the value of this type of collateral. NPLs are more than fully covered when taking into consideration the level of loan loss provisions and the value of collateral backing such loans.

With regards to the quality of the bond portfolio, almost a third of these holdings consisted of high investment grade bonds whereas about half of the bonds are rated as medium-investment grade mirroring the relative concentration in Malta Government Stocks (MGS).<sup>22</sup> Low-rated bonds accounted for only less than 7% of total bonds held, whereas the rest were unrated.<sup>23</sup> None of the bond holdings were non-performing resulting in a non-performing exposure (NPE) ratio of just 3.3% as at the end of June 2017, down from 3.7% six months earlier.

The capital position of the core domestic banks weakened somewhat since end 2016, albeit remaining above the regulatory minima. This weakening was largely driven by some leveraging by a number of banks which stepped up their risk weighted exposures by 6.6%. Indeed, the leverage ratio rose by 0.2 percentage point to 6.3% based on the fully phased-in definition in the Capital Requirements Regulation (CRR).<sup>24</sup> In turn, the banks' risk profile calculated as risk weighted assets to total assets, increased by 1 percentage point to 48.1%. This development largely reflected the expansion in non-resident corporate lending. Excluding this



<sup>21</sup> The total coverage ratio includes specific and collective provisions together with "Reserve for General Banking Risks" as per Banking Rule 09/2013. Should collective provisions be excluded, the specific coverage ratio would increase by 4.6 percentage points to 37.7%.

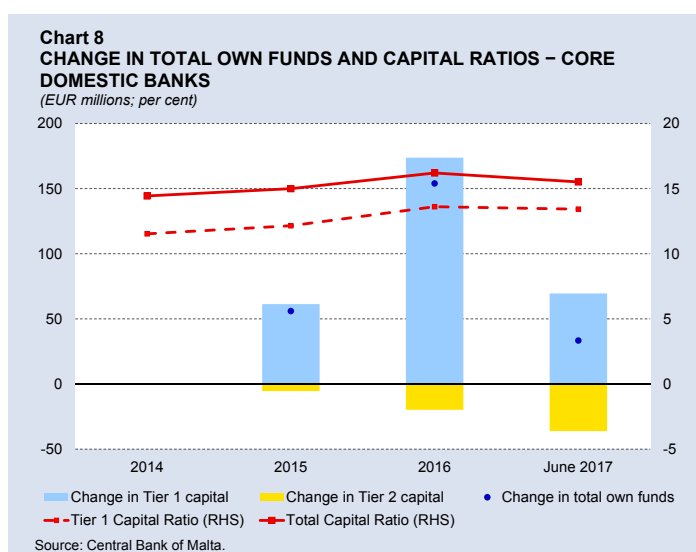
<sup>22</sup> High-rated investment grade bonds are AAA and AA-, medium-rated bonds are between A+ and A-, while low-rated investment grade bonds are between BBB+ and BBB-.

<sup>23</sup> The latter category includes a number of bonds which are unlisted.

<sup>24</sup> Refer also to the European Commission's Delegated Regulation (EU) 2015/62.

development, core domestic banks generally bettered their shock absorbing capabilities strengthening further their capital position.

Tier 1 capital expanded by 5.1% to €1.4 billion reflecting higher paid-up capital instruments (financed through retained earnings) and Tier 1 capital reserves (see Chart 8). In contrast, Tier 2 capital instruments and subordinated loans declined, leading to a more contained growth in total own funds of 2.1%. In June 2017 the Common Equity Tier 1 (CET 1) and the total capital ratio stood at 13.4% and 15.5%, respectively.



Capital Requirement Directive (CRD) IV also outlines a range of additional instruments meant to strengthen the resilience of the financial system. The gradual implementation of the capital conservation buffer led to an add-on of 1.25 percentage points on the CET1 ratio for 2017. The Countercyclical Capital Buffer (CCyB) has however remained unchanged at 0% due to subdued credit developments with the credit-to-GDP gap standing at 81.9% in June 2017, and its deviation from the long-term trend standing at -26.0 percentage points. The three domestic significant institutions are also subject to an Other Systemically Important Institutions (O-SII) buffer, as well as additional Supervisory Review and Evaluation Process (SREP) Pillar II requirements and guidance.<sup>25</sup> All banks met the required capital add-ons. Despite displaying adequate and healthy capital levels, banks ought to continue enhancing their capital buffers to ensure their sustainability over the longer term.

***Financial conditions of non-core domestic and international banks remained healthy. While their systemic footprint is limited, contagion implications cannot be excluded, warranting continuous monitoring.***

#### **Non-core domestic banks**

In the first six months of 2017 the balance sheet of the non-core domestic banks shrank by 5.4% to €2.3 billion, equivalent to 22.3% of GDP.<sup>26</sup> These developments were mainly impacted by one bank, which showed signs of deleveraging in the early months of 2017. The contraction in total assets was largely driven by lower loans granted to unrelated credit institutions and also due to the selling of bank bonds.<sup>27</sup> As a result of these developments 'claims on banks' as shown in Chart 9 declined by 14.8% and accounted for around a quarter of total assets.

Claims on non-banks also contracted by 8.5% in the first six months of 2017 mainly reflecting lower lending to non-resident 'other financial institutions' (OFI).<sup>28</sup> This fall was however partly offset by higher lending to non-resident private corporates concentrated in the manufacturing and transportation sectors as well as in the construction sector, and to lower extent households. The penetration of the non-core domestic banks in the domestic retail market remained very weak and largely dominated by one bank. Indeed, the proportion of resident customer loans to total resident customer lending in Malta remained contained at 1.0% in June 2017. Such lending is chiefly directed towards construction and real estate, and the financial and insurance

<sup>25</sup> Refer to <https://www.centralbankmalta.org/tools>.

<sup>26</sup> GDP figure for 2017H1 was calculated using the four-quarter moving sum.

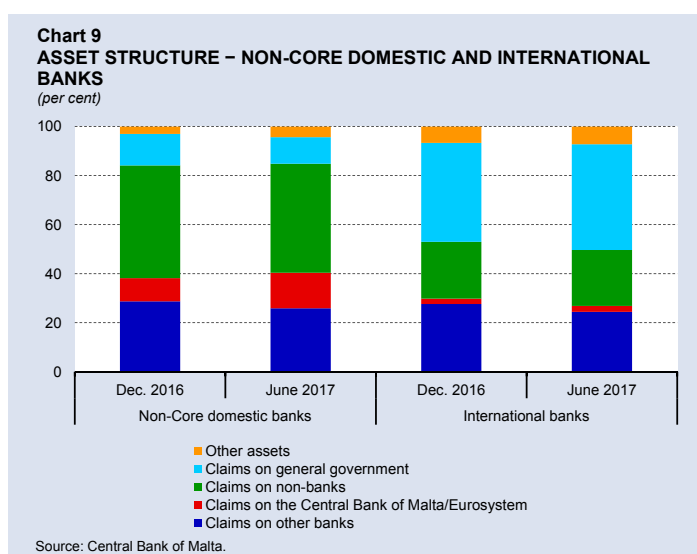
<sup>27</sup> The majority of the remaining bank bonds carried a medium or high rating.

<sup>28</sup> Claims on non-banks comprise OFIs, insurance corporations, pension funds, corporates and households. OFIs include 'financial intermediaries', 'financial auxiliaries' and 'captive financial institutions and money lenders' and exclude credit institutions.



activities sectors. Holdings of securities issued by non-banks remained relatively stable at 15.5% of total assets and consisted of units in resident non-money market funds as well as in equities of non-resident entities.

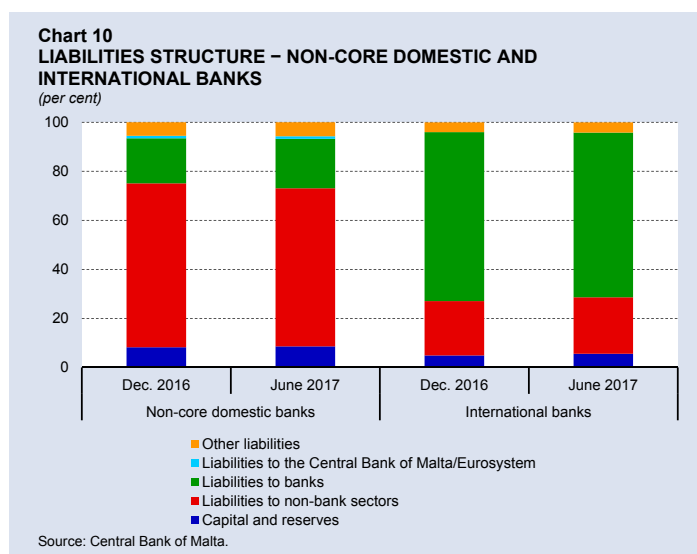
The contraction in total assets was also impacted by lower holdings of US Treasuries, down by almost a fifth. Exposure to domestic sovereign bonds remained stable, yet still accounted for almost half of the total sovereign securities portfolio. Default risk on sovereign bond holdings is low and contained as almost 96% of such debt was of medium- or high-investment grade.



Claims on the Central Bank of Malta was the only asset class that registered an increase during the period reviewed, reaching 14.5% of total assets. As in the case of other banks in Malta, the growing placements with the Central Bank of Malta may suggest that non-core domestic banks are depositing 'excess' funds with the Eurosystem awaiting better investment opportunities without compromising their liquidity levels. Such placements are considered as HQLA pushing the LCR ratio significantly above the regulatory threshold to 230.3%.

The credit quality of the loan portfolio of non-core domestic banks continued to improve with the NPL ratio narrowing by 0.9 percentage point to 2.3%. Outstanding NPLs contracted by over a third with the largest drop coming from problematic loans to non-resident credit institutions, which more than halved since end 2016. Deleveraging strategies and an active NPL resolution programme adopted by specific banks have been important drivers to address the loan quality of this group of banks. At the same time, these banks boosted their coverage ratio by 11.0 percentage points to 64.9%.

On the funding side, non-core domestic banks reported an outflow of 8.7% in customer deposits since end 2016 largely stemming from non-resident households (see Chart 10). Nevertheless, this group of banks continued to rely heavily on retail funding, financing around two-thirds of their business activities. Non-resident deposits from OFIs and private corporates also declined, albeit by a lower extent than household deposits. Meanwhile, non-core domestic banks managed to attract higher resident customer deposits originating predominantly from the OFIs sector, though increased efforts at tapping resident households and private corporates were reported. As a result, the share of resident customer deposits in total customer



deposits of non-core domestic banks increased by 6.4 percentage points to 30.3%. Nonetheless, links with domestic economy remained limited, as these deposits accounted to just 2.7% of the overall resident customer deposits in the banking system.

Wholesale funding by the non-core domestic banks increased by 3.7% and accounted for around a fifth of total funding. Non-core domestic banks increased their reliance on intra-group deposits but relied less on funding from unrelated credit institutions. Access to Eurosystem funding remained low and stable, financing a meagre 1.1% of total liabilities.

The capital position of the non-core domestic banks improved slightly owing to lower risk exposures, reflecting the contraction in their balance sheet size. As a result, the risk profile and the capital ratios of these banks improved, with the total capital ratio rising by 0.7 percentage point to 16.2% in June 2017.

Although remaining positive, profitability of non-core domestic banks narrowed in the first half of 2017. Although they reported higher trading and NII, these were more than offset by the substantial losses on the foreign exchange market. In the first six months of the year, the USD dollar depreciated by almost 8% against the euro, leading to some losses for two banks which traded significantly in this currency. As a result, the ROE and ROA (after tax) stood at 2.6% and 0.2% in June 2017, down from 3.4% and 0.3%, respectively in December 2016. The cost efficiency of these banks deteriorated with the cost-to-income ratio increasing by 7.5 percentage points to around 74%. Such weakening in efficiency was broad-based and stemmed from lower non-interest income coupled with higher operating expenses.

### **International banks**

International banks downsized further their operations with their balance sheet contracting by 5.4% to €20.8 billion in June 2017, equivalent to 201.3% of GDP. These developments were largely influenced by one bank which reduced its exposures with unrelated credit institutions situated in Turkey and the UK. Despite these developments, claims on banks remained the second most important asset class representing around a quarter of their total balance sheet value (see Chart 9).

Similarly, claims on non-banks which consisted mainly of non-resident customer loans contracted by 6.7%. This was mainly attributed to lower lending to non-resident OFIs and NFCs located in Turkey, Ireland and Luxembourg, though the latter by a lower degree. Customer loans were concentrated in manufacturing, construction, real estate, and in transportation and storage sectors.

Credit quality deteriorated in the first half of the year as the value of total outstanding NPLs increased by just over a quarter. Higher NPLs were registered in the construction and real estate sector, manufacturing, transportation and storage sectors, all of which pertained to non-residents. As a result, the NPL ratio rose by 0.7 percentage point to 2.5%. Higher NPLs were not matched by a corresponding increase in loan loss provisions. Consequently, the coverage ratio dropped to 42.5% in June 2017, down from 54.8% as at end 2016.

Claims on general government remained the major asset class for international banks, representing 43.2% of their total balance sheet value. This asset class is mainly influenced by the two largest branches of foreign banks which invest heavily in Turkish government bonds, reflecting their home-bias. Due to the higher exposure towards Turkish sovereign debt, the overall credit quality of the sovereign bond portfolio is rather low.<sup>29</sup> Should the non-EU branches be excluded; the remaining international banks invested primarily in high-rated sovereign paper mainly in the US and EU.

International banks continued to rely extensively on wholesale funding, financing over two-thirds of their business activities (see Chart 10). Deposits from unrelated credit institutions located in Turkey, UK, Germany and Switzerland remained the main source of funding. This group of banks also made use of intra-group funding, though in the first half of 2017, these banks reduced somewhat their reliance on funding from the parent and related companies. Such developments largely represented the operations of the two largest branches of foreign banks.

<sup>29</sup> Moody's rates debt issued by the Government of Turkey at Ba1, with negative outlook.

The relatively smaller banks tap the retail market to finance their activities, with customer deposits accounting for almost a quarter of total liabilities in June 2017. These deposits went down by 1.6% over the previous six months owing to outflows of non-resident private corporate deposits which were partly offset by higher deposits from non-resident households, insurance companies and OFIs. Funding from resident customer deposits remained negligible accounting for 1.3% of total resident customer deposits in the banking sector.

Capital and reserves increased by 7.7% in the first half of the year, financing 5.6% of total assets. This largely reflected a significant expansion in reserves, mainly from higher retained earnings, as otherwise total shareholders' funds decreased at a more modest pace. Nevertheless, at 47.9%, the regulatory capital position of this group of banks remained healthy and exceeded the regulatory minimum. With regards to liquidity, this group of banks operated with abundant liquidity as evidenced by the high LCR ratio of 281.3%.

Compared to end 2016, pre-tax profits improved by 2.6% in June 2017. Higher profitability mainly stemmed from the two largest branches of foreign banks, which registered lower losses from foreign exchange transactions and posted higher realised gains on financial assets. However, NII declined due to lower customer lending. Should the two largest branches be excluded from the computation of profits, the other international banks would have registered weaker profits, on account of lower fees and commissions income and higher investments losses. In June 2017, the post-tax ROA of international banks (including branches) remained relatively stable at 1.0%. However should the largest branches be excluded, the ROA after tax would have dropped by 0.5 percentage point to 1.5%. Furthermore, compared to end 2016, the ROE (excluding branches) stood at 4.4%, down by 1.1 percentage points.

***Stress test exercises continued to reaffirm the core and non-core domestic banks' overall adequacy in their loss absorption capacity, both in terms of liquidity and solvency.***

#### **Stress tests**

The univariate stress tests conducted by the Central Bank of Malta comprise of: (i) credit quality deterioration in the securities portfolio; (ii) persistent deposit withdrawals; (iii) a drop in property prices; and (iv) interest rate risk in the banking book. These exercises were based on balance sheet data of the core and non-core domestic banks for the first half of 2017, following the same methodology and magnitude of shocks to those presented in the *Financial Stability Report 2016* (pages 58-64). The post-shock CET1 ratios for tests (i), (iii) and (iv) mentioned above continued to exceed the regulatory thresholds. In addition, core and non-core domestic banks remained highly liquid during the one month survival period applied in the liquidity stress test (ii).

On 9 October 2017, the ECB published the findings from a supervisory sensitivity analysis of interest rate risk in the banking book.<sup>30</sup> Similarly to test (iv), various hypothetical scenarios of interest rate changes were tested. The higher interest rates would lead to higher NII in the subsequent three years for a majority of banks directly supervised by the ECB, including the three domestic significant institutions. Supervisors will follow up on the results in supervisory dialogues with the individual banks.

***The domestic insurance companies and investment funds remained focused on their core operations, without engaging in alternative businesses in a bid to search for higher yields.***

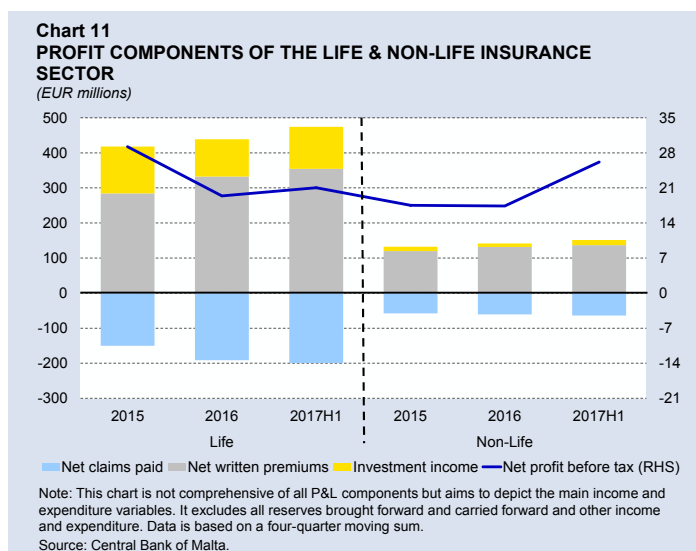
#### **Domestic insurance companies**

In June 2017, the insurance sector in Malta consisted of 62 companies (including reinsurance) with total assets of €11.0 billion, of which only eight firms have a systemic footprint as they write risks situated in Malta. These domestic insurance companies have assets of around €3.9 billion and accounted for 38.2% of GDP, expanding only marginally in the first half of the year.<sup>31</sup> The size of the three domestic life insurance companies expanded by 1.4% to €3.5 billion, whereas the non-life business grew by 6.7% to €406.6 million in the six months to June 2017.

<sup>30</sup> <https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr171009.en.html>.

<sup>31</sup> Domestic insurance companies include three life insurance principals and five non-life insurance companies of which one is a Protected Cell Company. The latter 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.

Although the prolonged low interest rates have impacted negatively investment returns, these still improved by 12.7% for the life sector, mainly owing to revaluation gains (see Chart 11). This contrasts somewhat with the trends reported across the EU, where the prolonged low interest rates weighed on investment returns and instigated a search-for-yield behaviour. In contrast, there is no evidence of such behaviour by domestic insurers, leaving their exposures largely stable. Also, unlike insurance companies in the EU, domestic insurance principals were never involved in guaranteed-rate insurance products



which would have compelled them to search for higher returns in a bid to match the relatively elevated guaranteed rates promised to policy holders. Meanwhile, the domestic insurers' participation in non-traditional non-insurance activities (NTNI) remained contained at 0.2% of the life insurance assets, channelled towards non-resident NFCs. Loans granted by the non-life sector also remained minimal, at 1.7% of total assets.

Profits for the life sector stood at €21.0 million as at end June 2017, up by 8.4% since end-2016. Apart from improved investment returns, profits were also aided by a 6.6% increase in net premia, primarily through a rise in single premium business. Furthermore, net claims grew by a lesser extent (+4.1%) than premia, spurred by maturing policies.<sup>32</sup> In June 2017, the median ROE and ROA (after tax) stood at 5.7% and 0.5%, respectively up from 5.4% and 0.3% in 2016.<sup>33</sup>

In the non-life insurance sector profitability was also positive, with net profit before tax improving from €17.4 million in 2016 to €26.2 million in June 2017. The improvement was stimulated by a 3.7% increase in net written premia backed by a rise in tariffs and an increase in new business. This was however partly offset by a 5.1% rise in claims. Investment returns increased by 53.4% during the first half of 2017 but this income remained a small contributor to the profit of the non-life business. The increase in profits was translated into a rise of 3.4 percentage points in ROE (after tax) to 11.6%, and an increase of 1.7 percentage points in the ROA (after tax) to 5.2% in June 2017. The sustainable underwriting activity of the non-life sector is evidenced by the combined ratio of 89.9% below the 100% threshold.<sup>34</sup>

During the first half of the year, domestic insurance companies did not report any particular changes in their balance sheet structure. Premia remained their main funding source and were channelled into bonds and equity, with limited exposures to complex products, such as derivatives. Almost 30% of the life insurers' investment portfolio remained focused on sovereign bonds of medium investment grade (see Chart 12). Exposure to corporate bonds consisted largely of debt issued by banks and OFIs, mainly originated from countries outside the euro area, including the US and UK. Holdings of domestic corporate bonds remained minimal and were predominately issued by OFIs. Foreign equity holdings were primarily issued in the euro

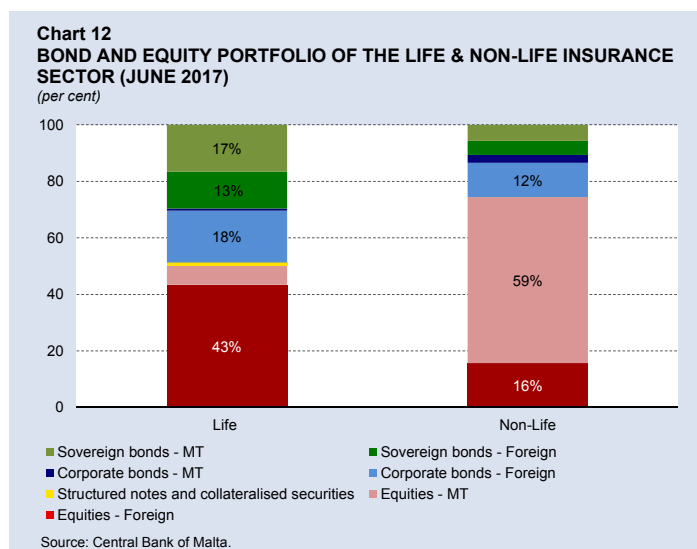
<sup>32</sup> Single premium business is a lump sum investment plan, which return is determined by the performance of the insurance company.

<sup>33</sup> In 2017H1, the EU median ROE for a sample of large euro area insurers exceeded 9%, while in 2016, the median ROA for 114 insurance undertakings and brokers from 23 EEA countries stood around 1.0%. Source: ROE: EIOPA Financial Stability Report, June 2017; ROA: EIOPA Financial Stability Report, June 2017.

<sup>34</sup> The combined ratio is measured as the sum of net claims incurred and the net operating expenses as a proportion of net premia earned. A combined ratio of less than 100% portrays underwriting profit as insurers are receiving more in premia than paying out in claims and other expenses.

area, mainly by investment funds in Luxembourg and by NFCs in Germany and France. Holdings of equities issued in Malta mainly related to NFCs and investment funds units.

For the domestic non-life insurers, equity holdings remained the main asset component in June 2017, increasing by 4.0% in the first half of the year. Equity holdings were mainly held in other insurance corporations belonging to the same group in Malta. Bond holdings contracted by 1.6 percentage points to 13.3% of total assets during the first half of the year. More than half of their bond portfolio remained composed of corporate debt, which were well-diversified both in terms of counterparty and country of origin. The remaining assets related to recoverables and receivables, as well as cash, deposits and fixed assets.



The domestic insurers held an adequate level of capital buffer composed of high-quality own funds. The median Solvency Capital Requirements coverage ratio exceeded 260% in June 2017, well above the minimum threshold of 100%. The large majority (a median level of over 90%) of total own funds was composed of Tier 1 capital, in line with EU levels.<sup>35</sup>

Domestic insurance companies thus continued to contribute positively to a well-functioning financial system. The main financial stability consideration surrounding the domestic insurance sector resides through links with the domestic economy, particularly the banking sector. These links are mainly structural in nature, due to ownership set-up.<sup>36</sup> Other contagion implications related to the insurers' exposures towards the Maltese Government through bond holdings which represented 13.1% of the insurers' total assets; and to domestic banks (11.9% of their total assets), mainly in the form of deposits. Another main exposure related to intra-group equity holdings of other domestic insurance companies. As in the nature of their business, domestic insurers are also connected to reinsurers through reinsurance activities. In Malta, the amount of reinsured risk exceeded 16% of total gross premia, standing significantly higher than the median in the EU of 5.1%, reflecting a more cautious approach in relation to the level of risk tolerance by domestic insurance companies.<sup>37,38</sup> Furthermore, insurance companies are operating on the back of healthy capital levels which ensures further resilience against potential shocks.

### Domestic investment funds<sup>39</sup>

In the first quarter of 2017 there were 469 investment funds in Malta with assets totalling €7.7 billion, down from €8.5 billion at end-2016. Only 12 investment funds are considered to be the most systemically-relevant since they mainly transact with residents (referred to as the domestic investment funds). These were six Collective Investment Schemes (CIS) and six Professional Investor Funds (PIF), holding €1.6 billion assets (15.8% of GDP) in March 2017. Most of the domestic CIS are regulated by the Undertakings for Collective

<sup>35</sup> The Solvency II ratio is defined as eligible own funds divided by Solvency Capital Requirement (SCR). The SCR reflects the amount of capital required to meet all obligations over one year, taking into account all significant quantifiable risks such as underwriting risk, risk pricing, provisional risk, market risk, credit risk, liquidity risk and operational risk. The SCR is measured at a 99.5% VaR confidence level.

<sup>36</sup> One of the largest non-life insurance companies is a subsidiary of a core domestic bank and partially owns a domestic life insurance company. The largest two life insurance companies are subsidiaries of two core domestic banks.

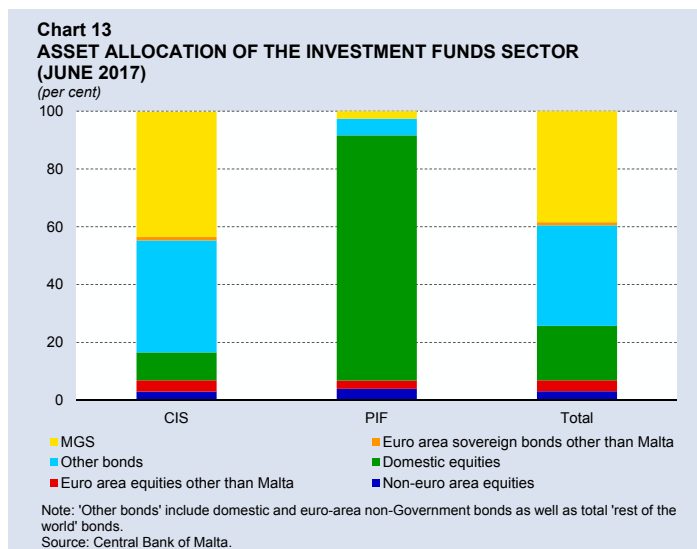
<sup>37</sup> EIOPA Risk Dashboard, October 2017.

<sup>38</sup> In June 2017, the risk retention ratio (premia net of reinsurance to gross premia) stood at 83.6% for the domestic insurance sector.

<sup>39</sup> Latest data for the domestic investment funds sector is for March 2017.

Investment in Transferable Securities (UCITS) Directive with assets reaching €1.2 billion in March 2017, down by 1.8% since December 2016. PIF's assets stood at €376.4 million which also fell by 1.6% in the first quarter of 2017.

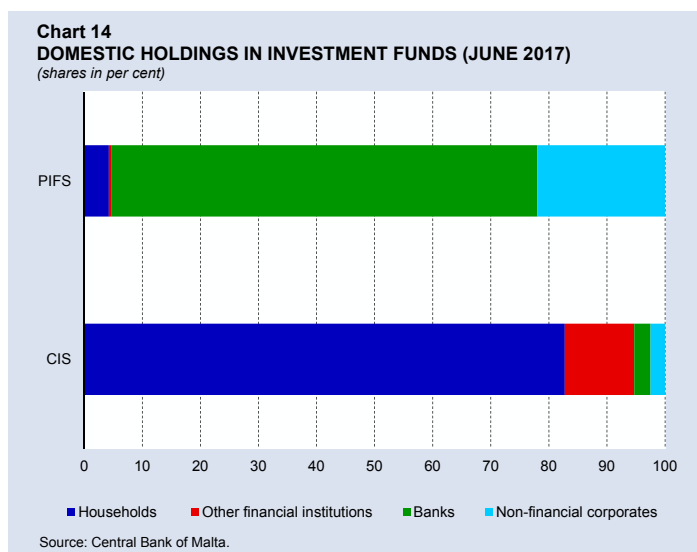
The main strategy of CIS remained targeted towards bonds accounting for just over 83% of their investment portfolio. Such holdings consisted mainly of MGS and corporate bonds issued locally and in the US, decreasing slightly during the first quarter of 2017, though the overall structure of the investment portfolio remained unchanged (see Chart 13). Equity holdings continued to form a minor proportion of the investment portfolio of CIS, remaining stable during the period under review.



Despite the contraction in total assets, PIF reported an expansion in their investment portfolio, with equity holdings rising by 11.3% in the first quarter of the year, remaining heavily exposed towards domestic equity. The decrease in assets registered by this category of investment funds was driven by a 7.2% drop in loan claims to the tune of €11.2 million. Loan origination by domestic funds is limited to 4.8% of the funds' total assets and largely channelled outside the euro area. Domestic funds are not leveraged given that their financing originates from shareholding and do not rely on loans and debt securities. The possibility of extensive leverage by investment funds is curtailed by the UCITS Directive and the Alternative Investment Fund Managers Directive (AIFMD) posing constraints on the amount of leverage they can take.

Banks located in Malta remained the main shareholders of PIF accounting for 73.3% of total investments in PIF, while households continued to be the main shareholders of CIS, reflecting their retail orientation (see Chart 14).

In the euro area risks from the funds' industry remained high with a stable outlook. Concerns about the low yield environment, excessive risk-taking and the possible reversal in risk premia remained key concerns surrounding this sector.<sup>40</sup> In contrast, risks posed by domestic investment funds are deemed to have remained low. Contagion risk through the structural links between core domestic banks and the investment funds sector and also through the placement of deposits is relevant, but is contained. Investment funds are separate legal entities subject to the provisions in the Maltese companies' law and the



<sup>40</sup> ESMA Risk Dashboard 2017Q1.

Investment Services Act. Contagion implications are also reduced through embedded mechanisms such as gating mechanisms and liquidity fees, whereby limits are placed on the amount of funds that can be withdrawn by an investor. Also both the investment funds and the core domestic banks have prudent business strategies mitigating the possibility of transmittable distress.

### **Regulatory Developments**

#### **Review of Directive and Regulation on banking prudential requirements – General Approach**

On November 2016 the European Commission proposed amendments to the banking prudential capital requirements Directive and Regulation (also known as CRDIV/CRR), the Banking Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM). The first discussions took place in December 2016 under the auspices of the Slovakian Council Presidency during the Financial Services Working Party (WPFS) meeting. Technical discussions by the WPFS on the CRDIV/CRR review continued under the Maltese Council Presidency ('the Presidency') during the first half of 2017.

During the Maltese Presidency of the EU, a number of issues were discussed, particularly, the International Financial Reporting Standard (IFRS) 9 and the phasing-in of its regulatory capital impact.<sup>41</sup> These discussions led to the Presidency reaching a 'General Approach' on the recognition of impairments under IFRS 9. The 'General Approach' provides that:

1. Where institutions' capital ratios fall as a result of increased expected credit loss provisions, they may add back an amount to their CET 1 capital equal to a percentage of the institution's increased provisions as of the first date of application of IFRS 9, in line with the 'static' approach methodology also developed by the Basel Committee on Banking Supervision (BCBS).<sup>42</sup>
2. Institutions may add a further amount to their CET 1 capital subsequent to the first date of application of IFRS 9 where they incur significant new provisions during the transitional period. This 'dynamic' component to the phase-in arrangements is intended to lessen the pro-cyclical nature of IFRS 9. The amount will be limited to any excess of provisions over 20% of the sum of stage 1 and stage 2 provisions held by the institution on the first day of application of the IFRS.
3. The transitional period will have a maximum duration of 5 years.

As stated in the *Financial Stability Report 2016*, the move to IFRS 9 is expected to increase the level of provisions. IFRS 9 becomes mandatory with effect from 1 January 2018. In July 2017, the European Banking Authority (EBA) published a report on the impact of IFRS 9 on banks across the EU.<sup>43,44</sup> According to the report, small banks are lagging behind in their implementation of IFRS 9, compared to big banks in the sample.<sup>45</sup> Furthermore, smaller banks which mostly make use of the Standardised Approach (SA) for measuring credit risk, estimated a larger impact on own funds ratios due to IFRS 9 when compared to larger banks. According to the EBA Report, this effect is mainly due to the impairment requirements of IFRS 9.

Based on the EBA report, the average estimated increase in IFRS 9 provisions compared with IAS 39 is 13.0% compared to 18.0% in the first exercise. This drop reflects the progress achieved by banks in implementing IFRS 9 as well as the improvement in economic conditions.

<sup>41</sup> Council of the European Union (12 June 2017): "Strengthening of the Banking Union / Risk-reduction measures - Presidency Progress Report".

<sup>42</sup> BCBS (March 2017): "Regulatory treatment of accounting provisions – interim approach and transitional arrangements".

<sup>43</sup> EBA (13 July 2017) "Report on results from the second EBA impact assessment of IFRS 9".

<sup>44</sup> The first impact assessment was published in November 2016.

<sup>45</sup> According to footnote 6 of the EBA impact Assessment, banks with total financial assets below EUR 100 billion are deemed as small banks.

## BOX 1: THE SINGLE EUROPEAN DEPOSIT INSURANCE SCHEME (EDIS)

The financial and sovereign debt crisis experienced during the last decade has emphasised the links between national banking sectors and their sovereigns and brought to light the undesirable ramifications that could arise. The Banking Union was created to break this link and avoid taxpayers from being the first in line to bail out ailing banks. The Banking Union is composed of three pillars; common supervision achieved through the Single Supervisory Mechanism, effective resolution of failing banks achieved through the Single Resolution Mechanism and a Common Deposit Insurance, which ensures that all depositors in the Union enjoy the same level of protection, irrespective of their geographical location.<sup>46,47,48</sup> Currently, a single European Deposit Insurance Scheme remains one of the missing pillars for a fully-functioning banking union.

During the Maltese Presidency of the EU, the *Ad Hoc* Working Party on the Strengthening of the Banking Union (the “AHWP”) was responsible for examining the EDIS proposal with the aim of taking forward the work of previous presidencies addressing pending technical issues in line with the June 2017 European Council Conclusions.<sup>49</sup> The Maltese Presidency identified a number of areas that required further work. These mainly related to the contributions to the Deposit Insurance Fund, whereby delegations agreed that such contributions would be risk-based, possible uses of participants’ available financial means and issues related to the scope of EDIS and membership in the Scheme. With regards to the latter, the issues related to two aspects, the possible inclusion of third country branches established in a Member State and the possible inclusion of deposit-taking non-Capital Requirements Regulation (CRR) entities which are already being covered by existing national Deposit Guarantee Schemes (DGS).<sup>50</sup> Given the conflicting views in this regard, the Maltese Presidency launched a comprehensive questionnaire to take stock of the prudential treatment of non-CRR entities and third country branches established in EU Member States. The results indicated that while Member States applied heterogeneous frameworks in line with the CRR/CRDIV frameworks, in general, the frameworks applied were often adapted to the specificities of the institutions, indicating that further work needs to be carried out in this area. The Maltese Presidency also continued discussions on other areas including the accession to and departure from EDIS and the possible impact of EDIS on the internal market which were already discussed under previous Presidencies.

The Estonian Presidency continued to build on the work of the Maltese Presidency. However, given the diverging views on the design of EDIS, the lengthy discussions and the varying degree of risks present across national banking systems, progress on EDIS has slowed down. In this regard, the Commission, through its Communication on Completing the Banking Union, is proposing the introduction of EDIS in a more gradual manner to ensure that banks are sufficiently robust on a stand-alone basis before sharing the potential burden of bank failures within the Banking Union.<sup>51</sup> The Commission proposes that in the first re-insurance stage, EDIS would only provide liquidity coverage and no loss coverage.<sup>52</sup> In case of failure, national DGSs would first deplete their funds before an

<sup>46</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions.

<sup>47</sup> Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010.

<sup>48</sup> Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme.

<sup>49</sup> Council Conclusions on a roadmap to complete the Banking Union (June 2016).

<sup>50</sup> Non-CRR entities refer to those that do not fall within the scope of the CRR.

<sup>51</sup> Source: [http://ec.europa.eu/finance/docs/law/171011-communication-banking-union\\_en.pdf](http://ec.europa.eu/finance/docs/law/171011-communication-banking-union_en.pdf).

<sup>52</sup> Liquidity coverage provided by EDIS relates to the coverage of the shortfall that arises when total available financial means in the national DGS are insufficient to cover the amount of covered deposits in the failing bank. Loss Coverage on the other hand relates to the coverage of the loss that the national DGS still needs to cover after collecting insolvency proceeds and received long-term extraordinary contributions from the banks, but before additional the additional funding are made available by supra-national agreements.



intervention by EDIS is possible. Provision of liquidity by EDIS to national DGSs (which effectively is a loan that would be recovered from the domestic banking sector ex-post) would cover the liquidity shortfall gradually from 30% in the first year, 60% in the second and 90% in the third year (2021). The rest would need to be covered via ex-post contributions from domestic banks. By letting losses to be borne nationally, legacy and moral hazard issues are addressed, while depositor protection is still ensured.

The proposal includes a move from re-insurance to co-insurance which is not automatic but conditional on selected criteria, including satisfactory asset quality reviews to address non-performing loans and Level III assets.<sup>53</sup> Once these conditions are met and upon initiation of the co-insurance phase, full liquidity coverage (100%) is provided and losses are gradually covered from the first euro, starting from 30% in the first year to 100% in its final stage.

A single EU fund provides greater risk absorption capacity and breaks the sovereign-bank loop to any national system. Filling this gap would also align the architecture of the three pillars of the Banking Union. Common supervision and resolution, coupled with common deposit insurance will allow for deeper financial integration underpinned by a stable financial system. This will reinforce financial stability both within the Member States participating in the Banking Union and in the European Union as a whole.

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<sup>53</sup> Assets which are typically very illiquid, and their valuation cannot be determined by using observable measures such as market prices or models.



# APPENDIX



**Appendix:  
Financial Soundness Indicators**

	Core Domestic Banks			Non-Core Domestic Banks			International Banks			Total Banks					
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
<b>Core FSIs</b>															
Regulatory capital to risk-weighted assets <sup>1</sup>	16.51	14.44	15.00	16.20	15.51	22.59	17.44	22.11	15.53	16.19	119.60	69.15	56.34	49.20	47.90
Regulatory Tier 1 capital to risk-weighted assets <sup>1</sup>	12.86	11.53	12.15	13.57	13.38	22.12	17.05	16.89	12.31	13.21	119.59	68.14	50.60	41.90	40.46
Regulatory capital to total own funds <sup>1</sup>	39.01	41.03	36.58	27.15	26.53	2.19	7.77	7.86	11.97	6.66	0.79	2.96	0.92	9.25	14.63
Non-performing loans to total gross loans <sup>1</sup>	8.95	7.56	7.13	5.29	4.59	3.71	4.31	3.83	3.11	2.26	1.39	0.69	0.70	1.73	2.46
Sectoral distribution of resident loans to total loans															
Agriculture	0.29	0.24	0.23	0.19	0.16	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Fishing	0.13	0.09	0.10	0.07	0.09	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Mining and quarrying	0.05	0.06	0.09	0.07	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Manufacturing	3.20	2.73	2.75	2.57	2.62	0.68	0.65	0.57	0.31	0.46	0.00	0.00	0.00	0.00	0.01
Electricity, gas, steam and air conditioning supply	2.22	2.83	2.15	2.30	2.17	3.27	5.14	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Water supply; sewerage waste management and remediation activities	0.72	0.63	0.54	0.46	0.46	0.06	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Construction	9.78	7.32	5.24	4.88	4.58	0.06	0.00	0.00	0.03	1.51	0.00	0.00	0.00	0.00	0.00
Wholesale and retail trade; repair of motor vehicles and motor cycles	8.46	8.27	8.19	7.80	7.49	1.08	0.67	1.11	0.42	0.51	0.00	0.00	0.00	0.00	0.00
Transportation and storage	3.85	2.82	2.80	2.30	2.08	1.29	0.80	0.00	0.00	0.00	0.00	0.11	0.22	0.24	0.15
Accommodation and food service activities	5.06	3.78	4.12	3.47	2.84	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Information and communication	1.26	0.93	0.83	0.67	0.39	0.18	0.11	0.11	0.02	0.04	0.00	0.00	0.00	0.00	0.00
Financial and insurance activities	4.32	4.70	5.86	6.79	6.26	0.78	0.74	0.90	2.59	3.08	0.01	0.02	0.03	0.03	1.31
Real estate activities (includes imputed rents of owner-occupied dwellings)	4.78	6.63	6.70	7.26	7.05	2.43	3.55	3.80	4.18	4.97	0.00	0.00	0.45	0.48	0.03
Professional, scientific and technical activities	0.48	0.67	1.12	1.26	0.96	0.00	0.00	0.00	0.00	0.35	0.00	0.00	0.00	0.00	0.00
Administrative and support service activities	1.05	1.37	1.22	1.02	0.89	0.07	0.08	0.11	0.69	0.95	0.01	0.01	0.01	0.01	0.01
Public administration and defence; compulsory social security	1.48	1.54	1.58	1.13	1.28	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Education	0.38	0.36	0.44	0.33	0.30	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Human health and social work activities	0.67	0.67	0.73	0.71	0.76	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Arts, entertainment and recreation	0.70	0.52	0.47	0.38	0.34	0.59	0.39	0.00	0.00	0.00	0.00	0.00	0.02	0.02	0.02
Other services activities	0.39	0.28	0.27	0.21	0.18	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Households and individuals (incl. Sole Proprietors)	43.27	43.80	46.18	48.26	46.23	0.12	0.11	0.14	0.14	0.89	0.01	0.01	0.01	0.01	0.01
Hotels and restaurants	35.84	36.87	39.77	42.28	39.45	0.02	0.01	0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.00
Activities of extraterrestrial 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
Non-resident loans to total loans	7.46	9.60	8.37	7.84	12.76	89.56	87.82	93.57	91.60	87.24	99.97	99.86	99.26	99.26	98.46
Return on assets <sup>2</sup>	0.84	0.71	0.71	0.75	0.62	0.71	-1.32	0.18	0.30	0.22	0.64	0.86	1.01	0.99	1.05
Return on equity <sup>2</sup>	11.92	9.82	9.84	10.24	8.52	2.32	-6.42	1.44	3.38	2.63	1.88	2.38	3.38	3.38	3.38
Interest margin to gross income	63.69	64.84	64.48	62.21	68.00	42.04	46.31	43.54	31.24	35.28	173.55	201.85	137.81	92.57	86.04
Non-interest expense to gross income	47.10	51.23	54.15	52.71	56.54	64.77	56.14	73.39	66.52	74.92	9.96	11.87	24.78	31.89	33.73
Non-interest income to gross income	36.42	35.16	35.52	37.79	32.00	57.96	53.69	56.46	68.76	64.72	-73.55	-101.85	-37.81	7.43	11.96
Liquid assets to total assets	27.16	28.31	31.77	36.54	36.07	20.19	31.68	36.34	31.55	39.56	28.14	19.67	22.72	30.15	29.52
Liquid assets to short-term liabilities	51.65	50.42	50.24	55.80	55.16	72.09	77.92	63.26	62.69	81.29	204.20	84.73	83.59	98.31	100.31
<b>Other FSIs</b>															
Total coverage ratio <sup>3</sup>	37.87	40.40	45.52	45.94	46.33	94.64	77.11	65.24	53.88	64.87	42.98	40.45	50.37	54.81	42.52
Liquidity Coverage Ratio			165.10	164.43	172.56			100.17	194.89	230.27			188.27	357.63	281.28
Domestic debt securities to total assets	10.84	9.69	9.30	7.90	7.87	5.54	4.56	7.74	4.86	5.02	0.00	0.00	0.17	0.09	0.18
Foreign debt securities to total assets	19.30	23.32	21.81	20.63	19.01	20.98	19.48	12.45	14.96	11.50	37.60	52.76	50.39	46.91	49.42
Unsecured loans to total lending	26.15	28.97	27.41	25.38	28.45	74.78	65.23	70.87	65.39	67.32	57.28	48.44	30.69	26.69	27.36
Assets to total capital and reserves	12.56	14.05	13.72	13.29	13.93	3.41	8.41	8.42	12.12	11.64	1.33	1.67	1.96	2.91	3.08
Large exposure to total own funds <sup>1</sup>	107.95	103.40	96.48	110.84	85.63	199.90	339.94	157.63	264.32	244.32	17.08	45.31	129.94	129.91	119.96
Gross asset position in financial derivatives to total own funds <sup>1</sup>	2.12	1.08	1.27	1.65	1.34	0.44	0.33	0.61	0.53	0.01	0.01	15.74	67.23	104.36	110.21
Gross liability position in financial derivatives to total own funds <sup>1</sup>	4.52	4.49	2.02	2.04	1.67	0.45	2.24	0.27	3.60	1.11	0.12	15.86	38.13	54.88	58.17
Personnel expenses to non-interest expenses	50.61	50.81	51.18	48.33	47.66	42.05	44.98	42.46	49.74	47.58	33.32	27.40	23.18	19.88	18.47
Customer loans to customer deposits	67.80	63.98	58.22	55.95	59.75	96.24	75.69	60.68	46.51	46.31	79.50	93.05	104.08	108.14	102.17
Net open position in equities to total own funds <sup>1</sup>	13.48	14.43	15.44	13.98	12.71	1664.43	44.87	81.83	146.78	188.75	0.02	0.26	2.74	1.15	0.97
Loan-to-value <sup>4</sup>															
Residential	71.49	74.18	75.25	75.10	72.70										
Commercial <sup>5</sup>	67.30	69.00	62.99	67.50	71.50										

<sup>1</sup> Capital data based on the COREP returns from 2015. NPL data based on FNREP from 2014.

<sup>2</sup> Based on profit after tax.

<sup>3</sup> For the core domestic banks the ratio includes 'Reserve for General Banking Risks' as per the revised Banking Rule 09/2013, implemented over a three-year period up to 2015.

<sup>4</sup> Based on a sample of core domestic banks.

<sup>5</sup> The market share of the banks was adjusted to cater solely for the banks that provided commercial real estate loans. Also, the limited transaction of these loans explains the volatility in the weighted indicators.