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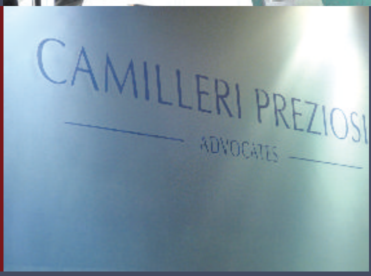
ADVOCATES

MALTA

# Malta: a stable and robust banking system

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*(The Legal 500)*

The recent events surrounding the collapse of the Cypriot banking system and the Eurogroup's unprecedented plans for a Cypriot restructuring programme have brought to the fore questions about Malta's economy and its banking sector.

These questions have been fuelled mostly by pieces drawn up by certain members of the international press suggesting speculative and superficial comparisons between the two Mediterranean island states - comparisons which are both misinformed and misconstrued. This briefing note sets out some considerations.

### Are there similarities?

Malta and Cyprus have fundamentally different economies, as proved by various statistical parameters. The list of similarities between Cyprus and Malta which observers spot immediately is short: both are Mediterranean island states, members of the European Union and the Eurozone, and both have a track record of financial services activity and hosting of holding companies.

### Reasons attributed to the Cyprus' financial crisis

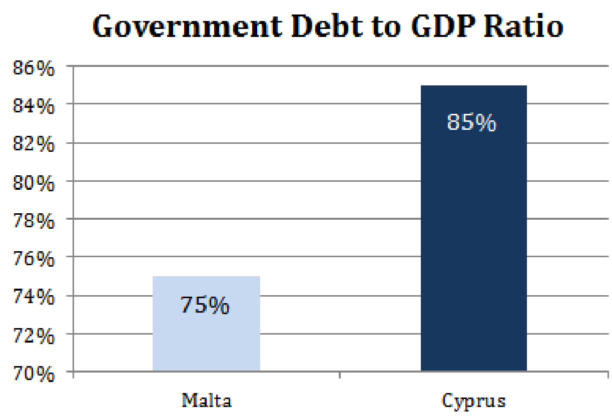
The principal reason attributed to the Cypriot crisis is the significantly high exposure of Cypriot Banks to Greek debt and the consequent adverse impact of the EU's decision to implement a haircut on Greek bonds in 2011. Coupled with the large size and influence of the Cypriot financial sector within the Cypriot economy (circa 40% of the entire Cypriot economy) – the effects of the Greek debt crisis were rapidly disseminated throughout the rest of the Cypriot economy.

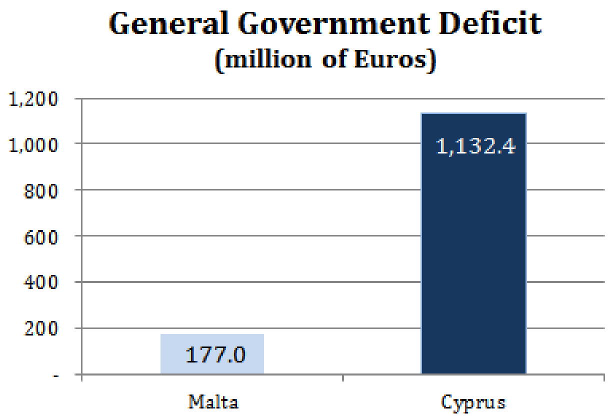
**Maltese Banks had no or very marginal exposure to Greek debt or debt of any other "bailed-out" sovereign.**

### Comparison of national financial data

*Why is Malta different:* **The main economic indicators demonstrate that Malta's economy and debt levels differ significantly from the position of Cyprus**.

Malta's ratio of government debt to GDP is less than the EA 17 and the EU 27 rate and less than the respective rates of Germany, UK or France. Across the 27 EU Member States, Cyprus lead the increase of government debt to GDP ratio in Q3 of 2012 as compared to Q3 of 2011 with a 17.5 percentage point increase over this 12-month period. This increase is significantly higher than that experienced by Ireland and Spain, with increases of 13.4 and 10.7 percentage points respectively.



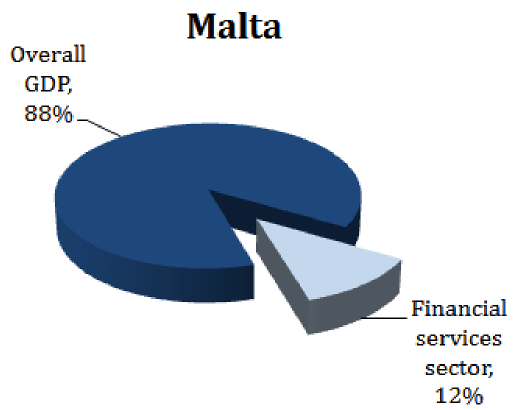

| Statistic | Malta | Cyprus |
|---|---|---|
| **GDP (2011)[(a)]** | €6.86 billion | €19.07 billion |
| **GDP per capita at current market prices (as at 31/03/2012)** | € 15,300 | € 20,500 |
| **General government deficit(2011)[(b)]** | €177 million | €1,132.4 million |
| **Balance of trade deficit (Jan 2013)** | €106.5 million | €294.9 million |

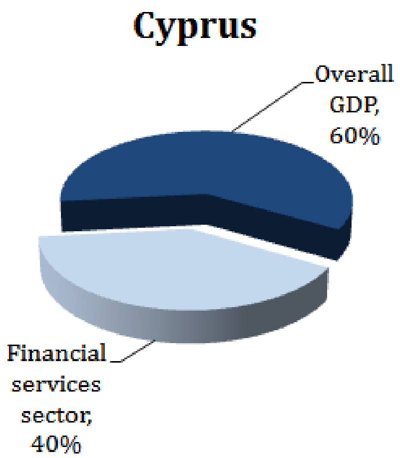
(a) In 2012 as compared to 2011, Cyprus GDP decreased by 2.8% to EUR 20,500 per capita.

(b) Malta's government deficit in 2011 was equal to 2.7% of its GDP. In the same year, Cyprus' government deficit was more than six times higher and was equal to 6.3% of its GDP.

Whereas Malta's financial services sector contributes 12% to the total GDP of the country[1], Cyprus' economy is much more dependent on its financial sector, with financial services in Cyprus contributing 40% of the country's GDP.

[1]*Finance Malta: Investment Funds and Asset Management* – January 2012




## Comparison of financial situation of banks in Cyprus and in Malta

*Why is Malta different:*

- **Malta's banks have consistently been noted for their resilience and soundness;**
- **Malta's banking sector scored significantly higher in terms of stress-test indicators and in the Global Competitiveness Report;**
- **Malta's debt is also mainly held locally and Maltese Banks are not materially exposed to foreign sovereign debt risks.**

▪ The Global Competitiveness Report (2012-2013) issued by the World Economic Forum, ranked Malta's banking sector in the 13th place out of 144 countries in terms of the soundness of its banking sector. In contrast, the same report ranked Cyprus in the 83rd place for the soundness of its banking sector.[2]

▪ Bank of Valletta p.l.c. (BOV) was Malta's participant in the 2011 EU-wide stress tests conducted across the EU. As a result of the assumed shock under the adverse scenario, the estimated Core Tier 1 capital ratio of BOV would **only change marginally from 10.5% (December 2010) to 10.4% (end of 2012). This demonstrates the resilience of the bank to the unlikely yet plausible shocks assumed in the stress-test.**[3]

▪ In Cyprus' case, the Bank of Cyprus and Marfin Popular Bank were the banks that were subjected to this stress-test. Both banks passed this test. The estimated consolidated Core Tier 1 capital ratio of Bank of Cyprus would change from 8.1% (end of 2010) to 6.2% (under the adverse scenario at the end of 2012). Marfin's corresponding capital ratio would change from 7.3% (end of 2010) to 5.3% (under the adverse scenario at the end of 2012).

| 2011 EU stress test results | Malta - BOV | Cyprus – Bank of Cyprus | Cyprus – Marfin Bank |
|---|---|---|---|
| Core Tier 1 capital ratio (December 2010) | 10.5% | 8.1% | 7.3% |
| Core Tier 1 capital ratio (Adverse scenario - 2012) | 10.4% | 6.2% | 5.3% |
| Percentage change | 0.1% | 1.9% | 2.0% |

▪ Maltese banks' debt is mainly local debt so that any economic downturn would have a limited geographical impact. In fact, according to the findings of an exercise carried out by the European Banking Authority at the end of 2012, Bank of Valletta (Malta's participating bank in this study), 92.2% of the bank's gross exposure across the EEA zone was attributable to Malta, with the corresponding figure for the bank's exposure to Greece only at 0.1% of the bank's gross exposure across the EEA zone.[4]

▪ Maltese banks also have a low exposure to the sovereign debt of other European countries. This contrasts significantly with Cyprus' position, with its banks heavily exposed to the Greek bonds – no corresponding dependence exists between the Maltese banking sector and any other country.

[2] The *Global Competitiveness report 2012-2013* published by the World Economic Forum

[3] *MFSA Media Release 15 July 2011*

[4] The Guardian http://www.guardian.co.uk/news/datablog/2013/mar/26/europe-banks-sovereign-exposure#data

- Figures quoting the Maltese banking sector as "oversized" and similar to that in Cyprus in terms of its asset base as compared to GDP are misleading, in that they take into account international banks operating from Malta to manage intra-group liquidity with little or no exposure for Malta and posing little if any risk to the stability of the island's banking system or its deposit guarantee scheme.

- In fact, the Maltese Government also confirmed that the "*size of Malta's domestic banking system was at present below the euro area average.*"[5] The total assets of the five banks which were domestically oriented amounted to 218% of GDP, with the same ratio decreasing to 77% for the eight banks whose links with the domestic market were limited.

- It was only with respect to the rest of the banking sector, which is made of up 14 international banks which do not have any links to the domestic economy, where this ratio increased to 494% of GDP.[6] These banks are not considered as "core" to the Maltese banking system. **The size of the core banking sector in Malta is around two times its GDP placing it at around 50 per cent of the EU average. The approach of these five banks is recognised as being conservative and thorough, and traditionally, these banks have always been considered as risk-averse.**

## Comparison of AML provisions

*Why is Malta different:* ***"Malta has a comprehensive legal structure to combat money laundering"*** [7]

- Malta and Cyprus are members of MONEYVAL (The Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism).

- Although in 2012 a team of IMF experts had ruled that Cyprus's house seems in order, and that it only required minor legislative amendments in this area, a number of EU Member States expressed concern about the extent of application and enforcement of these rules and legislation. Similar concerns were expressed by MONEYVAL, which reported that Cyprus should increase its supervisory activities for Money Transfer Business, Regulated Markets and investment firms. MONEYVAL also reported that "*a few effectiveness issues remain as regards the implementation of the ML offence when considering the number and type of ML convictions and the volume of confiscation orders achieved.*"[8]

- MONEYVAL also noted that Cyprus "*needs to take additional measures to ensure a comprehensive system for freezing terrorist assets in application of the United Nations Security Council Resolutions (UNSCR)".*[9]

- On the other hand, according to MONEYVAL, "*Malta has a comprehensive legal structure to combat money laundering."*[10]

- Consistent with its approach to AML, following the Cypriot crisis and the ensuing imposition of currency control measures on capital movements, and taking into account the prospect of possible migration of funds into Malta by disenchanted depositors once

[5] Times of Malta, '*Malta's banking sector 'robust and stable' – government'*, Thursday, March 28, 2013, accessed 1 April 2013<http://www.timesofmalta.com/articles/view/20130328/local/malta-s-banking-sector-robust-and-stable.463360>

[6] Ibid

[7] MONEYVAL, *Report on Fourth Assessment Visit – Executive Summary, Anti-Money Laundering and Combating the Financing of Terrorism – Malta*, 6 March 2012, <http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/round4/MLT4_Summ_MONEYVAL(2012)3_en.pdf > accessed 27 March 2013

[8] MONEYVAL, *Report on Fourth Assessment Visit – Executive Summary, Anti-Money Laundering and Combating the Financing of Terrorism – Cyprus*, 27 September 2011, <http://www.coe.int/t/dghl/monitoring/moneyval/Evaluations/round4/CYP4_Sum_MONEYVAL(2011)02_en.pdf > accessed 1 April 2013

[9] Ibid

[10] MONEYVAL, *Report on Fourth Assessment Visit – Executive Summary, Anti-Money Laundering and Combating the Financing of Terrorism – Malta*, (n 8)

the said controls are lifted, Malta has already reacted by putting in place new regulations for corporate service providers, banks, and other subject persons for greater vigilance and enhanced AML procedures to be adopted for any new business originating from or believed to be originating from Cyprus.

**At a glance…**

Even a cursory analysis of the principal triggers for the Cypriot crisis should be sufficient to demonstrate that there can hardly be any comparison between Cyprus and Malta. The disproportionate exposure of the Cypriot banks to Greek debt has largely been identified as the main cause of the Cypriot crisis. Contrary to the position in Cyprus, Malta's banks have a negligible level of exposure to Greek debt, or, for that matter, to any crisis-hit country in particular.

A deeper analysis of the two countries' respective banking systems and economic fundamentals indicate that a comparison between the two is indeed, untenable. The same is true also of the approach taken by each of these two Mediterranean island states in attracting international business to their shores and growing that business, with Malta adopting a much more conservative approach driven by a policy of gradual but steady growth, with a more widely diversified base of international clients and, importantly, without having become over-dependent on the growth of the financial services sector, susceptible as it is to the realities of the market, for the economic output and stability of its economy.

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April 2013