

Circular to Credit Institutions on the consultation on proposed amendments to Banking Rule 09 under the Banking Act 1994

High levels of non-performing loans are not only a source of risk for credit institutions individually but also have a collective bearing at a macroeconomic level. Elevated levels of non-performing loans have long been identified by international institutions such as the IMF as a source of financial stability risk, since they hinder the efficient flow of credit to productive investment in the real economy, thus constraining future growth prospects. Non-performing loans also limit the future income streams for credit institutions, threatening the long term sustainability of their business models. In turn, this threat is gaining more impetus in the current low interest rate environment. Motivated by these same concerns, on the 12th of September, the European Central Bank in its SSM capacity published a guidance report¹ on NPL reduction for consultation.

Against this background the CBM/MFSA Joint Financial Stability Board ('the Board'), following extensive discussions with both the MFSA and Central Bank of Malta, has determined the need for the banking sector in Malta to reduce its level of non-performing loans and has advocated a more direct approach to achieve this target. The Board's views were motivated by a relatively higher NPL ratio for core domestic banks when compared to the European average, more so when taking into account that the latter is biased upwards by the stock of non-performing loans of distressed countries. This notwithstanding, the Board also took note of the particular traits of the banking industry in Malta, such as the size of the institutions, their structural characteristics and their operational constraints.

The Board has also determined that an amended version of the MFSA's Banking Rule 09 issued under the Banking Act 1994 is the most appropriate instrument to achieve this objective.

For this reason, the MFSA would like to draw the attention of credit institutions licensed in Malta to a [consultation on the amendments to BR09](#) that are being proposed following close cooperation with the Central Bank of Malta.

The proposed amendments are essentially anchored around a medium-to-long-term ceiling on the NPLs ratio of credit institutions. Credit institutions holding a higher ratio will be required to devise a concrete reduction plan to bring the levels of non-performing loans below this ceiling. Failure to adhere to this plan will require the institution to shore up its resiliency through the accumulation of an additional capital reserve. Further details on this proposed framework could be found in the said consultation document.

¹ <https://www.bankingsupervision.europa.eu/press/pr/date/2016/html/sr160912.en.html>

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Interested parties are being invited to submit any written comments by not later than Friday 21st October 2016. Any comments and feedback are to be addressed to Alexandra Filletti, Senior Manager, Regulatory Development Unit on afilletti@mfsa.com.mt. The Authority reserves the right to disregard any responses sent after the said date.

Communications Unit
Malta Financial Services Authority
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