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MBA Malta Bankers' Association

The Future of Banking in Malta


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Contents

List of Abbreviations

AI	Artificial Intelligence
AML	Anti-Money Laundering
AMLA	Anti-Money Laundering Authority
Bn	Billion
CBM	Central Bank of Malta
CEO	Chief Executive Officer
CFT	Combatting Financing of Terrorism
CMDI	Crisis Management and Deposit Insurance
CSRD	Corporate Sustainability Reporting Directive
DORA	Digital Operational Resilience Act
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EFRAG	European Financial Reporting Advisory Group
ESA	European Supervisory Authority
ESCB	European System of Central Banks
ESG	Environmental, Social, and corporate Governance
ESRS	European Sustainability Reporting Standards
EU	European Union
EuGB	European Green Bonds Regulation
EY	Ernst & Young
FATF	Financial Action Task Force
FiDA	Financial Data Access
GDP	Gross Domestic Product
GDPR	General Data Protection Regulation
GVA	Gross Value Added
IReF	Integrated Reporting Framework
KPI	Key Performance Indicators
MBA	Malta Bankers' Association
Mn	Million
NFCs	Non-Financial Corporations
NFRD	Non-Financial Reporting Directive
NPL	Non-Performing Loans
OFF	Open Finance Framework
PSD	Payment Services Directive
PSR	Payment Services Regulation
ROE	Return on Equity
RWA	Risk Weighted Assets
SMEs	Small and Medium Enterprises
SHS	Securities Holding Statistics
SSM	Single Supervisory Mechanism

Preface & Purpose

Traditionally, banks have served as guardians of people's wealth and credit lenders. Over time their role has evolved and expanded and nowadays they are involved in virtually every aspect of our life, from paying for our coffee to managing our wealth. Banks support economic growth and prosperity through solutions aimed at meeting these needs. With such an important and ever-growing role, it is timely to reflect on how Malta's banking sector needs to innovate and adapt in the years to come to continue to meet the needs of all its stakeholders.

The sector is at an inflection point - rapid technological advances, changing customer preferences, increasing competition, heightened regulatory scrutiny as well as the growing importance of funding the transition towards a green economy and integrating Environmental, Social, and corporate Governance (ESG) principles in business models, all against a backdrop of global market volatility and inflation. All these factors contribute to a changing landscape, with uncertainties and challenges that present risks, but which, with effective response and quick adaptation could be turned into opportunities and unlock significant value.

Transformation initiatives were already underway prior to the global pandemic, however Covid-19 has accelerated the pace of change. Digitalisation, sustainable profit and green financing are currently top of the agenda for Maltese banks.

Purpose of the Report

This report, supported by the Malta Bankers' Association (MBA), showcases the role and importance that the Maltese banking sector has in the economy and society, identifies current and upcoming challenges and opportunities, and conveys messages to banks and stakeholders to embrace change and progression on four key pillars, namely:

1. **Becoming a purpose-led sector**
2. **Securing continued viability**
3. **Ensuring safety and stability**
4. **Driving progressiveness**

The report has been developed in consultation with local banking experts and senior industry representatives. It seeks to provide an overview of the sector, explain to the various stakeholders of the banks the current state of flux and present a framework for collaborative and future-focused discussion. There are many factors, challenges and opportunities to reflect on when considering the future of banking in Malta, particularly in the current environment surrounding the sector.

Executive Summary

Malta's banking sector is a key pillar for the economy with a significant contribution to Malta's Gross Value Added (GVA) of 6.2% in 2022, compared to a Eurozone average of 2.8%. The sector operates more than 75 branches, employs over 5,400 persons and holds over €41bn in assets, equivalent to 249% of GDP.

The banking sector came out of the Covid-19 pandemic relatively intact, supporting borrowers and the economy alongside targeted Government initiatives. The sector is now feeling the ripple effects of more recent exogenous shocks, such as the supply chain issues, high inflation rates, rising interest rates and geopolitical tensions as well as the regulatory changes. Faced with these realities, the local sector continues to weather these challenges from a position of strength as a result of the largely traditional operating models, strong capitalisation and well-balanced risk portfolios.

The sector is now at a crossroads – the socioeconomic environment is transforming rapidly resulting in a growing diversity in the needs of stakeholders. Banks are hence faced with the challenge of aligning their strategic objectives with the increasingly dynamic needs of their stakeholders. To this end, Malta's banking sector should continue to build around four core and mutually reinforcing pillars which tackle the needs of the banking sector's ecosystem:

1) **A purpose-led banking sector** which places the customer at the centre of operations to create long lasting relationships, while also balancing the needs of other stakeholder groups and delivering long-term value to all.

2) **A viable banking sector** which ensures sustainable profitability through diversified revenue streams, inspires trust amongst customers, delivers value to shareholders and customers, and remains competitive by investing in technologies.

3) **A safe and stable banking sector** which is robust, secure and transparent from a capitalization perspective, acting in line with the expectations of regulators and in the best interest of customers and shareholders.

4) **A progressive banking sector** which embraces technology, increasing the value delivered to customers and shareholders through analytics, talent and other forms of innovation.

Malta's Banking Sector as Purpose Led

In being purpose-led, the banking sector seeks to define success over the long term by providing **value to customers, employees, shareholders and society as a whole in a sustainable manner** which seeks to build trust among all stakeholders. Purpose-led banking commands enhanced customer loyalty through long-term value generation. Research has found that organisations operating with a defined purpose beyond the singular goal of profits outperformed the S&P 500 by a factor of 10 over a decade.[1] This was driven mainly by stronger investor confidence, increased employee retention rates and increased customer loyalty.

Banks are cognizant of the importance of their role in society as evidenced by growing focus on **ESG** strategies. Regulators, investors and consumers are becoming increasingly demanding of banks to embrace the green transition, whilst aligning also to social priorities. Many organisations are focusing on establishing their ESG policies and reporting capabilities, as well as articulating an ESG strategy, which is a fundamental framework to benchmark present status, set ambitions and measure incremental progress towards the set targets. **A strong ESG strategy drives value creation via top line growth, reduction in costs, higher levels of staff attraction and retention, as well as optimization of assets and capital.**

Culture is also an integral ingredient in purpose-led banking. A positive culture reduces the risk of misconduct, cultivates positive reputation and public trust, builds loyalty among the customer base, improves employee attraction and retention, and helps increasing the regulators' confidence. **A healthy culture within banks requires continuous effort to maintain through clear communication, the right tone from the top, collaborative and exemplary leadership, support for professional development, transparency and rapid but fair conflict resolution.**

Malta's Banking sector as Viable

A viable banking sector seeks to **deliver products and services efficiently, allocate its capital in an optimal manner to maximise return on investment, and offer a diversified portfolio of services to secure multiple sources of income.**

[1] The business case for purpose (ey.com)

Viable banks are more resilient to economic shocks, compliant with regulation and well-positioned to serve the needs of existing and potential customers.

In recent years Malta's banking sector has delivered a return on equity around the 4% mark, compared to 8% in the European Union (EU). This is mostly due to net interest income accounting for over 70% of total income for Malta's banks, which is circa 15% higher than the EU average, thus highlighting the need to further diversify income streams to secure sustainability and future viability. Viability requires a sustainable **business model built on income diversification, cost management and embracing technology, trends and opportunities.** For example, growth of revenue streams generated through commissions and other fee-based services will better position the Maltese banking sector against unfavourable market conditions, geopolitical instability and the international decisions that steer the base interest rates.

Technology and digital transformation also present an array of opportunities to enhance the viability of Malta's banking sector. Artificial Intelligence (AI), Automation and Advanced Analytics can be highly effective in streamlining operations, reducing costs, and enhancing the customer experience. **The local banking sector may also consider ways to collaborate on the establishment of cross-sector technology driven utility centres that carry out back-office services in areas that do not provide material competitive advantage or are non-core for banks, such as in Know Your Customer checks and achieve greater cost efficiencies at scale.**

Malta's banking sector as Safe & Stable

The banking sector constantly needs to anticipate and manage risks to ensure a financially stable and secure banking environment for its customers and the country's economy. Malta's banks have made, and continue making, significant investments to meet increasing regulatory expectations.

The strong **capital position** of Malta's banks ensures resilience towards operating losses and sudden surges in customer withdrawals, while also enabling the banks to continue their lending activities to support households and businesses, even during uncertain times. The sector's **risk-weighted asset density** is on a healthy downward trajectory and achieved positive results in recent stress tests carried out by the Central Bank of Malta. The sector's **Non-Performing Loans (NPL)** ratio of 2.2% in 2022, standing above EU averages (1.8% in 2021) is partly a result of lengthy legal proceedings to liquidate collateral and the limited NPL sales compared to other countries. The NPL ratios can be mitigated further through enhanced early detection and warning mechanisms of potential defaulters enabled by leveraging robust data sets and AI.

The sector faces significant changes in the **regulatory landscape** in the next few years and continued compliance is crucial for a safe and stable sector. Key developments include:

- **Basel III**, which aims to enhance the capital adequacy of banks through the introduction of stricter capital requirements.
- **Digital Operational Resilience Act (DORA)**, which requires financial services firms to focus on a digital resilience strategy, and a digital resilience framework.
- **Anti-Money Laundering (AML) reform**, which will introduce centralised EU-level AML coordination and oversight, while strengthening national AML frameworks with enhanced access to critical information.
- **Corporate Sustainability Reporting Directive (CSRD)**, which will broaden the scope of NFRD by enhancing reporting on various fronts, such as the resilience of the business model and strategy in relation to risks concerning sustainability matters.
- The adjusted **Crisis Management and Deposit Insurance (CMDI) framework**, which will give resolution authorities even more effective tools to shield depositors when a crisis occurs and when financial stability is at stake.
- **Integrated Reporting Framework (IReF)**, which will seek to reduce the reporting burden on Euro area banks while meeting the information needs of the European System of Central Banks through the integration of different statistical obligations and harmonisation of data collection across countries.
- **Financial Data Access (FiDA)**, which will further improve consumer protection and competition in electronic payments.

Malta's banking sector as Progressive

Malta's banking sector needs to be forward looking and doing so means embracing and exploiting the many opportunities presented by **digital transformation** as a way to remain resilient to future challenges. Investments in digitalisation will increase long-term value to customers and other stakeholders through enhanced technology, data-driven analytics, and efficiency. Malta's banks must also continue **to invest, upskill and innovate to create new products and services that drive growth through diversified revenue streams and leaner operating models.**

In order to achieve the desired outcomes of a successful transformation journey, **Malta's banks of the future will need to rethink what transformation means, inspire and lead the change from the top, recalibrate investment payback evaluation metrics, implement organisational agility, redefine the talent value proposition and monitor transformation success against relevant KPIs.**

Banks of the future must take onboard lessons from the growing **FinTech** sector. The penetration and growth of certain types of FinTechs in Malta is redefining customer expectations and in turn spurring transformation efforts among traditional banks. **Traditional banks and FinTechs can have symbiotic relationships that leverage each others' strengths to grow customers bases and new markets and meet customer expectations.**

The economy-wide war for **talent** in most roles is a reality that Malta's banks must navigate effectively on their journey to be progressive. **Purpose-led banks that foster a positive culture and that offer competitive remuneration, frameworks for continuous development, transparent career progression paths, great working conditions with attractive benefits, flexibility and trust** will be more effective in attracting and retaining the talent required to progress operations in line with best practices at the cutting edge.

In striving to be progressive, Malta's banks **must strike the right balance between innovative service offerings enabled by the latest technology and remaining accessible to all to ensure that no customers are left behind.** The wide-reaching branch networks, dedicated in-branch hours for elderly customers, implementation of intuitive user interfaces and initiatives related to proliferation of financial and technology literacy of all citizens are all necessary initiatives driven or supported by Malta's banks with the aim of ensuring accessibility for all.

Foundation for debate

Despite the various challenges, the current banking landscape offers opportunities for Malta's banks to further pursue their diversification, innovation and sustainable finance agenda and to play an even more central role in the country's economic and social progress.

The unique circumstances currently at play present an opportunity for banks to transform and grow while also shifting towards leaner operating models in anticipation of further changes in the sector.

This report analysed a range of challenges, issues, trends, and opportunities that are set to shape the future of banking in Malta and provides an opportunity to initiate a wider discussion among bank executives, regulators, industry leaders and wider stakeholders on the current and future state of Malta's banking sector.

1

Role and Significance of the Banking Sector in Malta

Over the past two decades, the banking sector in Malta has grown from 4 retail banks serving the local population to 19 (operative) licensed banks and 2 branches of foreign banks operating under freedom of services and establishment.[2] Three of the banks are Maltese majority owned, whilst the ownership of the remaining banks originate from various EU and non-EU jurisdictions. Over the years, Malta's robust banking sector has also been a primary enabler for growth across virtually all sectors of the economy. A snapshot of the Maltese banking sector as relating to the domestic economy is presented below:

	Core domestic banks	Non-core domestic banks	International banks	Total
Number of banks in Malta	6	6	9	21
Bank categorisation	APS Bank plc; Bank of Valletta plc; BNF Bank plc; HSBC Bank Malta plc; Lombard Bank Malta plc; MeDirect Bank (Malta) plc	FCM Bank Limited; FIMBank plc; IIG Bank (Malta) Limited; Izola Bank plc; Merkanti Bank Limited; Sparkasse Bank Malta plc	AKBANK T.A.S.; Credit Europe Bank NV Malta Branch*; Credorax Bank Limited; ECCM Bank plc; european depositary bank sa - malta branch*; Lidion Bank plc; Multitude Bank plc; Novum Bank Limited; Turkiye Garanti Bankasi Anonim Sirketi	
Assets (€billion)	€28.48	€3.42	€10.09	€41.99
Share of total assets	68%	8%	24%	100%
Share of total assets in GDP (%)	168.8%	20.3%	59.8%	249%
Physical locations (inc. Head Office)	65 (51 belong to 2 largest banks)	7	9	81

Source: CBM (2023); MFSA Financial Services Register (Accessed 09/01/24); EY calculations;
* Branches of Foreign Banks operating under Freedom of Services and Establishments - Exercise of the right of establishment in Malta

View from local core banks

Core banks are of the view that banks' role remains that of traditional banking, by going back to basics (core banking services), whilst continuing the investment in the digital aspect, and changing legacy aspects of banking (e.g. omni-channel experience; late evening services). Services on the periphery (non-core) can be complementary.

Other banks view that the traditional banking market is relatively saturated due to the size of the population and number of players already operating in the sector. As such, Malta's competitive edge lies in the use of its technology infrastructure to promote set-ups in, and introduction to, niche markets (for example, payments/ gaming) that provide access to international markets and innovative solutions. Also, access to offshore markets provides invaluable experience for growth and innovations as it provides benchmarking/ideation against what others are doing.

The local sector's strengths lie within the language, legislative framework (based on UK framework), good digital landscape, culture, and robustness (and passporting) of Malta licence. Opportunities which Malta is currently missing out on, include instant payments and shared infrastructure. Competition with local and international alternative e-money institutions also remains a threat.

Across the sector, focus on customer experience remains key – customers are increasingly looking for ease of transactions and value-added services which keep them informed around their financial operations, with added flexibility (e.g. option to go to branch for certain transactions in view of heightened concern by certain groups of the population over increasing cyber-security issues and need for physical interaction). Need for customer segmentation remains essential.

[2] Financial Services Register - MFSA

1.1. Economic Contribution

The banking sector as a whole contributed 6.2% to Malta's GVA in 2022 (Euro area: 2.8%), equivalent to €1bn[3], a value which has been relatively stable over the past decade. Malta's banking sector activities constitute 72% of the country's total financial service activities (except insurance and pension funding)[4] in GVA terms in 2022, in line with the average across the previous 10 years.

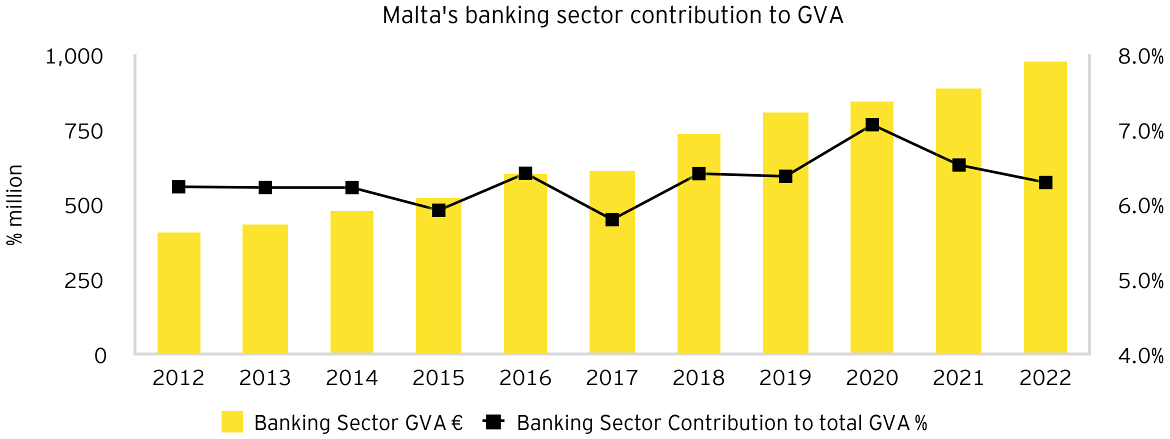


Figure 1
Source: Eurostat

1.2. Deposits and Indebtedness

Over the last 10 years, deposits have consistently exceeded loans, with the Liabilities-Assets ratio hovering around the 80% mark since 2018, thereby indicating the highly liquid position of the banking sector in Malta. As at year-end 2022, total deposits (liabilities) stood at €35.8 bn[5] compared to total loans (assets) of €27.6 bn, resulting in a loan-deposit ratio of 77% (Euro Area: 103.52%[6]), as well as a banking sector holding a sizeable 249% of national GDP in deposits.

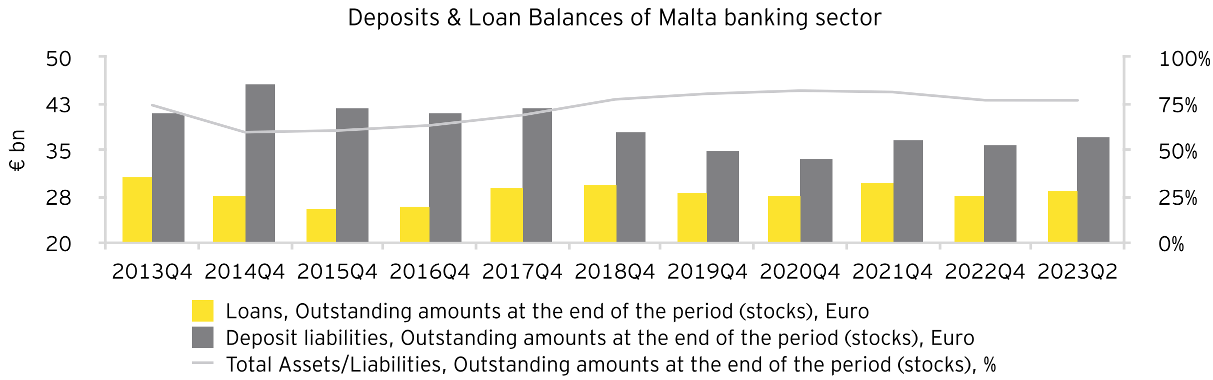


Figure 2
Source: ECB Statistical Data Warehouse

[3] Statistics | Eurostat (europa.eu)

[4] The country's total financial service activities (except insurance and pension funding) are captured under NACE Division K, and include financial leasing, credit granting, monetary intermediation, activities of holding companies, trusts, funds and similar financial entities.

[5] Credit institutions - Credit institutions and money market funds - ECB Statistical Data Warehouse (europa.eu)

[6] Ratio for significant institutions at the highest level of consolidation for which common reporting (COREP) and financial reporting (FINREP) are available. https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.supervisorybankingstatistics_first_quarter_2023_202307~43c5bf1395.en.pdf

Overnight deposits remain the dominant category of deposits for residents, reflecting a preference for liquid assets in the context of a low interest environment pre-2022 and limited effects of the first ECB rate hikes to retail deposit rates in 2022 (within the context of rapidly increasing inflation). On the other hand, assets (loans) as a % of GDP as at year-end 2022 decreased by 35% from 284% the year earlier, as a result of the GDP base effect in 2021.

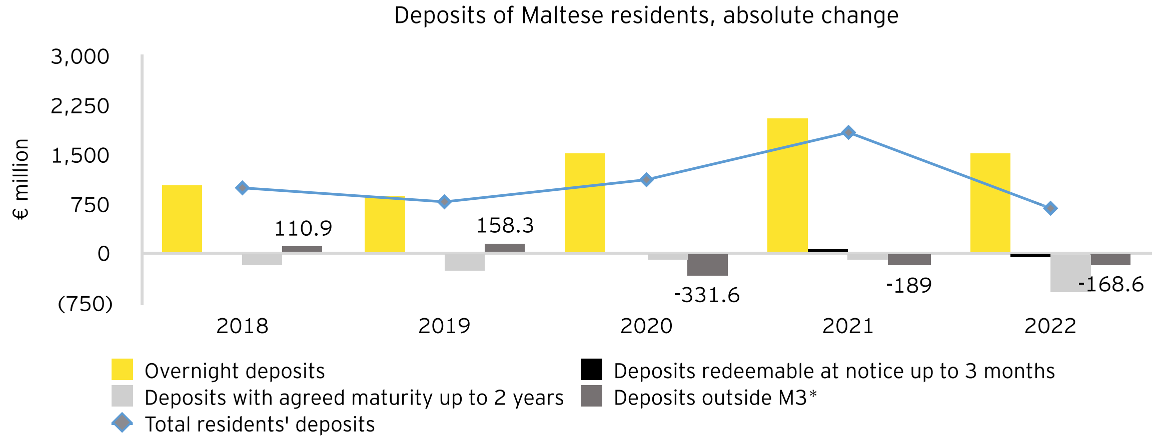


Figure 3
Source: Central Bank of Malta Annual Reports
** Deposits outside M3 include deposits redeemable at notice of more than 3 months and deposits with an agreed maturity of over 2 years.*

Credit to residents has maintained its increasing trajectory in 2022, albeit at a slower pace than in 2021[7] - driven by a 7.8% growth in loans to Non-Financial Corporations[8] (NFCs) and 9.5% growth in loans to households. Loans to households are predominantly driven by mortgages which account for 92.6%% of loans to households (as at 2022) and which grew by 9.8 over the 12 months to December 2022. Consumer credit continues to be relatively low compared to EU average however, this increased by 4.8% over the period December 2021 to December 2022 it %.

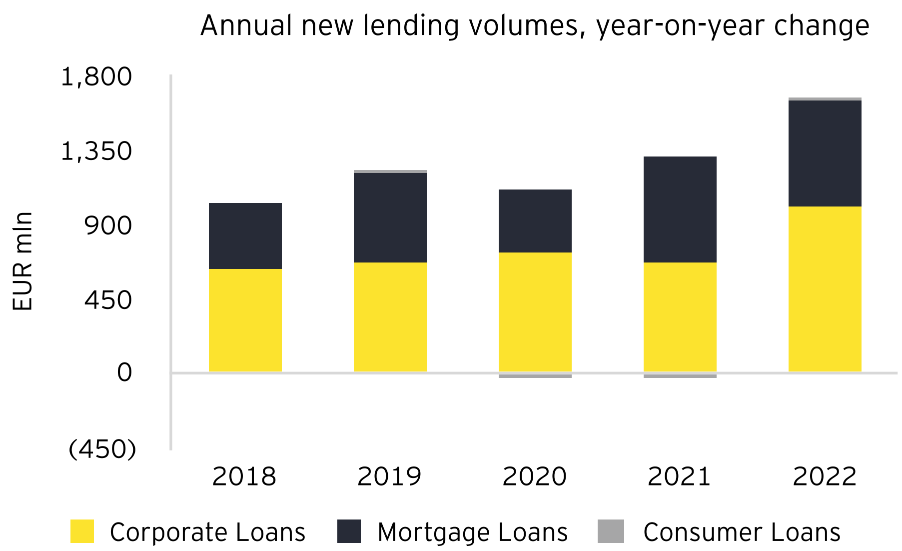


Figure 4
Source: Central Bank of Malta Annual Reports

[7] Central Bank of Malta Annual Report 2022
[8] NFCs are incorporated legal entities that produce goods and services for the market

1.3. Social contribution

1.3.1. Employment and presence

As at 2022, banks in Malta employed directly c 5,400 persons which is equivalent to 2% of total employment in Malta (Euro area: 2.2 mn; 1.1%).

In spite of a declining trend over the years reflecting cost-cutting efforts, especially accelerated by the Covid-19 pandemic, the sector maintains strong physical presence and financial access in the market. This is highlighted by the average of 23.51 branches per 100,000 adults in 2021[9] (Euro area: 16.78) and the number of ATMs per 1,000km² for Malta at 613 (Euro area: 115), 77).

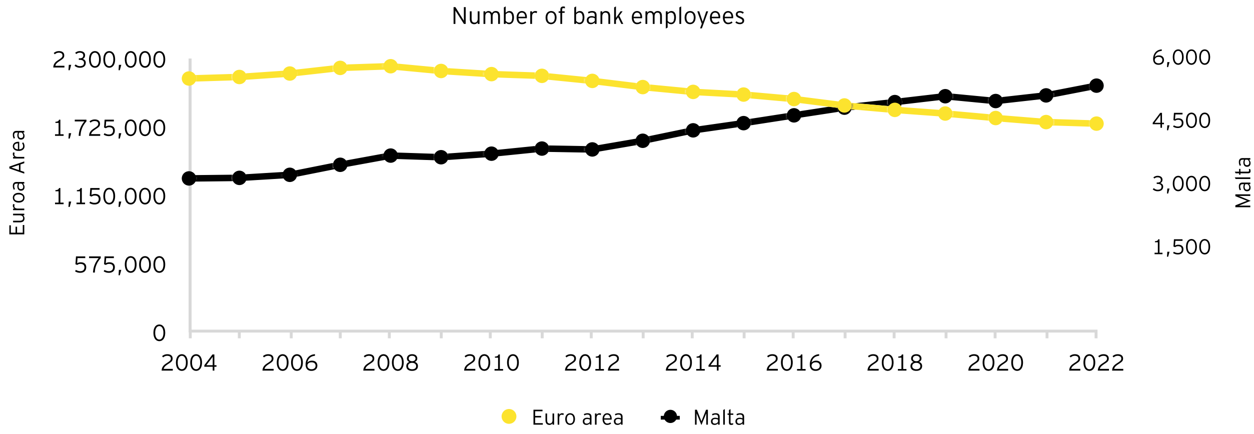


Figure 5
Source: European Central Bank (Statistical Data Warehouse)

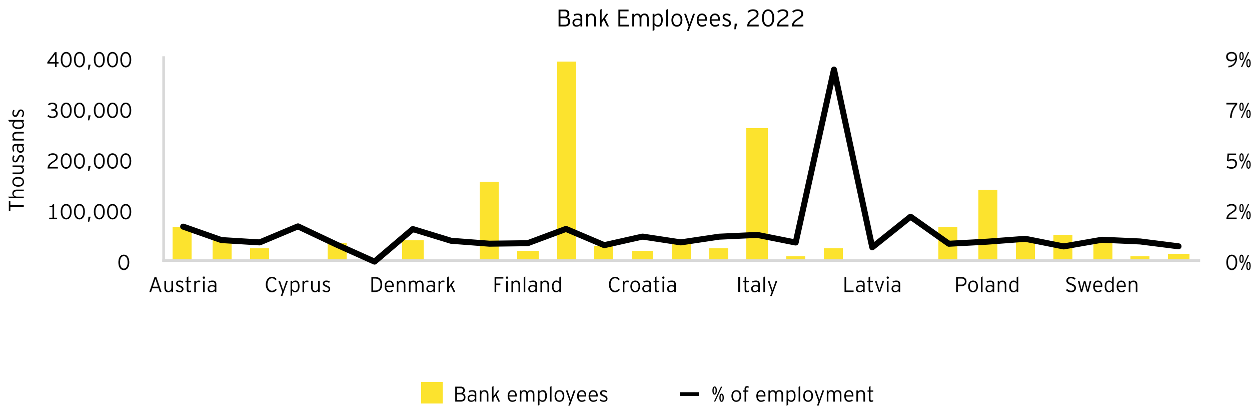


Figure 6
Source: European Central Bank (Statistical Data Warehouse), Eurostat, EY calculations

[9] As per the latest Financial Access Survey (FAS) undertaken by the IMF for 2022, this is equivalent to 22.4 commercial branches per 100,000 adults, and 318.8 branches per 1,000km²

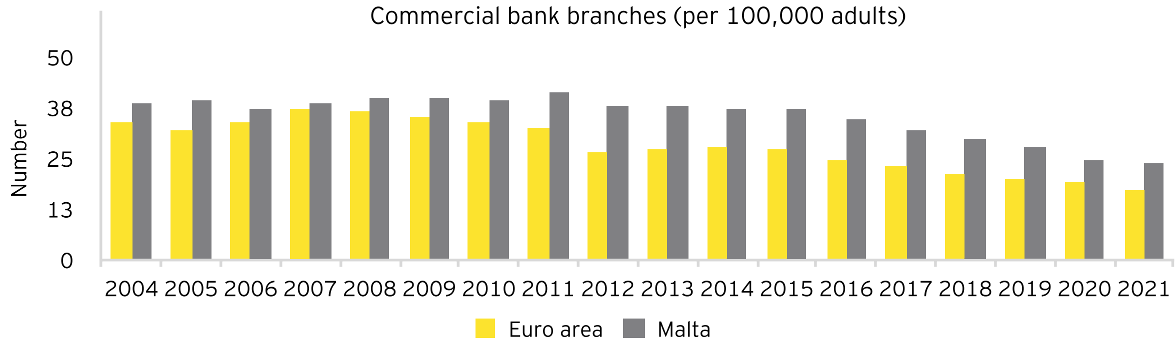


Figure 7
Source: The World Bank

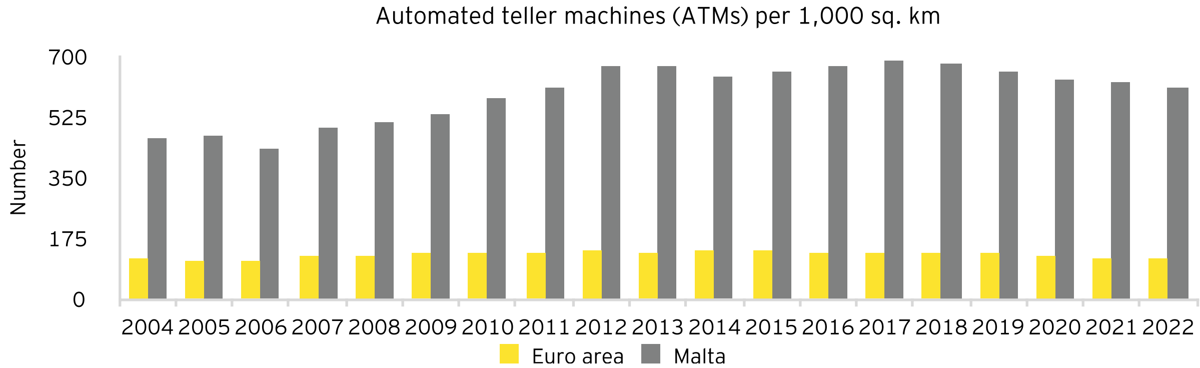


Figure 8
Source: IMF, EY Calculations

1.3.2. Supporting the Economy

Small, Medium and Micro Enterprises (SMEs) account for about 98% of businesses in Malta. These provide employment for 78% of the country's active workforce[10] and generate 82% of the economy's value added, significantly exceeding the respective EU averages of 66.6% and 56.4%, respectively.[11]

During the Covid-19 pandemic, 27% of the loan repayment value held by Maltese SMEs and 10% of that held by households was granted moratorium[12], highlighting the role banks played in supporting the economy, compared to EU averages. According to various local banks' annual reports for the financial year 2022, there has been no long-term impact on repayments of loans which were provided moratoria during the height of the pandemic, indicating the positive and timely impact of the moratoria on supporting businesses and households.

[10] NSO Malta | Structural Business Statistics: 2020 - NSO Malta (gov.mt)

[11] European Commission, Malta SBA Fact Sheet

[12] Thematic note on moratoria and public guarantees.pdf (europa.eu)

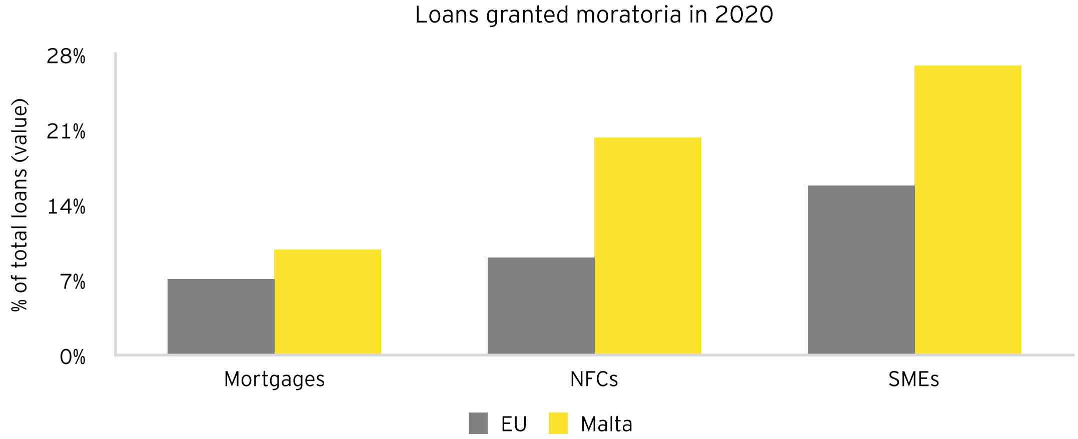


Figure 9
Source: European Banking Association (EBA)

1.3.3. Financial Literacy

Over the years, the local retail banks have driven various initiatives aimed at increasing society's financial literacy (saving, investing and managing debt). As at 2020, only 21%[13] of adults in Malta had a high confidence in their financial knowledge, whereas 45% had an average financial knowledge, and 34% had a low-level of knowledge. Only Italy, Czech Republic and North Macedonia had more adults with low financial knowledge.

Initiatives by Malta's banking sector have targeted different cohorts and were delivered through various formats with the aim of maximising their reach. These initiatives include online webinars, mentoring sessions on managing personal finances, courses for teenagers on how to budget effectively and the role banks play in one's financial independence, as well as seminars on understanding investments and how to plan one's finances.

The banking sector, together with EY, are key supporters and collaborators of GEMMA, the body established to drive the implementation of the National Strategy for Retirement and Financial Capability. Since its inception, GEMMA has grown to a one-stop-shop for anyone seeking to enhance their financial literacy and capabilities, through a plethora of resources for all age and skill groups aimed at improving one's money management, debt management and retirement planning.

Furthermore, banks continuously strive to provide more simple, seamless and integrated services and platforms for their customers, however, this does not automatically equate to increased uptake of digitised services by cohorts of customers who are typically resistant to technology. Hence, more targeted outreach is necessary among such cohorts to guide them and demonstrate the benefits of digital services first hand. In the long run these skills will also contribute towards enhanced financial literacy and management of personal finances.

1.4. Impact of Malta's Greylisting

Whilst working in an environment characterized by post-pandemic recovery, geo-political instability and overseas market volatility, the Maltese banking sector, together with the financial services industry as a whole, has formed part of a national concerted effort to strengthen the effectiveness of AML and Combatting Financing of Terrorism (CFT) efforts. Following significant progress made in improving the AML/CFT regime, and after addressing strategic deficiencies and recommendations made by MONEYVAL and the Financial Action Task Force (FATF) in June 2021, Malta was officially removed from the FATF list of jurisdictions under increased monitoring in June 2022.

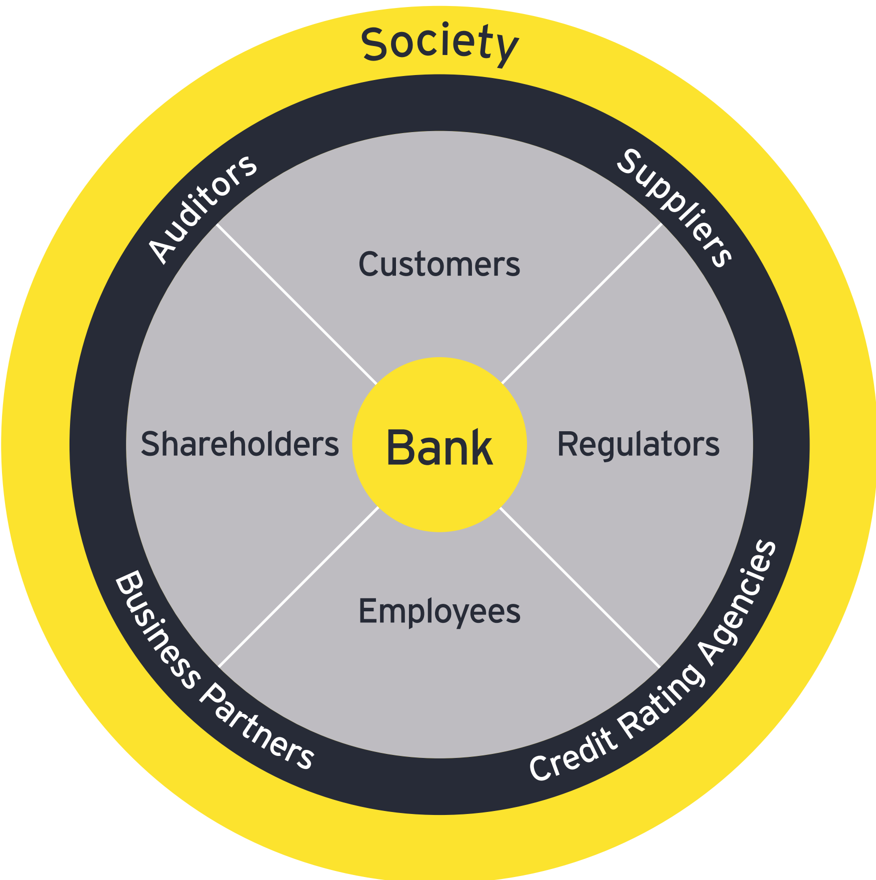
[13] OECD/INFE 2020 International Survey of Adult Financial Literacy

More robust practices were put in place to bolster information gathered on ultimate beneficial ownership and data sharing with local and international authorities, thus ensuring the jurisdiction is better placed to tackle money laundering and financing of terrorism. Banks played, and continue to play a significant role in this, as significant investments have been made to implement and enhance the tools and capabilities being applied in risk and compliance functions, particularly in financial crime. While the rapid scaling up of anti-financial crime controls placed notable burden and inconvenience on customers (especially on micro and small businesses with limited resources to handle additional administrative work), banks are heavily engaged in the second phase of their transformations with an aim to streamline processes and improve customer experience, with administrative requirements commensurate with a client's risk profile.

1.5. Balancing Stakeholder Needs

Banks must run their core functions and remain competitive in the market, whilst consistently meeting a highly diverse set of competing stakeholder needs. These stakeholders include:

- **Customers:** seek value through trustworthy, reliable services and intuitive solutions for their everyday banking needs.
- **Regulators:** demand transparency, resilience customer protection, capital adequacy and compliance. Regulators are constantly adapting to new market entrants and to the transformative nature of sector.
- **Employees:** seek employment, job security and satisfactory benefits. They are the key channel through which a bank's identity is transmitted, thus shaping the public perception of the bank and how it delivers value.
- **Shareholders:** demand strong and consistent return on investment. Their interests are not always aligned with the interests of other stakeholder groups, such as employees and customers, thus rendering their relationship management a difficult but important task.
- **Society:** seeks a trustworthy banking system which supports the attainment of societal objectives including banking for all, educational projects, donations and support initiatives.

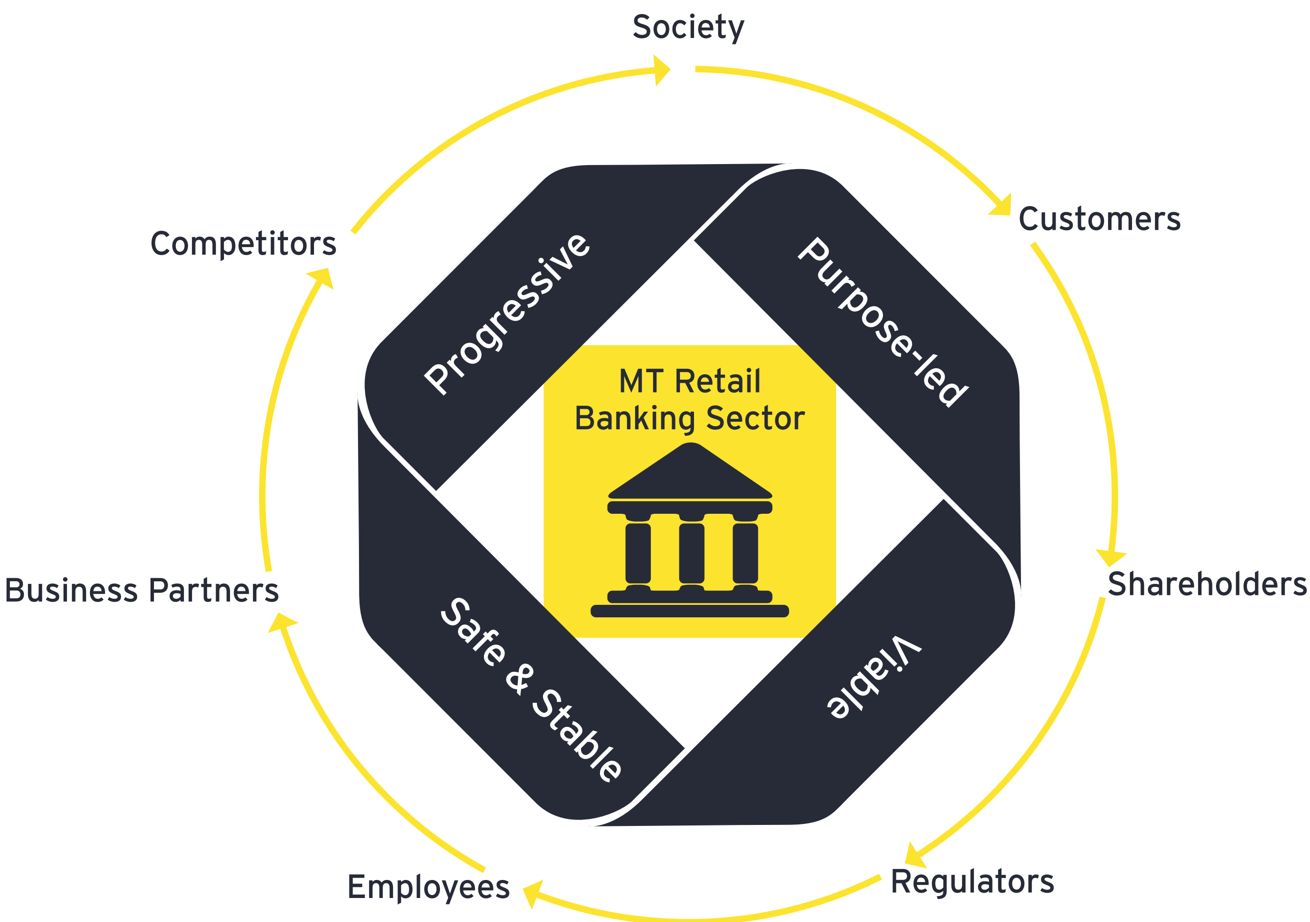


Interacting effectively with all the bank's stakeholders is crucial for the maximisation of market value. A bank that creates sufficient surplus to invest in all channels of interactions with each stakeholder group is likely to drive economic stability, profitability, and growth. Successfully meeting stakeholders' needs and expectations can be a source of competitive advantage.

Banks in Malta are faced with the challenge of meeting their own strategic objectives, whilst also satisfying the needs of their stakeholders with their diverse and often competing perspectives and interests. Meeting customer needs is crucial given that this stakeholder group is the main source of income for a bank.

Looking at best practice characteristics of banking systems globally, the future of Malta's banking sector should be built on four core and mutually reinforcing pillars which tackle the needs of the banking sector's stakeholder ecosystem:

1. **A purpose-led banking sector** which places the customer at the centre of operations to create long lasting relationships, while also balancing the needs of other stakeholder groups and delivering long-term value to all.
2. **A viable banking sector** which ensures sustainable profitability through diversified revenue streams, inspires trust amongst customers, delivers value to shareholders and customers, and remains competitive by investing in technologies.
3. **A safe and stable banking sector** which is robust, secure and transparent from a capitalization perspective, acting in line with the expectations of regulators and the interests of customers and shareholders.
4. **A progressive banking sector** which embraces technology, increasing the value delivered to customers and shareholders through analytics, talent and other forms of innovation.



We believe that this set of performance dimensions (often utilised by key research institutions in the sphere of finance), seek to maximize value while balancing stakeholder needs.

	A Purpose-led Banking Sector	A Viable Banking Sector	A Safe & Stable Banking Sector	A Progressive Banking Sector
Description	A purpose-led banking sector places the customer at its centre. It elicits trust, loyalty and legitimacy through delivery of long-term value generation.	A viable banking sector is characterized by long-term sustainable profitability via efficient and diversified services and effective capital allocation.	A safe and sound banking sector is robust, secure, transparent and resilient to future challenges by maintaining adequate capital.	A progressive banking sector invests value creation through technology, analytics and by keeping pace with innovation.
Why is it important	Without purpose and trust, the banking sector loses competitiveness and long-term success.	Without sustainable profitability, the banking sector cannot deliver value to shareholders and society.	Without capital adequacy and regulatory compliance, the sector is exposed to shocks and faces sustainability risks.	If products and services fail to keep up with innovation, the incumbents will face increasing competition which threatens their existence.
How the pillar addresses stakeholder needs	A purpose-led sector reassures stakeholders that long-term customer and societal value is prioritised ahead of short-term gains.	A viable sector balances costs and benefits to ensure efficiency in generating the financial resources required to re-invest in initiatives that benefit stakeholders.	A safe and stable sector protects customer interests, provides comfort to the regulator and customers that there is sufficient liquidity, which also reassures shareholders that their investments are sound.	A progressive sector will leverage its investments in technology to strengthen customer loyalty and satisfy shareholders by remaining competitive against disruptive competition.

2

Malta's Banking Sector as "Purpose-led"

2.1. A purpose-led banking sector

In compiling this report, the views of industry experts were sought on what it truly means to be led by purpose. In being purpose-led, the banking sector:

- **Defines success over the long term** by placing values and purpose at the centre of strategy and measuring success, not just in monetary terms but in the context of supporting long term sustainable performance and value for customers, employees and society as a whole.
- **Elicits the trust** of stakeholders by having the capability, capacity and track-record to do the right thing for customers, employees and society.

There is widespread agreement that purpose-led banking commands the loyalty of its customers through long-term value generation which is delivered across stakeholders.

2.2. Why is it needed?

Companies across the world are seeking to run their businesses in a way that holistically considers their impact on the full range of stakeholders.[14] This is part of the response to calls for businesses, including banks, to commit to a purpose that serves to advance the wellbeing of consumers, society and also shareholders.

There are also sound business and financial reasons. Research carried out by the Harvard Business Review Analytic Services in association with EY has found that organisations operating with a defined purpose beyond the singular goal of profits outperformed the S&P 500 by a factor of 10 over a decade.[15] This was driven mainly by increased employee retention rates, increased customer loyalty, and stronger investor confidence.

This evidences that purpose and trust are foundational for the future of banks in Malta. **Successful banks will be seen as partners who are trusted by the customers and society in general. Defining their purpose and placing it at the centre of operations will drive the trust needed to be competitive and sustainable in the long-term through enhanced customer loyalty.**

2.3. ESG Focus

The local market, including banks, recognize the importance of their role in society, as evidenced by the growing emphasis on ESG factors. The heightened emphasis on ESG is being driven by practical expectations of policy makers and regulators, as well as a growing understanding among stakeholders of the long-term risks that drive the need to create a more sustainable economy. In essence, ESG, which was initially largely perceived as a reputational element, is now included as a financial risk.

Significant steps are being taken in the space of ESG reporting. In Europe, the CSRD will require entities[16] to report on the environmental and social impacts as well as certain governance elements of their activities. The reporting obligation will be phased in, with large entities in scope of the non-financial reporting directive having to report for financial year 2024 onwards. Before the CSRD was enacted, the ECB has been approaching banks (starting initially from the SSM banks) on procedures and policies in place to address and manage climate and environmental-related risks, in line with the EU Taxonomy.

[14] Why business must harness the power of purpose | EY - Global

[15] The business case for purpose (ey.com)

[16] FY2024 with reporting in FY2025 for large public interest companies with over 500 employees ;FY2025 with reporting in FY2026 for large companies meeting 2 of the 3 criteria [criteria: 250 employees, Assets of €20m+, Net Turnover of €40m+]; FY 2026 with reporting in FY2027 for SMEs; FY2027 with reporting in FY2028 for remaining entities on a voluntary basis.

Given the regulatory pressures, many organisations are focusing on establishing their ESG policies and reporting capabilities, as well as articulating an ESG strategy, which is a fundamental framework to benchmark present status, set ambitions and measure incremental progress towards the set targets. An ESG strategy drives value creation[17] via top line growth, reduction in costs, enhanced productivity and efficiency, higher levels of staff attraction and retention, as well as optimization of assets and capital.

Robust ESG data will enable banks to price risks and allocate capital accordingly since, as things stand, banks and investors do not have sufficient visibility of the ESG risk on their own exposure and their borrowers' exposures. It is therefore in the interest of banks to act proactively and incentivise their corporate customers to collect and monitor ESG data in return for more favourable lending conditions.

Regulators, investors and consumers are becoming increasingly demanding of banks to embrace the green transition, whilst aligning also to social priorities. At the same time, there is a gap in regulatory data requirements – whilst the requirements for banks are getting more stringent (e.g. policies on climate and environment-related risks; ESG ratings for investments; ESG scores for corporates; pricing of ESG risk in credit; etc), non-financial institutions falling outside the scope of the CSRD will have less regulatory pressures to maintain ESG information. Hence, in the absence of such regulatory alignment, there will be a mismatch in the momentum towards this transition. Here, banks also have a unique role to play in proliferating ESG throughout all sectors in Malta's economy by raising the ESG awareness of clients by upskilling relationship managers to educate their clients about the financial and non-financial benefits of incorporating ESG risk (and consequently maintaining ESG information) and by establishing requirements for borrowers to present ESG disclosures when applying for new lending facilities.

That being said, Malta's retail banks are starting to embrace ESG through the roll out of accessible and attractive green products to the market, such as green loans with preferential rates for energy efficiency improvements in one's home or business and purchase of electric vehicles. This will play an increasing role in supporting the country to achieve its goal to be carbon neutral by 2050.

The challenges banks are facing at present in ESG may seem overwhelming compared to the short-term benefits. Changing clients' ingrained culture of short-term gains to long-term benefits and the added risk management requirements over and above existing regulatory pressures are among the key challenges. However, the market is set to experience a cascading effect wherein organisations that abide by ESG principles may progressively start to exclude non-ESG players (clients, suppliers) from their operations. **Banks are among the key sectors that stand on both sides of the fence in this situation, serving both as drivers and beneficiaries of this transition.**

Views from local banks

From interviews undertaken locally, it emerges that from a regulatory compliance aspect, most banks are in the process of aligning to latest ESG-related requirements. Despite homogenous pricing driven by nature of services, banks continue to explore ways to promote green transition amongst its clientele, with some currently segmenting customers based on the nature of their activities and their environmental credentials.

[17] How ESG creates long-term value

2.4. Culture

Culture is an integral part of a bank's DNA. It acts as a catalyst for value creation and is critical for a purpose-led banking sector to exist. A positive culture reduces the risk of misconduct, cultivates positive reputation and public trust, builds loyalty among the customer base, improves employee attraction and retention, and decreases the risk of regulatory scrutiny. Hence, **building a healthy culture within banks is imperative and requires a continuous effort to maintain through clear communication, the right tone from the top, collaborative leadership, leading by example, supporting professional development, transparency and rapid but fair conflict resolution.**

The current tight labour market, particularly on a local level, has made it more challenging to attract and retain talent and that is why banks must provide the necessary environment for employees to grow and advance their careers, constantly encouraging their teams to take advantage of training and development resources in order to upskill and reskill themselves, and remain competitive. Continuous learning is a core culture trait for banks to remain successful as it cultivates innovation, creativity and loyalty.

Today's employees prioritise collaboration, teaming and trust at the workplace. Banks must build on more collaborative leadership structures in which collaborative leaders involve their teams, instil a sense of safety, empowerment and trust. Open and continuous communication is also crucial and the right tone from the top is vital to ensure that everyone collectively has a role to play in proper conduct and prudent risk-taking. A strong communication culture also encourages employees to speak up through robust whistleblowing frameworks that facilitate the surfacing of any information related to workplace misconduct.

Research on a European level has shown that several banks' senior management structures do not explicitly oversee culture or effectively cascade culture and ethical standards across all levels of the bank.[18] Good practices in this regard include the setting up of rigorous monitoring of internal culture and conduct, including effective and transparent management information.

Furthermore, transparency in the form of fair and proper remuneration schemes, performance appraisal systems and decisions surrounding promotions also speaks volumes of an organisation's culture. Key performance indicators (KPIs) must be clear and transparent. KPIs should also measure elements such as risk management and conduct, while being aligned with the organisation's risk appetite and risk taxonomy.

[18] Strong risk culture – sound banks (europa.eu)

3

The Maltese Banking Sector as "Viable"

A viable banking sector is one that serves the core needs of the economy while doing so in a profitable way that adds value to shareholders, serves customers well and grows the business sustainably. A viable banking sector must seek to deliver products and services efficiently, allocate its capital in an optimal manner to maximise return on investment, and offer a diversified portfolio of services to secure multiple sources of income. Viable banks are also resilient to economic shocks, compliant with regulation and well-positioned to serve the needs of its existing and potential customers.

Banking is susceptible to sudden interest rate fluctuations, changes in asset quality and inefficient operations. Furthermore, the rapid change in customer demands and expectations, mainly driven by the younger generations, has seen the swift growth of challenger banks on an international level, as well as growing penetration into the local market, particularly for digital services which local banks do not offer or are less convenient to use. If left unchecked, this may eventually threaten the viability of traditional banks. Hence, future viability rests on the ability of traditional banks to continue to transform their operations such that they remain relevant to the younger cohorts of customers whilst at the same time not leaving anyone behind.

3.1. Sustainable Profitability

European banks operated in a near-zero percent interest rate environment up till September 2022, creating a highly challenging setting to generate desirable returns on equity. Furthermore, the Covid-19 pandemic also impacted profitability for at least 4 quarters between March 2020 and March 2021.

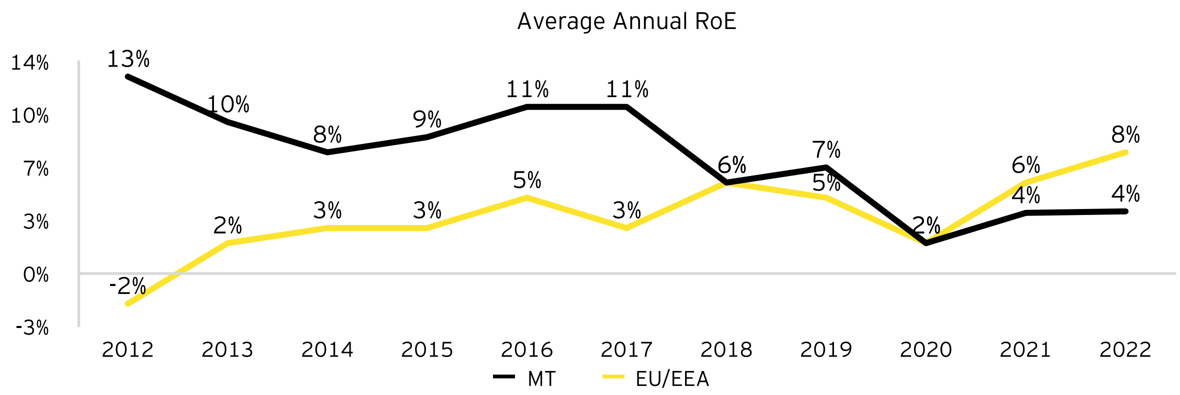


Figure 10
Source: World Bank, EBF

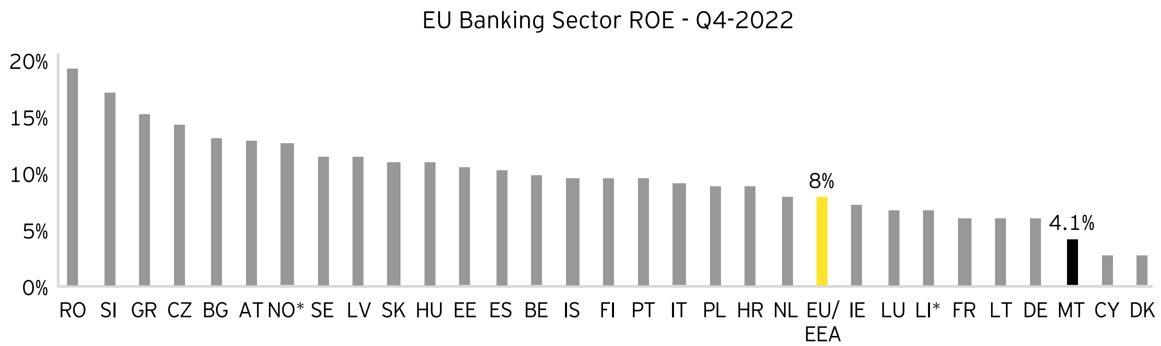


Figure 11
Source: EBA

After a decade of strong ROE performance by the local banking sector vis-à-vis the European averages, as from 2020 EU averages have outpaced the ROE generated by Malta's banks. This is due to the challenging economic conditions in recent years, the increased costs to ensure regulatory compliance and also a result of the comparatively high liquidity on the balance sheets of Malta's banks coupled with a low loan to deposits ratio.

The ECB has often flagged low ROE as posing a key risk to the viability of the European banking sector as prolonged periods of low profitability impact the availability of credit in an economy, which in turn negatively impacts economic growth and societal welfare. What should be considered a desired level of profitability is a long-standing debate as excessive profitability also poses potential risks to an economy as it may indicate high-risk taking, which in an industry built on trust, may lead to risks of future banking crises.[19]

Realistic medium-term ROE targets should acknowledge the fact that banks are currently much safer than before the outbreak of the financial crisis in 2007-2008. A combination of efforts by banks to tackle structural challenges as well as higher loss-absorption capacity in the system and enhanced supervisory scrutiny should arguably have lowered the returns required by bank investors, compared with pre-crisis levels. Thus, the current gap between banks' cost of equity and ROE does not necessarily have to be closed exclusively by the ROE component; this may also come about via reduced required returns.

3.2. Income Diversification

The Maltese banking sector ratio of net interest income as a share of total income stands at almost 73% in Q4-2022, compared to an EU average of 58%[20], with such a gap being observed consistently in recent years.

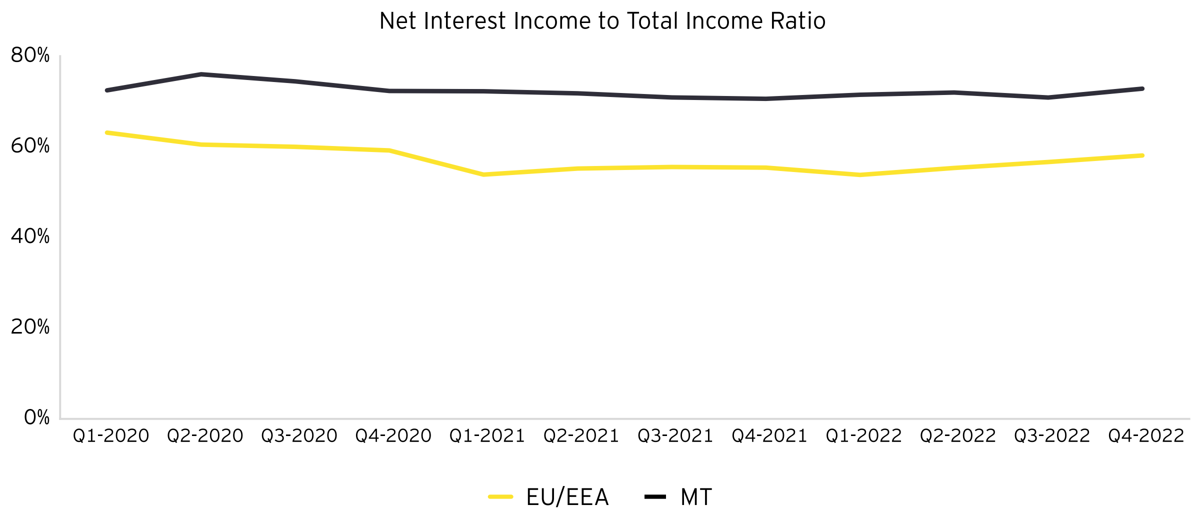


Figure 12
Source: EBA

[19] How can euro area banks reach sustainable profitability in the future? (europa.eu)

[20] Risk Dashboard | European Banking Authority (europa.eu)

Sustainable profitability requires a sustainable business model on which to build. The low interest rate environment of recent years, compounded by the impact of the Covid-19 pandemic, provided unparalleled impetus for banks to kick-off or accelerate their efforts to transform. Indeed, when observing the banking sectors both internationally and locally, one may note that the pandemic was a turning point for digital payments and digital services in general, with an acceleration in the transition towards becoming cashless economies coupled with changing customer preferences, who now seek less physical interaction as the primary mode of engagement with their bank. Locally, changing customer preferences in recent years is evidenced by an increase in the use of internet banking as well as by increases in the number and value of online payments by Maltese consumers between 2019 and 2022. Despite this upward trend, the share and value of online payments by Maltese consumers remain among the lowest when compared to the Euro area countries, indicating that there is room for further improvement and a role for banks to play in furthering the shift.

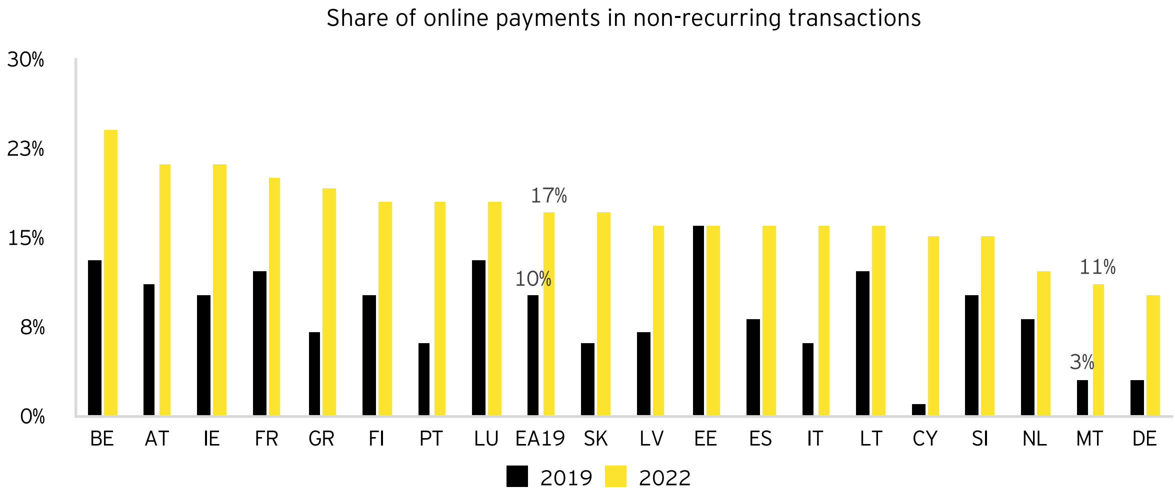


Figure 13
Source: ECB

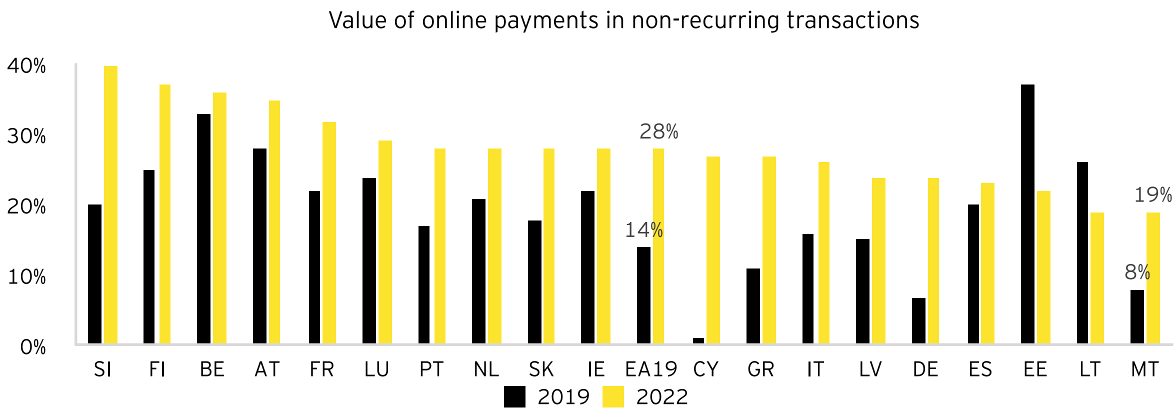


Figure 14
Source: ECB

Viable banks of the future must strive to diversify their income streams in order to be more resilient against shocks and ensure that liquidity is used effectively both for diversification but also to ensure that customers earn a fair return on their capital, particularly in the current inflationary environment which causes capital erosion. **Growth of revenue streams generated through commissions and other fee-based services** will better position the Maltese banking sector against unfavourable market conditions, geopolitical instability and the international decisions that steer the base interest rates. Globally, banks are increasingly providing services to their customers on insurance, advisory and private wealth services, as a viable and safe way to generate income through diversified streams. Though established players already exist on the local market for such services, local banks have the invaluable opportunity to **leverage the relationships with their existing customer base to cross-sell and up-sell more services by focusing efforts towards efficient, effective and value adding services.**

3.3. FinTech Opportunities

On an international level, an observable trend of inorganic growth through mergers and acquisitions with FinTechs is another avenue through which banks are securing diversified income streams to ensure continued viability. **The combination of a traditional banking operating model, which seeks to serve customers through multiple channels including brick-and-mortar branches, combined with the agile digital-first and cutting-edge operating models of FinTechs, has proven to be a recipe for success.**

Local banks clearly recognise the continued importance of physical interaction with their clients as large segments of the local customer base, especially the older generations, continue to value the relationship with their bank manager as a critical factor in their level of customer satisfaction especially when it comes to high value tasks and big decisions. The integration of these two worlds, though opposing at face-value, can be achieved by leveraging the right synergies. A FinTech stands to gain from a bank's large customer base and long-standing relationships with clients as a way to quickly and easily extend its reach. **A bank can exploit a FinTech's speciality to gain plug-and-play expertise which is otherwise lacking in the market, thus also gaining efficiency and hence reducing costs.**

3.4. Digital Transformation to enhance Customer Experience

Given that traditional banking operating models have been around for decades, many legacy systems and processes are also anchored in tradition. This dynamic needs to be reversed to enhance customer experience by **leveraging advanced analytics technologies that drive customer prediction models to pre-empt client needs before even they do. This would help banks build tailor-made value propositions for clients.**

Automation is also proving greatly beneficial in banks' efforts to enhance customer experience. With the right technology and processes, client onboarding can become more streamlined, waiting times for approvals on opening of new accounts or loan applications can be reduced significantly, customer support can be available 24/7, security features can be greatly enhanced while any disputes on fraudulent transactions can be tackled rapidly, thus contributing to an improved customer experience by freeing up personnel to assist customers with more complex problems and more value-adding services. Robo-advisors and automated product offerings in wealth management services are other examples of innovative technologies that are becoming standard for the banks of the future.

3.5. Cost Management

Sustainable profitability requires continuous evaluation and optimisation of a bank's cost profile. Throughout 2021, Malta's significant institutions within the Single Supervisory Mechanism (SSM) registered the highest cost-to-income ratio across all SSM participating countries, peaking at 91% in Q1-21 and closing at 85% in Q4-21 compared to an average of 64%[21].

This cost to income ratio is mainly being driven by expenses such as regulatory compliance, depreciation, costs associated with sustaining and staffing branch networks, and investment in transformation and digitalisation all of which would benefit from economies of scale in markets larger than Malta's. In regulatory compliance and digital transformation, scale matters. Investments in these areas are often large, requiring significant expenditure by a bank, irrelevant of its size, which automatically places Malta's banks, all of which are small by international standards, at a disadvantage due to longer periods required to generate a return on investment (where this is actually applicable).

Furthermore, the fact that net interest income has been practically stable in recent years due to the lengthened period of negative base interest rates meant that increasing costs were not compensated for by a proportional growth in interest income. Towards the end of 2022 the base interest rates of the ECB deposit facility moved into positive territory for the first time since July 2012, thus positively impacting local banks given their strong liquidity position.

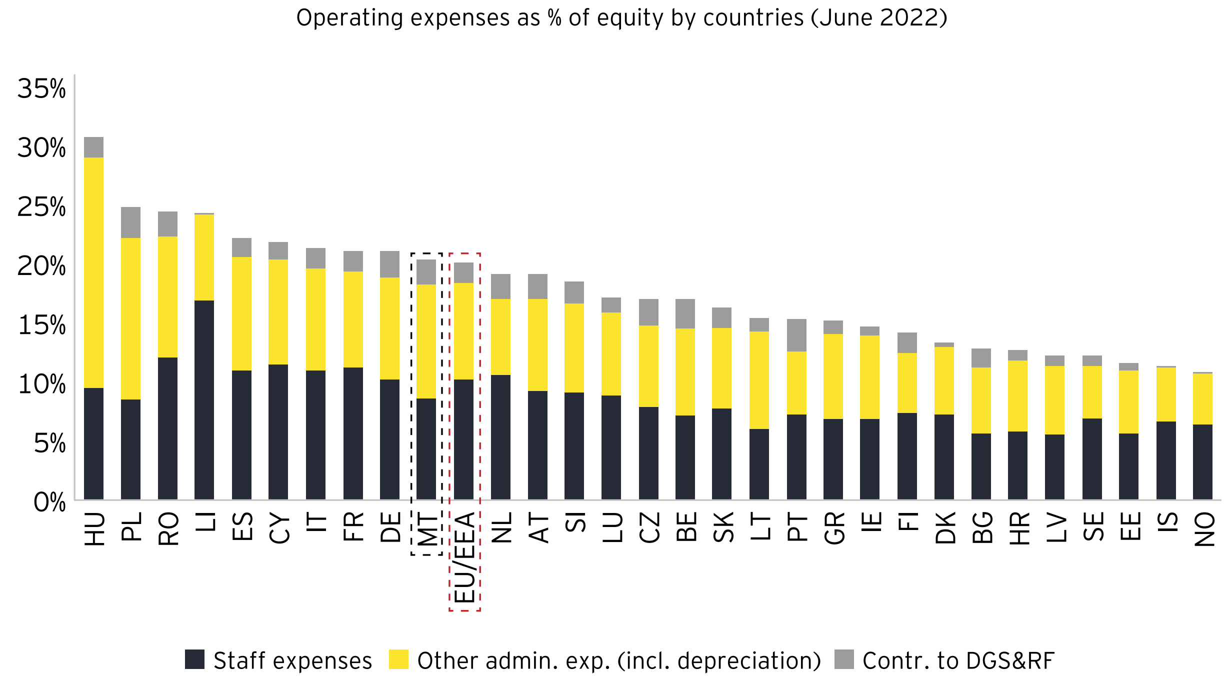


Figure 15
Source: EBA

[21] Balance sheet composition and profitability | ECB Data Portal (europa.eu)

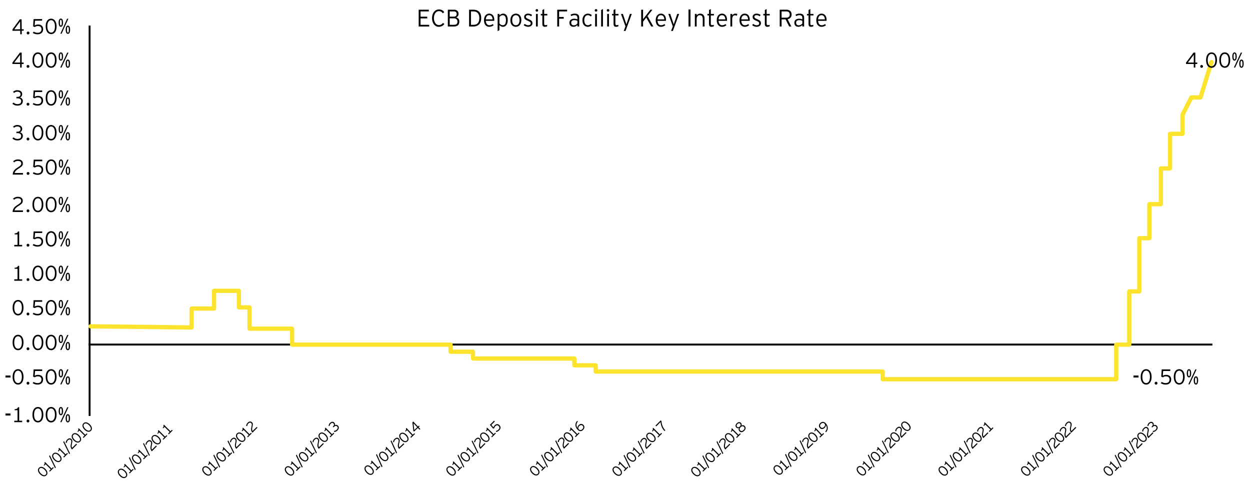


Figure 16
Source: ECB

Nevertheless, **keeping costs under control must be a key focus for the banks to remain profitable.** Across Europe, banks that have embraced digitalisation early and aggressively have been able to register cost savings in various overheads, particularly those related to headcount and facilities. In fact, since 2007, European banks have reduced headcounts by 21% on average.[22]

Digital transformation is an essential investment to maintain competitiveness, keep up with the times, retain clients and attract younger generations who value user-friendly digital interfaces while driving longer term cost-savings. While the investments may seem substantial, the longer-term outlook is favourable. In addition to the somewhat piecemeal and fragmented digitalisation approach that has been observable among some local banks, which in most cases has focused on delivering quick-wins, it is now critical to truly embrace digital transformation in a holistic manner as a key way to tackle their cost base to become more sustainable and profitable. A number of CEOs we have spoken to stated that while the potential value of the benefits derived from comprehensive digitalisation are highly attractive, they are concerned about organisational readiness.

3.6. What trends will shape future viability?

Malta's macroeconomic outlook remains positive, with a year-on-year real GDP growth average of 3.6% forecasted for the period 2023 to 2025.[23] Recent years have been characterised by various exogenous shocks, from the geo-political and energy crisis, to inflation and the tightening global and European monetary policy. For the rest of 2023, domestic demand and consumption are expected to continue driving growth, while investment is expected to recover after last year's contraction.

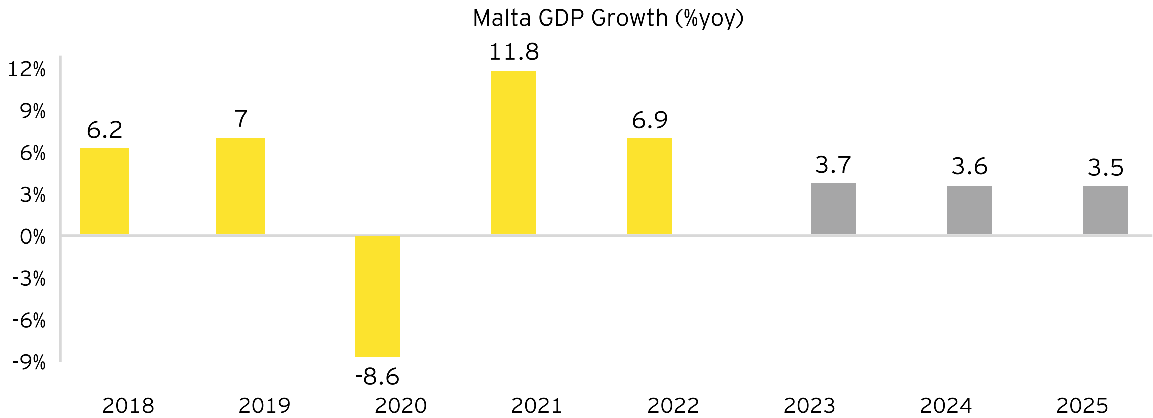


Figure 17
Source: Actuals - NSO, Forecasts-CBM

[22] Risk Assessment of the European Banking System - December 2020 (europa.eu)

[23] Central Bank of Malta (centralbankmalta.org)

The changing landscape, in terms of global economics, monetary policy, international regulation, technological developments and changing customer preferences brings challenges but also opportunities for Malta's banks to become more viable through new avenues for growth, leaner operations and ways to connect more deeply with customers.

Primarily, diversification is key to help address the large dependence on net interest income in the local banking sector and this diversification is also being supported by the green transition in banking and the wider economy.

Embracing technology, digitalising operations and leveraging data will also unlock opportunities that drive enhanced viability. Furthermore, modern operating models that truly enable remote and flexible working can provide the basis for operational cost reductions by reducing property overheads. The new flexible working model also positions banks to better match future customer and work demands, while retaining an attractive position in the talent market.

Finally, the local banking sector may also **consider ways to collaborate on the establishment of cross-sector utility centres that carry out back-office services in areas that do not provide material competitive advantage such as in AML and know your customer checks to achieve greater cost efficiencies at scale.** To this end, in Q3 2023 the Malta Business Registry issued a call for preliminary market consultation for the Development of a Central Data Repository Solution aimed at streamlining the process of identifying applicants engaged in business activities in Malta during KYC checks by businesses. This should go a long way to improve processes and time frames for onboarding new customers, thus enhancing customer experience and the ease of doing business in Malta's financial services sector.

Views from local banks

Interviews undertaken locally with a number of banking CEOs in Malta show that banks are increasingly prepared to open discussions around industry-wide collaboration when it comes to the provision of non-core services, such as ATM infrastructure and gathering of information in connection with Know Your Customer checks.

4

Malta's Banking Sector as "Safe & Stable"

A safe and stable banking sector is one that is secure, transparent, robust, compliant and acts in the best interest of its stakeholders. This means that it:

- Meets all regulatory requirements in an effective, efficient and timely manner
- Is resilient to economic, geopolitical and operational shocks
- Is well capitalised to be protected against unexpected events, as well as the credit and liquidity risks banks face in the normal course of day-to-day operations
- Is protected against threats such as cyberattacks, data breaches and financial crime.

The banking sector constantly needs to anticipate and manage risks to ensure a financially stable and secure banking environment for their customers and the country's economy. Malta's banks have made, and continue making, significant investments to meet increasing and indeed expanding regulatory obligations. The obligations are vast, ranging across capital adequacy, conduct, customer interaction, data protection, sustainability reporting, payments modernisation, tax, reporting, open banking, credit risk, anti-financial crime and AML, as well as cybercrime and digital resilience, amongst others. These investments are safeguarding customers and securing the stability of the banking sector. The effort and resources required to be fully compliant across the board cannot be underestimated and again highlights the reality faced by Malta's banks due to their size compared to the scale of investment required from a compliance and regulatory perspective.

4.1. Capital Adequacy

Capital is a key ingredient for effective risk management as it cushions potential losses in the event of unexpected events and enables banks to withstand shocks and continue operating and serving their customers. Malta's banks have made significant progress in terms of capital reserves and asset quality in recent years.

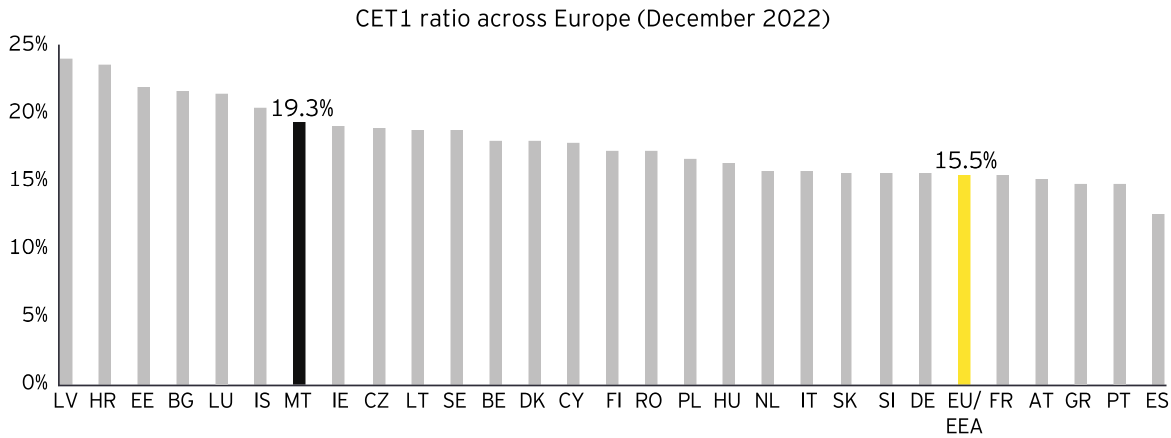


Figure 18
Source: EBA

Malta's banks also fare well in terms of their total capital ratio. This strong capital position ensures resilience towards sudden operating losses and sudden surges in customer withdrawals, while also enabling the banks to continue lending activity to support households and businesses, even through uncertain times.

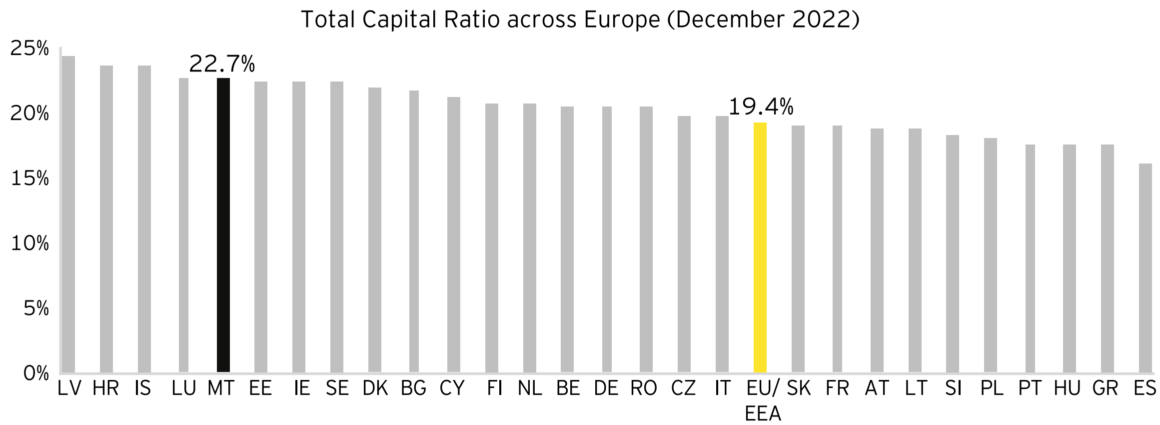


Figure 19
Source: EBA

In terms of its risk weighted asset (RWA) density, the Maltese banking sector is on a healthy downward trajectory, contracting by over 10 percentage points in the 6-year period between 2016 and 2021 and converging towards Euro Area average. The latest Central Bank of Malta's stress tests of the banking sector in 2022 showed that Maltese banks remained resilient, mainly due to their strong solvency and liquidity positions. However, going forward, any gains earned from rising interest rates could be offset by lower credit volumes or additional needs to step up further provisioning. During the period analysed by the CBM stress tests, credit remained strong, largely driven by a sustained growth in mortgages which also led to an increase in concentration risk in the banks' loan portfolios to the construction and real estate sector, coupled with other systemic cyclical risks emanating from real estate market developments.[24]

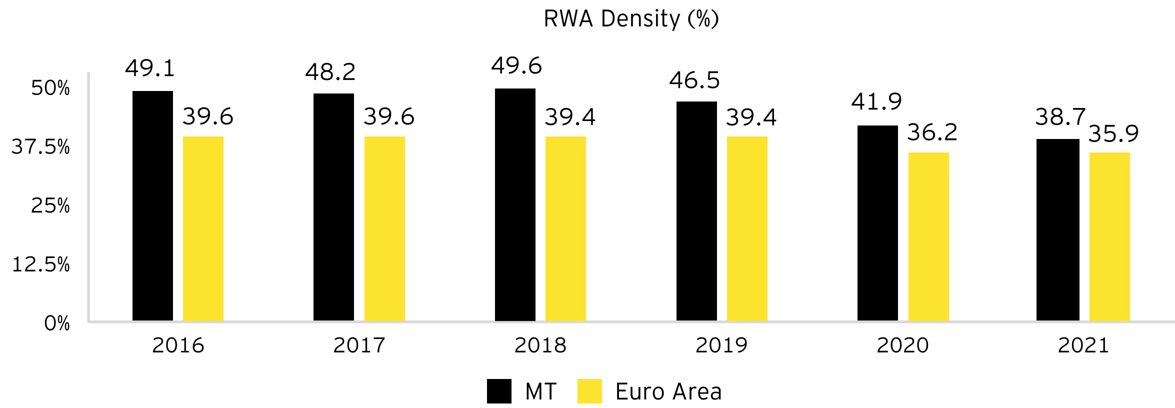


Figure 20
Source: ECB

The current macro-economic environment makes it somewhat likely that NPLs across Europe may increase, which may threaten the stability of the European banking system. However, most European banks are well prepared for such a situation given that regulatory developments in recent years have sought to implement numerous safeguards to avoid a repetition of the shockwaves caused by the 2007-2008 financial crisis.

The prevention of NPLs requires early detection and warning mechanisms which prompt immediate actions to be taken for effective handling of the case. **Advanced analytics and predictive modelling using robust data sets has a big role to play in this respect, while Artificial Intelligence (AI) can also be used to enhance human expertise in the identification of emerging threats.**

[24] Interim Financial Stability Report 2022 - Central Bank of Malta (centralbankmalta.org)

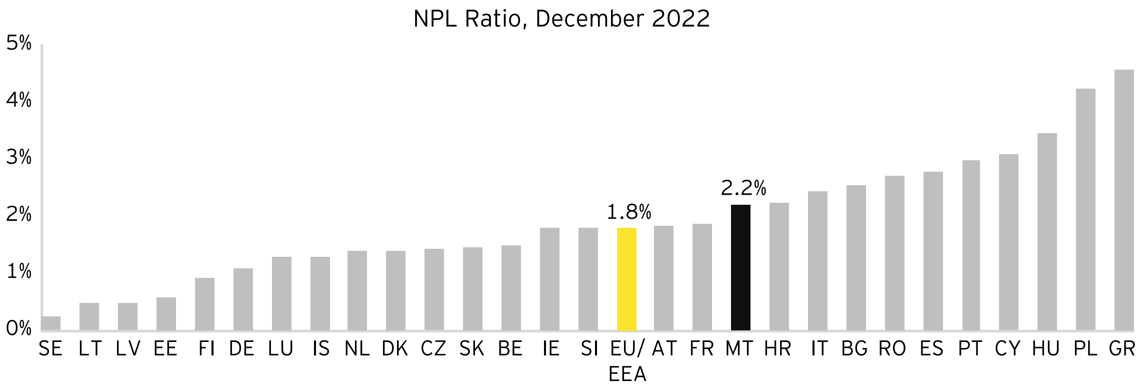


Figure 21
Source: EBA

Malta's NPL ratio must be interpreted in the context of the country's insolvency framework governed by the Companies Act, the Commercial Code, and the Insolvency Act all of which can be considered debtor-centric and quite limiting on the capacity of creditors, such as banks, to ultimately liquidate collateral pledged to them and the length of time it takes to liquidate. Efforts by the MBA to collaborate with the relevant authorities with the aim of amending the regulatory framework to make it less onerous on creditors to access debtors' collateral have been ongoing for several years. Furthermore, bar a recent occurrence, local banks rarely securitise NPLs into financial instruments for sale to investors, while this is a more common occurrence in other economies which helps keeping NPL statistics on the low side.

4.2. Regulatory Outlook

Banks in Europe will continue to face significant changes in the regulatory landscape over the coming years in various key areas, primarily stemming from dynamic market environment, evolving technologies, emerging risks, and the need to enhance financial stability and consumer protection.

4.2.1. Local Supervision Priorities

In its publication on supervision priorities for 2023, the MFSA highlighted six key areas of focus, all of which have been identified in consideration of the market environment, general regulatory developments, the EU's strategic priorities, recommendation of international standard setters as well as experiences of the local market in recent times. These priorities are grouped under two categories, namely (i) Ongoing Supervisory Priorities: Governance, Risk and Compliance; Financial Crime Compliance; Consumer Protection and Education; and (ii) High-Level Supervisory Priorities for 2023: Resilience of Supervised Entities; Sustainable Finance; and Digital Finance.

4.2.2. Basel III

The implementation of Basel III is anticipated to have significant implications for the future landscape of banking. One of its primary objectives is to enhance the capital adequacy of banks through the introduction of stricter capital requirements which seek to fortify banks against financial shocks, enhance risk management practices, and reduce the likelihood of systemic crises.

Basel III introduces liquidity requirements to ensure that banks have sufficient liquid assets to meet their short-term obligations during times of stress. Banks will also be required to enhance their risk governance frameworks, risk data aggregation capabilities, and stress testing methodologies. It is crucial for institutions to carefully assess their business models and maintain an open line of communication with regulatory bodies to ensure a smooth transition to the new regulatory framework.

Consequently, while local banks have been traditionally well capitalised and continue to maintain notable capital buffers, Basel III may require local banks to allocate an increased portion of resources towards capital buffers mainly as a buffer to the mortgage market for micro prudential purposes given the size and number of players in the local sector.

4.2.3. Cybersecurity

The proliferation of cyber threat actors combined with an increase in remote working, greater digital interconnectedness and the vast volume of transactions taking place electronically is raising the risk, frequency and severity of cyberattacks. In a recent EY survey held globally amongst Chief Risk Officers within the banking sector, cybersecurity featured prominently among the top concerns, ranking second only to Credit Risk.

Preventing cybercrime does not simply relate to measures to protect customers from falling victim to fraud or phishing attacks, but also requires banks to implement robust internal systems, practices and controls.

The ECB is monitoring banks' progress on cyber security through continuous off-site supervision and risk assessment, as well as targeted on-site inspections and has also introduced a cyber incident reporting framework that requires Eurozone banks to report cyber incidents to the Banking Supervision Unit within two hours of having carried out an assessment of the situation.

Furthermore, the DORA will require financial services firms to focus on a digital resilience strategy, and a digital resilience framework. These will take an end-to-end view of the entire IT landscape that support critical business functions, business continuity, incident management and third-party risk. DORA also calls for a shift in responsibilities, which will see CEOs and the Executive Committee as the main people responsible and accountable for this Digital Resilience Strategy. DORA shall come into force in 2025, meaning that at any time thereafter, the European Supervisory Authority (ESA) may request the mandatory reports outlined by DORA to be made available to them for assessment.

The dynamic evolution of resilience and compliance matters in the cybersecurity space require banks to retain and attract cybersecurity talent while upskilling their entire workforce on this topic. Additionally, in the same way that investments flow towards digital transformation efforts, banks must focus on developing, documenting and approving a clear cybersecurity roadmap which is backed by the required investment budgets.

4.2.4. BCBS239

Since its publication a decade ago, BCBS239 has become an integral part of the banking landscape, shaping the way banks approach their risk management, data aggregation and reporting practices.

Despite improvements in the implementation of the underlying principles in recent years, it is worth noting that banks with adequate risk data aggregation and reporting capabilities are still the exception and full adherence to the BCBS239 principles has yet to be achieved. This is primarily because BCBS239 compliance is not a one-time accomplishment, but rather an ongoing program that requires continuous fine-tuning in view of the fast-paced and dynamic banking environment.

Over the years, there have been significant technological developments that have enabled banks to become more data driven. While BCBS239 compliance is often hindered by a host of legacy system limitations, technological advances have also provided opportunities to take a more innovative approach in this space.

The BCBS239 journey will continue to play a large part in the transformational ambitions of banks. To ensure success, it is key to take a strategic approach to BCBS239 programs and data management initiatives, linking them to business objectives and priorities and embedding it in their data strategy.

4.2.5. Anti-Money Laundering and Terrorist Financing

Combating financial crime remains a key priority on the regulatory agenda with the EU pursuing its drive towards a comprehensive AML reform. This reform seeks to establish a more robust AML framework by addressing system vulnerabilities and cross-border compliance challenges brought by current variations in the implementation of directives across member states.
The proposed reform consists of four key elements:

- Establishment of the **Anti-Money Laundering Authority (AMLA)** to act as a centralised coordination and oversight entity involving national competent authorities.
- The **6th AML Directive** (6AMLD) which seeks to strengthen national AML frameworks and enhance information sharing to provide competent authorities with access to necessary and reliable information such as beneficial ownership registers and assets stored in free zones.

- **The EU "Single Rulebook" Regulation** will serve as a unified AML rulebook that provides guidelines for completing customer due diligence, disclosing the identities of beneficial owners, using anonymous instruments like crypto-assets, and introducing new entities such as crowdfunding platforms. It also includes clauses on "golden" passports and visas.
- Amendment of the EU **Transfer of Funds Regulation** on the information accompanying the transfers of funds and certain crypto-assets, in order to make it possible to trace respective transfers.

The Transfer of Funds regulation has been endorsed at all levels and is set to come into effect in January 2025. Discussions on proposed revisions to the remaining elements between the Parliament, Commission and Council of the EU are ongoing.

The increasing comprehensiveness of risk-based AML measures has a material impact on banks, in view of the underlying compliance costs. In recent years, local and international banks have increasingly invested in advanced technology, use of AI, systems and solutions coupled with skilled personnel to implement and maintain robust AML programs.

4.2.6. Sustainability

The Corporate Sustainability Reporting Directive (CSRD) was published towards the end of 2022 and entered into force on 5 January 2023. The Directive broadens the scope of the Non-Financial Reporting Directive (NFRD) and continues to push forward the green agenda by promoting capital inflows towards sustainable activities within the EU. The CSRD enhances reporting on various fronts, such as the resilience of the business model and strategy in relation to risks concerning sustainability matters as well as any plans that the entities are expected to follow to ensure that the underlying business model and strategy are compatible with the transition towards a sustainable economy with the objective of limiting global warming. Furthermore, a new set of related European Sustainability Reporting Standards (ESRS) have been developed, with the EU Commission expected to finalise the delegated acts in the second half of 2023. Following this, EFRAG is expected to continue working on a number of standards which will cover various economic sectors, including a specific set for SMEs.

The European Supervisory Authorities and the ECB published a joint statement in March 2023 on the disclosure on climate change for structured finance products in which they call on issuers, sponsors and

originators of such assets at EU level to proactively collect high-quality and comprehensive information on climate-related risks during the origination process. This call for improved disclosure concerns all funding instruments that are backed by the same type of underlying assets.

Meanwhile, negotiators of the Council of the EU and the European Parliament reached an agreement on the creation of European Green Bonds Regulation (EuGB), in February 2023. This Regulation lays down uniform requirements for issuers of bonds that wish to use the designation "EuGB" for their environmentally sustainable bonds that are aligned with the EU taxonomy and made available to investors globally. To prevent greenwashing in the green bonds market in general, the Regulation also provides for specific disclosure requirements linked to alignment to the Taxonomy Regulation. This agreement will now need to be adopted by the EU Council and EU Parliament, and shall apply within 12 months of its entry into force.

The EBA has also pledged its commitment to support the European banking and financial sector in tackling climate change and the transition to a more sustainable economy. In its 2022 ESG Roadmap, the EBA laid out its phased approach for ESG risk supervision by integrating ESG factors and risks into existing supervisory review and evaluation process (SREP) elements, firstly focusing on business model analysis and internal governance practices, followed by capital adequacy and liquidity adequacy factors. As a way to expedite the role of the banking sector in a more sustainable economy, the EBA's guidelines shall provide more prominence to the environmental aspects of ESG in the short term.

Adding to the plethora of ESG-related reporting requirements, in January 2022, the EBA also published its final draft implementing technical standards on Pillar 3 disclosures on ESG risks, setting out mandatory templates, tables and instructions that supplement the EBA's 'Pillar 3 package' prudential reporting requirements which financial institutions with listed securities on a member state's regulated market will be required to comply with under the Capital Requirements Regulation. The reporting requirements include, amongst other things, disclosures on the financial impacts of the physical and transition risks associated with climate change on institutions' balance sheets. Physical risks include the impacts of the "physical effects of environmental factors" (e.g. adverse weather events, global warming), whilst transition risks include the impacts of "the transition to an environmentally sustainable economy" (e.g. the effect of new renewable technologies or climate policy changes). In each case, these risks are assessed in disclosures by reference to their impact on the exposures to the institution's counterparties or financial assets.

4.2.7. Recovery and Resolution

In April 2023, the European Commission adopted a proposal to adjust and further strengthen the existing EU bank CMDI framework. Once the coming into force date is confirmed, the proposal will enable authorities to organise an orderly market exit for failing banks of any size and business model, including smaller players.

The legislation draws on the lessons learned from the first years of application of the framework, and makes further improvements. It provides resolution authorities with more effective tools to ensure that, when a crisis occurs and when financial stability is at stake, depositors – for instance individuals, businesses and public entities – can continue to access their accounts. In particular, it will facilitate the use of industry-funded safety nets to enable authorities to shield depositors in bank crises, such as through the transfer from an ailing bank to a healthy one.

The proposal has the following objectives:

i. Preserving financial stability and protecting taxpayers' money

ii. Shielding the real economy from the impact of bank failure

iii. Better protection for depositors

4.2.8. The NPL Directive

Directive (EU) 2021/2167 on credit servicers and credit purchasers (the "NPL Directive") aims to facilitate the sale and servicing of NPLs of credit institutions to third parties by improving the present market conditions and providing a harmonised regulatory framework.

The NPL Directive allows credit institutions that are struggling with a large build-up of NPLs to effectively outsource the servicing of the non-performing credit to a credit servicer or to transfer the credit agreement to a credit purchaser. The NPL Directive includes provisions regarding both the creditor's rights under a non-performing credit agreement and the non-performing credit agreement itself.

Some of the salient features of the NPL Directive include:

- the establishment of a new authorisation regime for credit servicers
- the possibility for credit servicers to passport services through the European Union
- the ongoing supervision requirements and obligations vis-à-vis credit services and the obligations to protect consumers and other borrowers in relation to credit agreements,

4.2.9. Integrated Reporting Framework

The main objective of the IReF is to reduce the reporting burden on euro area banks while meeting the information needs of the European System of Central Banks (ESCB). This will be achieved by integrating different statistical obligations and harmonising data collection across countries. The latter means statistical reporting will no longer depend on the country in which a bank is resident. The ECB envisages issuing an IReF Regulation on statistical data requirements which would be directly applicable to banks resident in the euro area.

The IReF Regulation will replace the existing regulations on balance sheet items (BSI), interest rates on Monetary financial institutions (MIR), the sectoral module of Securities Holding Statistics (SHS) and granular credit and risk data (AnaCredit) with respect to the requirements of deposit-taking corporations. The MIR and AnaCredit regulations would be repealed, and the BSI and SHS regulations recast or amended to exclude deposit-taking corporations from the reporting populations.

Subject to adoption of the IReF Regulation by the Governing Council in 2025, the IReF is expected to go live in 2027. In parallel, the Eurosystem is designing the organisation of Eurosystem statistical business processes as a preliminary step to investigating and implementing the IT solutions that will support data collection under the IReF.

4.2.10. Financial Data Access and Payments Package

In June 2023, together with Payment Services Directive (PSD3), Payment Services Regulation (PSR) and Digital Euro, the European Commission (EC) published its proposal for a new Regulation on a Framework for Financial Data Access (FiDA), also commonly referred to as the Open Finance Framework (OFF).

The proposed FiDA brings payments and the wider financial sector into the digital age and will further improve consumer protection and competition in electronic payments, empowering consumers to share their data in a secure way to enable a wider range of better and cheaper financial products and services. FiDA focuses on consumers' interests, competition, security, and trust.

The Commission proposed to amend and modernise the current PSD2 which will become PSD3 and establish, in addition, a PSR. These changes will ensure that consumers can continue to make electronic payments and transactions safely and securely in the EU, domestically or cross-border, in euro and non-euro.

A legislative proposal for a framework for financial data access is also being proposed by the Commission with the aim to establish clear rights and obligations to manage customer data sharing in the financial sector beyond payment accounts. This framework will lead to more innovative financial products and services for users and will stimulate competition.

4.2.11. Regulatory Outlook Overview

The impending regulatory changes in the local and European banking sector are poised to fuel the ongoing transformative era for financial institutions. As these changes take effect, banks will navigate a complex landscape of heightened regulatory scrutiny, evolving compliance requirements, and a renewed focus on transparency and consumer protection. While these reforms may pose additional challenges and costs for banks, they also present an opportunity for the industry to further strengthen its resilience, embrace innovation, and foster a more sustainable and customer-centric business model. The success of local banks in adapting to these regulatory changes will be pivotal in shaping the future of the Malta's financial landscape, ensuring stability, and strengthening trust in the banking sector. Ultimately, the evolving regulatory framework provides a catalyst for positive change, driving banks to adopt progressive practices and contribute to the overall health and stability of the economy.

Furthermore, on a local level, the regulatory outlook will be coming in to play in the context of a refreshed National Strategy for Financial Services. Launched in 2023, the strategy will act as a cornerstone to re-enable Malta to position itself as a reputable and successful jurisdiction that excels in innovation through a nimble regulatory framework and robust technology foundations. The strategy seeks to leverage the opportunity to target a new era of digitally-enabled financial services and to re-assert Malta's presence in a globally competitive marketplace and from a unique European perspective. The strategy's priorities are focused on streamlining Malta's regulatory processes and institutional architecture, building a national payments infrastructure, consolidating identity management, enabling financial services law reform and harmonisation, modernising Malta's tax structure, and building up Malta's talent pool in the financial services industry, amongst others.

5

A Progressive Banking Sector

Malta's banking sector needs to be forward looking and doing so means embracing and exploiting the many opportunities to diversify service offerings and streamline operations presented by digital transformation as a way to remain relevant to customer and resilient to future challenges. Such investment is necessary in order to catch up to the rapid advancements made by industry leaders on an international level and thereby secure the local sector's position as a vital part of the country's continued development going forward.

Increasing automation and digitalisation has consistently ranked first among the measures being taken for European banks to tackle their operating expenses[25] as these result in long-term value to customers and other stakeholders through enhanced analytics and technology, more efficient processes and stronger attraction and retention rates for top talent.

Primary measures banks are adopting to reduce operating expenses (% of respondents)

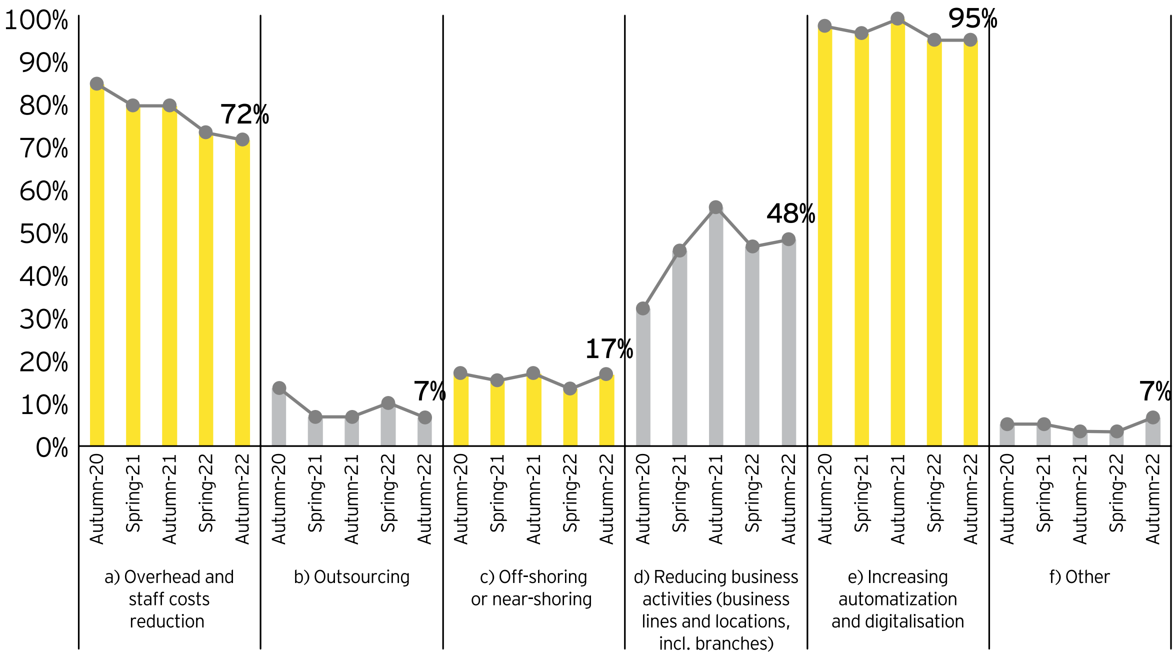


Figure 22
Source: EBA

5.1. Digital Transformation & Data-Driven Strategy

Through the latest technologies in cloud computing, microservices, advanced analytics and AI, digitalisation in banking has the power to:

- Simplify banking and transactions, thereby allowing banks to offer more efficient services to their clients resulting in enhancing customer satisfaction and loyalty
- Rationalise internal processes to increase productivity, lower costs and reduce levels of human interaction and human errors particularly in simple and repetitive tasks
- Dismantle silos by democratising data and empowering people to take more informed decisions
- Enable a more data-driven and client-centric operating model which focuses on the delivery of tailor-made products and services based on insights derived from data analytics

[25] Risk Assessment of the European Banking System (europa.eu)

In order to achieve the desired outcomes of a successful transformation journey, Malta's banks of the future will need to:

a. **Rethink what transformation means.** Rather than simply maximizing cost takeout or meeting regulatory requirements, banks should focus on fundamentally improving customer and employee experiences. It is about radical rethinking, not refining and streamlining. Putting humans at the centre, whether that be employees or customers, is instrumental to success.

b. **Inspire and lead from the top** as transformation may only succeed if leaders, including board and executive management, engage with the process directly. Executive management must conceive and consistently communicate, both internally and externally, a transformative vision aligned with the bank's overarching strategy. It is also vital to outline why transformation is needed. This is crucial to secure buy-in across all levels of the organisation. The KPIs of those at the very top of the organization may also require adjustment so as to integrate transformation KPIs into compensation packages.

c. **Rethink transformation ideation** ensuring that the impact of initiatives on customer and employee experience, as well as on financial performance, is understood and considered. Employees that are closest to products and may fall into a recognized customer demographic can bring fresh, relevant perspectives. Therefore, banks should formalize processes to crowdsource ideation for transformation opportunities from across the workforce, and senior leadership should be strongly encouraged to engage. In addition, executive management should be made aware, regularly and formally, of key external trends that are shaping transformation initiatives across industries and on the international market.

d. **Recalibrate investment evaluation to capture longer-term payback.** Typically, investments feasibility is assessed on payback within the short to medium term. This can potentially lead to game-changing initiatives that require a longer payback period to be dismissed.

e. **Reposition for agility at scale,** focusing on core technology, culture, team structure and governance to ensure transformation can be executed swiftly. One of the most important but often overlooked aspects of agility is the ability to halt transformations that are not delivering and pivot to new opportunities without delay. This capacity to fail fast is essential to avoiding wasting resources on unproductive initiatives. Banks must provide the governance necessary to identify underperforming projects while developing a culture that does not punish unsuccessful initiatives but rather encourages them as part of an iterative learning process.

f. **Redefine the value proposition** in order to overcome talent shortages and attract, reskill and retain key skills necessary for transformation. Articulating the transformation trajectory on first contact with prospective new hires is key, as is communicating their potential role in that transformation.

g. **Assess transformation success** using multiple financial and non-financial metrics at various stages throughout the lifecyle of an initiative. These metrics should be aligned with the organisation's strategic objectives. Furthermore, lessons learned should be cascaded to future transformation initiatives so as to avoid similar pitfalls.

5.2. Lessons from FinTechs

By engaging customers with innovative solutions aimed at addressing specific needs, packaged within a distinctive experience while delivering useful customer insights based on advanced analytics, FinTechs have gained significant market share and attracted a wide audience of investors. In western Europe, 30% of retail banking clients are banking with a FinTech and the reasons are mainly linked to cost, easy access, rapid service and advanced features and functionalities, all of which contribute to an enhanced customer experience. FinTechs have started capturing growing shares of banking revenues in the global economy, including the Eurozone area, thus impacting the profitability of banks at noteworthy pace.

The inroads of FinTechs and big tech into banking are now real, not just a threat, and they are redefining banking customer expectations. Indeed on the international market, there are numerous examples of technology companies that have branched out into the banking sector such as Apple Pay and Apple Card, Google Pay, Amazon Cash and PayPal Credit to name a few. This is generating a flurry of digital transformation efforts among traditional banks with mixed results.

In 2021, Revolut had over 190,000 users from Malta[26], resulting in a market penetration rate of roughly 37% of the total population. This penetration rate ranks highest out of all the countries where Revolut is present, followed by Ireland at 32% and Cyprus at 21%. Revolut and similar FinTechs offer 24/7 service and leverage latest technologies and AI to understand the needs of their clients and roll out catered solutions rapidly. They also offer ancillary services such as transaction tracking, budgeting assistance, in built stock and forex trading platforms, robo-advisory services and international money transfer facilitation with low or zero fees.

Retail banks are well-aware that disruptors like Revolut and Wise are setting the standard in terms of customer expectations and without offering similar or better services, banks will continue to lose ground. **Banks must therefore digitally reimagine the products and services portfolio they offer in certain areas. Simply digitalising their existing ones will not be sufficient to retain existing customers and attract new ones.**

[26] Country ranking by user number - Revolut

5.3. Talent for the Digital Era

The present and future success of banks requires significant talent in technology roles such as data engineers, data analysts, AI specialists and computer scientists. Hiring for these roles is key to successfully digitalise operations in banks. However, banks are not the only sector looking to recruit such skillsets. In Malta, a significant share of technology talent is being brought in from overseas, both physically and remotely, primarily by the technology and gaming sectors. Banks are competing with these and other attractive sectors on both a global and local scale, given the advent of remote and hybrid working models. Hence, it is essential that attractive packages are on offer by the banks for the right talent. **Attractive packages include competitive remuneration that incentivises high-performance, frameworks for continuous development, transparent career progression paths, enhanced working conditions with attractive benefits, flexibility and trust – all of which are also fundamental to retain existing talent.**

Besides recruitment, banks must also strive to effectively reskill their existing workforce and redeploy them into new, higher value-adding roles. **Reskilling is usually a more cost-effective solution compared to recruitment of new talent and can deliver efficiency gains from the person's ingrained knowledge of the organisation, its processes and its structures.** As automation spreads throughout a bank's processes, pools of resources will become available for up- and re-skilling. Nevertheless, reskilling also presents the inherent challenge of willingness and collaboration from employees, which is not always easy to obtain. This can be overcome through a positive and human centric culture, transparent communication and clear articulation of the opportunities for progression and reward in the new field. **Strong learning and development journeys for its people also enhances the bank's reputation by branding itself as an organisation that offers opportunities for growth to its people.**

In driving successful transformations, banks must adapt a mindset where they put humans at the centre of all decisions. Indeed, a recent study by EY in collaboration with University of Oxford surveyed 900 C-level executives and found that organisations that put humans at the centre of their transformation efforts are 2.6 times more likely to succeed. In summary, the human element is not seen as a single workstream, but as a focal point underpinning and enabling the entire transformation. A **human centric transformation is one that considers the human element in all aspects, with specific attention paid to intangibles that may have previously been overlooked, such as emotional support, leadership, vision and culture.** Not only does a human-centric approach make sense when an organization is planning and executing a transformation, it's also key to building adaptability within personnel, preparing them for upcoming change and building a future-ready workforce that is key for a progressive organisation.

5.4. Accessibility for all

When digitalising operations, it is vital not to leave any customers behind and the local banks have recognized that despite their efforts to proliferate the use of digital banking services, there will always remain a cohort among customers who prefer banking services in traditional brick and mortar branches. This is both a matter of accessibility and inclusion, and also a matter of building trusted relationship with customers via face-to-face interaction.

Malta's banks must strike the right balance between cutting edge service offerings enabled by the latest technology and remaining accessible to all. In this regard, banks are actively applying a two-pronged approach that seeks to continue servicing customers via traditional channels while also facilitating their transition towards digital services. Examples of these initiatives include extended opening hours and dedicated hours in branches to service customers, simplification of user interfaces of digital services, talking ATMs, online appointment booking forms, and well as training seminars, live demonstrations and customer care representatives dedicated to supporting the elderly.

6

Conclusion

6.1. Purpose of the Report

This report by EY Malta, supported by the Malta Bankers' Association, seeks to outline the importance of the banking sector for Malta's economy and society. It also identifies current and future trends, challenges and opportunities for the sector while working towards the competing needs of the various stakeholders that impact, or are impacted by, the banking sector.

The report has been developed in consultation with senior leaders in the local banking sector and experts within EY's financial services teams. The report aims to convey messages for the future of banking in Malta, across four key areas. This with a view to drive further forward-looking discussions among the sector's stakeholders.

6.2. Banking Sector's Role and Significance

Malta's banking sector plays a critical role in the economy, evidenced by its strong contribution to Malta's total GVA of 6.3% in 2022, compared to the Eurozone average of 2.6%. At year-end 2022, Malta's banks held total deposits of €35.8 bn[27] compared to a total credit book of €27.6 bn. The core banks also employ over 5,200 people, with many other high-skilled professionals employed by the remaining licenced institutions.

The continued prosperity of the banking sector is vital for Malta's economy and society to continue on an upward trajectory as the sector is fundamental to enable citizens and companies to have a safe place to save their money, make transactions and obtain credit.

6.3. Stakeholders and Pillars

At this time, Malta's banking sector finds itself at an inflection point driven by rapid transformation in customer needs, the regulatory landscape and technological advancements. The primary challenge for the sector is to run its core functions in a way that achieve its own objectives while meeting the needs and expectations of stakeholders in parallel. In meeting these challenges, Malta's sector is observed through four mutually reinforcing pillars which global experts see as the essential pillars for a healthy banking sector in the future: Purpose-led, Viable, Safe & Stable, and Progressive.

6.3.1. Purpose-Led

A purpose-driven banking sector revolves around implementing strategies that generate sustainable long-term value and have a positive impact on society, the economy and the environment. In turn, this strong sense of direction and robust culture commands trust and loyalty from customers, employees and other stakeholders. In the years ahead, local banks can stimulate a purpose-driven agenda by adopting a more customer-centric operational approach that is responsive to customer needs, fostering a culture where employers and employees are aligned to deliver the highest possible value, and playing a key role in the transition towards a greener economy.

6.3.2. Viable

The sector's viability rests on reaching sustainable levels of profitability. At present, Malta's banking sector profitability is among the lowest in Europe when measured in terms of ROE (4.1%), standing at half the eurozone average. Malta's banks remain heavily reliant on interest income to drive their revenue and profitability, which was significantly impacted by the elongated period of historically low interest rates. This places the spotlight on the limited diversity in the revenue streams of Malta's banking sector, especially when compared to other banks in the EU and other markets, which continued to register strong ROE results (9% - 12% in the US; c. 8% in the Eurozone). Cost optimisation is another key avenue to secure sustainable profitability. Many banks are pursuing large scale transformation strategies which not only seek to redesign for more customer-centric operations, but also to leverage the latest technologies to be able to streamline, reengineer and automate processes, where possible, for greater efficiency and accuracy.

[27] Credit institutions - Credit institutions and money market funds - ECB Statistical Data Warehouse (europa.eu)

6.3.3. Safe & Stable

Malta's banks have proven to be resilient throughout the years as a result of relatively conservative and traditional operating models. This stability is being further augmented with the implementation of new regulatory requirements that seek to strengthen national and international banking systems so that banks can continue to contribute materially to supporting communities and economies.

Looking ahead, it is likely that the regulatory agenda will be sustained across an increasingly diverse range of priorities including the green agenda, financial crime, cybersecurity, operational resilience, and the traditional areas of focus of governance, credit risk, capital adequacy, liquidity and broader prudential reforms. Juggling these competing priorities while balancing the significant investments required by these regulatory mandates will continue to present a key challenge for the local banking sector.

6.3.4. Progressive

Digitalisation of banking operations was accelerated during the pandemic and banks will need to continue transitioning to a more automated and efficient business model that seeks to implement a more customer-centric approach, thus enhancing the customer's experience. Locally, a number of customers have turned to FinTechs such as Revolut for certain banking services such as quick and free digital payments, currency exchange stock trading and personal budget management tools, attracted by the fast, easy and personalised solutions available at their fingertips. To co-exist and thrive in the age of FinTechs, local banks will need to incorporate the capabilities of FinTechs and to do so, banks will need to train, reskill and reorganise their human capital to align with the requirements of modern banking. Strategic partnerships with FinTechs may provide a quicker avenue to the latest technologies, innovations and solutions, while white-labelling fintech products such as lending platforms, customer onboarding processes or digital payment processing platforms may be the most efficient way to enhance a banks service offerings.

6.4. Potential Future Opportunities

Despite the various challenges, the current banking landscape offers opportunities for Malta's banks to further pursue their diversification, innovation and sustainable finance agenda, and to play an even more central role in the country's economic and social progress.

The unique circumstances currently at play present an opportunity for banks to transform and grow while also shifting towards leaner operating models in anticipation of further changes in the sector.

6.5. Foundation for debate

This report analysed a range of challenges, issues, trends, and opportunities that are set to shape the future of banking in Malta and provides an opportunity to initiate a wider discussion among bank executives, regulators, industry leaders and wider stakeholders on the current and future state of Malta's banking sector.

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