BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

CONSULTATION DOCUMENT

CONSULTATION ON THE PROPOSED DIRECTIVE ON BORROWER-BASED MEASURES

[CBM REF: 01-2018]

1st October 2018

Closing Date: 24th October 2018

Note: The documents circulated by the CBM for the purpose of consultation are in draft form and comprise proposals. Accordingly, these proposals are not currently binding and are subject to changes and revisions following representations received. It is important that persons/entities involved in the consultation bear these considerations in mind.

1. Introduction

1.1 The Central Bank of Malta (CBM) and the Malta Financial Services Authority (MFSA) have been monitoring developments in the residential real estate (RRE) market in relation to the financial system. Following a recommendation of the Joint Financial Stability Board in this regard the CBM will be issuing a Directive on borrower based measures applicable to all credit institutions in Malta. The objective is to continue strengthening the resilience of banks and borrowers against the potential build-up of vulnerabilities stemming from changing economic conditions. A copy of the draft Directive is being made available with this consultation document.

1.2 Real estate represents a major part of household wealth and constitutes a major source of collateral for lenders. Housing construction is an important component of the real economy - a source of employment, investment and growth. The continued growth in mortgage lending and demand for properties may however result in potential macro-financial imbalances. Owing to this, the robust momentum in the RRE market warrants the introduction of pre-emptive regulatory measures.

In the Authorities' view the deployment of macroprudential limits on mortgages in the form of borrower-based measures will enhance the resilience of banks and household balance sheets to possible house price corrections and interest rate reversals. Under such conditions, high Loan-to-Value-at-Origination (LTV-O) ratios may impact on default rates as borrowers are more likely to fall into negative equity. The introduction of LTV-O limits would restrict the size of loans and impose a requirement on the minimum deposit of households relative to the market value of the property. In the event of a downturn in property prices, LTV-O limits will therefore mitigate bank exposures by reducing the banks' loss-given-default in the event of a default.

On their own, LTV-O caps do not completely eliminate procyclicality because as property prices increase, the capped credit limit also increases - thus becoming less effective in limiting an overstretch in borrowers' income. Accordingly, LTV-O caps will be complemented by another measure in the form of caps on the Debt-Service-to-Income-at-Origination (DSTI-O) ratio. High DSTI-O ratios mean that the borrowers' repayment capacity becomes stretched in the event of a shock to income or interest rates, thereby increasing the probability of default of borrowers. The introduction of caps on the DSTI-O ratio as a preventive measure will therefore act to further dampen procyclicality in such circumstances.

By setting LTV-O and DSTI-O limits, the CBM seeks to promote financial stability and ensure that both bank and household balance sheets are protected.

This more direct approach is required to pre-empt any potential real-estate vulnerabilities through the implementation of borrower-based measures via limits on LTV-O, DSTI-O and maturity requirements. This Directive is therefore not intended to replace banks' existing internal credit risk assessment policies but rather to strengthen the existing menu of credit risk mitigation tools adopted by domestic credit institutions.

2. Outline of Borrower-Based Measures

The macroprudential measures will differentiate between two categories of borrowers – Category I and Category II. The first category comprises first-time buyers (FTBs) and non-FTBs purchasing their primary residence whilst the second category comprises borrowers purchasing their second or additional residential property and individuals and other body corporates borrowing for buy-to-let (BTL) purposes. Loans to Category I Borrowers with a collateral market value below EUR175,000 (excluding haircuts) are *exempted* from the LTV-O and DSTI-O limits specified in the Directive. Loans falling below this threshold are still subject to prudent lending policies in terms of the MFSA Notice on the Management of Credit Risk by Credit Institutions authorised under the Banking Act 1994 (BN/01/2002). Credit institutions may implement tighter credit standards than those established in the proposed Directive. The table below gives an overview of the borrower-based measures for Category I and Category II borrowers.

	(LTV-O)	(DSTI-O)	Maturity
Category I Borrowers:	90% LTV-O cap with a '*speed limit*' of 10% on the volume of loans, for loans with a market value in excess of EUR175,000	A stressed DSTI-O of 40% for loans with a market value in excess of EUR175,000 with a shock to interest rates of 150 bps	A maturity term of 40 years or the official retirement age – whichever occurs earlier 1952 – 1955: 62 years 1956 – 1958: 63 years 1959 – 1961: 64 years Born after 1961: 65 years
Category II Borrowers:	Gradual Phase-in: 1st year: 85% LTV-O cap with a '*speed limit*' of 20% on the volume of loans 2nd year: 75% LTV-O cap with a '*speed limit*' of 20% on the volume of loans	A stressed DSTI-O of 40% with a shock to interest rates of 150 bps	A maturity term of 20 years or the official retirement age – whichever occurs earlier 1952 – 1955: 62 years 1956 – 1958: 63 years 1959 – 1961: 64 years Born after 1961: 65 years

Contacts

Interested parties are being invited to submit any written feedback to Mr. Stephen Attard on attards@centralbankmalta.org, Mr Raniero Polidano on polidanor@centralbankmalta.org and Ms Svetlana Privitelli on privitellis@centralbankmalta.org. The Authorities reserve the right to disregard any responses sent after the said date.