**LAPSE OF TIME**

SM/20/76
Correction 1

April 6, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Malta—Staff Report for the 2020 Article IV Consultation**

| | |
|---|---|
| Board Action: | The attached corrections to SM/20/76 (3/25/20) have been provided by the staff: |
| **Evident Ambiguity** | **Pages 10 (footnote 5, line 1, "high-level"), 29, 57** |
| **Factual Errors Not Affecting the Presentation of Staff's Analysis or Views** | **Pages 10 (para. 13 and footnote 5, lines 2–3), 13, 15, 22, 34, 37, 38, 58** |
| Questions: | Mr. Natal, EUR (ext. 35983)<br>Mr. Salas, EUR (ext. 35549)<br>Mr. Foda, EUR (ext. 34359)<br>Ms. Shi, EUR (ext. 37438)<br>Ms. Fernando, LEG (ext. 38658) |

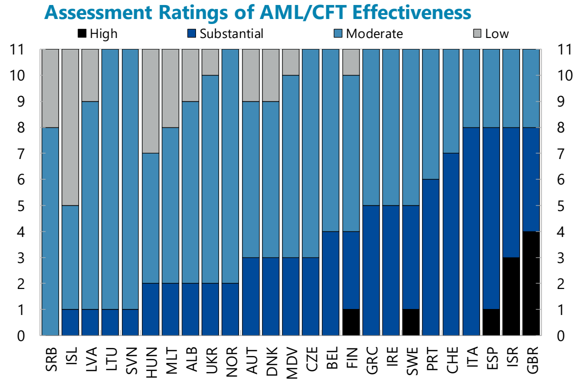
# POLICY AGENDA

## A. Financial Sector: Speeding Up Reforms to Safeguard Financial Stability

***Tackling Financial Integrity Risks***

**12. Deficiencies in Malta's AML/CFT framework must be urgently addressed.** A July 2019 report by Moneyval noted significant deficiencies in Malta's AML/CFT framework, particularly with respect to the effectiveness of supervision, investigation, prosecution and confiscation.[3] Failure to address these shortcomings can expose the financial system to further financial integrity and reputational risks—potentially threatening financial stability—and may result in Malta being identified by the FATF as a country with strategic AML/CFT deficiencies by early 2021 (also known as the FATF's grey list).[4]

**Assessment Ratings of AML/CFT Effectiveness**




Sources: FATF; Consolidated Assessment Ratings, November 18, 2019.

**13. Steps are being taken to tackle some of these issues.** The National Coordinating Committee for AML/CFT (NCC)[5] is coordinating the efforts of all relevant stakeholders to implement the authorities' detailed action plan that covers the range of deficiencies identified in the Moneyval assessment. As part of key measures, the Financial Intelligence Analysis Unit (FIAU), in coordination with the Malta Financial Services Authority (MFSA), have developed a risk-based automated tool to identify institutional risk and introduced a new supervisory strategy and methodology to enhance the frequency and depth of compliance reviews. In addition, they are recruiting new staff for supervision and both agencies have improved their collaboration on supervision of financial institutions through a new financial crimes compliance function created within the MFSA. An Asset Recovery Bureau has been set up to strengthen confiscation processes. The understanding of risk has been further improved by conducting sectoral risk assessments of legal entities, virtual financial assets (VFAs)[6] and non-governmental organizations. Furthermore, the MFSA has licensed several VFA agents to assist VFA issuers and service providers during their registration process and beyond,[7] and the Fifth EU AML directive ~~should soon be~~has been transposed into national law.

[3] Malta received "low" ratings for supervision, ML investigations and prosecutions and confiscations. It received "moderate" ratings for understanding of risks and related policy and coordination, preventive measures, legal persons and arrangements, financial intelligence, as well as for TF investigation and prosecution, TF preventive measures and financial sanctions.

[4] See also Malta 2019 FSAP which identified shortcomings with the authorities' assessment and understanding of risk, banks' application of preventive measures and fit and proper requirements.

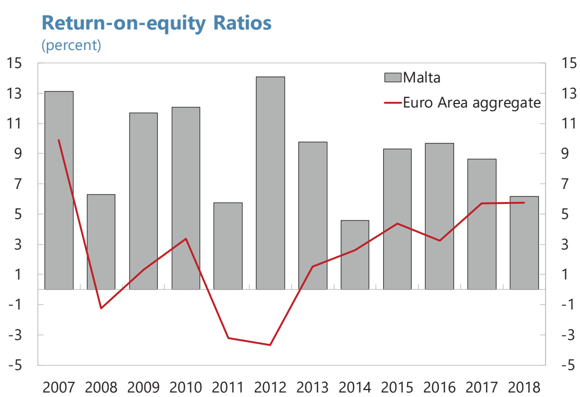
[5] The NCC is made up of high-level ~~the~~ representatives of the Central Bank of Malta, Ministry of Finance and Financial Services, Ministry of Home Affairs, National Security and Law Enforcement, Ministry for Justice, Equality and Governance~~Culture and Government~~, Malta Financial Services Authority, the Financial Intelligence Analysis Unit, Commissioner of Revenue, Malta Gaming Authority, Malta Police Force, Office of the Attorney-General and the Asset Recovery Bureau.

[6] Malta uses the term VFA to capture virtual assets (as defined by FATF).

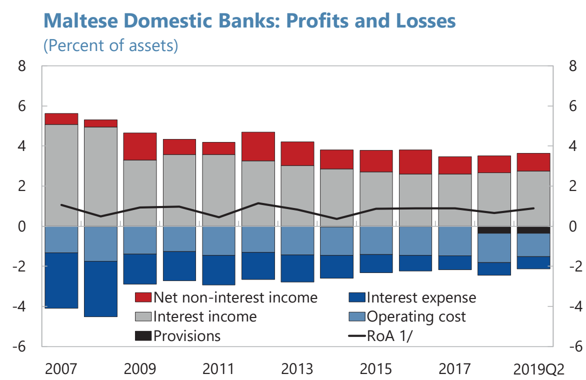
[7] However, no licenses for VFA service providers have been granted yet.

### *Upgrading Risk Analysis and Supervision*

**16. Improving the efficiency of the corporate insolvency process is key to safeguarding profitability in the banking sector.** Liquidity and capitalization of core domestic banks remained at healthy levels in 2019:H1, with the loan-to-deposit ratio hovering around 60 percent and key regulatory capital and liquidity ratios rising further (Figure 4). However, bank profitability has dropped from its peak level in 2012, reflecting the low-interest environment and shrinking corporate loan portfolio, higher regulatory compliance costs and, in the past two years, higher loan-loss provisioning and further write-offs of legacy NPLs. Going forward, legacy NPLs reduction plans may have to be accelerated—as profitability may be further challenged by increasing competition from non-banks and the growing corporate bonds market—which will require further reforms of the corporate insolvency process.



Sources: European Banking Authority and IMF Staff Calculations



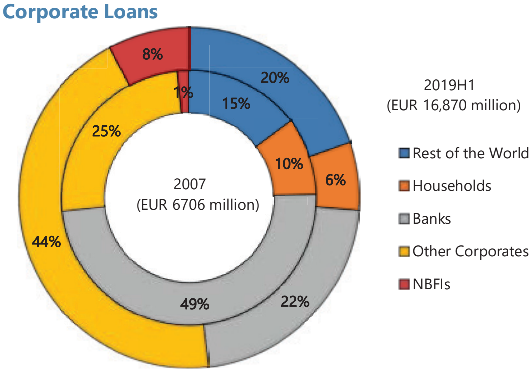
Sources: European Central Bank and IMF staff.
1/ RoA is based on a four-quarter moving average.

**17. Continuing efforts to enhance supervisory capacity and improve the regulatory framework are warranted.** While significant progress has been made to increase supervisory capacity along the lines recommended by the 2019 FSAP, further actions are needed to ensure adequate and stable recruitment of qualified staff. Moreover, important gaps in the crisis management framework persist. (see Annex II).

- *The authorities should take prompt actions to improve the crisis management framework.* Greater clarity regarding the bank insolvency regime—which should be led by the resolution arm of the MFSA—and explicit powers to transfer assets or liabilities in liquidation should be provided.
- *Long-term financial and operational independence of the MFSA should be guaranteed and its resources further increased.* The MFSA's new business plan—which envisages a reform of the supervisory fee structure—should be implemented as it provides room for steady capacity increase and grants the supervisor full financial independence by 2024. This is all the more urgent because the effective implementation of the new regulations regarding the licensing of VFA companies and supervision of higher-risk sectors will demand significant resources and appropriate expertise.

diversification to Maltese firms, it also raises new questions about macro-financial risk developing within the corporate sector. The question is particularly relevant in Malta where NFCs' leverage is high and two sectors, i.e. construction and manufacturing, could become possible sources of contagion to the rest of the economy through inter-company linkages (see Annex V). To assess and monitor these potential vulnerabilities, a deeper understanding of the flow of funds between companies and of their risk-management practices is required—in particular within business groups where the bulk of inter-company lending takes place. Information on inter-sectoral exposure, credit conditions, maturity, concentration and costs would help identify potential financial risks and contagion before they emerge. At the same time, it is important to continue incentivizing equity financing and to avoid over-concentration of banks' exposure to large indebted and interconnected corporates.

**Corporate Loans**




Sources: ECB and IMF staff calculations.

***Authorities' Views***

**20. The authorities remain committed to safeguard financial stability and integrity.** The authorities recognize the need to rapidly address the drivers of pressures on CBRs such as AML/CFT-related concerns. They are taking a number of steps to address deficiencies identified in the Moneyval report by implementing a detailed action plan and recognize the need to demonstrate the effective implementation of AML/CFT controls, taking into account higher--risk sectors. MFSA's new business plan is expected to help it achieve funding and operational independence in the medium term. Regarding financial risks, the authorities acknowledged the rapid increases in house prices and mortgage credit, but they consider it as mainly driven by fundamental factors. They stand ready to tighten macroprudential instruments in the future if necessary. They indicated that a working group is being set up to analyze progress in improving the bank insolvency framework. The authorities are also conducting analytical work to address remaining gaps in the deposit compensation scheme, the emergency liquidity assistance framework and crisis management planning. They agreed that further efforts to step up the monitoring of potential risks developing outside of the banking sector is warranted. Continued enhancement of data collection with regards to intercompany and NBFI lending would be a useful way forward in this regard.

## B. Fiscal Policy: Enhancing Management and Addressing Risks

**21. Given the presence of material fiscal risks, gradual structural adjustment will allow building further buffers while still supporting inclusion.** The 2019 Stability Program Update envisaged further reduction in the public debt ratio by maintaining a headline fiscal surplus at around 1 percent of GDP over the next few years (similar to staff's forecast) together with a medium-term strategy to achieve a gradual structural adjustment. Excluding IIP proceeds, which are volatile and difficult to predict, staff projects the structural balance to be neutral in the near term,

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**31. The Maltese economy has continued to overperform European peers.** Prudent fiscal policy and timely structural reforms have helped boost employment and build fiscal buffers while promoting social inclusion. Growth remained strong in 2019, even though it weakened from 2018. Domestic demand is expected to remain the main engine of growth as the economy gradually reaches cruising speed and the large current account surplus declines. The risks to the outlook are skewed to the downside and a lot will depend on how pervasive and long-lasting disruptions related to the Coronavirus epidemic will be.

**32. Continued efforts are needed to mitigate financial integrity and stability risks.** As pressures on CBRs intensify, it is critically important to continue to address deficiencies identified with the AML/CFT system. The focus should be on improving and demonstrating effectiveness of the AML/CFT framework. In particular, the understanding of risks and the monitoring and supervision of banks and other higher-risk sectors and programs—such as remote gaming, VFAs, and the IIP—should continue to be strengthened. It is also key to enhance AML/CFT enforcement actions, including through timely and adequate sanctions in case of breaches.

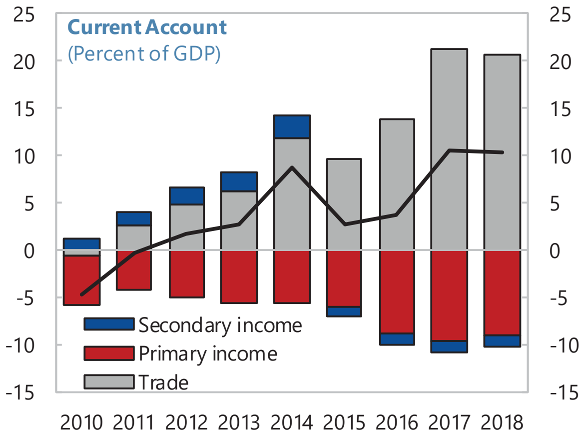
**33. Supervisory capacity should be further enhanced and remaining deficiencies in the crisis management framework addressed.** The operational and financial independence of the financial supervisor should be assured. Despite commendable progress, the MFSA remains under strain due to the large number of financial institutions under supervision, the evolving regulatory environment, and challenges associated with new and complex products. The legal framework for bank insolvency should also be updated and streamlined. An administrative regime for the orderly closure and liquidation of a failing bank should be introduced to avoid that supervisory actions are unduly delayed through judicial appeal.

**34. Further improving the analysis of potential risks developing outside of the banking sector will help uphold financial stability.** Inter-company lending is gradually displacing bank lending as the main source of corporate funding, posing new challenges to supervision. A better understanding of the flow of funds between corporates and of their risk-management practices could help identify potential financial risks and contagion channels to the financial system. In the meanwhile, it is important to avoid over-exposure to large, indebted and interconnected corporates and to monitor developments on the housing market, standing ready to tighten the recently introduced borrower-based macroprudential measures in due course.

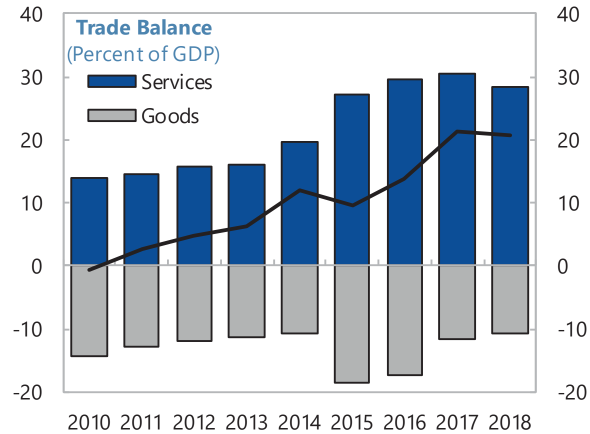
**35. Prudent fiscal policy needs to be maintained.** Maintaining gradual consolidation excluding the proceeds from the IIP is warranted due to fiscal vulnerabilities from contingent liabilities, age-related spending pressures, and heavy reliance on corporate income tax revenues Current-expenditure also needs to be kept in check to ensure enough space within the budget limits for necessary public investment in transport, health, education, the environment and additional expenses targeted at improving social inclusion.

## Figure 5. Malta: External Sector

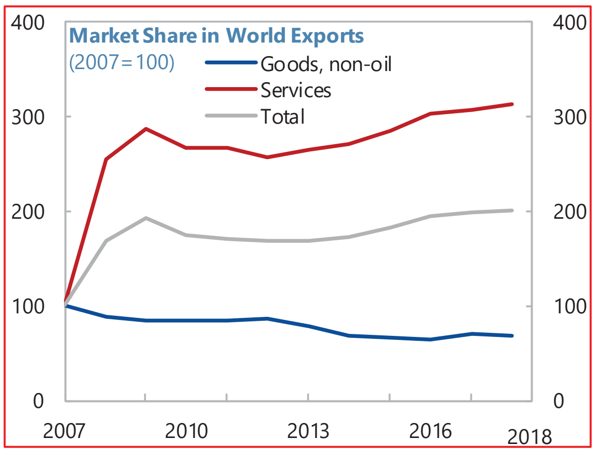
*The current account surplus held broadly steady in 2018...*



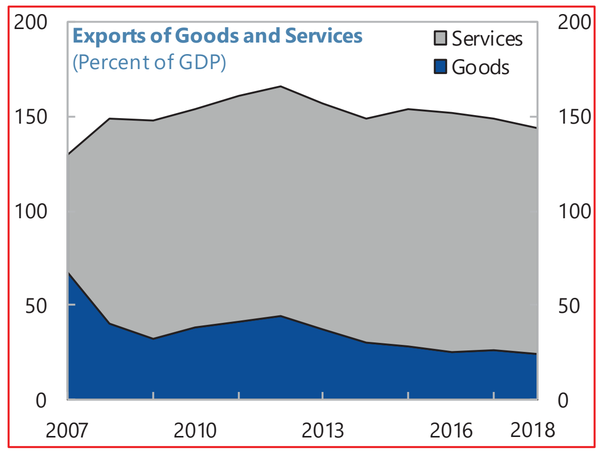

*...as services surplus and goods deficit were little changed.*



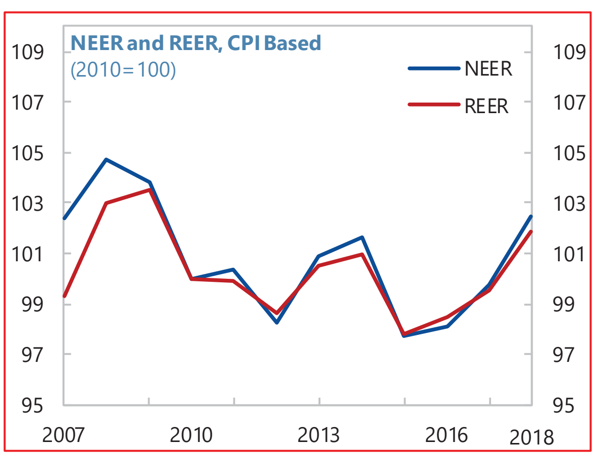

*The share of services rose considerably in recent years...*



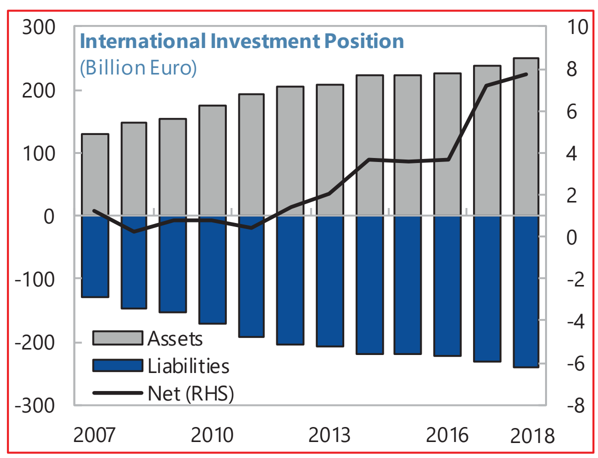

*...resulting in a higher export market share.*




*The REER CPI based slightly appreciated in 2018.*




*The large net IIP surplus held broadly steady in 2018.*




Sources: Haver Analytics; Eurostat; UNCTAD; IMF *World Economic Outlook*; and IMF staff.

# Table 4. Malta: Financial Soundness Indicators, 2014–2019:H1 1/

(Percent, unless otherwise indicated)

| | Core Domestic Banks | | | | | | Non-Core Domestic Banks | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019H1 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019H1 |
| Core FSIs | | | | | | | | | | | | |
| Regulatory capital to risk weighted assets | 14.4 | 15.0 | 16.2 | 17.3 | 18.1 | 19.1 | 17.4 | 22.1 | 15.5 | 16.7 | 17.2 | 18.0 |
| Regulatory Tier 1 capital to risk-weighted assets | 11.5 | 12.2 | 13.6 | 15.2 | 16.0 | 16.7 | 17.1 | 18.6 | 12.3 | 13.3 | 17.0 | 18.0 |
| Non-performing loans net of provisions to capital | 42.2 | 42.8 | 28.9 | 22.4 | 19.8 | 19.2 | 7.7 | 7.9 | 12.0 | 6.9 | 11.5 | 18.1 |
| Non-performing loans to total gross loans | 7.6 | 7.2 | 5.4 | 4.1 | 3.4 | 3.3 | 4.4 | 4.0 | 4.0 | 2.3 | 3.6 | 4.7 |
| Sectoral distribution of resident loans to total loans | | | | | | | | | | | | |
| Agriculture | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Fishing | 0.1 | 0.1 | 0.1 | 0.4 | 0.2 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Mining and quarrying | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Manufacturing | 2.7 | 2.8 | 2.6 | 2.6 | 2.5 | 2.5 | 0.6 | 0.6 | 0.3 | 0.4 | 0.3 | 0.4 |
| Electricity, gas, Steam and Air Conditioning Supply | 2.9 | 2.2 | 2.3 | 1.6 | 1.4 | 1.4 | 5.1 | 0.0 | 0.0 | 0.0 | 0.9 | 0.0 |
| Water Supply; Sewerage waste management and remediation activities | 0.6 | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Construction | 7.3 | 5.2 | 4.9 | 4.5 | 4.4 | 4.3 | 0.0 | 0.0 | 0.0 | 2.5 | 3.3 | 3.9 |
| Wholesale and retail trade; Repair of motor vehicles and motor cycles | 8.3 | 8.2 | 7.8 | 6.9 | 6.3 | 5.6 | 0.7 | 1.1 | 0.4 | 2.2 | 5.2 | 3.3 |
| Transportation and storage | 2.8 | 2.8 | 2.3 | 2.3 | 1.7 | 1.4 | 0.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 |
| Accomodation and food service activities | 3.8 | 4.1 | 3.5 | 2.8 | 3.0 | 3.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Information and communication | 0.9 | 0.8 | 0.7 | 0.5 | 0.5 | 0.5 | 0.1 | 0.1 | 0.0 | 0.1 | 0.1 | 0.1 |
| Financial and insurance activities | 4.8 | 5.9 | 6.8 | 6.3 | 6.1 | 6.3 | 0.7 | 0.9 | 2.6 | 3.7 | 1.9 | 1.6 |
| Real estate activities [includes inputed rents of owner-occupied dwellings] | 6.6 | 6.7 | 7.3 | 7.0 | 6.9 | 6.9 | 3.6 | 3.5 | 4.2 | 4.4 | 4.8 | 6.4 |
| Professional, scientific and technical activities | 0.9 | 1.1 | 1.3 | 1.4 | 1.7 | 2.3 | 0.0 | 0.0 | 0.0 | 0.9 | 0.8 | 0.6 |
| Administrative and support service activities | 1.4 | 1.2 | 1.0 | 0.8 | 0.7 | 1.2 | 0.1 | 0.1 | 0.7 | 1.1 | 0.8 | 1.3 |
| Public administration and defence; Compulsory social security | 1.5 | 1.6 | 1.1 | 1.3 | 1.2 | 1.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Education | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Human health and social work activities | 0.7 | 0.7 | 0.7 | 0.7 | 0.8 | 0.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Arts, entertainment and recreation | 0.5 | 0.5 | 0.4 | 0.3 | 0.3 | 0.2 | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other Services activities | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.3 | 0.0 |
| Households and individuals (excl. Sole Proprietors) | 43.6 | 46.2 | 48.3 | 47.5 | 46.9 | 47.3 | 0.1 | 0.1 | 0.1 | 2.6 | 3.5 | 6.0 |
| Mortgages | 36.9 | 39.8 | 42.3 | 42.4 | 42.3 | 42.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Activities of extraterritorial organisations and bodies | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Non-resident | 9.6 | 8.4 | 7.8 | 12.2 | 14.6 | 13.9 | 87.8 | 93.6 | 91.6 | 82.1 | 78.3 | 76.2 |
| Return on assets | 0.7 | 0.7 | 0.8 | 0.7 | 0.5 | 0.7 | -1.3 | 0.2 | 0.3 | 0.3 | 0.2 | 0.2 |
| Return on equity | 9.8 | 9.8 | 10.1 | 9.2 | 6.5 | 8.0 | -6.4 | 1.4 | 3.4 | 2.9 | 2.2 | 1.9 |
| Interest margin to gross income | 64.8 | 64.5 | 62.3 | 70.8 | 62.3 | 62.6 | 46.3 | 43.5 | 31.2 | 31.1 | 37.7 | 49.3 |
| Non-interest expenses to gross income | 51.2 | 54.2 | 52.2 | 58.8 | 64.3 | 55.5 | 56.1 | 73.4 | 66.5 | 78.3 | 62.0 | 64.1 |
| Non-interest income to gross income | 35.2 | 35.5 | 37.8 | 29.2 | 37.7 | 37.4 | 53.7 | 56.5 | 68.8 | 68.9 | 62.4 | 50.7 |
| Liquid assets to total assets | 28.3 | 31.8 | 36.5 | 29.4 | 28.3 | 29.4 | 31.7 | 36.3 | 33.5 | 28.6 | 32.0 | 37.1 |
| Liquid assets to short-term liabilities | 50.4 | 50.2 | 55.8 | 43.5 | 37.2 | 39.0 | 77.9 | 63.3 | 67.8 | 37.4 | 38.8 | 44.8 |
| Other FSIs | | | | | | | | | | | | |
| Total Coverage ratio (total provisions to NPLs as per BR/09) | 40.4 | 43.5 | 45.9 | 45.2 | 44.4 | 44.2 | 77.1 | 65.2 | 53.9 | 65.9 | 64.6 | 53.6 |
| Liquidity Coverage Ratio | | 165.1 | 164.4 | 188.3 | 316.1 | 286.6 | | 100.2 | 194.9 | 263.9 | 421.3 | 389.8 |
| Domestic debt securities to total assets | 9.6 | 9.3 | 7.9 | 7.0 | 6.5 | 6.7 | 4.6 | 7.7 | 4.9 | 3.2 | 2.0 | 2.5 |
| Foreign debt securities to total assets | 23.3 | 21.8 | 20.6 | 16.8 | 15.8 | 15.7 | 19.5 | 12.5 | 15.0 | 11.9 | 14.1 | 12.1 |
| Unsecured loans to total lending | 29.0 | 27.4 | 25.4 | 27.7 | 28.6 | 16.6 | 65.2 | 70.9 | 65.4 | 67.2 | 73.4 | 76.2 |
| Assets to total capital and reserves | 14.1 | 13.7 | 13.3 | 12.0 | 12.2 | 11.6 | 8.4 | 8.4 | 12.1 | 11.5 | 8.9 | 9.0 |
| Large exposure to total own funds | 103.4 | 96.5 | 110.9 | 88.4 | 92.8 | 82.3 | 339.9 | 157.6 | 268.6 | 274.9 | 205.7 | 194.1 |
| Gross asset position in financial derivatives to total own funds | 1.1 | 1.3 | 1.7 | 0.9 | 0.6 | 0.5 | 0.8 | 0.3 | 0.6 | 0.3 | 0.0 | 0.2 |
| Gross liability position in financial derivatives to total own funds | 4.5 | 2.0 | 2.0 | 1.0 | 0.9 | 1.2 | 2.2 | 0.3 | 3.6 | 0.3 | 0.9 | 0.4 |
| Personnel expenses to non-interest expenses | 50.8 | 51.2 | 48.8 | 48.1 | 37.9 | 46.0 | 45.0 | 42.5 | 49.7 | 45.6 | 49.8 | 48.9 |
| Customer loans to customer deposits | 64.0 | 58.2 | 56.0 | 58.9 | 60.9 | 62.2 | 75.7 | 60.7 | 46.5 | 47.1 | 50.5 | 44.4 |
| Net open position in equities to total own funds | 14.4 | 15.4 | 14.0 | 13.1 | 10.8 | 10.4 | 45.0 | 81.8 | 146.8 | 138.8 | 107.4 | 110.2 |
| Loan-to-value | | | | | | | | | | | | |
| Residential | 73.9 | 77.8 | 75.1 | 73.5 | 72.7 | 75.8 | | | | | | |
| Commercial | 64.5 | 56.9 | 67.5 | 65.1 | 56.7 | 62.5 | | | | | | |

| | International Banks | | | | | | Total Banks | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019H1 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019H1 |
| Core FSIs | | | | | | | | | | | | |
| Regulatory capital to risk weighted assets | 69.2 | 56.6 | 49.2 | 47.9 | 53.0 | 52.0 | 25.7 | 21.8 | 21.2 | 21.7 | 22.7 | 23.0 |
| Regulatory Tier 1 capital to risk-weighted assets | 69.1 | 56.2 | 46.7 | 45.3 | 50.4 | 51.9 | 23.6 | 19.2 | 18.5 | 19.4 | 20.7 | 21.1 |
| Non-performing loans net of provisions to capital | 2.2 | 3.8 | 8.2 | 6.9 | 7.7 | 5.1 | 18.3 | 24.3 | 20.1 | 16.3 | 15.3 | 15.2 |
| Non-performing loans to total gross loans | 0.7 | 1.2 | 1.7 | 1.9 | 2.5 | 2.2 | 6.0 | 4.7 | 4.1 | 3.2 | 3.1 | 3.0 |
| Sectoral distribution of resident loans to total loans | | | | | | | | | | | | |
| Agriculture | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Fishing | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 |
| Mining and quarrying | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Manufacturing | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 1.7 | 1.7 | 1.6 | 1.6 | 1.5 | 1.6 |
| Electricity, gas, Steam and Air Conditioning Supply | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 2.0 | 1.3 | 1.4 | 0.9 | 0.9 | 0.9 |
| Water Supply; Sewerage waste management and remediation activities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.4 | 0.3 | 0.3 | 0.3 | 0.2 | 0.2 |
| Construction | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 4.4 | 3.2 | 3.0 | 2.7 | 2.8 | 2.8 |
| Wholesale and retail trade; Repair of motor vehicles and motor cycles | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | 5.0 | 5.0 | 4.8 | 4.1 | 4.0 | 3.6 |
| Transportation and storage | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.0 | 1.8 | 1.8 | 1.5 | 1.4 | 1.1 | 1.0 |
| Accomodation and food service activities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 2.3 | 2.5 | 2.1 | 1.6 | 1.8 | 1.9 |
| Information and communication | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.6 | 0.5 | 0.4 | 0.3 | 0.3 | 0.3 |
| Financial and insurance activities | 0.0 | 0.0 | 1.3 | 0.1 | 0.0 | 0.0 | 2.9 | 3.6 | 4.7 | 3.8 | 3.8 | 3.9 |
| Real estate activities [includes inputed rents of owner-occupied dwellings] | 0.0 | 0.5 | 0.0 | 0.0 | 0.0 | 0.0 | 4.2 | 4.4 | 4.7 | 4.2 | 4.4 | 4.5 |
| Professional, scientific and technical activities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.5 | 0.7 | 0.8 | 0.9 | 1.1 | 1.4 |
| Administrative and support service activities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.8 | 0.7 | 0.7 | 0.5 | 0.4 | 0.8 |
| Public administration and defence; Compulsory social security | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.9 | 1.0 | 0.7 | 0.8 | 0.7 | 0.8 |
| Education | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 |
| Human health and social work activities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.4 | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 |
| Arts, entertainment and recreation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.3 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 |
| Other Services activities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.2 |
| Households and individuals (excl. Sole Proprietors) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 26.2 | 27.8 | 29.6 | 27.7 | 28.2 | 29.2 |
| Mortgages | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 22.1 | 23.9 | 25.9 | 24.6 | 25.3 | 26.2 |
| Activities of extraterritorial organisations and bodies | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Non-resident | 99.9 | 99.3 | 98.5 | 99.7 | 99.7 | 99.7 | 45.1 | 44.3 | 42.6 | 48.2 | 47.8 | 46.1 |
| Return on assets | 0.9 | 1.0 | 1.0 | 1.5 | 1.5 | 1.8 | 0.7 | 0.9 | 0.8 | 1.0 | 0.9 | 1.1 |
| Return on equity | 2.4 | 3.4 | 3.7 | 4.9 | 5.3 | 7.6 | 3.6 | 5.9 | 6.7 | 7.3 | 5.8 | 7.3 |
| Interest margin to gross income | 201.9 | 137.8 | 92.6 | 78.8 | 80.8 | 68.8 | 115.1 | 93.0 | 73.0 | 73.3 | 69.8 | 64.9 |
| Non-interest expenses to gross income | 11.9 | 24.8 | 31.9 | 28.1 | 30.7 | 29.7 | 36.8 | 43.3 | 44.7 | 44.0 | 48.4 | 43.5 |
| Non-interest income to gross income | -101.9 | -37.8 | 7.4 | 21.2 | 19.2 | 31.2 | -15.1 | 7.0 | 27.0 | 26.7 | 30.2 | 35.1 |
| Liquid assets to total assets | 19.7 | 22.7 | 30.1 | 20.6 | 12.4 | 6.8 | 27.3 | 31.2 | 35.6 | 16.6 | 26.5 | 28.2 |
| Liquid assets to short-term liabilities | 84.7 | 83.6 | 96.3 | 43.7 | 46.7 | 13.0 | 53.9 | 52.6 | 58.7 | 43.0 | 37.8 | 38.0 |
| Other FSIs | | | | | | | | | | | | |
| Total Coverage ratio (total provisions to NPLs as per BR/09) | 40.5 | 50.4 | 54.8 | 51.9 | 53.2 | 57.0 | 37.5 | 40.0 | 48.0 | 47.4 | 45.6 | 45.3 |
| Liquidity Coverage Ratio | | 188.3 | 357.6 | 279.4 | 411.7 | 511.5 | | 159.7 | 173.9 | 198.2 | 329.4 | 298.9 |
| Domestic debt securities to total assets | 0.0 | 0.2 | 0.1 | 0.2 | 0.1 | 0.1 | 3.9 | 4.5 | 4.0 | 3.6 | 3.7 | 4.0 |
| Foreign debt securities to total assets | 52.4 | 50.4 | 46.9 | 42.7 | 29.5 | 28.3 | 39.9 | 36.0 | 32.8 | 28.9 | 21.1 | 20.0 |
| Unsecured loans to total lending | 48.4 | 30.7 | 26.7 | 16.2 | 17.2 | 18.1 | 37.7 | 30.8 | 28.2 | 25.0 | 26.8 | 19.9 |
| Assets to total capital and reserves | 1.7 | 2.0 | 2.9 | 3.4 | 2.8 | 2.7 | 6.4 | 8.0 | 9.6 | 9.3 | 8.9 | 8.8 |
| Large exposure to total own funds | 45.3 | 129.9 | 128.8 | 119.2 | 78.1 | 85.9 | 88.9 | 115.8 | 130.1 | 111.1 | 97.5 | 92.6 |
| Gross asset position in financial derivatives to total own funds | 15.7 | 67.2 | 103.0 | 131.2 | 166.8 | 174.9 | 8.9 | 25.9 | 37.8 | 42.7 | 52.7 | 48.8 |
| Gross liability position in financial derivatives to total own funds | 10.4 | 15.9 | 69.2 | 80.2 | 102.8 | 113.8 | 10.4 | 15.3 | 22.6 | 26.4 | 32.9 | 32.4 |
| Personnel expenses to non-interest expenses | 27.4 | 23.2 | 19.9 | 16.2 | 14.1 | 14.1 | 47.4 | 44.0 | 40.5 | 37.6 | 31.5 | 35.7 |
| Customer loans to customer deposits | 93.1 | 104.1 | 108.1 | 111.6 | 207.7 | 342.1 | 71.8 | 67.9 | 65.7 | 70.4 | 79.0 | 82.3 |
| Net open position in equities to total own funds | 0.3 | 2.7 | 1.1 | 3.4 | 4.6 | 6.2 | 9.0 | 18.1 | 20.2 | 18.6 | 16.8 | 17.5 |
| Loan-to-value | | | | | | | | | | | | |
| Residential | | | | | | | | | | | | |
| Commercial | | | | | | | | | | | | |

1/ Banks' total assets amounted to 467 percent of GDP (about €46 billion) at 2016. About 48 percent of these assets are owned by international banks, which have limited or no linkages to the domestic economy. Core domestic banks, which account for 47 percent of the banking sector's total assets, are tightly linked to domestic activity as they rely mainly on domestic deposits and provide the bulk of lending to residents. The remainder of the assets are held by non-core domestic banks, which maintain small exposure to residents.

| Recommendations | Timing | Progress |
|---|---|---|
| ***Banking Regulation and Supervision*** | | |
| Increase the number and risk orientation of onsite inspections of LSIs. Enhance supervision of third country branches. (MFSA) | ST | **In progress.** The MFSA carried out two on-site inspections to Turkish credit institutions in 2019, but more are needed for adequate supervision of third-country branches as well as high priority LSIs. In addition, the authorities should address the gaps between the related-parties framework and the Basel Core Principles. |
| Take timely supervisory actions (including for ML/TF) and increase the use of monetary fines. Ensure supervisory action is not delayed through judicial appeal, including by amending the law, if needed. (MFSA, FAIU, Government) | ST | **In progress.** The FIAU has taken various initiatives including by increasing human resources, separation of functions, and improving its risk-based supervision approach together with enhanced collaboration with the MFSA. In Feb 2020, the FIAU acquired the legal power to publish notification of administrative sanctions that have been issued, even if these are still undergoing judicial review. The judicial system should be improved in a timely manner to ensure greater effectiveness of the sanctions policy. |
| ***Insurance and Securities Regulation and Supervision*** | | |
| Strengthen conduct supervision and enhance the sectoral risk-based supervision framework. (MFSA) | MT | **In progress.** The MFSA's financial stability function has been conducting more comprehensive analysis of the insurance and funds sectors. On conduct supervision, the MFSA is planning to carry out more on-site inspections in 2020 and to launch off-site thematic reviews. |
| ***AML/CFT*** | | |
| Improve the authorities' assessment and understanding of ML/TF risks and strengthen the national coordination. (National Coordination Committee) | I | **In progress.** Sector specific risk assessments (legal entities, VFAs, voluntary organizations) and a thematic risk assessment on TF have been completed, and the NCC has ~~started working on~~developed targeted action plans to mitigate identified risks. The FIAU acquired new tools for and is dedicating further resources to improve its overall risk understanding. Authorities should make sure to continue to focus on risks related to higher-risk sectors and programs, including banking, remote gaming, VFAs, the IIP, and connected sectors, as well as foreign and cross-border flows. |
| Adopt a multi-prong strategy that includes: (i) ensuring that banks appropriately apply preventive measures; (ii) fully implementing a risk-based AML/CFT supervision; and (iii) applying timely, dissuasive, and proportionate sanctions and effective fit-and-proper tests. (MFSA, FIAU, ROC, Government) | I | **In progress.** The MFSA recently set up the coordination function—Financial Crime Compliance function, enhanced risk-ranking model, and updated single shareholder/risk appetite policy. The FIAU has increased supervisory inspections of credit institutions and adopted a new methodology which aims to ensure that all credit institutions will be subject to an on-site examination within a four-year supervisory cycle. The FIAU and the MFSA in |

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|---|---|---|
| | | collaboration have also increased training and outreach for banks and other subject persons and issued related guidance documents.<br><br>In terms of the beneficial ownership transparency, the Malta Business Registry was established ~~ROC~~ and is empowered by law to verify the beneficial ownership information and can refuse registration if violations are identified. However, more efforts should be made to ensure proper and timely verification and robust sanctions if needed. |
| Support establishing an EU-level arrangement responsible for AML/CFT supervision. (Government) | MT | **In progress.** Malta is supporting the EU-level initiative of a harmonized higher-level AML regulation and supervision. |
| ***Safety Nets and Crisis Management*** | | |
| Adopt an administrative bank insolvency regime with explicit powers to transfer assets/liabilities. Clarify the creditor hierarchy. (Government) | I | **In progress.** Malta is following the EU level initiative on a harmonized insolvency law applicable to credit institutions. However, the authorities should react more promptly as this process could take considerable period of time. |
| Shift responsibility for decisions on bank insolvency and liquidation, post-license revocation, from the MFSA's supervisory function to its resolution function (MFSA) | I | **Not done.** The recommendation is currently under discussion. |
| Review the adequacy of the Resolution Unit's staffing and increase its resources accordingly (MFSA) | I | **Not done**. Increasing staff in the Resolution Unit of MFSA is under consideration. |

PRESS RELEASE

PR[20/XX]

# Appendix I. Draft Press Release

## IMF Executive Board Concludes 2020 Article IV Consultation with Malta

**FOR IMMEDIATE RELEASE**

**WASHINGTON, DC – April 6, 2020**

On April 6, 2020 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Malta and considered and endorsed the staff appraisal without a meeting on a lapse-of-time basis[2] (see below an important note on the timing of the report which precedes the outbreak of COVID-19).[3]

Malta is facing significant challenges owing to the recent COVID-19 outbreak. Entire sections of the Maltese economy, especially in the services sector, are forced to operate well below normal capacity due to reduced labor supply and administrative closures. Sectors related to tourism and transportation, which provide major sources of income for the Maltese people, are especially affected. The authorities' near-term efforts are rightly focused on limiting and containing the adverse social and economic effects of the COVID-19 outbreak.

In light of recent developments, the risk to the outlook is undoubtedly skewed to the downside and the extent of the downturn will depend on how long normal economic activity is subject to pervasive disruptions related to the COVID-19 ~~epidemic~~pandemic. Malta's main medium-term challenge is to mitigate financial integrity risks by continuing to address deficiencies identified in the anti-money laundering and combating the financing of terrorism (AML/CFT) framework. The focus should be on improving and demonstrating the effectiveness of the AML/CFT regime.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when it is agreed by the Board that a proposal can be considered without convening formal discussions.

[3] The Staff Report was prepared by a staff team of the IMF for the Executive Board's consideration on April 6, 2020. The staff report reflects discussions with the Maltese authorities in February 2020 and is based on the information available as of February 28, 2020. It focuses on Malta's near and medium-term challenges and policy priorities and was prepared before COVID-19 became a global pandemic and resulted in unprecedented strains in global trade, commodity and financial markets. It, therefore, does not reflect the implications of these developments and related policy priorities. The outbreak has greatly amplified uncertainty and downside risks around the outlook. Staff is closely monitoring the situation and will continue to work on assessing its impact and the related policy response in Malta and globally.

**Executive Board Assessment**

In concluding the Article IV consultation with Malta, Executive Directors endorsed the staff's appraisal as follows:

The Maltese economy has continued to overperform European peers. Prudent fiscal policy and timely structural reforms have helped boost employment and build fiscal buffers while promoting social inclusion. Growth remained strong in 2019, even though it weakened from 2018. Domestic demand is expected to remain the main engine of growth as the economy gradually reaches cruising speed and the large current account surplus declines. The risks to the outlook are skewed to the downside and a lot will depend on how pervasive and long-lasting disruptions related to the Coronavirus epidemic will be.

Continued efforts are needed to mitigate financial integrity and stability risks. As pressures on CBRs intensify, it is critically important to continue to address deficiencies identified with the AML/CFT system. The focus should be on improving and demonstrating effectiveness of the AML/CFT framework. In particular, the understanding of risks and the monitoring and supervision of banks and other higher-risk sectors and programs—such as remote gaming, VFAs, and the IIP—should continue to be strengthened. It is also key to enhance AML/CFT enforcement actions, including through timely and adequate sanctions in case of breaches.

Supervisory capacity should be further enhanced and remaining deficiencies in the crisis management framework addressed. The operational and financial independence of the financial supervisor should be assured. Despite commendable progress, the MFSA remains under strain due to the large number of financial institutions under supervision, the evolving regulatory environment, and challenges associated with new and complex products. The legal framework for bank insolvency should also be updated and streamlined. An administrative regime for the orderly closure and liquidation of a failing bank should be introduced to avoid that supervisory actions are unduly delayed through judicial appeal.

Further improving the analysis of potential risks developing outside of the banking sector will help uphold financial stability. Inter-company lending is gradually displacing bank lending as the main source of corporate funding, posing new challenges to supervision. A better understanding of the flow of funds between corporates and of their risk-management practices could help identify potential financial risks and contagion channels to the financial system. In the meanwhile, it is important to avoid over-exposure to large, indebted and interconnected corporates and to monitor developments on the housing market, standing ready to tighten the recently introduced borrower-based macroprudential measures in due course.

Prudent fiscal policy needs to be maintained. Maintaining gradual consolidation excluding the proceeds from the IIP is warranted due to fiscal vulnerabilities from contingent