Executive Summary

Following the first publication in June 2016, PwC, in collaboration with FinanceMalta, are publishing the next in a series of semi-annual financial services surveys. This survey was carried out in September/October 2016 and respondents were invited to give their views on various topics in comparison to their sentiments 6 months earlier.

The survey shows 34% of respondents reporting increased business volumes. This can be compared to the result of 59% reported in the previous survey. Furthermore, 9% of respondents indicated increased optimism on the overall business situation in the sector, slightly down from the 18% reported in the previous survey.

Confidence in the banking sector has remained robust, with 36% of respondents being more optimistic about the overall business situation in the sector and the balance reporting unchanged sentiment levels. This result remains similar to that reported in the previous survey. Additionally, respondents from the banking sector reported an increase in business volumes over the past 6 months and remain bullish about the next 6 month period with 64% expecting further increases in activity. It appears that this increase is expected to stem primarily from commercial rather than retail customers.

Growth in net interest as well as non-interest income has continued to be reported in this survey. This growth is driven mainly by increased trading in commercial banking activities. 82% of respondents have reported no significant change in non-performing loans, similar to that reported in the previous survey. Furthermore, although total operating costs have continued to increase, a net balance of 55% of banking respondents expect to report an improvement in profitability going forward.

Within the insurance sector, 36% of firms reported increased volumes of business in the past 6 months, down from 75% reported in the previous survey. In fact, only 18% were more optimistic about the overall business situation in the sector during the past 6 months. With regards to premium income, a net balance of 36% of respondents expect an increase going forward (compared to 42% in the previous survey). On the other hand, there is a reported drop in net investment income. An increase in total operating costs was reported by 75% of respondents, driven mainly by increased levels of insurance claims as well as an increase in the average cost per claim. Staff turnover within the sector has increased with 55% of respondents indicating an increase in the past 6 months. Furthermore, 36%

All numbers provided are balances unless otherwise stated, i.e. the difference between the percentage of respondents reporting an increase and those reporting a decrease.
of firms also experienced increased levels of employment and 73% experienced increased payroll costs. Insurance companies are also reporting higher capital expenditure, particularly on IT systems as well as regulatory compliance.

Unlike their banking counterparts, 55% of insurance respondents have indicated a drop in profitability in the past 6 months, with 36% expecting the decline to continue over the coming 6 month period.

Asset management firms have reported no change in volume of business in the past 6 months and in fact, a net balance of 8% expect volumes to decrease going forward. Additionally, a net balance of 23% of respondents report to be less optimistic about future prospects. Furthermore, a net balance of 8% have indicated that income has declined, with 23% expecting further declines in the next 6 months.

Notwithstanding this decrease in activity, over the next 6 months, 23% of asset management firms expect staff levels to increase albeit at a slower rate. Furthermore, 62% of respondents have reported an increase in operating costs in the past 6 months, driven mainly by increased levels of employment and therefore increased payroll costs.

Respondents were asked to evaluate Malta’s overall competitiveness as a financial centre. The main issues highlighted related to the increasing burden of regulations and the difficulty in finding suitably qualified human capital, with some suggesting that employing non-EU nationals should be made easier. Some respondents also highlighted the need to increase custodian services in Malta. Sentiment was particularly negative in the asset management sector.

While the financial services sector is relatively healthy and buoyant, respondents feel that there are challenges and threats on the horizon. Costs are rising, especially those relating to human capital and compliance, while proposed changes to EU regulations appear to be on most firms’ agenda, with many commenting that a one-size-fits-all approach would be a disadvantage to Malta’s financial services industry.
Banking
Sentiment remains upbeat underpinned by increases in volumes and profitability
36% more optimistic about overall business situation over the past 6 months

73% report increased volume of business over the past 6 months

36% report increased net-interest income during the past 6 months

Volume of business
36% of banking sector respondents reported increased levels of optimism for the business sector over the past 6 months. Over the past 6 months, a net balance of 73% of firms reported increased volumes of business. For the next 6 months, the banking sector remains bullish as 64% of respondents believe that their business volumes are likely to increase.

36% of banking respondents have indicated growth in net-interest income over the past 6 months. The outlook for the next 6 months is also positive, with a balance of 55% of respondents expecting growth in interest income. Banking respondents are also optimistic in their outlook for non-interest income, with 64% envisioning an increase going forward.

A balance of 73% of banking sector firms have witnessed growth in business from commercial banking activities; and expect a similar continued performance for the next 6 months. However, as regards retail sector banking, three quarters of respondents have reported same levels of business and 18% reported decreased activity. Over the coming 6 months, 82% of firms expect private individual business to remain unchanged.

Charges, costs and profitability
Trends for average spreads have continued to decline, with 27% of respondents indicating a decrease and 55% indicating no change in average spreads over the past 6 months. On the other hand, a balance of 18% foresee an increase in average spreads for the coming 6 months.

Average commissions, bank fees and premiums charged have been more resilient and a balance of 36% of firms report increases over the past 6 months, and 27% foresee increases in the next 6 months.
27% of banking organisations reported increased **operating costs** over the past 6 months, with a similar outlook for the next 6 months.

**Non-performing loans** appear to be in line with 82% of respondents, indicating no change in the value over the past 6 months. There is a similar outlook in non-performing loans for the 6 months ahead.

**Profitability** appears to be increasing for banks, with a balance of 55% of respondents indicating improved profitability over the past 6 months. The same is envisaged for the coming 6 months.

**Employment Training**
Growth with regards to the number of persons employed within the banking sector appears to have somewhat slowed down, with a net balance of 9% of respondents indicating increased **employment** over the past 6 months, compared with 50% in the previous survey. For the coming 6 months 27% envisage further increases in employment.

**Training expenditure** still appears to be a priority for most banks, with 27% of respondents indicating an increase in training expenditure in the past 6 months. The outlook for the next 6 months is similar.

Given the rather slow growth in employment, respondents indicated that **staff costs as a proportion of total costs** have remained unchanged over the past 6 months. They are expected to increase marginally over the next 6 months, with a balance of 18% indicating an increase.

When considering **staff turnover**, 45% of respondents have reported an increase in the past 6 months. However, the outlook appears to be stable for the coming 6 months. This is in line with what was reported in the previous survey.
Marketing and Capital Expenditure

A balance of 9% of respondents indicated that marketing expenditure in the coming 12 months is expected to increase compared to the previous 12 months.

27% of banks are expecting to authorise more capital expenditure on IT services in the coming year. A balance of 9% foresee less spending on land and buildings. The principal reasons for capital expenditure are statutory legislation (22%) followed by increased efficiency (17%) and replacement purposes (15%).

In considering the limiting factors for capital expenditure, going forward, the main factors include uncertainty about demand (17%), inadequate net return on proposed investment (8%) and shortage of labour including managerial and supervisory staff (8%).
Business prospects and growth

Statutory legislation is the top limiting factor when it comes to firms increasing their level of business, with 33% indicating that this is the case. 19% of banking respondents indicated that the ability to raise funds was the most limiting factor.

A net balance of 36% of respondents have indicated that they expect to spend more on regulatory compliance in the next year when compared to the past 12 months. While this is significant, it is well below the 92% indicated in the previous survey.

For the coming 12 months, 58% of banking firms are envisaging that competition will come from their own sector, whilst another 25% foresee competition coming from other sectors of the industry.

With regards to the efficiency and effectiveness of Malta’s regulatory framework and supporting services in the past 6 months, there is an even split between those who feel that their business activities are affected more favourably and those who feel that levels are affected less favourably. The remaining half of respondents have indicated that business levels have remained the same.

Over the next 12 months, 46% of respondents indicated that growth will come from new customers. The remaining respondents indicated that growth will come from existing customers, acquisition of customers and new products.

In considering organic growth strategies, a balance of 82% indicated that acquiring new customers was most important, while 42% said the same about retaining existing customers and 18% about launching new products.

In considering inorganic growth initiatives, a balance of 55% of respondents foresee a decrease in importance in engaging in M&A transactions within the banking industry for the coming 12 months.

When considering market focus compared to the past 12 months, respondents show a clear preference for internationalisation. Increasing market share in domestic markets is, on balance, neither more important nor less important. On the other hand, a balance of 55% of respondents consider increasing market share abroad to be more important.

In considering enablers for growth when compared to the past 12 months, one notes the following to be more important: CRM capabilities (27%), IT systems and applications (27%) and performance measurement tools (18%).
Insurance
Firms remain largely optimistic, notwithstanding declines in profitability
Volume of business
18% of insurance sector respondents reported increased levels of optimism for the business sector over the past 6 months.

Over the past 6 months, a balance of 36% of firms reported increased volumes of business, while the same balance is envisioning further growth over the next half a year. The same results were noted for premium income.

A balance of almost one-third of respondents in the insurance industry registered a drop in investments income over the past 6 months, and a balance of 9% predict a further decrease in the coming 6 months.

In analysing further, one notes that the increased volume of business is being driven by both the commercial market and the private-individuals market.

A balance of 18% have witnessed growth in commercial business over the past 6 months, with 27% forecasting growth going forward. A balance of 36% have reported growth in private individual business, with a similar outlook for the next 6 months.

Charges costs and profitability
A net balance of 27% of respondents in the insurance sector report an increase in average commissions, insurance fees and premiums charged over the past 6 months, with the outlook for the next 6 months being similar.

Total operating costs, however, increased over the past 6 months, as reflected by 73% of respondents. For the next 6 months, 82% of the insurance sector are foreseeing these costs to continue increasing.
A net balance of 55% of respondents report reduced **profitability** in the past 6 months. This trend is likely to continue, with 36% expecting profitability to drop further in the coming 6 months.

A net balance of 73% of respondents have reported increases in the total **amount of insurance claims** in the past year, with the same percentage indicating that this increase is likely to be maintained in the coming year. At the same time, a net balance of 55% of respondents have reported an increase in the average cost per claim over the past year. For the year ahead, 73% of respondents forecast further increases in the cost per claim.

As regards the loss ratio, 36% of respondents have witnessed an increase in the past 12 months. However, only 9% are foreseeing further increases in loss ratios in the year ahead.

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**Employment and training**

A net balance of 36% of insurance firms reported an increase in the **number of persons employed** in the past 6 months with the outlook equally bullish.

**Training** still appears to be regarded as a priority, with 45% of respondents indicating that related expenditure in the past 6 months has increased, while 36% claim that this is likely to be maintained for the 6 months ahead.

An overall net balance of 73% of insurance firms reported an increase in **staff costs as a proportion of total costs** in the past 6 months whilst 64% of respondents are forecasting a continued increase in staff costs going forward.

**Staff turnover** appears to have increased with 55% of respondents indicating this for the past 6 months. Net balance of 18% forecast an increase for the coming 6 month period.
**Marketing and capital expenditure**

9% of the respondents from insurance firms believe that more expenditure will be spent on **marketing** in the coming year when compared to the past 12 months.

In the next 12 months, a net balance of 64% of respondents plan to authorise increased **capital expenditure** on Information Technology.

The **principal reasons for capital expenditure** are increased efficiency (27%), followed by replacement considerations (23%) and statutory legislation and regulations (19%).

In considering the **limiting factors for capital expenditure**, going forward, the main factors include uncertainty about demand (29%), inadequate net return on proposed investments (24%) and the shortage of labour (12%).

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**Business prospects and growth**

Competition remains the top factor that will **limit insurance firms’ ability to increase their level of business** in the next year, with 35% indicating this.

For the coming 12 months, 79% of insurance firms are envisaging that **competition** will come from their own sector, whilst another 14% foresee competition coming from other sectors of the industry.

**Regulatory compliance** remains significant, with a net balance of 64% of respondents have indicating that they expect to spend more on regulatory compliance in the next year when compared to the past 12 months.

A net balance of 18% of respondents have reported a decrease in the **efficiency and effectiveness of Malta’s regulatory framework** and supporting services that have influenced the outcome of their business activities in the past 6 months.

In considering **organic growth strategic initiatives**, when compared to the past 12 months, a balance of 82% of respondents feel that retaining existing customers will become more important over the next 12 months. 73% consider the acquisition of new customers to become more important going forward. A slightly lower balance of 45% feel that cross-selling to existing customers will become more important.

Launching new products is anticipated to become more important as a strategy by a balance of only 18% of respondents.
In considering **inorganic growth initiatives**, a balance 27% of respondents foresee a decrease in importance in engaging in M&A transactions within the insurance industry for the coming 12 months. A balance of 18% also foresee less importance in the need to consider partnerships and alliances for the coming 12 months. These findings are largely in line with those in the previous survey.

Increasing market share in international markets is deemed less important than the local market. On balance, 9% report increasing market share in the domestic market to have become more important as opposed to a net balance of 55% reporting less importance for international markets.

In considering enablers for growth when compared to the past 12 months, one notes the most important to be performance measurement processes (64%) and IT systems and applications (64%).

Surveyed respondents were asked to gauge their readiness for Solvency II compliance. The majority (56%) indicated a low level of preparedness for Pillar I and Pillar II, while 67% indicated a medium level of readiness for Pillar III.

Only 11% of respondents indicated a high level of preparedness for the introduction of IFRS9 and IFRS4, with the remainder split evenly between medium and low levels of readiness. In considering the availability of actuarial support, the majority of respondents (64%) consider it to be a managed risk, while 36% view it as a growing concern.

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The Solvency II Directive (2009/138/EC) came into force on 1 January 2016. The Solvency II framework has three main pillars:

- **Pillar 1** addresses quantitative requirements (e.g. the amount of capital an insurer should hold).
- **Pillar 2** sets out requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers.
- **Pillar 3** focuses on disclosure and transparency requirements.
Asset Management
Optimism and profitability fall on the back of increased uncertainty, declining activity and higher costs
Volume of business

A net balance of 23% of asset management company respondents reported decreased levels of optimism for their business sector over the past 6 months.

In sharp contrast to what was reported in the previous survey, the majority of respondents reported that volume of business in the past 6 months remain unchanged. Furthermore, for the next 6 months, 8% of asset management company respondents believe that their own business volumes are likely to decline.

A net balance of 8% of respondents have indicated a drop in income over the past 6 months, with a net balance of 23% expecting a decline in income going forward.

Total operating costs have increased as indicated by 62% of respondents, with the same number anticipating further increases in the next 6 months.

A net balance of 8% of respondents reported a decrease in overall profits in the past 6 months. This sentiment is likely to be maintained in the next 6 months of the year, as a net balance of 15% of respondents are expecting further declines in profitability going forward.

Employment and training

A net balance of 54% of respondents from asset management companies have reported an increase in employment in the past 6 months. Going forward, a net balance of 23% of respondents are envisaging this increase to be maintained.

An overall balance of 23% of respondents within asset management companies have indicated an increase in training expenditure in the past 6 months. A net balance of 31% of participants are forecasting a continued increase in training expenditure in the next 6 months.

In line with the increased employment and training costs, a net balance of 62% of respondents have reported an increase in staff costs as a proportion of total costs over the past 6 months. The same percentage are envisaging this increase to be maintained in the next 6 months.

In the opinion of 15% of respondents, staff turnover has increased in the past 6 months. This is predicted to increase only marginally in the coming 6 months.
Marketing and capital expenditure

A net balance of 50% of respondents foresee an increase in marketing expenditure in the next 12 months, while a net balance of 15% of respondents plan to authorise increased capital expenditure on IT over the next 12-month period.

The principal reason for capital expenditure is increased efficiency (27%), followed by replacement requirements (23%).

In considering the limiting factors for capital expenditure, going forward, the main factors include: uncertainty about demand (29%), the shortage of labour (24%) and an inadequate net return on proposed investment (24%).
Business prospects and growth

In analysing further the business prospects for asset management companies, 33% of respondents are foreseeing that statutory legislation and regulation is the highest factor that will limit their ability to increase their level of business in the coming year. The level of demand is another limiting factor that will have an impact on the business’ performance in the next 12 months.

Statutory legislation is indeed a significant consideration for such firms, with a net balance of 85% of respondents expecting to spend more on regulatory compliance in the next 12 months.

Competition will mainly come from other asset management companies providing the same services. This has been reported by 86% of respondents while just 7% of respondents are expecting competition to come from other sectors of financial services.

A net balance of 54% of respondents have reported a decrease in the efficiency and effectiveness of Malta’s regulatory framework and supporting services that have influenced the outcome of their business activities in the past 6 months.

Over the next 6 months growth across asset management companies will mainly come from new customers (37%), existing customers (37%) and new products/services (16%).

In considering organic growth strategic initiatives, when compared to the past 12 months, a balance of 77% consider the acquisition of new customers to have become more important and 62% for the retention of existing customers.

In addition, 23% of asset management companies foresee the launch of new products and services to be more important for growth when compared to the past 12 months.

In considering inorganic growth initiatives, a balance of 69% of respondents foresee a decrease in the importance of engaging in M&A transactions within the asset management industry for the coming 12 months.

In considering enablers for growth when compared to the past 12 months, one notes sales force and distribution channels (31%) and IT systems and applications (31%) to be the most important, followed by brand and advertising (8%). CRM capabilities and performance measurement tools are deemed by the majority to be less important.
Thematic issues
Malta’s competitiveness as a financial services centre

Respondents were asked to gauge Malta’s competitiveness as a Financial Services Centre over the past 6 months. Respondents found competitiveness within the Banking and Insurance sectors to have remained more or less unchanged compared to 6 months ago. On the other hand, asset management firms feel that Malta’s competitiveness has declined. On this basis, the overall industry index is -17% as compared to -9% 6 months ago.
**Brexit**

As the EU’s second largest economy, and having enjoyed close ties with Malta for over two centuries, the UK is one of Malta’s key trading partners.

We asked respondents to provide us with insight on their views with regards to the implications of Brexit on their business, both during the negotiation stage and after.

The majority of respondents (80%) indicated that during the prescribed two year negotiations stage, they expect the impact on their business to be neutral, with only 11% of respondents expecting the effects to be negative. Following the negotiations, 69% of respondents still envisage Brexit to be neutral to their business, with 17% expecting their business to benefit.

Looking at the individual sectors, the banking sector appears to be the most resilient with 82% expecting Brexit to be neutral to their business in the longer term post negotiations. In insurance, this figure drops slightly to 73%. Clearly, asset management companies expect the most change arising from Brexit, with about 54% of respondents expecting the long term situation to remain unchanged, and with 31% of respondents expecting a positive effect on their business post-Brexit.
Fintech

The Fintech industry refers to all technological innovations in the financial sector and includes anything from mobile-apps for conducting payments to peer-to-peer lending sites and even crypto-currencies. As part of an increasingly globalised world, stakeholders in Malta's financial services industry need to be aware of the threats and opportunities associated with Fintech.

In this survey, respondents in the Banking and Insurance sectors were asked to identify to what extent they believe the growth of Fintech affects their business. Fintech appears to be seen as a long term opportunity in both sectors, with 64% of banking respondents and 55% of insurance respondents indicating as such. However, a portion in both sectors outlined it as a threat in the long term, (banking 27%, insurance 18%), or a threat in the short term (banking 9%, insurance 27%).

Thus, it appears that while the majority perceive Fintech as an opportunity in the long run, none see it as an opportunity in the short term. This could imply that respondents do not feel they currently have the technological readiness to capitalise on the potential opportunities offered by Fintech.

Cybersecurity

Cybersecurity refers to the protection of networks, computers, programs and data from unauthorised access. Given the sensitive data that service providers in the banking sector handle on a daily basis, cybersecurity is a very relevant concern.

In this survey, banking sector respondents were asked their views on cybersecurity, given its increasing importance in a data-driven economy. 45% of respondents indicated that the threats to cybersecurity and the ability to defend against them were a growing concern. The same portion view this as a managed risk, while only 9% feel that this is a receding risk.