

The Role of the Financial Services Industry in moving Malta's economy in a COVID-19 situation

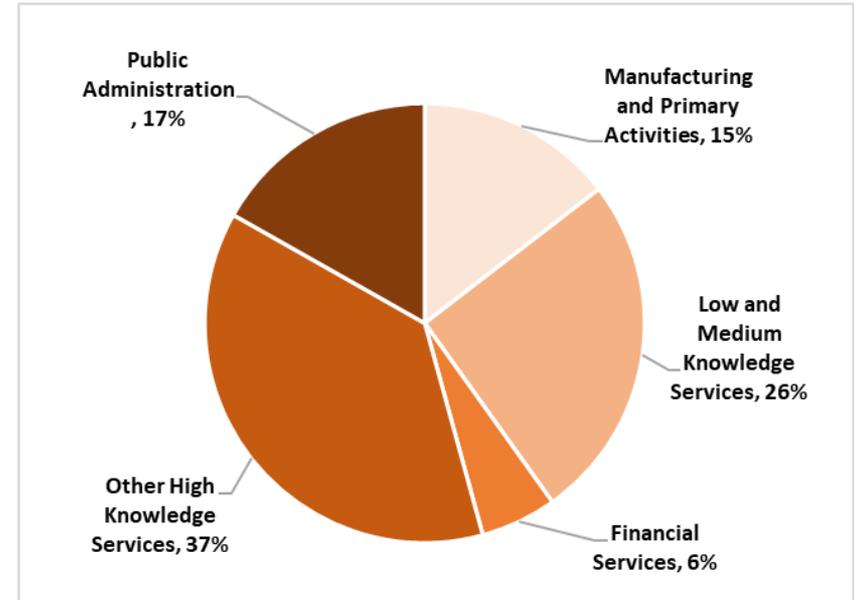
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The Financial Services Industry in Malta

- The Financial Services industry is one of the main pillars of the Maltese economy, contributing around **6% of Gross Value Added (GVA)** in 2019¹.
- This contribution is estimated to amount to around **9.1% through multiplier effects**.
- In 2019, there were around **12,230 persons working in the financial services industry**, representing around 4.9% of the total employed population.

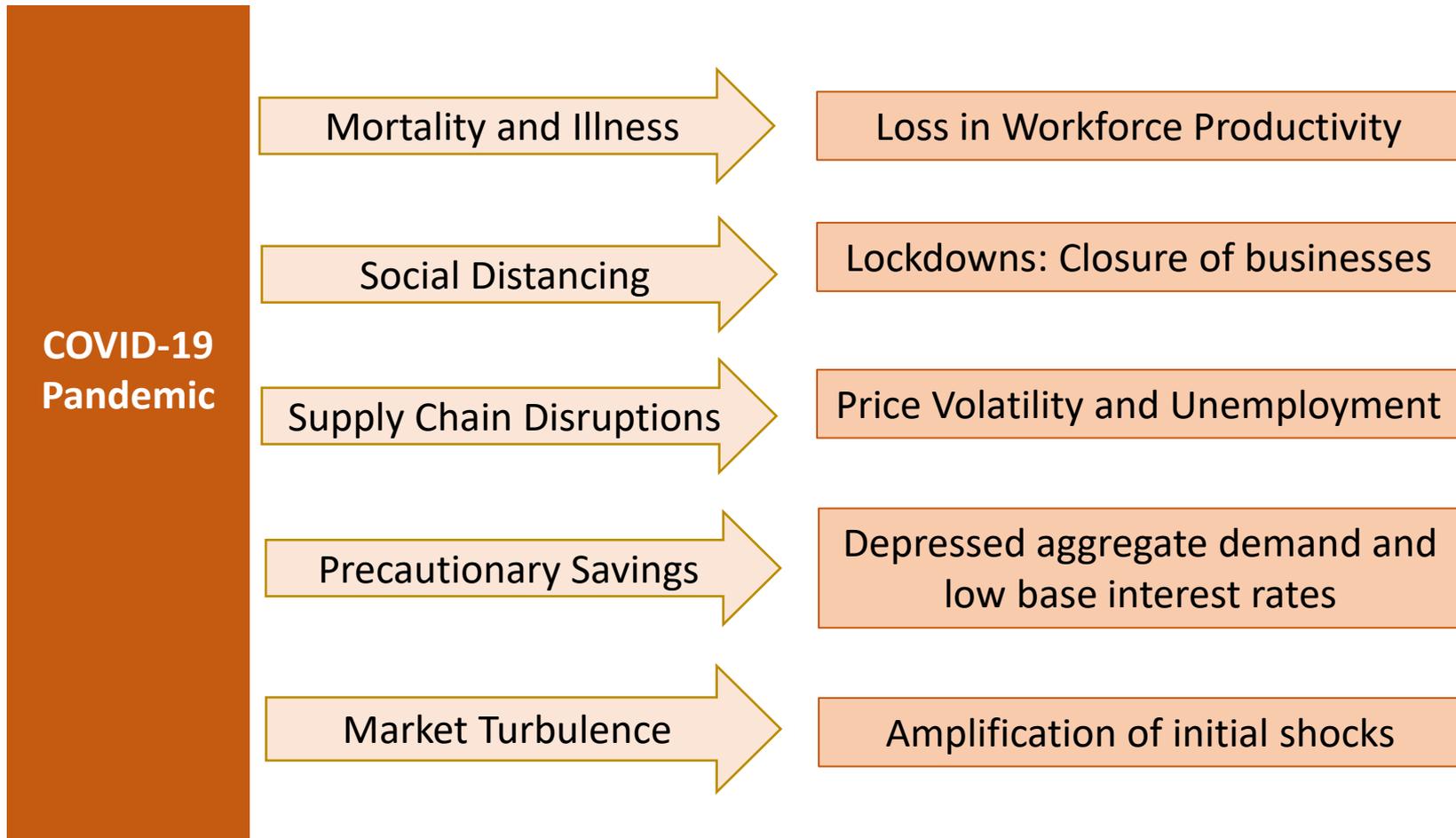


Pre-COVID 19 challenges

- Jurisdictional reputation risks
- Skills shortages
- Emerging financial integrity risks
- Deterioration in consumer trust
- Climate-related risks

COVID-19: Economic Impact

TRANSMISSION CHANNELS OF COVID-19 SHOCK



COVID-19: Impact on the Financial Sector

SHORT-TERM IMPACTS

- ↑ **Closure of bank branches:** The pandemic has forced banks to temporarily close branches. This may signal the beginning of branchless banking services.
- ↑ **Shift to remote working:** Alternative work arrangements are being implemented to limit the spread of the virus and ensure employee safety.
- ↑ **Increased demand on Digital/IT infrastructure:** Higher demands on organisations' digital infrastructure to replace manual operations.
- ↓ **Drop in banks' earnings:** The drop in consumption and investment leads to lower credit purchases and investment projects, thereby reducing interest earnings for banks.
- ↓ **Cybersecurity and fraud risk:** Crisis and rapid change always create an opportunity for bad actors, and COVID-19 will be no different.
- ↓ **Higher level of insurance claims:** Event cancellations may cause greater losses to insurers as some large events have policies that may cover them even for epidemics or pandemics.
- ↓ **Higher market and counterparty credit risk:** Due to increased volatility and decline in prices across many asset classes.
- ↓ **Tax, financial and regulatory compliance:** Looming deadlines may be jeopardized due to operational disruptions.

COVID-19: Impact on the Financial Sector

MEDIUM-TERM IMPACTS

- ↑ **Digitalisation of financial services:** A more rapid process of digital transformation for the financial sector.
- ↑ **Opportunities for Fintech:** The unprecedented growth in the use of digital financial services and e-commerce may create new opportunities for Fintech companies.
- ↑ **Potential increase in demand for health insurance:** The pandemic may cause people to reconsider their health insurance needs. This could lead to rising sales of health insurance, critical illness and even life cover.
- ↓ **Reduced demand for financial services:** If general economic conditions deteriorate, there could be reduced demand for banking products and services.
- ↓ **Low interest rates:** Large asset purchase programmes lower borrowing costs, thereby impacting on profitability within the financial sector.
- ↓ **Surge in liquidity risk:** The potential increase in credit default swaps and loan moratoriums could lead to higher liquidity risk. This could lead to reduced dividends and/or share buybacks.
- ↓ **Higher risks for life insurance:** Movements in equities, interest rates and credit spreads create significant asset liability management risks for life insurers as yield curves flatten.

COVID-19: Impact on the Financial Sector

LONG-TERM IMPACTS

- ↑ **Cashless society:** Digital payments may become not only a convenience but a necessity.
- ↑ **Advancement of Sustainable Finance:** Policymakers have acted swiftly to provide fiscal and monetary support during this pandemic. This is an important lesson to learn for tackling other global challenges, including the impending threat of climate change.
- ↓ **Potential increase in NPLs:** If banks are exposed to firms and industries that are significantly impacted by the current pandemic, banks could potentially face a build-up in NPLs. Furthermore, pledged collateral may experience a decline in value.
- ↓ **Mental health impacts:** Unemployment, social isolation and demoralisation could have an impact on mental health and in turn on labour productivity.

Challenges and Opportunities

CHALLENGES

- **Economic Uncertainty:** The continued uncertainty about the scale and duration of the economic impact of the pandemic continues to pose strains on the financial system.
- **Pressures on the supply of credit to the real economy:** Liquidity strains have grown. The key challenge is to keep credit flowing amidst deteriorating credit quality and rising defaults.
- **Business survival:** Cash flow constraints spurred by a drop in demand may lead to businesses, in particular SMEs, to shut down.
- **Transition to Digital Services:** The outbreak has made the situation more urgent for traditional financial institutions and businesses. There are also new risks emerging from digitalisation.
- **Cyberattacks:** The surge in internet usage as a result of stay-at-home measures may have weakened cyber security defences.

Challenges and Opportunities

OPPORTUNITIES

- **Digital acceleration:** The future post-outbreak is likely to be dominated by online usage of financial services.
- **Health insurance growth:** Health insurers face unprecedented growth opportunities which can be captured with well-developed strategies.
- **Remote working:** The shift to remote working could present opportunities related to cutting costs on office space, cutting commuting times and higher labour productivity.
- **Contactless and cashless transactions:** The COVID-19 pandemic is likely to accelerate the switch to a cashless society and the adoption of alternative integrated payment features powered by mobile wallets.

Business Strategies for success in the 'New Normal'

- **Business Continuity Management:** Financial institutions are to implement Business Continuity Management strategies.
- **Recession Readiness:** Financial institutions and regulators should be prepared for a potential global recession.
- **Digitalisation Transformation Plan:** Develop digitalisation transformation plan that manage threats and channel disruptive forces for growth.

BANKING

- **NPL Management** will be essential for banks to deal with increasing bad debts after the outbreak and retain long-term credit worthiness.
- **Recovery and Resolution Planning** should be undertaken to be prepared for potential events of severe stress.
- **Explore new revenue streams:** remote authentication and signing services, online trading platforms, and online credit platforms.

FINTECH

- **Expand partnership strategies** (with financial institutions, other Fintechs or non-financial services companies)
- **Contribute to higher financial inclusion:** Fintechs can play an important role in distributing benefits to more vulnerable populations.
- **Accelerate the adoption of the Internet of Things,** namely IoT enabled contactless payments.

Business Strategies for success in the 'New Normal'

INSURANCE

- **Health insurance growth strategy** will be essential to take advantage of new growth opportunities.
- **Potential reconsideration of current operating models** since the existing approach may be hard to sustain with interest rates near zero.
- **Need for additional provisions** for what could become adverse circumstances.
- **Prepare for potential increases in operational volume** by ensuring that the digital infrastructure and workforce are adequately prepared.

SECURITIES AND MARKETS

- **Reassessing valuation process, policies and controls** to adequately address reduced price discovery and liquidity and increased valuation risk.
- **Create flexible plans to deal with significantly larger transaction volumes** from shareholders and customers, as well as the trades that portfolio managers are making.
- **Ensure that clients, investors and other stakeholders know when the NAV-related processes and procedures diverge from the norm.** COVID-19 related volatilities could create issues with Net Asset Value (NAV) determination.

Thank you

