

## Notification template for Article 131 CRD – Other Systemically Important Institutions (O-SII)

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1. Notifying national authority											
1.1 Name of the notifying authority	Central Bank of Malta (CBM) and Malta Financial Services Authority (MFSA)										
2. Description of the measure											
2.1 Categorisation of measures	Other systemically important institutions (O-SII) identification and buffer setting as per Article 131 of the CRD IV.										
2.2 Concerned institution or group of institutions	<p>The measure applies to the following institutions at the highest level of consolidation in Malta:</p> <ul style="list-style-type: none"> <li>• Bank of Valletta Group LEI Code: 529900RWC8ZYB066JF16</li> <li>• HSBC Bank Malta Plc LEI Code: 549300X34UUBDEUL1Z91</li> <li>• MDB Group Ltd. LEI Code: 213800TC9PZRBHMJW403</li> <li>• APS Bank plc. LEI Code: 213800A1O379I6DMCU10</li> </ul>										
2.3 Level of the buffer applied	<table border="1"> <thead> <tr> <th>Institution</th> <th>Buffer rate</th> </tr> </thead> <tbody> <tr> <td>Bank of Valletta Group (BOV)</td> <td>2.00%</td> </tr> <tr> <td>HSBC Bank Malta plc (HSBC)</td> <td>1.50%</td> </tr> <tr> <td>MDB Group Ltd. (MED)</td> <td>1.00%</td> </tr> <tr> <td>APS Bank plc. (APS)</td> <td>0.25%</td> </tr> </tbody> </table> <p>The additional capital requirement is calculated on the basis of the institutions' total risk exposure amount and must be covered by Core Equity Tier 1 capital (CET1 capital).</p>	Institution	Buffer rate	Bank of Valletta Group (BOV)	2.00%	HSBC Bank Malta plc (HSBC)	1.50%	MDB Group Ltd. (MED)	1.00%	APS Bank plc. (APS)	0.25%
Institution	Buffer rate										
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2.4 Name of the EU ultimate parent institution	<p>HSBC Bank Malta plc: HSBC Holdings, LEI Code: MLU0ZO3ML4LN2LL2TL39</p> <p>MDB Group Ltd: AnaCap Financial Partners LLP, LEI code: 254900TAGFZB4HS1LG48</p> <p>Bank of Valletta Group and APS Bank plc are ultimate parent institutions.</p>										

2.5 Names of subsidiaries	<p>MDB Group Ltd. is the holding company of:</p> <ol style="list-style-type: none"> <li>1) MeDirect Bank (Malta) plc LEI code: 529900SYUCFQHI3JZQ05</li> <li>2) MeDirect Bank SA (BE) LEI code: 529900MATKY89NT0U738</li> </ol> <p>The other O-SIIs do not own banking subsidiaries.</p>
<b>3. Timing of the measure</b>	
3.1 Timing of the Decision	The CBM and the MFSA - the Authorities – are expected to reach their final O-SII decision on 12 January 2021, after duly noting the opinion of the ECB.
3.2 Timing of the Publication	The O-SII decision is expected to be published in early 2021.
3.3 Disclosure	The same communication strategy followed in the 2019 identification process will be followed during 2020 i.e. informing the respective banks of their O-SII status and applicable buffer rate through a dedicated private letter to all designated O-SIIs and informing the public through the respective Authorities' websites.
3.4 Timing of Application	The activation date of the buffers is 1 January 2021.
3.5 Phasing in	<p>The O-SII buffer in Malta has been implemented for the first time in 2016 through a four-year phase-in period, starting from 1 January 2016 becoming fully phased-in on 1 January 2019. Therefore, institutions previously identified as O-SIIs with no material changes in their applicable capital buffer rates during 2020 (i.e. BOV and HSBC) will continue to maintain their fully-loaded O-SII capital buffer rates (i.e. 2.00% and 1.50% respectively).</p> <p>The repercussions that surround the COVID-19 pandemic, have highlighted the need for further considerations on the phasing-in arrangements. In this regard, the Authorities are postponing any phasing-in arrangements for institutions currently subject to transitory provisions; to newly designated O-SIIs or to credit institutions registering an increase in their buffer rate stemming from the 2020 O-SII identification exercise.</p> <p>Therefore, APS Bank plc, which has been designated as an O-SII in 2019, shall continue to maintain its level of O-SII buffer for 2021 as held throughout 2020 and will then resume its phasing-in provisions as communicated in the Authorities' 2020 statement of decision from 1 January 2022 until reaching its fully-loaded O-SII buffer rate in 1 January 2024.</p> <p>Currently designated O-SIIs for which the 2020 identification exercise resulted in an increase in the institutions' applicable capital buffer rate, will still be subject to a four-year phasing-in period; however, such O-SIIs will start building up their buffer rate as from 1 January 2022.</p> <p>With regard to MDB Group Ltd., the 0.50% increase in the Group's O-SII buffer rate will likewise be subject to a four-year phasing-in period, starting from 1 January 2022 and ending on 1 January 2025. These phasing-in arrangements will be communicated to the concerned institutions through the dedicated private letters and made public through the Authorities' statement of decision.</p>
3.6 Review of the measure	The O-SII buffer will be reviewed annually.

#### 4. Reason for O-SII identification and activation of the O-SII buffer

##### 4.1 Scores of concerned institution or group of institutions, as per EBA guidelines on the assessment of O-SIIs (Article 131.3)

In line with the Authorities' current O-SII methodology, four credit institutions (i.e. Bank of Valletta Group, HSBC Bank Malta Plc, MeDirect Group Ltd and APS Bank plc) were identified as O-SIIs having surpassed the 425 bps threshold, which the Authorities have set as a cut-off point (the Authorities applied the + 75 bps leeway to the 350bps threshold as established in the EBA Guidelines EBA/GL/2014/10). The resulting scores are highlighted in the table below:

Institution	Scores (in bps)
Bank of Valletta Group (BOV)	2,817
HSBC Bank Malta plc (HSBC)	1,448
MDB Group Ltd. (MED)	1,046
APS Bank plc. (APS)	536

##### 4.2 Methodology and indicators used for designation of the O-SII (Article 131.3)

During the course of 2019, the Authorities decided to revise their methodology for the O-SII identification process and have thus established a new methodology to reflect the developments in the domestic financial sector and also to bring it more in line with the criteria established in the EBA Guidelines.

Therefore, under the current O-SII methodology, domestic systemically important institutions are identified as such, based on their relative importance within the sector as per a set of specific criteria. The categories and indicators are based on those put forward in the EBA Guidelines; however, to capture particular characteristics of the Maltese financial sector and the strong orientation of banks towards domestic deposits and loans, additional indicators are included in the 'importance' category.

The Maltese banking sector is characterised by a small number of market participants, dominated by a few 'systemically relevant' institutions which are more integrated with, and interlinked to the domestic economy when compared to the rest of the banks within the sector. Most of these 'systemically relevant' banks operate under a 'traditional' retail banking business model. In view of this characteristic, the current methodology has been designed in such a way as to identify as O-SIIs the aforementioned 'systemically relevant' institutions.

The homogenous weight of 25% for all categories stipulated in EBA methodology does not reflect adequately the domestic financial system's characteristics. Consequently, as highlighted in the table below, a relatively higher weight is attributed to the 'importance' and the 'size' categories, with a total weight of 40% and 22% respectively. The Authorities deem these categories as being the most reflective of the specificities of the domestic banking sector's business model, thereby representing the potential channels of systemic risk for the institutions domiciled in Malta. In line with this, given the rather traditional business models of domestic banks, the 'complexity' and 'interconnectedness' categories are assigned a lower weight of 18% and 20% respectively.

Category	Indicators	Indicator weight	Category weights
<b>Size</b>	Total Assets	22.00%	22.00%
<b>Importance</b>	Value of domestic payment transactions	8.00%	40.00%
	Private sector deposits from depositors in the EU*	5.50%	
	Private sector loans to recipients in the EU**	5.50%	
	Private sector deposits from Maltese residents	10.50%	
	Private sector loans to Maltese residents	10.50%	
<b>Complexity</b>	Value of OTC derivatives (notional)	4.00%	18.00%
	Cross-jurisdictional liabilities	7.00%	
	Cross-jurisdictional claims	7.00%	
<b>Interconnectedness</b>	Intra-financial system liabilities	9.00%	20.00%
	Intra-financial system assets	9.00%	
	Debt securities outstanding	2.00%	

\* MT deposits are incorporated in 'private sector deposits from depositors in the EU' indicator.  
\*\* MT loans are incorporated in 'private sector loans to recipients in the EU' indicator.

**4.3 Supervisory judgement**

In addition to refinements in the methodology with regards to the applicable weights and the addition of other indicators, the Authorities decided to set the cut-off threshold point at 425 bps (in line with the leeway established in the EBA guidelines) to reflect the relatively small Maltese financial sector and high concentration levels due to the small number of market participants.

**4.4 Calibrating the O-SII buffer**

A bucketing methodology is being employed as part of the calibration stage based on the scores achieved in the O-SII identification stage in section 4.2:

1. An O-SII can be classified into one of any of the five buckets presented in the table below, depending on the O-SII score obtained with the identification methodology. Bucket 1 contains the lowest capital rate (0.25%) and bucket 5 entails the highest capital buffer rate (2.0%).
2. Intermediate buffer rates of 0.5%, 1.0% and 1.5% are also applicable, thus reinforcing a proportionate and commensurate application of an O-SII surcharge; the higher the potential systemic risk posed by the respective O-SII, the higher the capital buffer rate applied.
3. The overall score obtained in the identification methodology (refer to section 4.2) is used to indicate the resulting capital buffer rate as per table below:

Buckets	Capital Buffer Rate	Score range for each bucket (bps)
<b>5</b>	2.00%	1700 ≤ Score
<b>4</b>	1.50%	1200 ≤ Score < 1700
<b>3</b>	1.00%	830 ≤ Score < 1200
<b>2</b>	0.50%	580 ≤ Score < 830
<b>1</b>	0.25%	425 ≤ Score < 580

<p><b>4.5 Effectiveness and proportionality of measure</b></p>	<p>The O-SII buffer is an essential element of the ESRB Recommendation on the intermediate objectives and instruments of macro-prudential policy<sup>1</sup>, and is a macro-prudential tool legally embedded in the CRD/CRR framework which, in turn, is domestically transposed in CBM Directive No. 11<sup>2</sup> and MFSA Banking Rule No. 15.<sup>3</sup></p> <p>The O-SII buffer consists of a capital surcharge applied to institutions that may, in the event of failure, have considerable impact on the financial system and the real economy. This additional capital buffer is applied to domestic systemically important institutions to enhance their resilience by increasing their loss absorbing capacity and thereby ensuring that they pose minimal risk to the domestic economy in the form of externalities. Market failures targeted by the O-SII buffer mainly relate to excessive risk-taking due to expectations of a bailout (moral hazard) given the perceived systemic relevance by individual institutions ('too big to fail'). In this respect, the O-SII buffer is a macro-prudential instrument that contributes to financial stability by mitigating the structural element of systemic risk stemming from moral hazard, thereby promoting market discipline.</p> <p>The domestic banking system is composed of a number of banks which are classified into three categories i.e. (a) core domestic banks; (b) non-core domestic banks and (c) international banks.</p> <p>The core domestic banks' category consists of a set of banks that exhibit relatively stronger links with the domestic economy and are therefore more likely to be classified as systemically important. These banks operate a widespread branch network, provide a full spectrum of banking services and are important providers of credit and deposit takers in Malta. With total assets of €26.58 billion, the size of core domestic banks was equivalent to approximately 208% of GDP by June 2020. All four banking groups identified as O-SIIs fall in this category, three of which are identified as significant for SSM purposes.</p> <p>The non-core domestic banks, while still having links with the domestic economy, play a more restricted role in the economy, as the volume of operations and banking services they offer to residents are somewhat limited. As such, the linkages with the domestic economy are limited, restricted to deposit-taking and domestic credit intermediation to a much smaller extent. In turn, internationally oriented banks are mainly subsidiaries and branches of international institutions and therefore have virtually no links with the domestic economy. Together the non-core and international banks, by June 2020, make around 125% of domestic GDP.</p> <p>Collectively, the four domestic banking groups classified as O-SIIs account for around 93% of the total assets of the core domestic banks and around 58% of the total banking system assets.</p>
<p><b>5. Cross-border and cross-sector impact of the measure</b></p>	
<p><b>5.1 Assessment of cross-border effects and the likely impact on the internal market</b> <b>(Recommendation ESRB/2015/2)</b></p>	<p>From the internal market perspective, given the relatively small size of the domestic financial sector vis-à-vis its European counterparts, no impact is expected to materialise as a result of the domestic O-SII buffer.</p>

<sup>1</sup> Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1).

<sup>2</sup> Directive No. 11 – Macro-prudential Policy.

<sup>3</sup> BR/15/2015 Capital Buffers of Credit Institutions Authorised under the Banking Act 1994.

5.2 Assessment of leakages and regulatory arbitrage within the notifying Member State	The buffers are set at the highest level of consolidation in Malta. This avoids the possibility that institutions shift their business activities within the group, whether domestically or elsewhere.
<b>6. Combinations and interactions with other measures</b>	
6.1 Combinations between G-SII and OSII buffers (Article 131.14)	N/A
6.2 Combinations with SRB buffers (Article 131.14 + Article 133.5)	N/A
6.3 O-SII requirement for a subsidiary (Article 131.8)	N/A
6.4 Interaction with other measures	No interaction with other measures.
<b>7. Miscellaneous</b>	
7.1 Contact person(s) at notifying authority	<p>Contact person(s) for further inquiries (name, phone number and e-mail address):</p> <p>Mr. Stephen Attard  Head Financial Stability Policy, Crisis Management and Stress Testing Department  Central Bank of Malta  E-mail: <a href="mailto:attards@centralbankmalta.org">attards@centralbankmalta.org</a></p> <p>Mr Joseph Agius  Head Financial Stability  Malta Financial Services Authority  E-mail: <a href="mailto:joseph.agius@mfsa.mt">joseph.agius@mfsa.mt</a></p>
7.2 Any other relevant information	N/A