



BANK ĊENTRALI TA' MALTA  
EUROSISTEMA  
CENTRAL BANK OF MALTA

**MFSA**  
MALTA FINANCIAL SERVICES AUTHORITY

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**FEEDBACK STATEMENT FURTHER TO INDUSTRY RESPONSES TO  
THE JOINT CONSULTATION ON THE METHODOLOGY FOR THE IDENTIFICATION OF OTHER  
SYSTEMICALLY IMPORTANT INSTITUTIONS AND THE RELATED CAPITAL BUFFER  
CALIBRATION ISSUED ON 5<sup>TH</sup> NOVEMBER 2015**

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## **1. INTRODUCTION**

On 5<sup>th</sup> November 2015, the Malta Financial Services Authority ['MFSA'] and the Central Bank of Malta ['CBM'] (hereinafter jointly referred to as the 'Authorities') launched a joint consultation on the methodology for the identification of other systemically important institutions and the related capital buffer calibration. The consultation period ended on 18<sup>th</sup> November 2015.

This document presents a summary of the proposed Other Systemically Important Institutions ('O-SII') methodology, followed by a report on the feedback received and the corresponding views of the Authorities. This document concludes with the Authorities' final decision on the designation of O-SIIs in Malta.

## **2. OVERVIEW OF THE PROPOSED O-SII METHODOLOGY**

The consultation document outlined a proposed framework for the development and application of the Other Systemically Important Institutions (O-SII) buffer to strengthen the resilience of the domestic financial system. This buffer consists of a capital surcharge applied to institutions that may, in the event of failure or impairment, impact considerably the financial system and the real economy. It is also an essential element of the ESRB Recommendation on the intermediate objectives and instruments of macro-prudential policy, and is a macro-prudential tool pursuant to Article 131 CRD as transposed in Banking Rule BR/15/2015 – Capital Buffers of Credit Institutions Authorised under the Banking Act 1994 and Central Bank of Malta Directive No. 11 – Macro-prudential Policy. The CBM and the MFSA are jointly responsible for the implementation of Article 131 CRD in Malta pursuant to the Central Bank of Malta Act (Appointment of Designate Authority to implement Macro-Prudential Instruments) Regulations, 2014 [L.N. 29 of 2014].

The implementation of the framework of an O-SII buffer involves the identification of institutions as O-SIIs and the calibration of the buffer rate which will be applied to identified O-SIIs. The framework for the identification of O-SIIs can be divided into two steps as indicated hereunder:

### ***2.1. Step 1***

As a first step, systemically important institutions have been identified and assessed on the basis of their relative importance within the sector based on the criteria of [i] size; [ii] substitutability; [iii] cross-border activity; and [iv] resident interconnectedness. The higher the score, the more important is the institution within the sector. Table 1 outlines the scoring methodology for domestic O-SII identification.



**Table 1: Scoring Methodology for domestic O-SII identification**

Criterion	Indicators	Weight	
<b>Size</b>	Total assets	20.00%	20%
<b>Substitutability</b>	Resident customer loans	13.33%	40%
	Resident customer deposits	13.33%	
	Holdings of Government debt	13.33%	
<b>Cross-border activity</b>	Cross-border assets	10.00%	20%
	Cross-border liabilities	10.00%	
<b>Resident Interconnectedness</b>	Resident Interbank assets	10.00%	20%

## *2.2. Step 2*

Once the scoring methodology proposed under the first step is undertaken, institutions that do not qualify under Step 1 shall be subject to a second step on the basis of the criteria of [i] size i.e.  $\geq 25\%$  of the domestic GDP; and [ii] covered deposits i.e.  $\geq 2.5$  times the domestic Depositor Compensation Scheme (DCS) funding.

An institution that meets or exceeds the criteria established in either steps 1 and 2 would qualify as an O-SII and would thus be added to the list of O-SIIs and may be subject to an O-SII capital buffer. This buffer shall be reviewed on an annual basis. An institution shall cease to qualify as an O-SII, if for two consecutive years it does not exceed the established thresholds in either step 1 or step 2, unless otherwise determined by the Authorities.

## *2.3. Capital Buffer calibration*

The proposed bucketing methodology is based on the scores achieved in the O-SII identification stage in Step 1 as follows:

- i. the highest bucket remains the maximum legal O-SII buffer rate of 2%, whilst the lowest is set at 1.0%;
- ii. buffer rates are allocated into three buckets in steps of 0.5% as per Table 2;
- iii. the overall score obtained in the identification methodology is used to indicate the bucket in which an institution is allocated starting from bucket 1 indicated in Table 2 above.



**Table 2: The Bucketing Methodology – Step 1**

<b>Buckets</b>	<b>Capital Buffer rate</b>	<b>Criterion for each bucket</b>
<b>3</b>	<b>2.0%</b>	High risk due to most of the criteria and/or Score equal to or above 1.75
<b>2</b>	<b>1.5%</b>	Risk due to most of the criteria and/or Score equal to or above 1.25 and below 1.75
<b>1</b>	<b>1.0%</b>	Some risk due to some criteria and/or Score equal to or above 1 and below 1.25

For credit institutions that qualify as O-SIIs in Step 2, a capital buffer rate of 0.5% shall apply as indicated in Table 3

**Table 3: Capital buffers for Step 2**

<b>Capital Buffer rate</b>	<b>Criterion</b>
<b>0.5%</b>	Additional Indicators

### **3. SUMMARY OF THE FEEDBACK RECEIVED**

This section features the feedback received by subject-matter followed with the Authorities' views on the subject as well as any necessary changes to the policy resulting from such feedback.

#### **3.1. Consolidation level**

##### **3.1.1. Feedback received**

A respondent maintained that the proposed methodology does not specify how the ratios in step 2 are being calculated when a group of companies includes entities that are domiciled and operate in a foreign country.

Specifically, it was suggested that the assets to GDP ratio should be calculated by taking into account the total assets held by Maltese credit institutions divided by the Maltese GDP figure.



The reason put forward is that when establishing the systemic importance of the credit institution to the Maltese economy, one should only take into consideration those assets that are held by entities registered in Malta.

Thus it was argued that those assets held by a credit institution licensed in a foreign country and that are funded through deposits taken in that country should not be factored into the equation.

### ***3.1.2. Authorities' views***

The domestic methodology for the identification of O-SIIs requires the Authorities to calculate a score for each relevant institution at the highest level of consolidation in Malta, including subsidiaries in other Member States and third countries as per section 2 of the Consultation Document.

The sub-consolidation of subsidiaries in other Member States is an important part of the methodology. The activities of a credit institution outside the home jurisdiction can, in the event of failure, have a ripple effect and potential significant spill-overs to the domestic economy via the real or information contagion channel. Jurisdictions that are home to banking groups that engage in cross-border activity could be impacted by the failure of any entity in the group and not just the part of the group that undertakes domestic activity in the domestic economy. This is particularly important given the possibility that the domestic Government may have to fund and/or resolve the foreign operations in the absence of relevant cross-border agreements.

The Authorities are thus of the view that they should assess entities in their jurisdictions on a consolidated basis, to include any of their own downstream subsidiaries, including those which may be in other jurisdictions.

## ***3.2. Definition of Covered Deposits***

### ***3.2.1. Feedback Received***

A respondent maintained that the covered deposits criteria were not appropriately defined.



### ***3.2.2. Authorities' views***

The Authorities would like to clarify that the definition of 'covered deposits', cited in Article 2(1)(5) of Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes, shall apply.

## ***3.3. Risk-Weighting of the Indicators used***

### ***3.3.1. Feedback Received***

One respondent remarked that the proposed methodology does not take into consideration the risk weights of the underlying assets, suggesting that the indicators should be adjusted to take into consideration the risk weights of the underlying assets before the final scoring is reached.

### ***3.3.2. Authorities' views***

In this respect, it is worthwhile highlighting the fact that the indicators are designed to screen institutions in terms of their relevance to the real economy rather than their risk profile. The latter is purely a micro-prudential matter and hence fully integrated in the SREP process of the ECB/MFSA. The absence of risk weighting is also in line with the Commission Implementing Regulation (EU) No 1030/2014 of 29 September 2014 laying down implementing technical standards with regard to the uniform formats and date for the disclosure of the values used to identify global systemically important institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council.

Furthermore, from a technical point of view, the methodology does not only include assets-based indicators but contains also criteria related to liabilities to which the concept of risk weighting does not apply.

## ***3.4. Z-Score methodology***

### ***3.4.1. Feedback Received***

One respondent maintained that the Z-score methodology was originally intended for corporations and would need to be adjusted before being applied to banks. As a result, more information was requested on the application of the Z-score model.



### ***3.4.2. Authorities' views***

From the feedback received it is evident that the consultation document was not clear enough in terms of the Z-score method used. For this reason the Authorities would like to clarify that the Z-score model featured in the consultation document refers to the standard Z-statistic rather than the Altman Z-score model (1968) which attempts to rank companies in terms of their likelihood to default.

The Z-statistic is computed as:

$$z = \frac{x - \mu}{\sigma}$$

where  $\mu$  is the mean and  $\sigma$  is the standard deviation.

## **4. WAY FORWARD**

After taking into account the feedback received from the industry, the Authorities will proceed by publishing a statement of decision on the methodology on the identification and calibration of O-SII buffers. The decision will contain the list of credit institutions falling within scope of this measure together with their corresponding capital buffers.

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