LOMBARD

Lombard Bank Malta p.l.c.

2017

ANNUAL REPORT

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ANNUAL REPORT
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During 2017 banking activity was again conditioned by a challenging operating environment. It is therefore encouraging to note that the changes to our business model introduced in previous years in response to record low interest rates and an increasingly demanding and costly regulatory regime, together with more recent initiatives designed to further diversify sources of income and to increase operational cost effectiveness, have begun to yield the desired results in support of Lombard Bank Malta p.l.c.'s underlying profitability.

Despite the downward pressure exerted by persistently low-to-negative market interest rates, net interest income registered a further improvement. As in the previous year this was the combined result of an increase in interest received and lower interest payable. The former was entirely attributable to substantial growth in the loan book in the context of a rapidly expanding economy even as interest rates charged to borrowers continued to drop in a competitive credit market. Revenue from the investment portfolio, which is almost entirely composed of low-risk domestic central bank balances and government securities, fell again in 2017 under the impact of negative interest rates associated with the ECB's accommodative monetary policy. The improvement in the net interest margin was also partly due to a further decline in the interest paid out to depositors. This was the outcome of a combination of factors: a marked shift in customer preference towards short-term deposits at the expense of interest-bearing term accounts, on the one hand, and lower average rates on the latter, on the other.

The contribution of the Bank's core deposit-taking and lending operations to income generation was supplemented by increased inflows of fee and commission-based income generated mainly by transaction and international banking business. The recruitment of more investment services specialists during the year as part of the Bank's diversification strategy should result in more growth in this area. Together with the increase in net interest income mentioned earlier, these activities made for a higher level of total operating income, even after adjustment for the substantial one-time gain recorded in 2016.

The Bank's operating expenses rose faster than income in 2017 such that the cost-to-income ratio increased after falling the previous year, though remaining at an acceptable level. While the staff complement grew only slightly, related costs were inevitably higher as the Bank sought to satisfy the need for more specialized expertise and to retain existing staff in a tight labour market. The growing regulatory and compliance obligations also called for more investment in human resources and information technology hardware and software as well as considerable payments of professional fees.

Since the quality of the loan portfolio registered a marked improvement in 2017, largely reflecting the success of the Bank's efforts to reduce its non-performing exposures, a smaller amount was required to be set aside in the shape of impairment allowances than in 2016, such that the profit before tax increased to €7.5 million. The Board is again this year recommending a gross payout of four cent per share.

This result further consolidated the Bank's capital buffers and hence its capacity to expand its lending activities and to absorb potential losses. The total capital ratio stood at 14.3% at year end, well above the regulatory minimum of 8%, while the leverage ratio was 9.8%, more than three times the required level. The liquidity ratio fell slightly but, at 65.3%, was still more than twice the statutory minimum level. The Bank's financial strength is also evidenced by another addition to shareholders' funds, which reached €96.1 million in 2017.

A satisfactory performance was also recorded by the Bank's subsidiary, MaltaPost p.l.c., with an increased pre-tax profit of €3.1 million, achieved in spite of a continued downward trend in Letter Mail volumes and a highly competitive environment in the area of parcel post, as well as higher staff and other fixed costs. This outcome once again validates the Bank's decision to acquire a strategic stake in MaltaPost p.l.c. in 2006 and encourages the Company to actively pursue its current initiatives, mainly by way of postal products and document management and financial services, while also not overlooking new opportunities for growth.

Chairman's Statement to the Members

Going forward the Bank is facing challenges on a number of fronts ranging from an increasingly competitive market, the prospect of continuing low interest rates and advances in technology which threaten the traditional modes of delivery of banking services, on the one hand, to ever tighter and costlier regulation and the imposition of stricter provisioning and capital requirements, on the other. The Board of Directors is confident, however, that the Bank's strong market presence and its robust balance sheet fundamentals represent a solid base from which to successfully pursue the objective of meeting changing customer needs while ensuring long-term financial sustainability.

In this regard consideration will be given to a further expansion of the Bank's capital base and to this end the Board is examining the possibility of an increase in Tier 1 capital by means of a rights issue. This would allow the Bank to continue to grow while also permitting it to meet possibly even higher minimum levels of regulatory capital. The introduction of a new international accounting standard in 2018 requiring higher levels of provisioning will represent another claim on available resources.

At the same time the Board will continue to implement the growth strategy already in place, with a particular focus on new products and services such as home loans and investment funds, to create a broader income base needed to meet higher operating costs and to add shareholder value. This will be accompanied by more investment in systems and human resources to deal with the challenge posed by the rapid pace of change in financial technology. Emphasis will also continue to be placed on the Bank's plan to reduce non-performing loans, which is well on track to achieve the set targets.

During the past year the Board made repeated efforts to resolve the issue surrounding the 49.01% shareholding owned by Cyprus Popular Bank Public Co Ltd (CPB). These included our offer to buy back these shares, which initiative, however, was not supported by CPB itself at the last Annual General Meeting. This would have resulted in a greater participation by small shareholders in the Bank's capital, thus ensuring that no single shareholder would be in a position to influence the direction of the Bank to his own advantage. Furthermore, it would have also opened up the possibility for the Board to reactivate its beneficial staff share ownership scheme. In the circumstances, the failure of the CPB Special Administrator to find a suitable investor was prolonged even further.

The Bank achieved satisfactory financial results in 2017, in spite of the difficult operating environment and the fact that it cannot benefit from the economies of scale available to larger institutions. The year's positive outcome would not have been possible without the professional competence, commitment and integrity of the staff and the management team ably led by the Chief Executive Officer, Joseph Said. On behalf of the Board I would like to thank them, as well as you the Bank's shareholders for your support and all our customers for their continued loyalty, and to assure you all of the Board's firm commitment to good corporate governance.

Michael C. Bonello
Chairman

Chief Executive Officer's Review of Operations

The results of the Group for the financial year ended 31 December 2017 combine the financial performance of Lombard Bank Malta p.l.c. and Redbox Limited, which is the company holding the Bank's shares in MaltaPost p.l.c.

Summary Overview

During the year under review the eurozone experienced a healthy economic expansion. Although at the start of 2018 there was a softening of eurozone economic sentiment, resulting mainly from a markedly lower confidence in services and retail trade, there seems to be general consensus that the European economy is set to continue gathering momentum. In December 2017 the ECB reported an improvement in private consumption, underpinned by ongoing employment gains and strong investment as a result of favourable financing conditions. However inflation rate remained below target and in December the ECB Governing Council reported that a significant degree of monetary stimulus was still necessary. As a consequence interest rates were kept at their historic low and the asset purchase programme was maintained, albeit at a slower pace.

Malta maintained a healthy economic performance that was also driven by favourable domestic and external conditions. For the period 2018-2020 domestic demand is forecast to become the major contributor to economic growth resulting from continued strength in private and government consumption.

On the back of an economy that is doing well, regulators pressed on with action to reduce Non Performing Exposures of credit institutions by the issue of new accounting standards. Whereas past guidelines focused on existing non performing exposures the revised regulations will now also focus on probable non-performers. At the Bank we continue dedicating suitable resources and remain fully committed to satisfy all regulatory requirements in this regard - irrespective of the fact that our non-performing exposures are in the majority both manageable and also well collateralised.

Overall therefore the underlying business performance was encouraging. We continued to invest in development along three main lines: commercial lending, retail and transaction banking, and investment services.

In commercial lending we remained focused on establishing long-term relationships. In retail banking, particularly home loans and cards, we invested in systems and processes, as well as planned the launch of new product packages. Transaction banking, particularly that relating to our International Business Banking activity, remained a significant source of fee income as did earnings from foreign exchange transactions. In investment services we proceeded with the recruitment of specialised staff and our efforts to launch our first products, expected in 2018, gathered momentum.

For its financial year ended 30 September 2017, MaltaPost realised a 4.1% increase in its Profit Before Tax, reaching €3.1 million with this subsidiary remaining a key player within the Group.

In Malta, reflective also of international trends, traditional Letter Mail continued on its downward trend. On the other hand the volumes of parcels grew healthily even though competition from other operators was not lacking. This scenario does not discourage us at all. Indeed it spurs us to assist in the fulfilment of the diversification strategy at MaltaPost, particularly but definitely not limited to the areas of Document Management and Financial Services. We are also committed to see that this subsidiary of ours remains the foremost provider of postal services of these Islands and a key strategic asset of the Bank.

Review of Financial Performance

For the financial year ended 31 December 2017 the Group's Profit Before Tax rose by 7.7% to €8.87 million. Notwithstanding that interest rates generally remained at record low levels, we still managed to increase interest income mainly from Credit operations. Whereas our general business activity could easily have developed at a faster rate, our culture however dictates that our relations be limited to those customers who meet our exacting standards. We remain most conscious of the fact that the pursuit of short-term gains presents a dangerous path. Consequently foremost on our mind is the development of long-lasting and robust relationships thereby also reassuring our customers that Lombard is their all-weather partner.

Net Interest Income at €15.43 million rose by 8.7% as a result of increased customer lending, and also because of lower cost of deposits - as customers continued to migrate towards shorter term deposits.

Transaction banking activity also resulted in higher fee and commission income.

The increase in Other Operating Costs for the Group includes those related to Risk Management and Compliance.

Employee Compensation and Benefits increased by 12.6% to €19.95 million in part as a result of the challenges being faced in recruiting and retaining the right calibre of staff that meet the standards set by the Group. The constant updating of the Group's electronic and technology infrastructure remains driven by the dynamic nature of its business and again this year proved to be a major area of investment. Considerable time and effort were also spent on Compliance and regulatory matters. Consequently the Bank's Cost Efficiency Ratio rose to 51.4% (FY 2016: 46.8%) while that of the Group stood at 79.6% (FY 2016: 73.2%), reflecting the high volume, low margin and also the significant human resource requirements of the postal business. Although seemingly high, these ratios remain well placed when compared to other operators in the respective industry segments.

Our efforts to reduce Non Performing Exposures brought significant improvements as such customers now better understand the need to abide by agreed terms and conditions. Impairment Allowances for individually assessed exposures were set as in previous years, using prudent criteria, while also taking into account the high quality of collateral held. Total Impairment Allowances rose by €2.84 million in 2017, compared to an increase of €3.95 million in 2016. It is to be noted that a significant portion of the Specific Impairment Allowance relates to the element of interest accrued on such exposures. As from 2018, Impairment Allowances will be based on statistical calculations as prescribed by the new accounting standard IFRS 9. The methodology and actual calculations are still in the process of being finalised.

Our Loans and Advances to Customers increased by 24.8% to €428.61 million from €343.49 million. This was the result of our conscious efforts to diversify our loan portfolio away and also by entering the Home Loan sector. Loans and Advances to Deposits Ratio stood at 58.5% compared to 47.6% at the start of the year.

Liquidity and Own Funds

In spite of the difficult financial scenario, we actively sought to manage our liquidity and limit the adverse effect of negative interest rates. Customer deposits increased by €11.59 million (1.6%) to €733.15 million.

Total assets as at FYE 2017 stood at €882.75 million (2016: €862.73 million), while Equity Attributable to the Shareholders of the Bank increased by a further 2.5% to €96.1 million. Net Asset Value (NAV) per share stood at €2.18 (2016: €2.12), while Group Earnings per Share (EPS) increased to 11.6 cent. Return on Assets (ROA) increased marginally to 0.6% while Post Tax Return on Equity (ROE) was 5.4% (2016: 5.2%).

Treasury Management

Treasury opportunities remained elusive, and as a result we frequently incurred negative interest rates on placement of funds, as we continue to prefer capital protection to short term interest gains. Also, the movement into positive territory of interest rates on USD and GBP had minimal impact on our Treasury earnings given that our balance sheet is predominantly euro-based.

Our strategy of investing in the local economy continued and our positions mainly consisted of Malta Government Treasury Bills and Stocks. Negative yields on Treasury Bills were marginally better than those on funds placed with the ECB.

Year-end balances held with the Central Bank of Malta stood at €130.30 million (2016: €44.26 million). The increase resulted mainly from USD and GBP deposits placed with the CBM in view of the reasonably competitive money market interest rates offered when compared to those offered by other market counterparties.

Correspondent Banking

The trend of most leading international banks to de-risk by reducing their number of correspondent relationships presented a considerable challenge. Despite this we still retained our network of respected and leading correspondent banks. By no means was this accidental.

It is only because we consciously adopt a thorough and uncompromising approach when onboarding new customers; have in place strict ongoing monitoring of relationships and simply do not entertain business in those sectors and activities, which most leading international banks also keep away from. We are firm believers in the tenets that prudence is foresight and that an impeccable reputation is earned not simply inherited.

Risk Management

Risk identification, management and mitigation pervade all of our activities. Risks inherent in the Bank's operations are identified, quantified and monitored on a frequent basis using sound and recognised quantitative methods. Our Risk function is active in all of the Bank's internal committees and working groups, in the formulation of new or review of current operational processes and in related decision-making processes.

Stress tests on our financial risks were frequently conducted using various adverse internal and external scenarios relevant to the Bank's business model. Other stress testing carried out included that on the resilience of our IT network.

Pillar I requirements and any additional regulatory buffers were fully met while our Internal Capital Adequacy Assessment Process (ICAAP) confirmed that 'Pillar II' risks not fully catered for under 'Pillar I', were also fully complied with. Additionally, our Internal Liquidity Adequacy Assessment Process (ILAAP) ensured that the Bank had the necessary liquidity.

At year-end we had a Common Equity Tier 1 (CET1) Ratio of 14.1% on a CRD IV basis, which is over three times the minimum requirement of 4.5%; while Total Capital Ratio stood at 14.3%, well over the minimum 8% requirement. The Liquidity Coverage Ratio as at 31 December 2017 stood at 302.1% exceeding future minimum regulatory requirements and ensuring the financial stability of the Bank.

Human Resources

A headwind we faced was in recruitment, especially in entry-level staff where availability remained scarce and candidates' expectations are increasingly demanding. There is no doubt that the labour market in Malta has changed drastically as job mobility is widespread and not limited to within the financial services sector. We also took measures to improve staff engagement and retention in an effort to maintain a work force of the right size and quality - an absolute must if we are to meet objectives and deliver positive results. We continued to invest in the skills and development of our staff by providing internal and external training and development opportunities coupled with on-the-job training.

Chief Executive Officer's Review of Operations

Promoting our culture and values remained key in our dealing with matters relating to human resources and important factors in the assessment of performance.

The staff complement at the Bank stood at 166 while that of the Group reached 900 full time equivalents.

Projects

We acquired a property in Santa Venera where we plan to build the Bank's operations centre and we also intend to extend our branch network while also refurbishing existing ones. MaltaPost also made further acquisitions replacing inadequate outlets and carried out renovation of a number of others. There is no doubt that the Lombard-MaltaPost link is a success as both entities share and benefit from the strengths and competences of each other. Products and services such as *PostaHomeLoan* and also *PostaPay&Save* will be followed by others. While both these services are 'powered' by Lombard Bank, MaltaPost provides the necessary reach while concurrently adapting to the changes that the postal industry is experiencing. All dealings are carried out at arm's length and the harnessing of substantial and intertwined synergies between the two entities coupled with knowledge transfer have helped increase efficiency and also enhanced customer experience.

Community Involvement and Corporate Social Responsibility

The Group maintained its community involvement by supporting various initiatives and entities including the Malta Community Chest Fund, Id-Dar tal-Providenza, Inspire, Puttinu Cares, Volserv and several others.
We do not believe that fulfilment of one's social responsibility should serve as a public relations exercise - hence our unobtrusive approach in this area.

Outlook

Positive results, a healthy brand and sound fundamentals encourage us to face the coming year with optimism. The local economic climate is set to remain healthy during 2018 and we shall ensure that within this scenario our approach to business remains prudent and consistent with our values - even though the one-size-fits-all regulation does at times tend to somewhat dampen one's risk appetite.

Our business model is simple yet robust. It has stood the test of time and events, not least the global financial crisis, which brought down many a mighty financial institution. We therefore have no intention of changing it, and will resolutely utilise our core competencies in areas where we have consistently proven we excel.

Joseph Said
Chief Executive Officer

Directors' Report

The Group

The Lombard Bank Group (the Group) consists of Lombard Bank Malta p.l.c. (the Bank), Redbox Limited and MaltaPost p.l.c., a subsidiary of Redbox Limited. Tanseana Limited is a subsidiary of MaltaPost p.l.c.

Principal Activities

The Bank was registered in Malta in 1969 and listed on the Malta Stock Exchange (MSE) in 1994. It is licensed as a credit institution under the Banking Act, 1994 and is an authorised currency dealer and financial intermediary. It also holds a Category 2 Investment Services licence issued by the Malta Financial Services Authority (MFSA) in terms of the Investment Services Act, 1994. It is a member of the Depositor Compensation Scheme and the Investor Compensation Scheme set up under the laws of Malta. The Bank is also a member of the MSE for the purpose of the carrying out of stockbroking on the MSE. The Bank has a network of seven branches in Malta and Gozo providing an extensive range of banking and financial services. A list of branches, outlets and departments is found on page 28 of this Annual Report.

Redbox Limited, a company virtually wholly owned by the Bank, was registered in 2006. During the year under review, Redbox Limited continued to serve as the special purpose vehicle holding, as at 31 December 2017, the Bank's 71.5% shareholding in MaltaPost p.l.c, with the remaining 28.5% of the ordinary share capital of MaltaPost p.l.c. being held by the general public. MaltaPost p.l.c. was listed on the Malta Stock Exchange on 24 January 2008. MaltaPost p.l.c. is Malta's leading postal services company, being the sole licensed Universal Service Provider of postal services in Malta.

Tanseana Limited was established in 2016 to carry out the document management services and other related services being offered by MaltaPost p.l.c.

Review of Performance

An overview of the development in the Bank's business and that of its subsidiaries during the year under review together with an indication of likely future developments may be found in the 'Chief Executive Officer's Review of Operations' of this Annual Report.

Results for 2017

Profits after taxation of €5.7 million and €4.8 million for the Group and the Bank, respectively were registered for the twelve months ended 31 December 2017.

A gross dividend of 4 cent per nominal 25 cent share (net 2.6 cent) for the twelve months ended 31 December 2017 is being proposed for approval by the shareholders. A Resolution to this effect will be proposed to the Annual General Meeting.

Board of Directors, Senior Management and Heads of Department

The composition of the Bank's Board of Directors, Senior Management and Heads of Department is shown in the section on 'Company Information' on page 27 of this Annual Report and further information is given in the 'Statement of Compliance with the Principles of Good Corporate Governance'.

Risk Management

The Financial Risk Management note to the Financial Statements (note 2), illustrates the process of how the Group identifies and manages its risks and uncertainties. The main categories of risk described in this note are credit risk, market risk, liquidity risk and operational risk. The same note includes extensive detail of the processes undertaken by the Bank to manage these risks.

Directors’ Report

Statement of Directors’ Responsibilities for the Financial Statements

The Directors are required by the Companies Act, 1995 to prepare financial statements which give a true and fair view of the state of affairs of the Group and the parent company as at the end of each reporting period and of the profit or loss for that period.

In preparing the financial statements, the Directors are responsible for:

- ensuring that the financial statements have been drawn up in accordance with International Financial Reporting Standards as adopted by the EU;
- selecting and applying appropriate accounting policies;
- making accounting estimates that are reasonable in the circumstances; and
- ensuring that the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business as a going concern.

The Directors are also responsible for designing, implementing and maintaining such internal controls as they deem necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the Companies Act, 1995 and the Banking Act, 1994. They are also responsible for safeguarding the assets of the Group and the parent company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The financial statements of the Bank for the year ended 31 December 2017 are included in this Annual Report, which is being published in printed form and made available on the Bank’s website. The Directors are responsible for the maintenance and integrity of the Annual Report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the Bank’s website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

Statement of the Directors pursuant to Listing Rule 5.68

The Directors confirm that, to the best of their knowledge:

- the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2017, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU; and
- the Annual Report includes a fair review of the development and performance of the business and the position of the Bank, together with a description of the principal risks and uncertainties that they faced.

Investment Services Rules for Investment Service Providers

In accordance with Rule R4-5.3.5 of the Investment Services Rules for Investment Service Providers regulated by the MFSA, licence holders are required to disclose any regulatory breaches of the Rules or other regulatory requirements in this Annual Report. Accordingly, the Directors confirm that no breaches of the Rules and no other breach of regulatory requirements, which were subject to an administrative penalty or other regulatory sanction, were reported.

Information provided in accordance with Listing Rule 5.70.1

There were no material contracts to which the Bank, or any of its subsidiaries were a party, and in which any one of the Bank’s Directors was directly or indirectly interested, except for transactions disclosed in note 37 to the financial statements.

Going Concern

In compliance with Listing Rule 5.62 and after having duly considered the Bank's performance, the Directors declare that they expect the Bank will continue to operate as a going concern for the foreseeable future.

Listing Rules – Disclosures

In terms of Listing Rule 5.64, the Directors are required to disclose the following information.

As at the Annual General Meeting held on the 27 April 2017, the authorised share capital of the Bank was €20,000,000 made up of 80,000,000 ordinary shares of a nominal value of 25 cent each. As at that date the issued and fully paid-up share capital of the Bank was €11,044,479 divided into 44,177,914 ordinary shares of a nominal value of 25 cent each, all of one class. As at 31 December 2017 the authorised and issued share capital remained the same.

Equity attributable to shareholders as at 31 December 2017 stood at €96.1 million.

Amendments to the Memorandum and Articles of Association of the Bank are effected in conformity with the provisions in the Companies Act, 1995. Furthermore, in terms of the Articles of Association:

- Directors may be authorised by the Bank to issue shares subject to the provisions of the Memorandum and Articles of Association and the Companies Act;
- Directors may decline to register the transfer of a share (not being a fully paid share) to a person of whom they shall not approve;
- Directors may decline to recognise any instrument of transfer, unless accompanied by the necessary evidence;
- no registration of transfers of shares shall be made and no new particulars shall be entered in the register of members when the register is closed for inspection; and
- the Bank may, from time to time, by extraordinary resolution reduce the share capital, any Capital Reserve Fund, or any Share Premium Account in any manner.

Currently there are no matters that require disclosures in relation to:

- holders of any securities with special rights;
- employee share schemes;
- restrictions on voting rights or relevant agreements thereto;
- significant agreements to which the Bank is a party and which take effect, alter or terminate upon a change of control of the Bank; or
- agreements providing for compensations on termination of Board members or employees.

The rules governing the changes in Board membership are contained in the 'Statement of Compliance with the Principles of Good Corporate Governance'.

Shareholders holding five per cent (5%) or more of the share capital of the Bank:

	Shares in Lombard Bank Malta p.l.c.	
	at 31 December 2017	at 7 March 2018
Cyprus Popular Bank Public Co Ltd	49.01%	49.01%
GlobalCapital Life Insurance Ltd	5.55%	5.55%
First Gemini p.l.c.	5.31%	5.31%

Directors' Interest in Group Companies

Joseph Said, who is a Director of the Bank, is also a Director of the following companies that have a shareholding in the Group as follows:

Directors' Report

	Shares in Lombard Bank Malta p.l.c.	
	at 31 December 2017	at 7 March 2018
Safaco Ltd	42,188	42,188
First Gemini p.l.c.	2,344,134	2,344,134

	Shares in MaltaPost p.l.c.	
	at 31 December 2017	at 7 March 2018
Safaco Ltd	44,745	44,745
First Gemini p.l.c.	36,341	36,341

In addition Joseph Said holds preference shares in Safaco Ltd.

Other Matters

In 2016 the Bank had been notified that the Special Administrator of Cyprus Popular Bank Public Co Ltd (CPB) approved the disposal of CPB's shares held in the Bank, and that notice was given to the MFSA for the purposes of the provisions of Article 13(3) of the Banking Act and Article 10(2) of the Investment Services Act. (Refer to Company Announcement LOM 206) The Bank was later informed that a sale process was launched for the sale of the same shares. The Bank participated by lodging an expression of interest and indicative offer in terms of this process. The appropriate resolutions were put before the shareholders at the 2017 Annual General Meeting in this regard. (Refer to Company Announcement LOM 216) These resolutions were not carried by the Annual General Meeting. The Bank understands that CPB is still seeking to sell its shares. As at the date of approval of this Report by the Board of Directors, the Bank has not been informed of any share transfer by CPB and the above-mentioned shares are still held in the name of CPB.*

Audit & Risk Committee

The Audit & Risk Committee is composed of non-executive Directors and is intended to ensure effective internal controls, compliance and accountability. The Committee also acts to ensure that high ethical standards are maintained, as explained in the 'Statement of Compliance with the Principles of Good Corporate Governance' in another section of this Annual Report.

Auditors

PricewaterhouseCoopers have expressed their willingness to continue in office as auditors of the Bank and a resolution proposing their reappointment will be put at the forthcoming Annual General Meeting.

Non-Financial Statement

The Companies Act requires that a non-financial statement be included in this report containing information on the Group's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters and this in the form of particular disclosures on certain aspects. In seeking to comply with these obligations, guidance was sought from the European Commission Guidelines on non-financial reporting (methodology for reporting non-financial information) (2017/C 215/01).

The Bank is a Malta-based bank and for financial stability purposes is considered by the Central Bank of Malta as a core domestic bank (1 of 6 local core domestic banks). The Bank extends credit mainly to local corporate customers, the majority of whom are selected by the Bank itself. Such facilities are funded by a diversified deposits base and underpinned by solid capital and liquidity ratios. The Bank has never relied, and does not intend to rely, on the interbank market for its funding requirements. This approach to business enhances our image and facilitates pricing decisions. In this respect the Bank seeks to progress slowly, prudently yet surely, as evidenced by its track record of comparatively low write-offs.

In recent years, the Bank sought to broaden its product and services portfolio in a manner which complements rather than crowds out its traditional business focus, by venturing into the business of credit cards, home loans and investment services. As a result the Bank continues to invest in the development of business along three main lines, viz commercial lending, retail and transaction banking and investment services.

The Bank's business model is based on building stakeholder value by delivering financial services and solutions in a prudent, yet innovative and cost effective way and by setting the highest standards in professional behavior. The Bank's competitive strengths are in its unique business operating model, its conservative outlook towards risk and its financial strength. The characteristics of its model give the Bank a competitive advantage, enabling it to continue to deliver value to all its stakeholders in a challenging and highly competitive environment.

The Bank's acquisition of the majority shareholding of MaltaPost p.l.c. facilitates its induction to financial services, intended to target a market segment different from that of the Bank and this within the diversification strategy adopted by MaltaPost p.l.c.

MaltaPost p.l.c. is Malta's leading postal services company, being the sole licensed Universal Service Provider of postal service on the Maltese Islands in terms of the Postal Services Act (Chapter 254 Laws of Malta) and under the terms of the Universal Postal Union Convention and Constitution on behalf of the Government of Malta. It is regulated by the Malta Communications Authority and holds a network of 40 Post Offices and 32 Sub Post Offices around Malta and Gozo providing an extensive range of postal and financial services.

Tanseana Limited, MaltaPost p.l.c.'s subsidiary, was established to enter into any agreement or make any arrangement relating to the company's business to provide document management services and to carry on such services which include, but are not restricted to, scanning, printing, shredding, storage and retrieval of digital and/or physical documents.

MaltaPost p.l.c. seeks to remain the trusted postal and logistics operator offering a comprehensive product portfolio. The company is well positioned to execute this strategy also in view of its widespread representation, in many cases in core community locations, which benefit from high footfall and walk in custom.

As eCommerce traffic continues to grow at significant rates, MaltaPost p.l.c.'s strategy will necessitate closer concentration on this area of business and the related logistics market so as to keep up with demand and higher expectations.

The Board of Directors pursues policies and practices designed to meet all regulatory and legal requirements and also to assist in the discharge of its responsibilities and in the execution of its business model and strategy. The Board's functions are fully described in its Charter, which is reviewed periodically. The purpose of the Charter is to promote high standards of corporate governance and clarify the role and responsibilities of the Board and its committees, which enable the Board to provide strategic guidance for the Bank and provide effective management oversight. The oversight function concerns the review of management decisions, including approval of major decisions, the adequacy of systems and controls and the implementation of policies.

The effectiveness of the adopted policies is evidenced by, among other things:

- the Group's strong ethical culture based on trust, integrity and professional behavior;
- the rigorous custodianship of customers' deposits and shareholder capital;
- the pursuit of long-term corporate and financial objectives as against short-term gains;
- assurance of ongoing compliance with all applicable laws and regulations;
- risk awareness and oversight in the determination of risk appetite and risk profile;
- adoption of the four eyes principle in a manner which pervades all operations; and
- accountability through suitable reporting frameworks.

The Group's strong governance framework is supplemented by a clear organisation structure and reporting lines, and well defined procedures embedded in processes throughout the Group and is subject to ongoing review.

As stated above, the Financial Risk Management note to the Financial Statements (note 2) sets out the process of how the Group identifies and manages its risks. The principal risks discussed in the note are credit risk, market risk, liquidity risk and operational risk. The processes undertaken by the Bank to manage these risks are explained therein.

Social and employee matters are given full attention by the Group. The Group's human capital is a key resource for the carrying out of business. The ability to attract and retain human resources of the right skill, mix and experience condition to a large extent the Group's performance. The risk of not attracting or retaining the appropriate quality staff in line with the Group's business needs is mitigated generally by the approach to managing this resource and specifically through a number of measures. Information on employees is found in note 30 to the Financial Statements.

In this respect staff engagement is considered an important factor for the Group. During the year under review a staff engagement survey was run at the Bank by an independent third party with a 91% participation rate with satisfactory and informative results which are being reviewed. Group staff associations are supported through funding and other initiatives.

The Group is committed to ensuring the highest levels of health and safety and physical security of staff as well as their general well-being and that of their dependents. Staff members benefit from private health care insurance, as well as death in service and personal accident insurance cover. Occupational health awareness training is also provided. The Group carries out health and safety risk assessments to ensure that situations that may pose risks to the health and safety of staff and others on Group premises are identified and mitigated.

Investing in learning and development equips staff members with the knowledge and expertise to work in line with applicable internal policies and handbooks. Fully fledged training facilities are in place with a training manager responsible for keeping staff members well trained. During 2017, Bank staff members spent an average of more than 2 days each on training while MaltaPost p.l.c. staff members spent an average of 1 day each. This excluded on-the-job training.

All staff is treated on equal terms as regard training, career development and appointments and supports gender equality and diversity. Remuneration levels are regularly reviewed to ensure that they are in line with the Group's Remuneration Policy.

The Group encourages engaged and enabled colleagues. Positive conduct is reinforced and Group culture promoted. The Group abides by all applicable laws, rules and regulations relating to employment. While conscious of the fact that the legal obligations are the minimum acceptable standard, the Group strives to surpass standards in this area. The Group, for example, well exceeds the obligation of 2% in respect of the employment of persons with disabilities, which is an expression of its social outlook.

The Group holds and processes confidential data and for this purpose has the necessary data protection policies, procedures and safeguards to prevent the unlawful use of data, whether this might be as a consequence of data protection and / or human rights considerations.

The Group is satisfied with its non-financial performance in respect of staff related matters in areas such as work flexibility and well-being. Group staff members make use of family friendly measures which the Group commits to developing further. Performance in the area of adoption by staff of the Group's culture and values is considered satisfactory and is manifested in the interaction with customers, among colleagues and in the general manner in which staff members conduct themselves.

Directors' Report

The Group strives to conduct business in a way that not only protects but also values and respects the ***human rights*** of all stakeholders. For example, economic sectors that may be linked to violation of human rights or to social vices are avoided and services that promote financial inclusion have been introduced. Financial inclusion is considered to improve people's overall welfare and social development.

The Group has a zero tolerance to ***bribery and corruption*** and breaches of the relative laws and regulations. Bribery and corruption are serious criminal acts and the Group strives to act with integrity, care and diligence in all undertakings. Policies, procedures and controls such as those deriving from anti-bribery and corruption and whistle-blowing policies, are embedded in the Group's structures in order to ensure that staff members act responsibly within the work place and outside. The same standards are expected from any third parties providing services for or on behalf of the Group. Staff members who fail to comply with the Group's policies and standards may face disciplinary action, up to and including dismissal or termination of employment. Training sessions on these policies are planned to keep staff members abreast of their obligations at all times.

The Group is mindful of its obligations to safeguard the environment as much as possible and aims to minimise the ***environmental*** impact of its business particularly when assessing applications for financing of certain projects. Besides assisting in the reduction of costs, being environmentally friendly and taking measures to reduce its carbon footprint fits within the overall corporate social responsibility objectives of the Group. Measures are in place to reduce and recycle waste, procure energy efficient equipment, and periodically update the Group's motor vehicle fleet with reduced fuel emissions and electrically powered models. PVA panels have been installed with plans to extend installations on newly acquired premises.

The Group has renovated a number of buildings, some acquired in a derelict state, and converted them into modern and functional branches / offices. Premises, including self-service areas and ATMs, meet all accessibility regulations, apart from where physical restrictions make this impossible, in which case discussions with the relevant regulating bodies are held. '*Restoration with respect*' is a motto the Bank abides by in its endeavours to save buildings of an architectural heritage and value, delivering them back to society in their original grandeur. Awards were received for outstanding and significant contribution to Maltese cultural and architectural heritage. The Group is committed to continuing its work in this regard. MaltaPost p.l.c. also set up a postal museum in a restored building in Valletta, which houses an extensive collection of artefacts related to Malta's history as depicted in postal material.

The Group remains committed to dedicating resources to the matters outlined above which it considers to be important aspects of its varied and extensive business activities.

Approved by the Board of Directors on 8 March 2018 and signed on its behalf by:

Michael C. Bonello
Chairman

Joseph Said
Director and Chief Executive Officer

* Since the approval of this Directors' Report on 8 March 2018, the Board of Directors was notified that pursuant to a share purchase agreement dated 16 March 2018, the National Development and Social Fund (NDSF) agreed to acquire from Cyprus Popular Bank Public Co Limited (CPB) 21,651,746 ordinary shares in the issued share capital of the Bank, representing 49.01% of the total issued share capital of the Bank . This purchase is subject to a number of conditions. (Refer to Company Announcement LOM223)

Statement of Compliance
with the Principles of Good Corporate Governance

A. Introduction

In terms of the Malta Financial Services Authority (MFSA) Listing Rules (Listing Rule 5.97), Lombard Bank Malta p.l.c. (the Bank), as a company having its securities admitted to trading on a regulated market, is obliged to report on the extent to which it has adopted the '*Code of Principles of Good Corporate Governance*' (the Principles) embodied in Appendix 5.1 to Chapter 5 of the same Listing Rules, as well as the measures which have been taken by the Bank to ensure compliance with these Principles.

While the Principles are not mandatory, the Board of Directors of the Bank has endeavoured to ensure that they are upheld to the fullest extent possible, and this while acknowledging that good corporate governance is indeed beneficial to all the Bank's stakeholders. The instances in which the Bank has departed from the Principles are explained below under Section C – '*Non-Compliance with the Code*'.

After having carried out a review of the extent to which the Bank has been compliant with the Principles throughout the financial year ended 31 December 2017, the Board of Directors, in terms of Listing Rule 5.94, presents its report as follows:

B. Compliance with the Code

Principle 1: The Board

The Board of Directors of the Bank consists of five (5) Directors, four (4) of whom are non-executive Directors together with the Chief Executive Officer of the Bank who is also a Director. The Directors, individually and collectively, are considered fit and proper to direct the business of the Bank, having the necessary skills and experience to be able to do so.

In order to assist it in the execution of its duties and responsibilities, the Board of Directors has set up a number of committees and these include the Audit & Risk Committee, the Assets & Liabilities Committee and the Credit Committee, all of which are regulated by their own Terms of Reference as approved and periodically reviewed by the Board. During the year under review, the *ad hoc* committee which was previously set up by the Board tasked with carrying out suitability assessments and assessing Board and Committee evaluations continued to be convened and was confirmed to remain as a permanent Committee and named the Suitabilities & Evaluations Committee as regulated by its own Terms of Reference. Details regarding the composition of these committees are set out below in this report.

Principle 2: Chairman and Chief Executive Officer

Different individuals occupy the positions of Chairman and Chief Executive Officer. A clear division of responsibilities exists between the Chairman's responsibility for the running of the Board of Directors and the Chief Executive Officer's responsibility for the running and managing of the Bank's business. This separation of roles of the Chairman and Chief Executive Officer avoids concentration of power, authority and unfettered discretion in one individual alone and differentiates leadership of the Board from the running of the Bank's business.

The Chairman's responsibilities, *inter alia,* include: (i) leading the Board and helping it reach its full potential, particularly by facilitating the effective contribution of Directors and encouraging discussion; (ii) setting of the Agenda for Board meetings; (iii) ensuring that the Directors receive precise, timely and objective information so that they can take sound decisions and effectively monitor the performance of the Bank; (iv) ensuring that all strategic and policy issues are appropriately discussed and formally approved; and (v) maintaining effective communication with the Bank's shareholders at all times.

As stated below, the Chairman meets the independence criteria set out in the Principles.

On the other hand, the Chief Executive Officer is responsible for managing the day-to-day business of the Bank in conformity with the agreed plans, policies and strategies approved by the Board.

Principle 3: Composition of the Board

The following Directors served on the Board during the period under review:

Michael C. Bonello
Graham A. Fairclough
Kimon Palamidis
Joseph Said
Michael Zammit

All Board members are non-executive Directors who are not engaged in the daily management of the Bank, with the exception of Joseph Said who is also Chief Executive Officer of the Bank. Furthermore, the Board considers Michael C. Bonello, Michael Zammit, and Kimon Palamidis as independent Directors. Mr. Zammit is still considered to be independent despite the fact that he has served on the Board for more than twelve consecutive years. In determining the independence of its members, the Board has taken into consideration the relevant criteria and Principles as well as what are generally considered sound, acceptable standards. All non-executive Directors have declared in writing to the Board that they undertake:

- to maintain in all circumstances their independence of analysis, decision and action;
- not to seek or accept any unreasonable advantages that could be considered as compromising their independence; and
- to clearly express their opposition in the event that they find that a decision of the Board may harm the Bank.

It is considered that, in the circumstances, the size of the Board is sufficient for the requirements of the business and that the balance of skills and experience therein is appropriate to enable the Board to carry out its duties and responsibilities.

The composition and election of the Board of Directors is determined by the Bank's Articles of Association wherein it is established that it is the shareholders who must appoint Directors to serve on the Board. In addition, however, the Bank, by virtue of the Board-appointed Suitabilities & Evaluations Committee, carries out suitability assessments of its existing Directors and any new nominated Directors and the MFSA undertakes due diligence exercises in order to ensure that the suitability, fit and proper criteria are observed, pursuant to all applicable laws, rules, regulations, guidelines etc.

The Suitabilities & Evaluations Committee when carrying out suitability assessments of existing or nominated Directors takes into account a number of attributes in terms of applicable laws, rules, regulations, guidelines etc. The overall composition of the Board and the collective knowledge and expertise required are evaluated during each individual suitability assessment so as to ensure that the Board is effectively discharging all its duties and obligations at all times.

Taking into account the Bank's size, complexity and business model, the Board considers that as a policy and as reflected in its Board of Directors' Charter, it endeavours to have a varied board, particularly in terms of diverse educational and professional backgrounds and extensive and specialised experience of its members. The Board is confident that for this reason, and in light of the current circumstances in which it is operating (particularly the position of its qualifying shareholder Cyprus Popular Bank Public Co Limited), it benefits from a satisfactory diversity of views and expertise which allows for a good understanding of current affairs, the environment in which the Bank operates and longer-term risks and opportunities related to the Bank's business. It also benefits from international expertise and also employee representation in the form of an executive director.

The Board will consider formalising its diversity policy and remains committed to achieving further diversity among its members particularly in terms of number, age, gender, experience, educational and professional backgrounds. This, however, depends on the profiles of nominees proposed and their suitability in terms of applicable laws, rules, regulations, guidelines etc.

Principle 4: The Responsibility of the Board

In pursuing the execution of the four basic roles of corporate governance, namely, accountability, monitoring, strategy formulation and policy development, the Board of Directors, having the first level of responsibility for such execution:

- regularly reviews and evaluates corporate strategy, major operational and financial plans, risk policy, performance objectives and monitors implementation and corporate performance within the parameters of all relevant laws, regulations and codes of best business practice;
- applies high ethical standards and takes into account the interests of stakeholders and acts responsibly and with integrity and on a fully informed basis, in good faith, with due diligence and in the best interests of the Bank and its shareholders;
- recognises that the Bank's success depends upon its relationship with all groups of its stakeholders, including employees, suppliers, customers and the wider community in which the Bank operates;
- monitors effectively the application and implementation by Management of its policies and strategy;
- recognises and supports enterprise and innovation within Management and examines how best to motivate the Bank's Management;
- seeks to establish an effective decision-making process in order to develop the Bank's business efficiently; and
- ensures that a balance is struck between enterprise and control in the Bank.

Furthermore, the Board of Directors:

- defines in clear and concise terms the Bank's strategy, policies, management performance criteria and business policies and effectively monitors the implementation of such by Management;
- establishes a clear internal and external reporting system so that the Board has continuous access to accurate, relevant and timely information;
- has established an Audit & Risk Committee;
- continuously assesses and monitors the present and future operations' opportunities, threats and risks;
- evaluates the Management's implementation of corporate strategy and financial objectives;
- ensures that the Bank has appropriate policies and procedures in place to assure that the Bank and its employees maintain the highest standards of corporate conduct, including compliance with applicable laws, regulations, business and ethical standards;
- ensures that the financial statements of the Bank and the annual audit thereof are completed within the stipulated time periods; and
- requires Management to constantly monitor performance and report fully and accurately to the Board.

Furthermore, Directors are informed on an ongoing basis of their statutory and fiduciary duties, the Bank's operations and prospects, the general business environment and skills and competences of Senior Management. The expectations of the Board are also discussed regularly.

Principle 5: Board Meetings

The Board convened fourteen (14) times during the period under review with attendance as follows:

Michael C. Bonello	14
Graham A. Fairclough	14
Kimon Palamidis	13[1]
Joseph Said	14
Michael Zammit	13

[1] K. Palamidis appointed an Alternate Director when he was unable to attend.

The dates when the Board meetings are scheduled to be held are determined at the beginning of the year. When required, further meetings are scheduled. Board members, at times, participate in meetings by appointing an Alternate Director or attend via teleconference.

Ahead of Board meetings an agenda and supporting documentation is sent to all Directors. Other than in the case of meetings specially convened to discuss particular matters, generally, the agendas of regular Board meetings balance items of a long-term strategic nature, as well as performance-related issues together with credit applications which fall within the discretionary limits of the Board. During meetings, Directors are encouraged to present their views pertinent to the subject matter and are given every opportunity to contribute to the relevant issues on the agenda. Following each meeting, minutes which record attendance as well as all decisions taken are circulated to all Board members.

Principle 6: Information and Professional Development

The Board of Directors appoints the Chief Executive Officer.

Each newly appointed Member of the Board is briefed by the Chief Executive Officer and Senior Management officials on all aspects of the Bank's business, while the Company Secretary provides each newly appointed Director with a dossier containing reference to the more important relevant Legislation, Rules, Guidelines, the Bank Statute as well as policy documents.

Board members are reminded that the Company Secretary is at their disposal to provide any advice or service that may be required in the discharge of their duties and responsibilities. The Company Secretary is responsible for advising the Board, through the Chairman, on all governance matters. The Secretary is responsible for ensuring that Board procedures are complied with as well as that effective information flows within the Board, its committees and with Senior Management. The Secretary also facilitates induction and assists with professional development, as required.

Directors are given the opportunity to update and develop their skills and knowledge, particularly through detailed presentations, briefings and training by senior executives and other relevant Bank officials. They are invited to attend training sessions organised specifically for the Board and are also informed of and encouraged to attend externally run seminars throughout their directorship. In addition, all Board members may obtain independent professional advice at the Bank's expense.

Furthermore, Directors have access to the advice and services of the external auditors who are invited to attend Audit & Risk Committee meetings as well as Board meetings when required, including the meetings at which the Bank's financial statements are approved.

The Board continues to be mindful of the crucial importance of recruiting, retaining and motivating quality management. The ongoing training and development of staff at all levels is considered of the utmost importance and this also in the light of the need for orderly succession.

Principle 7: Evaluation of the Board's Performance

An assessment exercise of the Board's performance was carried out through a 'self-evaluation' questionnaire in which Board members participated. Furthermore, assessment exercises of performance of the committees were also carried out by virtue of 'self-evaluation' questionnaires completed by the members of the Audit & Risk Committee, the Assets & Liabilities Committee and the Credit Committee. These exercises also included an evaluation of the Chairman of each respective Committee. These 'self-evaluation' questionnaires were then set to be analysed by the Suitabilities & Evaluations Committee established by the Board to report to the Board accordingly. This exercise did not reveal the need for any material changes in the Bank's governance structures and organisation. Board members did however agree that it was in the interest of the Bank and all its stakeholders that the long protracted share disposal process by Cyprus Popular Bank Public Co Limited be successfully concluded, particularly to allow the Board to dedicate its entire focus and resources to other important matters.

Principle 8: Committees

The Board has appointed the following committees:

Audit & Risk Committee

The primary purpose of the Audit & Risk Committee is to protect the interests of the Bank`s shareholders and to assist the Directors in conducting their role effectively so that the Bank's decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times. The Committee assists the Board in fulfilling its supervisory and monitoring responsibility for effective financial reporting, risk management, control and governance and this by, *inter alia*, reviewing any financial information, statements and disclosures to be issued, systems of governance, systems of internal control established by Management and the Board, the risk management processes as well as the external and internal audit processes. The Audit & Risk Committee met seven (7) times during the period under review.

With respect to Risk Management, the Committee, *inter alia,* reviews reports from Management which enable the Committee (and the Board) to consider the process of risk identification and management, to assess the risks involved in the Bank's business and to understand how they are controlled and monitored by Management. The Committee also advises the Board on the Bank's overall current and future risk appetite and strategy and assists the Board in overseeing the implementation of that strategy by Management.

The Audit & Risk Committee is currently composed of the following four (4) non-executive Board members three (3) of whom are independent: Michael C. Bonello (Chairman), Graham A. Fairclough, Kimon Palamidis and Michael Zammit in accordance with the Audit & Risk Committee's Terms of Reference.

Michael C. Bonello is considered by the Board to be independent and competent in accounting and/or auditing in terms of the Listing Rules, having previously served in various senior positions within other institutions, including as Governor of the Central Bank of Malta for a number of years.

The Bank's Head of Internal Auditor attends meetings of the Audit & Risk Committee. The Bank's External Auditors and members of Senior Management and others, including, *inter alia*, the Chief Executive Officer, Chief Financial Officer, Risk Management officials and the Compliance Officer, are also invited to attend meetings as is deemed necessary by the Committee. The Company Secretary acts as Secretary to the Audit & Risk Committee.

Assets & Liabilities Committee (ALCO)

Membership of this Committee is made up of a number of Chief Officers and senior officers, including from the Finance and Treasury departments. The Chief Executive Officer chairs the ALCO whose main objective is to manage risks within approved limits at the same time as maximising the Bank's returns by efficient and judicious management of the Bank's assets and liabilities. Risk Management officials are also invited to attend meetings. A Secretary is appointed by the Committee.

Credit Committee

The Credit Committee is responsible for considering and approving credit applications within delegated limits of authority and is composed of a number of Chief Officers and senior officers. The Chief Executive Officer chairs this Committee and a Secretary is appointed by the Committee.

Suitabilites & Evaluations Committee

This Committee is responsible for carrying out suitability assessments of nominated/existing Directors, Key Function holders or any other persons as may be required and also assesses the Board's annual performance and that of its committees following the completion of the self-evaluations by the Board and committee members. The chairman of the Committee is selected by the Board of Directors (currently the non-executive Director and Committee member, Graham A. Fairclough) and the Company Secretary acts as Secretary.

Remuneration Committee

The functions of the Remuneration Committee are carried out by the Board of Directors in view of the fact that the remuneration of Directors is not performance-related.

A separate 'Remuneration Report' features on page 24 of this Annual Report in compliance with the Principles.

Principle 9 and 10: Relations with Shareholders and Markets and Institutional Shareholders

The Bank fully appreciates the importance of maintaining open lines of communication with shareholders, the markets and institutional shareholders. The Board, in this regard, considers that throughout the period under review the Bank has continued to communicate appropriately by means of regular company announcements as well as press releases.

Specifically, the Bank communicates with its shareholders during the Annual General Meetings when Directors and senior officers are also present in order to answer any questions that may arise. The Annual Report and Financial Statements are sent to all shareholders at least twenty-one (21) days prior to the holding of the Annual General Meeting.

The Bank's website (www.lombardmalta.com), contains information about the Bank and its business and is updated regularly.

It is therefore the Bank's policy:

- to publish information that can have a significant effect on the Bank's share price through the MSE and immediately after on the Bank's website;
- to make other published information available to the public on the Bank's website;
- to strive for open, transparent communications;
- to ensure continuity and high quality in the information disclosed; and
- to be accessible to all stakeholders.

Minority shareholders are entitled to call special meetings should a minimum threshold of share ownership be established in accordance with the Bank's Memorandum and Articles of Association.

Furthermore, minority shareholders may formally present an issue to the Board if they own the predefined minimum threshold of shares.

Principle 11: Conflicts of Interest

The Board of Directors recognises that its members have a primary responsibility to always act in the interest of the Bank and its shareholders as a whole, irrespective of who appointed them to the Board.

Strict policies are in place, particularly in the Board of Directors' Charter, to enable the management of conflict of interest, both actual as well as potential, should the occasion arise.

In addition, the '*Code of Conduct for Dealing in Financial Instruments*' was adopted and implemented in conformity with Market Abuse laws and regulations. Directors and staff members are regularly reminded of their obligations when dealing in securities of the Bank and other scheduled financial instruments.

Joseph Said, who is a Director of the Bank, holds a directorship in two companies that have a shareholding in the Group, as disclosed in the Directors' Report.

Principle 12: Corporate Social Responsibility

Directors are fully aware of the need to adhere to accepted principles of corporate social responsibility. The Bank remains fully committed to behaving ethically at all times and to contributing to economic development while at the same time improving the quality of life of the work force and their families, as well as of the local community and society at large. The Bank continues to put into practice the principles of corporate social responsibility through its extensive contributions and initiatives and direct community involvement as well as the support it gives to a number of causes.

C. Non-Compliance with the Code

Principle 4: (Code Provision 4.2.7)

The above Code Provision states, *'The Board should develop a succession policy for the future composition of the Board of Directors and particularly of the executive component thereof, for which the Chairman should hold key responsibility'.*

The appointment of Directors to serve on the Board is a matter which is entirely reserved to the shareholders of the Bank in terms of its Memorandum and Articles of Association (except where the need arises to fill a casual vacancy). Therefore, the Board does not at this stage consider it necessary to develop a succession policy for the future composition of the Board.

Principle 8A: (Remuneration Committee)

The Board did not establish a Remuneration Committee as specified in Code Provision 8.A.1. In terms of Code Provision 8.A.2 of the Principles, given that the remuneration of Directors is not performance-related, the functions of the Remuneration Committee are carried out by the Board of Directors.

Principle 8B: (Nomination Committee)

A Nomination Committee has not been set up since the appointment of Directors to the Board is a matter that is reserved entirely to the Bank's shareholders in terms of the Memorandum and Articles of Association.

In this connection every member of the Bank holding in the aggregate at least fifteen percent (15%) of the ordinary issued share capital of the Bank shall be entitled to appoint one (1) Director for each and every fifteen percent (15%) of the ordinary issued share capital owned by that member. Any fractional shareholding in excess of fifteen percent (15%) not applied in appointing such a Director or Directors, and only that fraction, shall be entitled to vote in the election of the remaining Directors together with the remaining body of shareholders. These are entitled to appoint the remaining Board members in accordance with the provisions of the Bank's statute.

This notwithstanding, in light of regulatory requirements, the Suitabilities & Evaluations Committee referred to above was set up specifically to carry out suitability assessments of nominated/existing Directors, Key Function holders or any other persons as may be required and also to assess the Board's annual performance and that of its committees.

Principle 9: (Code Provision 9.3)

There are no procedures disclosed in the Bank's Memorandum or Articles as recommended in Code Provision 9.3 to resolve conflicts between minority shareholders and controlling shareholders.

D. Internal Control (Listing Rule 5.97.4)

The Board is ultimately responsible for the Bank's internal controls as well as their effectiveness, while authority to operate the Bank is delegated to the Chief Executive Officer. The Bank's system of internal controls is designed to manage all the risks in the most appropriate manner. Such controls, however, cannot completely eliminate the possibility of material error or fraud. The Board, therefore, assumes responsibility for executing the

four basic roles of corporate governance, i.e. accountability, monitoring, strategy formulation and policy development.
In summary, the Board is therefore responsible for:

- reviewing the Bank's strategy on an ongoing basis as well as setting the appropriate business objectives in order to enhance value for all stakeholders;
- appointing and monitoring the Chief Executive Officer whose function it is to manage the operations of the Bank; and
- identifying and ensuring that significant risks are managed satisfactorily.

Given the fiduciary responsibility involved, the Board of Directors also sets high business and ethical standards for adoption right across the organisation.

The Board upholds a policy of clear demarcation between its role and responsibilities and those of Management. It has defined the level of authority that it retains over strategy formulation and policy determination together with delegated authority and has vested accountability for the Bank's day-to-day business in the Assets & Liabilities Committee, Credit Committee and in the management team comprising of the:

- Chief Executive Officer; and
- Chief Officers and other senior officers.

The Board frequently participates in asset allocation decisions as well as credit proposals above a certain threshold, after the appropriate recommendations have been made.

E. General Meetings (Listing Rule 5.97.6)

General meetings are called by giving at least twenty one (21) days' notice and conducted in accordance with the provisions contained in the Bank's Articles of Association.

The 'Ordinary Business' which is dealt with at the Annual General Meeting consists of the adoption of the annual financial statements, declaration of a dividend, appointment of Board members, appointment of auditors and the fixing of their remuneration together with the voting of remuneration to the Directors for the holding of their office. All other business shall be deemed 'Special Business'.

All shareholders registered in the shareholders' register on record date as defined in the Listing Rules have the right to attend, participate and vote in the general meeting.

A shareholder or shareholders holding not less than five per cent (5%) of the voting issued share capital of the Bank may: (i) request the Bank to include items on the agenda and; (ii) table draft resolutions for items included in the agenda of a general meeting. Such requests shall be submitted to the Bank at least forty six (46) days before the date set for the general meeting.

Every shareholder shall be entitled to appoint only one (1) person to act as proxy holder to attend and vote at a general meeting instead of him. The proxy holder shall enjoy the same rights to speak and ask questions in the general meeting as those to which the member thus represented would be entitled.

Approved by the Board of Directors on 8 March 2018 and signed on its behalf by:

Michael C. Bonello
Chairman

Joseph Said
Director and Chief Executive Officer

Remuneration Report

As indicated in the 'Statement of Compliance with the Code of Principles of Good Corporate Governance', in terms of the Malta Financial Services Authority (MFSA) 'Code of Principles of Good Corporate Governance', the Board of Directors performs the functions of a Remuneration Committee, on the basis that the remuneration of the Bank's Directors is not performance-related and does not include share options, pension benefits, profit-sharing arrangements or any emolument related to the performance of the Bank. Among the obligations established in the Listing Rules, the Board, where applicable, carries out the main duties established in the Supporting Principles enshrined in Principle 8A of the 'Code of Principles of Good Corporate Governance'. This Remuneration Report was approved by the Board of Directors at the Board Meeting held on 8 March 2018.

Remuneration Policy

Directors

There were no changes effected in the Remuneration Policy for the Bank's Directors during the financial year under review. In terms of the Bank's Memorandum and Articles of Association, the Bank's shareholders determine the maximum annual aggregate remuneration of the Directors. The maximum amount is established by resolution at each Annual General Meeting of the Bank. The aggregate amount fixed for this purpose during the last Annual General Meeting was seventy thousand euro (€70,000).

No Board committee fees were payable to any of the Directors during the year under review.

It is confirmed that none of the Directors in their capacity as Directors of the Bank are entitled to profit sharing, share options, pension benefits, variable remuneration or any other remuneration or related payments from the Bank. Only one of the Directors has a service contract with the Bank.

The fees paid to Directors for the holding of their office during 2017 amounted to €48,900. This amount is within the limit of €70,000 approved by the Annual General Meeting of 27 April 2017.

Directors' fees attributable to the current financial year are disclosed in note 32 to the financial statements. During the year, Directors received fees as follows:

	€
Michael C. Bonello (Chairman)	20,960
Graham A. Fairclough	6,985
Joseph Said	6,985
Michael Zammit	6,985
Kimon Palamidis	6,985
Total	**48,900**

Remuneration (other than directors' fees) paid to the executive member of the Board of Directors is included with the emoluments to Senior Management detailed below.

Senior Management

There were no changes effected in the Remuneration Policy for the Bank's Senior Management during the financial year under review which warrant reporting. The Board of Directors is satisfied that the packages offered to Senior Management continue to ensure that the Bank attracts and retains management staff with the necessary qualities and skills. The Bank's policy remains that of engaging its Senior Management staff on the basis of indefinite contracts of employment, and this after a period of probation. The terms and conditions of employment of Senior Management are established in the relative employment contracts. The applicable notice periods, after probation, are those provided for in the relevant legislation.

Share options, share incentive schemes and profit sharing do not feature in the Bank's Remuneration Policy, and the individual contracts of employment of Senior Management do not contain provisions for termination payments and/or other payments linked to early termination other than as determined by the Law. While a retirement gratuity is due to the Chief Executive Officer, no pension benefits are currently payable by the Bank.

Senior Management staff are eligible for annual salary increases, which are not directly performance-related. Annual bonuses are paid to Senior Management staff members according to individual overall performance during the previous financial year. Bonus payments do not exceed 100% of the fixed component of the total remuneration for each individual.

Non-cash benefits include private health care insurance, as well as death in service and personal accident insurance cover. The Chief Executive Officer is entitled to the use of a company car.

Total emoluments received by Senior Management during the period under review are as detailed below, in terms of Code Provision 8.A.5.

Fixed Remuneration	Variable Remuneration	Share Options	Others
€1,018,215	€80,500	None	Non-Cash Benefits referred to above

Other

For other staff members, fixed pay is determined by a Collective Agreement and annual bonuses are differentiated by individual performance and grade.

The Bank does not plan to effect any changes in its Remuneration Policy in the forthcoming financial year, unless required to do so in terms of any regulatory obligations.

Company Information

Number of shareholders at 31 December 2017 analysed by range:

Range	Shareholders	Shares
1 – 500	153	25,447
501 – 1000	102	72,654
1001 – 5000	499	1,292,032
5001 and over	710	42,787,781
Total	**1,464**	**44,177,914**

Number of shareholders at 7 March 2018 analysed by range:

Range	Shareholders	Shares
1 – 500	155	25,643
501 – 1000	104	73,963
1001 – 5000	501	1,285,797
5001 and over	707	42,792,511
Total	**1,467**	**44,177,914**

The Bank has one class of shares and each share is entitled to one vote.

Company Information

Board of Directors
Michael C. Bonello (Chairman)
Graham A. Fairclough
Kimon Palamidis
Joseph Said
Michael Zammit

Company Secretary
Helena Said

Senior Management

Joseph Said	Chief Executive Officer
David Attard	Chief Officer - Group Corporate Services
Anthony Bezzina	Chief Officer - Credit
Paul Debono	Chief Officer - Legal Services
Eugenio Farrugia	Chief Operations Officer
Aurelio Theuma	Chief Financial Officer
Anthony Zahra	Chief Information Officer

Heads of Departments

Joan Aquilina	Internal Audit
Robert Aquilina	Treasury
Victoria Azzopardi	Data Processing Management
Moira Balzan	Finance
Michael Borg	Wealth Management
George Camilleri	Software and Business Intelligence
Philip Depares	Business Processes
Godwin Farrugia	Commercial Credit
Kathleen Flynn	International Business Banking
Mark Gauci	Branch Operations and Retail Credit
Edward Pirotta	Premises
Maria Psaila	Human Resources
Helena Said	Credit Support Services
Karl Sammut	Technology
Brigid White	Card Services
Christopher Zammit	Home Loans

Company Information

Registered Office
67 Republic Street, Valletta VLT 1117
Tel: 25581 117

Branches
67 Republic Street, Valletta VLT 1117
Tel: 25581 100

4 Main Street, Qormi QRM 1100
Tel: 25581 300

Ninu Cremona Street, Victoria VCT 2561
Tel: 25581 600

Balzan Valley Road, Balzan BZN 1409
Tel: 25581 500

82 St Sebastian Street, Qormi QRM 2335
Tel: 25581 360

225A Tower Road, Sliema SLM 1601
Tel: 25581 260

24/7 Outlet
Paceville Avenue, St. Julian's STJ 3103

Credit
9A St. Frederick Street, Valletta VLT 1470
Tel: 25581 115

Wealth Management
67 Republic Street, Valletta VLT 1117
Tel: 25581 112

Legal Office
59 Republic Street, Valletta VLT 1117
Tel: 25581 116

Home Loans
82 St. Sebastian Street, Qormi QRM 2335
Tel: 25581 370

International Business Banking
Graham Street, Sliema SLM 1711
Tel: 25581 200

Independent Auditor's Report
to the Shareholders of Lombard Bank Malta p.l.c.

Report on the Audit of the Financial Statements

Our opinion

In our opinion:

- Lombard Bank Malta p.l.c.'s consolidated and stand-alone parent company financial statements (the "financial statements") give a true and fair view of the financial position of the Group and Bank as at 31 December 2017, and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU; and
- The financial statements have been prepared in accordance with the requirements of the Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386).

Our opinion is consistent with our additional report to the Audit and Risk Committee.

What we have audited

Lombard Bank Malta p.l.c.'s financial statements, set out on pages 40 to 143, comprise:

- the consolidated and parent company statements of financial position as at 31 December 2017;
- the consolidated and parent company income statements, and statements of comprehensive income for the year then ended;
- the consolidated and parent company statements of changes in equity for the year then ended;
- the consolidated and parent company statements of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group and the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements of the Accountancy Profession (Code of Ethics for Warrant Holders) Directive issued in terms of the Accountancy Profession Act (Cap. 281) that are relevant to our audit of the financial statements in Malta. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

Independent Auditor's Report

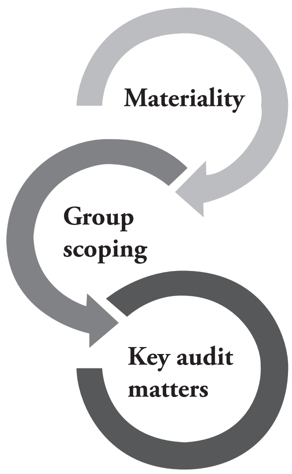
to the Shareholders of Lombard Bank Malta p.l.c.

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the parent company and its subsidiaries are in accordance with the applicable law and regulations in Malta and that we have not provided non-audit services that are prohibited under Article 18A of the Accountancy Profession Act (Cap. 281).

The non-audit services that we have provided to the Group and its subsidiaries, in the period from 1 January to 31 December 2017, are disclosed in Note 32 to the financial statements.

Our audit approach

Overview



Overall group materiality: €296,000, which represents 5% of profit before tax adjusted for one-time gains.

The audit carried out by the group engagement team covered all the components within the Group as at and for the year ended 31 December 2017 comprising Lombard Bank Malta p.l.c. and its subsidiaries Redbox Limited and MaltaPost p.l.c., which are all based in Malta.

Impairment allowances of loans and advances to customers of the Group and the Bank.

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where the directors made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Overall group materiality	€296,000 (2016: €339,700)
How we determined it	5% of profit before tax adjusted for one-time gains
Rationale for the materiality benchmark applied	*We chose profit before tax adjusted for one-time gains as the benchmark because, in our view, it is the benchmark against which the performance of the Group is most commonly measured by users, and is a generally accepted benchmark. We chose 5% which is within the range of acceptable quantitative materiality thresholds in auditing standards.*

We agreed with the Audit & Risk Committee that we would report to them misstatements identified during our audit above €29,600 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter	How our audit addressed the Key audit matter
Impairment of loans and advances to customers of the Group and Bank Impairment allowances in respect of loans and advances to customers represent management's best estimate of the losses incurred within the loan portfolios at the balance sheet date. Impairment losses are calculated on an individual basis for loans and on a collective basis to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment. The calculation of both collective and individual impairment allowances is inherently judgemental; judgement is applied to determine appropriate parameters and assumptions used to calculate impairment. Collective impairment allowances are calculated using a statistical model, which approximates the impact of current economic and credit conditions on portfolios of loans. For incurred but not yet identified impairments, this model is based on the probabilities of default and loss given default parameters taking into account the Bank's historical experience as well as the estimated emergence period between impairment occurring and loss recognition. The inputs to these models are subject to management judgement and model overlays are often required. Key assumptions and judgements include the probabilities of default based on the transition from one credit grade to another and the loss given default based on the type of collateral secured in relation to the respective credit facility.	The policies and methodologies used by the Bank in respect of impairment of loans and advances to customers were discussed with the Audit & Risk Committee. Changes to inputs within the collective allowance models as well as individually significant loan impairments are discussed at Audit & Risk Committee meetings. For collective allowances the appropriateness of the modelling policy and methodology used was independently assessed by reference to the requirements of accounting standards and market practices. We understood and critically assessed the model used for collective allowances. Since, modelling assumptions and parameters are based on historic data, we assessed whether historic experience was representative of current circumstances and of the recent losses incurred within the portfolios. The appropriateness of management's judgements was also independently considered in respect of calculation methodologies and judgemental overlays. Model calculations were tested through re-performance. We tested the completeness and accuracy of data extracted from underlying systems that is utilised in the model. Based on the evidence obtained, we found the model assumptions, data used within the model and overlays to be reasonable. For specific allowances the appropriateness of provisioning methodologies and policies was independently assessed. We understood and evaluated the processes for identifying impairment events, as well as the impairment assessment processes.

Key audit matter	How our audit addressed the Key audit matter
The methodology used by the Bank to calculate collective impairment allowances is relatively standard which means that modelling risk is low but changes in individual inputs can have a significant bearing on the impairment charge. For specific impairments, judgement is required to determine when an impairment event has occurred and then to estimate the expected future cash flows related to that loan, which are dependent on parameters or assumptions such as the valuation of collateral for secured lending. Discounted cash flow models are utilised in this respect. We focused on impairment due to the subjective nature of the calculations and the subjective judgements involved in both timing of recognition of impairment and the estimation of the size of any such impairment. Relevant references in the Annual Report and Financial Statements: • Accounting policy: Note 1.8; • Credit risk management: Note 2.3; • Note on Loans and advances to customers: Note 8; • Note on Net impairment losses: Note 31; • Accounting estimates and judgements: Note 3.2.	The controls management has established to identify which loans and advances are impaired were tested. For specific impairment charges on individual loans this includes controls over the credit file review processes. In particular, we tested the design and operating effectiveness of the key controls to determine which loans and advances are impaired, including testing controls over the timely identification of impaired loans and advances. We determined that we could rely on these controls for the purposes of our audit. We assessed critically the criteria used for determining whether an impairment event had occurred and therefore whether there was a requirement to compute a specific impairment allowance. We haphazardly selected a sample of loans to challenge whether impairment events had actually occurred and to assess whether impairment events had been identified by management in a timely manner. For a sample of individually impaired loans we understood the latest developments at the level of the borrower and the basis of measuring the impairment provisions, and considered whether key judgments were appropriate given the borrowers' circumstances. An independent view was formed on the levels of provisions booked based on the detailed loan and customer information in the credit file. Calculations within the discounted cash flow models were re-performed. In addition, we tested key inputs to the impairment calculation including the expected future cash flows and valuation of collateral held, and challenged management to demonstrate that the valuations were up to date, consistent with the strategy being followed in respect of the particular borrower and appropriate for the purpose. Testing the estimation of the future expected cash flows from customers from realisation of collateral held for a sample of loans, involved assessing the work performed by external experts used by the Bank to value the collateral or to assess the estimates of future cash flows. We used our experts to assess the appropriateness of valuations and estimates utilised. In the case of some impairment provisions, we formed a different view from that of management, but in our view the differences were within a reasonable range of outcomes.

How we tailored our group audit scope

The Group is composed of three components: Lombard Bank Malta p.l.c. (the parent company), and its subsidiaries Redbox Limited and MaltaPost p.l.c., with the latter determined to be a financially significant entity. We tailored the scope of our audit in order to perform sufficient work on all components to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates, and local statutory requirements.

The group audit team performed all of this work by applying the Group overall materiality, together with additional procedures performed on the consolidation. This gave us sufficient appropriate audit evidence for our opinion on the Group financial statements as a whole.

Other information

The directors are responsible for the other information. The other information comprises the Directors' Report, (but does not include the financial statements and auditor's report thereon) which we obtained prior to the date of this auditor's report, and:

- The Chairman's Statement to the Members;
- The Chief Executive Officer's Review of Operations;
- The Remuneration Report;
- The Company Information;
- The Additional Regulatory Disclosures;
- The Five Year Summary;

which are expected to be made available to us after that date.

Our opinion on the financial statements does not cover the other information, including the directors' report.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

With respect to the Directors' Report, we also considered whether the Directors' Report includes the disclosures required by Article 177 of the Maltese Companies Act (Cap. 386).

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Independent Auditor's Report
to the Shareholders of Lombard Bank Malta p.l.c.

Based on the work we have performed, in our opinion:

- The information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- The Directors' Report has been prepared in accordance with the Maltese Companies Act (Cap. 386).

In addition, in light of the knowledge and understanding of the Group and its environment obtained in the course of the audit, we are required to report if we have identified material misstatements in the Directors' Report and other information that we obtained prior to the date of this auditor's report. We have nothing to report in this regard.

When we read the Chairman's Statement to the Members, the Chief Executive Officer's Review of Operations, the Remuneration Report, the Company Information, the Additional Regulatory Disclosures and the Five Year Summary, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance in accordance with International Standards on Auditing.

Responsibilities of the directors and those charged with governance for the financial statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with IFRSs as adopted by the EU and the requirements of the Banking Act (Cap. 371) and the Maltese Companies Act (Cap. 386), and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Bank or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's and the Bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's and the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's or the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group or the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Independent Auditor's Report

to the Shareholders of Lombard Bank Malta p.l.c.

Report on other legal and regulatory requirements

Report on the statement of compliance with the Principles of Good Corporate Governance

The Listing Rules issued by the Malta Listing Authority require the directors to prepare and include in their Annual Report a Statement of Compliance providing an explanation of the extent to which they have adopted the Code of Principles of Good Corporate Governance and the effective measures that they have taken to ensure compliance throughout the accounting period with those Principles.

The Listing Rules also require the auditor to include a report on the Statement of Compliance prepared by the directors.

We read the Statement of Compliance and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements included in the Annual Report. Our responsibilities do not extend to considering whether this statement is consistent with any other information included in the Annual Report.

We are not required to, and we do not, consider whether the Board's statements on internal control included in the Statement of Compliance cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

In our opinion, the Statement of Compliance set out on pages 16 to 23 has been properly prepared in accordance with the requirements of the Listing Rules issued by the Malta Listing Authority.

Opinion on other matters prescribed by the Banking Act, (Cap.371)

In our opinion:

- we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
- proper books of account have been kept by the Bank, so far as appears from our examination of those books;
- the Bank's financial statements are in agreement with the books of account; and
- to the best of our knowledge and according to the explanations given to us, the financial statements give the information required by any law in force in the manner so required.

Other matters on which we are required to report by exception

We also have responsibilities:

- under the Maltese Companies Act, (Cap.386) to report to you if, in our opinion:
  - returns adequate for our audit have not been received from branches not visited by us; and
  - certain disclosures of Directors' remuneration specified by law are not made in the financial statements, giving the required particulars in our report.
- under the Listing Rules to review the statements made by the Directors that the business is a going concern together with supporting assumptions or qualifications as necessary.

We have nothing to report to you in respect of these responsibilities.

APPOINTMENT

We were first appointed as auditors of the Bank on 10 April 2010. Our appointment has been renewed by shareholder resolution representing a total period of uninterrupted engagement of 8 years.

PricewaterhouseCoopers
78, Mill Street
Qormi
Malta

Simon Flynn
Partner

8 March 2018

LOMBARD

FINANCIAL STATEMENTS

For the Year Ended 31 December 2017

2017

Statements of Financial Position

As at 31 December 2017

	Notes	Group 2017 € 000	Group 2016 € 000	Bank 2017 € 000	Bank 2016 € 000
Assets					
Balances with Central Bank of Malta, treasury bills and cash	5	**215,133**	218,148	**214,500**	217,398
Cheques in course of collection		**1,755**	1,374	**1,755**	1,374
Investments	6	**75,895**	80,515	**72,282**	76,358
Loans and advances to banks	7	**97,048**	161,728	**90,258**	155,966
Loans and advances to customers	8	**428,611**	343,487	**428,611**	344,456
Investment in subsidiaries	9	**-**	-	**15,732**	13,186
Investment in associate	10	**1,575**	1,681	**1,645**	1,645
Intangible assets	11	**1,648**	1,809	**480**	554
Property, plant and equipment	12	**31,753**	30,198	**17,676**	16,826
Assets classified as held for sale	8	**822**	833	**822**	833
Current tax assets		**1,557**	190	**1,557**	190
Deferred tax assets	13	**8,980**	8,973	**8,369**	8,634
Inventories	14	**1,164**	1,197	**407**	398
Trade and other receivables	15	**10,949**	8,136	**3,649**	3,312
Accrued income and other assets	16	**5,856**	4,462	**2,095**	2,555
Total assets		**882,746**	862,731	**859,838**	843,685

Statements of Financial Position *(continued)*

As at 31 December 2017

	Notes	Group 2017 € 000	Group 2016 € 000	Bank 2017 € 000	Bank 2016 € 000
Equity and Liabilities					
Equity					
Share capital	17	**11,044**	11,044	**11,044**	11,044
Share premium	18	**18,530**	18,530	**18,530**	18,530
Revaluation and other reserves	18	**12,662**	13,723	**12,624**	13,434
Retained earnings		**53,904**	50,541	**51,887**	48,381
Equity attributable to equity holders of the Bank		**96,140**	93,838	**94,085**	91,389
Non-controlling interests		**6,734**	6,510	**-**	-
Total equity		**102,874**	100,348	**94,085**	91,389
Liabilities					
Amounts owed to banks	19	**5,362**	9,036	**5,362**	9,036
Amounts owed to customers	20	**733,151**	721,559	**736,695**	725,383
Provisions for liabilities and other charges	21	**3,177**	2,823	**1,064**	1,114
Current tax liabilities		**229**	310	**-**	-
Deferred tax liabilities	13	**3,914**	4,449	**3,136**	3,671
Other liabilities	22	**23,217**	16,100	**15,076**	8,829
Accruals and deferred income	23	**10,822**	8,106	**4,420**	4,263
Total liabilities		**779,872**	762,383	**765,753**	752,296
Total equity and liabilities		**882,746**	862,731	**859,838**	843,685
Memorandum items					
Contingent liabilities	24	**9,078**	8,775	**9,093**	8,887
Commitments	24	**247,737**	182,919	**247,737**	182,919

The notes on pages 49 to 143 are an integral part of these financial statements.

These financial statements on pages 40 to 143 are approved and authorised for issue by the Board of Directors on 8 March 2018 and signed on its behalf by:

Michael C. Bonello
Chairman

Joseph Said
Director and Chief Executive Officer

LOMBARD

Income Statements

For the Year Ended 31 December 2017

	Notes	Group 2017 € 000	Group 2016 € 000	Bank 2017 € 000	Bank 2016 € 000
Interest receivable and similar income					
- on loans and advances, balances with Central Bank of Malta and treasury bills	25	**19,490**	18,935	**19,462**	18,917
- on debt and other fixed income instruments	25	**1,936**	1,970	**1,823**	1,827
Interest expense	25	**(5,992)**	(6,703)	**(5,997)**	(6,711)
Net interest income		**15,434**	14,202	**15,288**	14,033
Fee and commission income	26	**4,431**	4,039	**3,357**	2,941
Fee and commission expense	26	**(298)**	(233)	**(299)**	(232)
Net fee and commission income		**4,133**	3,806	**3,058**	2,709
Postal sales and other revenues	27	**37,371**	26,772	**172**	75
Dividend income	28	**326**	361	**1,880**	1,740
Net trading income	29	**619**	634	**699**	731
Other operating income		**-**	1,479	**177**	1,645
Operating income		**57,883**	47,254	**21,274**	20,933
Employee compensation and benefits	30	**(19,945)**	(17,719)	**(6,269)**	(5,728)
Other operating costs	32	**(24,695)**	(15,456)	**(4,052)**	(3,511)
Depreciation and amortisation	11,12	**(1,411)**	(1,408)	**(622)**	(559)
Provisions for liabilities and other charges	21	**(23)**	(521)	**(22)**	(462)
Net impairment losses	31	**(2,835)**	(3,950)	**(2,831)**	(4,026)
Operating profit		**8,974**	8,200	**7,478**	6,647
Share of (loss)/profit of investment accounted for using the equity method, net of tax	10	**(106)**	35	**-**	-
Profit before taxation		**8,868**	8,235	**7,478**	6,647
Income tax expense	33	**(3,165)**	(2,905)	**(2,632)**	(2,395)
Profit for the year		**5,703**	5,330	**4,846**	4,252
Attributable to:					
Equity holders of the Bank		**5,129**	4,726	**4,846**	4,252
Non-controlling interests		**574**	604	**-**	-
Profit for the year		**5,703**	5,330	**4,846**	4,252
Earnings per share	34	**11c6**	10c7		

The notes on pages 49 to 143 are an integral part of these financial statements.

Statements of Comprehensive Income

For the Year Ended 31 December 2017

Group

	Notes	**2017 € 000**	2016 € 000
Profit for the year		**5,703**	5,330
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Fair valuation of available-for-sale financial assets:			
Net changes in fair value arising during the year, before tax	6	**(1,591)**	1,989
Reclassification adjustments - net amounts reclassified to profit or loss, before tax		**(81)**	(1,479)
Income tax relating to fair valuation of available-for-sale financial assets	33	**540**	(151)
Items that will not be reclassified to profit or loss:			
Remeasurements of defined benefit obligations		**(528)**	(74)
Deferred tax on remeasurements of defined benefit obligations		**304**	-
Other comprehensive income for the year, net of income tax		**(1,356)**	285
Total comprehensive income for the year, net of income tax		**4,347**	5,615
Attributable to:			
Equity holders of the Bank		**3,874**	5,010
Non-controlling interests		**473**	605
Total comprehensive income for the year, net of income tax		**4,347**	5,615

Bank

	Notes	**2017 € 000**	2016 € 000
Profit for the year		**4,846**	4,252
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Fair valuation of available-for-sale financial assets:			
Net changes in fair value arising during the year, before tax	6	**(1,460)**	1,911
Reclassification adjustments - net amounts reclassified to profit or loss, before tax		**(81)**	(1,479)
Income tax relating to fair valuation of available-for-sale financial assets	33	**540**	(151)
Other comprehensive income for the year, net of income tax		**(1,001)**	281
Total comprehensive income for the year, net of income tax		**3,845**	4,533

The notes on pages 49 to 143 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2017

Group		Attributable to equity holders of the Bank						
	Notes	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000	Non-controlling interests € 000	Total equity € 000
At 1 January 2016		10,943	17,746	13,152	47,556	89,397	6,101	95,498
Comprehensive income								
Profit for the year		-	-	-	4,726	4,726	604	5,330
Other comprehensive income								
Fair valuation of available-for-sale financial assets:								
Net changes in fair value arising during the year		-	-	1,297	-	1,297	23	1,320
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	(961)	-	(961)	-	(961)
Remeasurements of deferred benefit obligations		-	-	(52)	-	(52)	(22)	(74)
Transfers and other movements		-	-	284	(284)	-	-	-
Total other comprehensive income for the year		-	-	568	(284)	284	1	285
Total comprehensive income for the year		-	-	568	4,442	5,010	605	5,615
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Dividends to equity holders	35	-	-	-	(1,138)	(1,138)	(435)	(1,573)
Rights issue of ordinary shares	17	101	784	-	-	885	-	885
Changes in ownership interests in subsidiaries that do not result in a loss of control								
Change in non-controlling interests in subsidiary		-	-	3	(319)	(316)	239	(77)
Total transactions with owners		101	784	3	(1,457)	(569)	(196)	(765)
At 31 December 2016		11,044	18,530	13,723	50,541	93,838	6,510	100,348

The notes on pages 49 to 143 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2017

Group		Attributable to equity holders of the Bank						
	Note	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000	Non-controlling interests € 000	Total equity € 000
At 1 January 2017		**11,044**	**18,530**	**13,723**	**50,541**	**93,838**	**6,510**	**100,348**
Comprehensive income								
Profit for the year		-	-	-	**5,129**	**5,129**	**574**	**5,703**
Other comprehensive income								
Fair valuation of available-for-sale financial assets:								
Net changes in fair value arising during the year		-	-	**(1,044)**	-	**(1,044)**	**(37)**	**(1,081)**
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	**(52)**	-	**(52)**	-	**(52)**
Remeasurements of deferred benefit obligations		-	-	**(159)**	-	**(159)**	**(64)**	**(223)**
Transfers and other movements		-	-	**191**	**(191)**	-	-	-
Total other comprehensive income for the year		-	-	**(1,064)**	**(191)**	**(1,255)**	**(101)**	**(1,356)**
Total comprehensive income for the year		-	-	**(1,064)**	**4,938**	**3,874**	**473**	**4,347**
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Dividends to equity holders	35	-	-	-	**(1,149)**	**(1,149)**	**(433)**	**(1,582)**
Changes in ownership interests in subsidiaries that do not result in a loss of control								
Change in non-controlling interests in subsidiary		-	-	**3**	**(426)**	**(423)**	**184**	**(239)**
Total transactions with owners		-	-	**3**	**(1,575)**	**(1,572)**	**(249)**	**(1,821)**
At 31 December 2017		**11,044**	**18,530**	**12,662**	**53,904**	**96,140**	**6,734**	**102,874**

The notes on pages 49 to 143 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2017

Bank	Notes	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000
At 1 January 2016		10,943	17,746	12,869	45,551	87,109
Comprehensive income						
Profit for the year		-	-	-	4,252	4,252
Other comprehensive income						
Fair valuation of available-for-sale financial assets:						
Net changes in fair value arising during the year		-	-	1,242	-	1,242
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	(961)	-	(961)
Transfers and other movements		-	-	284	(284)	-
Total other comprehensive income for the year		-	-	565	(284)	281
Total comprehensive income for the year		-	-	565	3,968	4,533
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Dividends to equity holders	35	-	-	-	(1,138)	(1,138)
Rights issue of ordinary shares	17	101	784	-	-	885
Total transactions with owners		101	784	-	(1,138)	(253)
At 31 December 2016		11,044	18,530	13,434	48,381	91,389

The notes on pages 49 to 143 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2017

Bank

	Note	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000
At 1 January 2017		**11,044**	**18,530**	**13,434**	**48,381**	**91,389**
Comprehensive income						
Profit for the year		-	-	-	**4,846**	**4,846**
Other comprehensive income						
Fair valuation of available-for-sale financial assets:						
Net changes in fair value arising during the year		-	-	**(949)**	-	**(949)**
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	**(52)**	-	**(52)**
Transfers and other movements		-	-	**191**	**(191)**	-
Total other comprehensive income for the year		-	-	**(810)**	**(191)**	**(1,001)**
Total comprehensive income for the year		-	-	**(810)**	**4,655**	**3,845**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Dividends to equity holders	35	-	-	-	**(1,149)**	**(1,149)**
Total transactions with owners		-	-	-	**(1,149)**	**(1,149)**
At 31 December 2017		**11,044**	**18,530**	**12,624**	**51,887**	**94,085**

The notes on pages 49 to 143 are an integral part of these financial statements.

Statements of Cash Flows

For the Year Ended 31 December 2017

	Notes	Group 2017 € 000	Group 2016 € 000	Bank 2017 € 000	Bank 2016 € 000
Cash flows from operating activities					
Interest and commission receipts		**24,052**	23,337	**24,238**	22,514
Receipts from customers relating to postal sales and other revenue		**34,484**	30,068	**172**	75
Interest and commission payments		**(6,238)**	(7,072)	**(6,243)**	(7,079)
Payments to employees and suppliers		**(41,509)**	(34,879)	**(10,189)**	(9,219)
Cash flows from operating profit before changes in operating assets and liabilities		10,789	11,454	**7,978**	6,291
Decrease/(increase) in operating assets:					
Treasury bills		**47,116**	(36,150)	**47,115**	(36,150)
Deposits with Central Bank of Malta		**(917)**	(1,422)	**(917)**	(1,422)
Loans and advances to banks and customers		**(97,713)**	(41,753)	**(94,820)**	(42,041)
Other receivables		**(726)**	(2,026)	**(717)**	(1,993)
Increase/(decrease) in operating liabilities:					
Amounts owed to banks and to customers		**11,615**	71,043	**11,335**	71,066
Other payables		**6,259**	(2,807)	**6,247**	(2,840)
Net cash used in operations		**(23,577)**	(1,661)	**(23,779)**	(7,089)
Income tax paid		**(4,309)**	(3,956)	**(3,221)**	(3,021)
Net cash flows used in operating activities		**(27,886)**	(5,617)	**(27,000)**	(10,110)
Cash flows from investing activities					
Dividends received		**326**	361	**326**	362
Interest received from investments		**2,196**	2,157	**2,038**	1,972
Purchase of investments		**(906)**	(5,873)	**(879)**	(5,341)
Investment in subsidiary		**-**	-	**(1,500)**	-
Proceeds on maturity/disposal of investments		**3,285**	2,995	**2,850**	2,765
Purchase of property, plant and equipment		**(2,943)**	(4,604)	**(1,396)**	(3,504)
Acquisition of non-controlling interests		**(429)**	(283)	**-**	-
Net cash flows generated from/(used in) investing activities		**1,529**	(5,247)	**1,439**	(3,746)
Cash flows from financing activities					
Dividends paid to equity holders of the Bank	35	**(1,149)**	(252)	**(1,149)**	(252)
Dividends paid to non-controlling interests		**(244)**	(228)	**-**	-
Net cash flows used in financing activities		**(1,393)**	(480)	**(1,149)**	(252)
Net decrease in cash and cash equivalents		**(27,750)**	(11,344)	**(26,710)**	(14,108)
Cash and cash equivalents at beginning of year		**296,386**	307,730	**289,923**	304,031
Cash and cash equivalents at end of year	36	**268,636**	296,386	**263,213**	289,923

The notes on pages 49 to 143 are an integral part of these financial statements.

LOMBARD

Notes to the Financial Statements
For the Year Ended 31 December 2017

1 **Summary of significant accounting policies**

The principal accounting policies adopted in the preparation of these financial statements are set out below. Unless otherwise stated, these policies have been consistently applied to all the years presented and relate to both the Group and the Bank.

1.1 *Basis of preparation*

The consolidated financial statements include the financial statements of Lombard Bank Malta p.l.c. (the Bank) and its subsidiary undertakings (together referred to as 'the Group' and individually as 'Group entities'). The Bank's financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards (IFRSs) as adopted by the EU and with the requirements of the Banking Act, 1994 (Chapter 371 of the Laws of Malta) and the Companies Act, 1995 (Chapter 386 of the Laws of Malta). These consolidated financial statements are prepared under the historical cost convention, as modified by the fair valuation of available-for-sale financial assets, financial assets and financial liabilities at fair value through profit or loss (including all derivative financial instruments) and the revaluation of the land and buildings class of property, plant and equipment.

The preparation of financial statements in conformity with IFRSs as adopted by the EU requires the use of certain accounting estimates. It also requires the Directors to exercise their judgment in the process of applying the Group's accounting policies (see note 3.1 – Critical accounting estimates, and judgments in applying the Group's accounting policies).

1.2 *Standards, interpretations and amendments to published standards effective in 2017*

In 2017, the Group adopted new standards, amendments and interpretations to existing standards that are mandatory for the Group's accounting period beginning on 1 January 2017. The adoption of these revisions to the requirements of IFRSs as adopted by the EU did not result in significant changes to the Group's accounting policies impacting the Group's financial performance and position.

1.3 *Standards, interpretations and amendments to published standards that are not yet effective*

Certain new standards, amendments and interpretations to existing standards which are mandatory for accounting periods beginning after 1 January 2018 have been published by the date of authorisation for issue of this financial information. The Group's directors are of the opinion that, with the exception of the below, there are no requirements that will have a possible significant impact on the Bank's financial statements in the period of initial application.

1.3.1 IFRS 9 'Financial Instruments'

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments. IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement, and is effective for annual periods beginning on or after 1 January 2018. The Bank will apply IFRS 9 on 1 January 2018.

1 **Summary of significant accounting policies** *(continued)*

1.3.1.1 Classification and measurement

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

IFRS 9 includes three principal classification categories for financial assets: amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). It eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale financial assets.

Financial assets may be designated as at FVTPL if doing so eliminates an accounting mismatch. Other financial assets are measured at:

- amortised cost if they are held within a business model whose objective is to hold assets to collect contractual cash flows and their contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding; or
- FVOCI if they are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and their contractual terms give rise on specified dates to cash flows that are SPPI on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in other comprehensive income. This election is made on an investment-by-investment basis.

All financial assets not classified as measured at amortised cost or FVOCI are measured at FVTPL.

Business model assessment

The Bank's business model represents the way financial instruments are managed in order to generate cash flows. This assessment is performed at a portfolio level because this best reflects the way the business is managed and information is provided to the Bank's management. The information considered in making such an assessment includes:

- the objectives for the portfolio including whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of assets;
- the method for the evaluation of the performance of the portfolio and how such performance is reported to the Bank's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading and those that are managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

1 **Summary of significant accounting policies** *(continued)*

Assessment of whether contractual cash flows are SPPI

The Bank considers the assets' contractual terms in order to assess whether the contractual cash flows of a financial asset represent solely payments of principal and interest. For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition, while 'interest' is the compensation for time value of money and credit risk of a basic lending-type return. A basic lending-type return could also include consideration for other basic lending risks (for example, liquidity risk) and consideration for costs associated with holding the financial asset for a particular period of time (for example, servicing or administrative costs) and/or a profit margin.

Unlike the business model assessment, the SPPI assessment is performed for each individual product (or portfolio of products if they share identical features). The following considerations are made when assessing whether the cash flow characteristics of these assets meet the SPPI requirements of IFRS 9:

- contingent events that would change the amount and timing of cash flows such as contractual term resetting interest to a higher amount in the event of a missed payment;
- leverage features, being contractual cash flow characteristics that increase the variability of the contractual cash flows with the result that they do not have economic characteristics of interest, which would fail to meet the SPPI characteristics;
- features that result in principal or interest payments being linked to indices, equity or commodity prices, or other non-financial variables, all of which the Bank considers to be inconsistent with the SPPI characteristics;
- contractual terms that allow the issuer to prepay (or the holder to put a debt instrument back to the issuer) before maturity, which are considered to meet the SPPI characteristics if the prepayment amount substantially represents unpaid amounts of principal and interest (including, as applicable, reasonable compensation for early termination of the contract);
- contractual terms that allow the issuer or holder to extend the contractual term (these are consistent with the SPPI requirements if the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest, including, as applicable, reasonable compensation for the extension of the contract; and
- features that modify consideration for the time value of money (for example, periodic reset of interest rates).

Impact assessment

The Bank conducted an assessment based on the above considerations and the following classification and measurement matters have been determined:

- loans and advances to banks and to customers that are classified as loans and receivables under IAS 39 will continue to be measured at amortised cost under IFRS 9;
- debt investment securities classified as available-for-sale under IAS 39 will generally be classified at FVOCI under IFRS 9, given that the objective of the business model is achieved by both the collection of contractual cash flows and selling of the financial assets; and
- the Bank's portfolio of equity securities is not significant within the context of the Bank's total assets; equity securities will nevertheless continue to be measured at fair value. As the equity securities currently held by the Bank are held for strategic reasons rather than to generate a capital return, management has tentatively decided to recognise fair value movements in other comprehensive income.

There is no significant financial impact arising out of these changed classifications as the accounting measurements are principally the same as under IAS 39.

1 **Summary of significant accounting policies** *(continued)*

1.3.1.2 Impairment

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' model. This will require considerable judgement over how changes in economic factors affect expected credit loss (ECL) allowances, which will be determined on a probability-weighted basis.

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, and certain loan commitments and financial guarantee contracts.

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

- A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Group. At initial recognition, an impairment allowance (or provision in the case of commitments and guarantees) is required for ECL resulting from default events that are possible within the next 12 months (12-month ECL).
- If a significant increase in credit risk (SICR) since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. An allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument (lifetime ECL).
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Assets in Stage 3 also carry a lifetime ECL allowance or provision.

The Bank considers a debt security to have low credit risk when it is considered 'investment-grade', defined by recognised external rating agencies as a rating between AAA to BBB- (Standard & Poor's, Fitch) and Aaa to Baa (Moody's). The Bank applies a simplification in the case of debt investment securities that are determined to have low credit risk at the reporting date; such instruments are classified in 'Stage 1', and the Bank recognises loss allowances at an amount equal to the 12-month ECL.

The impairment requirements of IFRS 9 are complex and require management judgements, estimates and assumptions, particularly in assessing whether the credit risk of an instrument has increased significantly since initial recognition and the incorporation of forward-looking information into the measurement of ECL.

Significant increase in credit risk (SICR) and the definition of default

Under IFRS 9, when determining whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information. If the Bank determines that an exposure has experienced a SICR, it is moved to Stage 2.

The definition of default is important since the measure used to determine the extent of any increase in credit risk since initial recognition of a financial instrument is performed by considering the change in the risk of default occurring over the remaining life of the financial instrument. IFRS 9 does not specifically define default, but requires it to be applied on a consistent basis with internal credit risk management practice for the relevant instruments; it also requires consideration of qualitative factors where appropriate.

In assessing whether a borrower is in default, the Bank will consider indicators that are qualitative, such as breaches of covenant, as well as quantitative, such as overdue status and non-payment of another obligation of the same obligor to the Bank.

1 **Summary of significant accounting policies** *(continued)*

These indicators are based on data developed internally and obtained from external sources. Nevertheless, unless there is reasonable and supportable information to demonstrate that a more lagging criterion is more appropriate, IFRS 9 introduces a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due.

The Bank's SICR analysis is based on its historical experience, credit assessment and forward-looking information. The Bank primarily identifies whether a SICR has occurred for an exposure within the loans and advances to customers through the Bank's internal rating grades, which are dynamic in such a way that ongoing monitoring of exposures could result in an exposure being moved to a different internal rating grade. The internal rating grades are based on a variety of data that is determined to be predictive of the risk of default; they are also based on the application of experienced credit judgement. These factors may vary depending on the nature of the exposure and the type of borrower.

Identification of SICR, and a resulting classification into Stage 2, is considered by the Bank to be appropriate when at least one of the following conditions is met:

- the exposure is considered forborne as set out in note 1.8.1.1; or
- the borrower's internal rating grade – or the internal rating grade of other exposures of the same customer – is no longer considered to be in the highest level of performing grades (i.e. they no longer carry an internal grading of P1, as set out in note 2.3).

As a backstop, and as required by IFRS 9, the Bank will presumptively consider that a SICR occurs when an asset is more than 30 days past due. The Bank will determine days past due by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received.

The SICR assessment is not performed for exposures considered 'investment-grade', which comprise loans and advances to banks and investments in debt securities. Any such securities are, under the low credit risk simplification, considered to be in Stage 1 of the IFRS 9 hierarchy.

Definition of credit-impaired

The Bank determines that a financial instrument is credit-impaired – and therefore moved to Stage 3 – by considering relevant objective evidence, primarily whether:

- there are indications that the borrower is unlikely to pay, such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; or
- the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when contractual payments of either principal or interest are past due for more than 90 days.

The alignment, as far as permissible, between the Bank's definitions of 'default' and 'credit-impaired' is such that Stage 3 represents all loans which are considered defaulted or otherwise credit-impaired.

Modified loans and advances to customers

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer.

1 **Summary of significant accounting policies** *(continued)*

The Bank renegotiates loans and advances to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis if:

- the debtor is currently in default on its debt or if there is a high risk of default;
- there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms; and
- the debtor is expected to be able to meet the revised terms

The revised terms usually include extending the maturity, revision of interest rate and changing the timing of interest payments. Such modifications are generally not considered to be significant modifications, and the Bank therefore continues to recognise the original financial assets.

Measurement of ECLs

The Bank calculates its ECLs using three main components: exposure at default (EAD), probability of default (PD), and loss given default (LGD). These parameters will be derived from internally developed statistical models and other historical data. They will be adjusted to reflect forward-looking information as described below.

- EAD represents the expected exposure in the event of a default (including any expected drawdowns of committed facilities). The Bank will derive the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract, including amortisation and prepayments. The EAD of a financial asset will be the gross carrying amount at default.
- PD estimates are estimates at date of calculating ECL allowances. PD estimates for loans and advances to customers will be calculated based on statistical rating models and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models will be based on internally-compiled data comprising both quantitative and qualitative factors. PDs will be estimated considering the contractual maturities of exposures and, as applicable, estimated prepayment rates. PD estimates for investment securities will be based on market-derived data.
- LGD represents expected losses on the EAD given the event of default. In estimating LGD, the Bank will take into account a number of attributes, including the mitigating effect of collateral value at the time it is expected to be realised, and the time value of money. The Bank will estimate LGD parameters based on the history of recovery rates of claims, adjusted by the cure rates, against defaulted counterparties. The LGD models will consider the structure, collateral, seniority of the claim and recovery costs of any collateral that is integral to the financial asset.

The ECL is measured from the initial recognition of the financial asset. The 12-month ECL for assets in Stage 1 is calculated as a factor of the 12-month PD, LGD, and EAD. Lifetime ECL is calculated on a similar basis for the residual life of the exposure, rather than the 12-month period succeeding the ECL estimation date. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument, respectively.

The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the Bank is exposed to credit risk. With respect to non-revolving credit facilities, the contractual life of the facility is considered. In the case of revolving credit facilities, provided that such facilities do not have a fixed term or repayment structure, the Bank will define the lifetime of such exposures as the period to the expected date of the next substantive credit review, which normally is performed every 12 months.

1 **Summary of significant accounting policies** *(continued)*

Forward looking information

Under IFRS 9, the Bank will incorporate forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since initial recognition and its measurement of ECL. The Bank performs a historical analysis to identify the key economic variables affecting credit risk and ECL for each portfolio. In this respect, the Bank has identified key drivers of credit risk and credit losses for each portfolio of financial instruments and, using an analysis of historical data, has analysed relationships between macro-economic variables, credit risk and credit losses. These economic variables and their associated impact on the PD, EAD and LGD may vary by portfolio.

As required by IFRS 9, the ECL estimates will be performed under multiple, weighted scenarios to capture non-linearity across credit portfolios. The scenarios, numbering three for each calculation of ECL estimates, will include a 'base line' scenario which represents the most-likely outcome, together with two other macro-economic scenarios which represent a more optimistic and more pessimistic outcome. The base line scenario will be based on authoritative sources, while the more optimistic and more pessimistic scenarios will be economically plausible and will not necessarily be as severe as scenarios used in the Bank's stress testing.

As with any macro-economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of uncertainty and therefore, the actual outcomes may be significantly different to those projected. The Bank considers these forecasts to represent its best estimate of the possible outcomes.

Presentation of ECL in statement of financial position

For financial assets that are measured at amortised cost, the ECL allowance is presented against the carrying amount of the assets on the balance sheet, thereby reducing the carrying amount.

For financial assets measured at fair value through other comprehensive income, the loss allowance is presented within other comprehensive income and not against the carrying amount of the assets. The carrying amount of the asset is always the fair value.

1.3.1.3 Transition and impact on CET1

The classification and measurement and impairment requirements of IFRS 9 are applied retrospectively by adjusting the statement of financial position at the date of initial application, which for the Bank is 1 January 2018. As allowed by IFRS 9, the Bank will not restate comparative periods in the financial statements for the year ending 31 December 2018.

Based on assessments undertaken to date, adoption is expected to reduce net assets of the Bank at 1 January 2018, net of deferred tax, in view of application of ECL requirements and the Bank is in the process of determining the amount of the impact. As at the date of approval of these financial statements, this amount is not yet firmly determined. The above assessment is subject to further transition work including refinement of the Bank's models for expected credit loss calculations. The new accounting policies, assumptions, judgements and estimation techniques employed are subject to refinement until the Bank finalises its first financial statements that include the date of initial application.

The Bank has adopted the regulatory transitional arrangements adopted by the EU on 27 December 2017. These permit banks to add back to their capital base a proportion of the impact that IFRS 9 has upon their loan loss allowances during the first five years of use. The proportion that banks may add back starts at 95% in 2018, and reduces to 25% by 2022. As a result, the CET1 after the regulatory transitional period of five years will not change in a substantial manner.

1 **Summary of significant accounting policies** *(continued)*

1.3.1.4 Disclosures

IFRS 9 will require extensive new disclosures, in particular about credit risk and ECL.

1.3.1.5 Hedge accounting

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link with risk management strategy and permitting hedge accounting to be applied to a greater variety of hedging instruments and risks, but do not explicitly address macro hedge accounting strategies, which are particularly important for banks. As a result, IFRS 9 includes an accounting policy choice to retain IAS 39 hedge accounting. As the Bank does not apply hedge accounting, IFRS 9 will have no impact in this regard.

1.3.2 IFRS 16 'Leases'

Under IFRS 16, 'Leases', a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for a consideration. IFRS 16 requires lessees to recognise a lease liability reflecting future lease payments and a 'right-of-use asset' for virtually all lease contracts; an optional exemption is available for certain short-term leases and leases of low-value assets. The standard is effective for annual periods beginning on or after 1 January 2019. The Group is assessing the impact that IFRS 16 will have on the financial statements.

1.4 *Consolidation*

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

The Group manages and administers investment vehicles on behalf of investors. The financial statements of these entities are not included in these financial statements, except when the Group controls the entity.

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If this aggregate is less than the fair value of the identifiable net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.

1 **Summary of significant accounting policies** *(continued)*

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies of the subsidiaries are consistent with the policies adopted by the Group. In the Bank's separate financial statements, investments in subsidiaries are accounted for by the cost method of accounting, i.e. at cost less impairment. Provisions are recorded where, in the opinion of the Directors, there is an impairment in value. Where there has been an impairment in the value of an investment, it is recognised as an expense in the period in which the diminution is identified. The results of subsidiaries are reflected in the Bank's separate financial statements only to the extent of dividends receivable. On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to profit or loss.

1.5 *Segment reporting*

Operating segments are reported in a manner consistent with the internal reporting provided to the Board of Directors which is the Group's chief operating decision-maker.

An operating segment's operating results are reviewed regularly by the Board of Directors to make decisions about resources to be allocated to the segment and to assess its performance executing the function of the chief operating decision-maker.

1.6 *Foreign currency translation*

The financial statements are presented in euro (€), which is the Group's presentation currency.

1.6.1 Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in euro, which is the Group's presentation currency.

1.6.2 Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are remeasured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

1.7 *Financial assets*

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, held-to-maturity financial assets and available-for-sale investments. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

1 **Summary of significant accounting policies** *(continued)*

1.7.1 Initial recognition and derecognition

The Group recognises a financial asset in its statement of financial position when it becomes a party to the contractual provisions of the instrument. Regular way purchases and sales of financial assets are recognised on the trade date, which is the date on which the Group commits to purchase or sell the asset. Accordingly, the Group uses trade date accounting for regular way contracts when recording financial asset transactions.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership or the Group has not retained control of the asset.

1.7.2 Financial assets at fair value through profit or loss

This category comprises two sub-categories: financial assets classified as held for trading, and financial assets designated by the Group as at fair value through profit or loss upon initial recognition.

A financial instrument is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term or if it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.

Derivatives are also categorised as held for trading unless they are designated and effective as hedging instruments. Assets in this category are classified as current assets if expected to be settled within twelve months; otherwise, they are classified as non-current.

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to profit or loss. Gains and losses arising from changes in fair value are included directly in profit or loss and are reported as 'net gains/(losses) on financial instruments classified as held for trading'. Interest income and dividend income on financial assets held for trading are included in 'net interest income' or 'dividend income', respectively.

The Group may designate certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed. According to IAS 39, the fair value option is only applied when the following conditions are met:

- the application of the fair value option reduces or eliminates an accounting mismatch that would otherwise arise; or
- the financial assets are part of a portfolio of financial instruments which is risk managed and reported to Senior Management on a fair value basis; or
- the financial assets consist of debt hosts and embedded derivatives that must be separated.

The Bank's held for trading financial instruments consist of derivative contracts. The Group has not designated any financial assets as at fair value through profit or loss upon initial recognition.

1 **Summary of significant accounting policies** *(continued)*

1.7.3 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- those that the Group intends to sell immediately or in the short-term, which are classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;
- those that the Group upon initial recognition designates as available-for-sale; or
- those for which the holder may not recover substantially all of their initial investment, other than because of credit deterioration.

Loans and receivables arise when the Group provides money, goods or services directly to a debtor with no intention of trading the asset. They are included in current assets except for maturities greater than twelve months after the end of the reporting period. The latter are classified as non-current assets. Loans and receivables mainly consist of balances with Central Bank of Malta, loans and advances to banks and customers, trade and other receivables together with accrued income and other assets.

Loans and receivables are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest rate method. Amortised cost is the initial measurement amount adjusted for the amortisation of any difference between the initial and maturity amounts using the effective interest method. Interest on loans and receivables is included in profit or loss and is reported as 'interest and similar income'. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the loan and receivable and recognised in profit or loss as 'net impairment losses'.

1.7.4 Held-to-maturity financial assets

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity, other than:

- those that the Group upon initial recognition designates as at fair value through profit or loss;
- those that the Group designates as available-for-sale; and
- those that meet the definition of loans and receivables.

These are initially recognised at fair value, including direct and incremental transaction costs, and measured subsequently at amortised cost using the effective interest method.

Interest on held-to-maturity investments is included in profit or loss and reported as 'interest and similar income'. In the case of an impairment, the impairment loss is being reported as a deduction from the carrying value of the investment and recognised in profit or loss as 'net gains/(losses) on investment securities'. The Group did not hold any held-to-maturity investments as at the end of the reporting period.

1 **Summary of significant accounting policies** *(continued)*

1.7.5 Available-for-sale financial assets

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices, or that are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss. They are included in non-current assets unless the asset matures or management intends to dispose of it within twelve months of the end of the reporting period.

Available-for-sale financial assets are initially recognised at fair value, which is the cash consideration including any transaction costs, and measured subsequently at fair value with gains and losses being recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses (in case of monetary assets), until the financial asset is derecognised. If an available-for-sale financial asset is determined to be impaired, the cumulative gain or loss previously recognised in other comprehensive income is reclassified to profit or loss.

Interest income is calculated using the effective interest method, and is recognised in profit or loss as are foreign currency gains and losses on monetary assets classified as available-for-sale. Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security.

Translation differences related to changes in amortised cost are recognised in profit or loss, and other changes in carrying amount are recognised in other comprehensive income. Dividends on available-for-sale equity instruments are recognised in profit or loss in 'dividend income' when the Group's right to receive payment is established.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analyses, and option pricing models making maximum use of market inputs and relying as little as possible on entity-specific inputs. The investments and the Malta Government treasury bills of the Group were all classified as available-for-sale as at the end of the reporting period.

1.8 *Impairment of financial assets*

1.8.1 Assets carried at amortised cost

The Group assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

1 **Summary of significant accounting policies** *(continued)*

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- it becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
    - adverse changes in the payment status of borrowers in the portfolio; and
    - national or local economic conditions that correlate with defaults on the assets in the portfolio.

The estimated period between a loss occurring and its identification is determined by management for each identified portfolio. In general, the periods used vary between three months and twelve months; in exceptional cases, longer periods are warranted.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Group's grading process that considers asset type, collateral type, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

1 **Summary of significant accounting policies** *(continued)*

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in profit or loss.

1.8.1.1 Forborne loans

Granting a concession to a customer that the Bank would not otherwise consider, as a result of their financial difficulty, is objective evidence of impairment and impairment losses are measured accordingly.

A forborne loan is categorised as impaired when:

- there has been a change in contractual cash flows as a result of a concession which the Bank would otherwise not consider; and
- it is probable that without the concession, the borrower would be unable to meet contractual payment obligations in full.

Forbearance activity is undertaken selectively where it has been identified that repayment difficulties against the original terms already have, or are very likely to materialise. Accordingly, taking cognisance of the principles highlighted above, forborne loans are treated as impaired loans where: the customer is experiencing, or is very likely to experience, difficulty in meeting a payment obligation to the Bank (i.e. due to current credit distress); and the Bank is offering to the customer revised payment arrangements which constitute a concession (i.e. it is offering terms it would not normally be prepared to offer).

Forborne loans are typically assessed for impairment individually. The individual impairment assessment takes into account the higher risk of the non-payment of future cash flows inherent in forborne loans. Loans subject to individual impairment assessment, which have been subject to a forbearance measure, are subject to ongoing review to determine whether they remain impaired.

Loans subject to collective impairment assessment which have been subject to a forbearance measure are segregated from other parts of the loan portfolio for the purposes of collective impairment assessment, to reflect their risk profile and the higher rates of losses often encountered in these cases. Evidence indicates an increased propensity to default and higher losses on such accounts; these factors are taken into account when calculating impairment allowances. A basic formulaic approach based on historical loss rate experience is used by the Bank. When the Bank considers that there are additional risk factors inherent in the portfolio that may not be fully reflected in the historical experience, these risk factors are taken into account by adjusting the impairment allowances derived solely from historical experience.

1 **Summary of significant accounting policies** *(continued)*

The forborne loan will continue to be disclosed as impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there are no other indicators of impairment. For loans that are assessed for impairment on a collective basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis. The minimum period of payment performance required depends on the nature of the loan in the portfolio, but is not less than twelve months. The period of performance will vary depending on the frequency of payments to be made by the customer under the amended agreement and the extent to which the customer's financial position is considered to have improved. Forborne loans cannot be returned to a non-impaired grade when a specific impairment allowance remains against any of the customer's credit facilities.

Forborne loans are not classified as impaired where the forbearance has resulted from significant concern about a borrower's ability to meet their contractual payment terms but the modified terms are based on current market rates and contractual cash flows are expected to be collected in full following the renegotiation. Non-impaired forborne loans also include previously impaired forborne loans that have demonstrated satisfactory performance over a period of time or have been assessed based on all available evidence as having no remaining indicators of impairment.

Loans that have been identified as forborne retain this designation until payment performance has been observed for an extended period of time.

When principal payments are modified resulting in permanent forgiveness, or when it is otherwise considered that there is no longer a realistic prospect of recovery of outstanding principal, the affected balances are written off.

A loan that is subject to forbearance measures is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement are modified, such that the renegotiated loan is substantially a different financial instrument. When determining whether a loan that is restructured should be derecognised and a new loan recognised, the Bank considers the extent to which the changes to the original contractual terms result in the renegotiated loan, considered as a whole, being a substantially different financial instrument. Circumstances that are likely to result in this test being met and derecognition accounting being applied comprise modified terms under the new or modified contract that are substantially different from those under the original contract.

When a loan is restructured as part of a forbearance strategy and the restructuring results in derecognition of the existing loan, the new loan is disclosed as forborne.

1.8.2 Assets classified as available-for-sale

The Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired taking cognisance of the criteria referred to in 1.8.1.

In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost (or amortised cost as applicable) and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in profit or loss. Impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

1 **Summary of significant accounting policies** *(continued)*

In devising its accounting policy in relation to the impairment of available-for-sale financial assets, more specifically the significant or prolonged decline in fair value below cost, the Bank has considered the fact that its available-for-sale equity instruments comprise a limited number of investments.

1.9 *Offsetting financial instruments*

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

1.10 *Investment in subsidiaries*

The Group classifies investments in entities which it controls as subsidiaries.

The Bank's investments in subsidiaries are stated at cost less impairment losses in the Bank's stand-alone financial statements. Impairment losses recognised in prior periods are reversed through profit or loss if there has been a change in the estimates used to determine the investment's recoverable amount since the last impairment loss was recognised.

1.11 *Investment in associates*

Associates are all entities over which the Group has significant influence but not control or joint control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting in the consolidated financial statements, after initially being recognised at cost. Under the equity method of accounting, the investment is initially recognised at cost, and the carrying amount is adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses of the investee in profit or loss, and the Group's share of movements in other comprehensive income of the investee in other comprehensive income. The Group's investment in associates includes goodwill identified on acquisition. Dividends received or receivable from associates are recognised as a reduction in the carrying amount of the investment.

When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognises the amount adjacent to 'share of profit/(loss) of associates' in the income statement.

Profits and losses resulting from upstream and downstream transactions between the Group and its associate are recognised in the Group's financial statements only to the extent of unrelated investor's interests in the associates. Unrealised losses are eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income is reclassified to profit or loss where appropriate.

1 **Summary of significant accounting policies** *(continued)*

Dilution gains and losses arising in investments in associates are recognised in the income statement.

In the Company's separate financial statements, investments in associates are accounted for by the cost method of accounting, i.e. at cost less impairment. Provisions are recorded where, in the opinion of the Directors, there is impairment in value. Where there has been impairment in the value of an investment, it is recognised as an expense in the period in which the diminution is identified. The results of the associate are reflected in the Company's separate financial statements only to the extent of dividends receivable. On disposal of an investment, the difference between the net disposal proceeds and the carrying amount is charged or credited to profit or loss.

1.12 *Intangible assets*

1.12.1 Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose, identified according to operating segment. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit. The recoverable amount is the higher of fair value less costs to sell and value in use.

1.12.2 Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised on the basis of the expected useful lives. Software has a maximum expected useful life of four years.

1.13 *Property, plant and equipment*

All property, plant and equipment used by the Group is initially recorded at historical cost, including transaction costs and borrowing costs. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Land and buildings comprise mainly branches and offices. Land and buildings are shown at fair value based on periodic valuations by external independent valuers, less subsequent depreciation for buildings. Valuations are carried out on a regular basis such that the carrying amount of property does not differ materially from that which would be determined using fair values at the end of the reporting period. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the revalued amount of the asset.

1 **Summary of significant accounting policies** *(continued)*

All other property, plant and equipment is stated at historical cost less accumulated depreciation.

Borrowing costs which are incurred for the purpose of acquiring or constructing a qualifying asset are capitalised as part of its cost. Borrowing costs are capitalised while acquisition or construction is actively underway. Capitalisation of borrowing costs is ceased once the asset is substantially complete, and is suspended if the development of the asset is suspended.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

Increases in the carrying amount arising on revaluation of land and buildings are credited to other comprehensive income and shown as a revaluation reserve in shareholders' equity. Decreases that offset previous increases of the same asset are charged to other comprehensive income and debited against the revaluation reserve directly in equity; all other decreases are charged to profit or loss.

Land is not depreciated as it is deemed to have an indefinite life. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

	Years
Buildings	100 or over period of lease/arrangement
Leasehold property	Over period of lease/arrangement
Computer equipment	4
Other	4 – 8

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see note 1.14).

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised in profit or loss. When revalued assets are sold, the amounts included in the revaluation reserve relating to that asset are transferred to retained earnings.

1 **Summary of significant accounting policies** *(continued)*

1.14 *Impairment of non-financial assets*

Assets that have an indefinite useful life, for example goodwill or certain intangible assets, are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash-generating units). The impairment test also can be performed on a single asset when the fair value less costs to sell or the value in use can be determined reliably. Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

1.15 *Repossessed property*

In certain circumstances, property is repossessed following the foreclosure on loans that are in default. Repossessed properties are measured at the lower of carrying amount and fair value less costs to sell.

1.16 *Non-current assets held for sale*

Non-current assets are classified as assets held for sale and are stated at the lower of carrying amount and fair value less costs to sell when their carrying amount is to be recovered principally through a sale transaction rather than through continuing use and a sale is considered highly probable.

1.17 *Current and deferred income tax*

The tax expense for the period comprises current and deferred tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill; deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

1 **Summary of significant accounting policies** *(continued)*

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

1.18 *Inventories*

Inventories are stated at the lower of cost and net realisable value. The cost of postal stationery and inventories held for resale is determined on a weighted average cost basis. The cost of inventories is determined on a first-in first-out basis. The cost of inventories comprise the invoiced value of goods sold and in general includes transport and handling costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

1.19 *Trade and other receivables*

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provisions for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognised in profit or loss. When a receivable is uncollectible, it is written off against the allowance account for trade and other receivables. Subsequent recoveries of amounts previously written off are credited in profit or loss.

1.20 *Share capital*

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares are shown in equity as a deduction, net of tax, from the proceeds.

1 **Summary of significant accounting policies** *(continued)*

1.21 *Financial liabilities*

The Group recognises a financial liability on its statement of financial position when it becomes a party to the contractual provisions of the instrument. The Group's financial liabilities are classified as financial liabilities which are not at fair value through profit or loss (classified as Other liabilities) under IAS 39. Financial liabilities not at fair value through profit or loss are recognised initially at fair value, being the fair value of consideration received, net of transaction costs that are directly attributable to the acquisition or the issue of the financial liability. These liabilities are subsequently measured at amortised cost. The Group derecognises a financial liability from its statement of financial position when the obligation specified in the contract or arrangement is discharged, is cancelled or expires.

Financial liabilities measured at amortised cost comprise principally amounts owed to banks, amounts owed to customers, trade and other payables (note 1.23) together with other liabilities.

1.22 *Derivative financial instruments*

Derivative financial instruments, including currency forwards, are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently remeasured at their fair value. Fair values are obtained from valuation techniques for over-the-counter derivatives, including discounted cash flow models. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Fair values for currency forwards are determined using forward exchange market rates at the end of the reporting period. Discounting techniques, reflecting the fact that the respective exchange or settlement will not occur until a future date, are used when the time value of money has a significant effect on the fair valuation of these instruments.

Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in profit or loss.

1.23 *Trade and other payables*

Trade payables comprise obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities. Trade and other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

1.24 *Provisions*

Provisions for legal and other claims are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

1 **Summary of significant accounting policies** *(continued)*

1.24.1 Provision for pension obligations

A subsidiary of the Bank provides for the obligation arising in terms of Article 8A of the Pensions Ordinance, (Chapter 93 of the Laws of Malta), covering those former Government employees who opted to become full-time employees of the subsidiary of the Bank, and who continued to be entitled to pension benefits which go beyond the National Insurance Scheme.

The pension related accounting costs are assessed using the projected unit credit method. Under this method, the cost of the subsidiary's obligation is charged to profit or loss so as to spread the cost over the years of service giving rise to entitlement to benefits in accordance with actuarial techniques. The obligation is measured as the present value of the estimated future cash outflows using interest rates of long-term Government bonds which have terms to maturity approximating the terms of the related liability. Subsequent to the adoption of IAS 19 (revised 2011), all actuarial gains and losses are charged or credited to equity in other comprehensive income in the period in which they arise.

1.25 *Interest income and expense*

Interest income and expense for all interest-bearing financial instruments are recognised within 'interest income' and 'interest expense' in the profit or loss using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

1.26 *Fees and commissions*

Fee and commission income and expense that are an integral part of the effective interest rate on a financial asset or liability are included in the calculation of the effective interest rate and treated as part of effective interest. Other fees and commissions are generally recognised on an accrual basis when the service has been provided.

Fee and commission income, comprising account servicing fees, investment management fees, placement fees and other similar fees, are recognised as the related services are performed.

Loan commitment fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. When a loan commitment is not expected to result in the drawdown of a loan, the related loan commitment fees are recognised on a straight-line basis over the commitment period. Fee and commission expense, relating mainly to transaction and service fees, are expensed as the services are received.

1 **Summary of significant accounting policies** *(continued)*

1.27 *Postal sales and service income*

Postal sales and service revenue comprises the fair value of the consideration received or receivable for the sale of services in the ordinary course of the subsidiary's activities. Revenue is shown net of sales taxes and discounts. It comprises revenue directly received from customers, commissions earned on postal and non-postal transactions and income from foreign outbound mail receivable from overseas postal administrators.

Income from sale of stamps, commission earned on postal and non-postal transactions and revenue from foreign outbound mail from overseas postal administrators is recognised when the service is rendered. Allowance is made for the assessed amount of revenue from prepaid product sales at the end of the reporting period for which the service has not yet been provided. In the case of services rendered to postal administrators in countries subject to severe exchange control restrictions and undue delays in settlement, revenue is not recognised until the subsidiary is in a position to ensure that the economic benefits associated with the transaction will flow to it, which is often upon or shortly before actual receipt.

1.28 *Dividend income*

Dividends are recognised in profit or loss in 'dividend income' when the entity's right to receive payment is established.

1.29 *Leases*

1.29.1 A group company is the lessee

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease.

1.30 *Financial guarantee contracts*

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument. Such financial guarantees are given to banks, financial institutions and other bodies on behalf of customers.

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. The fair value of a financial guarantee at the time of signature is zero because all guarantees are agreed on arm's length terms and the value of the premium agreed corresponds to the value of the guarantee obligation. No receivable for the future premiums is recognised. Subsequent to initial recognition, the Bank's liabilities under such guarantees are measured at the higher of the initial amount, less amortisation of fees recognised in accordance with IAS 18, and the best estimate of the amount required to settle the guarantee. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the judgement of management. The fee income earned is recognised in profit or loss over the life of the guarantee. Any increase in the liability relating to guarantees is recognised in profit or loss.

1.31 *Cash and cash equivalents*

Cash and cash equivalents are carried in the statement of financial position at face value. Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

1 **Summary of significant accounting policies** *(continued)*

1.32 *Dividend distribution*

Dividend distribution to the Bank's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Bank's shareholders.

2. **Financial risk management**

2.1 *Introduction*

2.1.1 Preamble

The Group's business involves taking on risks in a targeted manner and managing them professionally. The core functions of the Group's risk management are to identify all key risks for the Group, measure these risks, manage the risk positions and determine capital allocations. The Group regularly reviews its risk management policies and systems to reflect changes in markets, products and best market practice. The Group's aim is to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Group's financial performance. The Group defines risk as the possibility of losses or profits foregone, which may be caused by internal or external factors.

The Group considers risk management a core competency that helps produce consistently high returns for its various stakeholders. The Group aims to manage all major types of risk by applying methods that meet best practice. The Group considers it important to have a clear distribution of responsibilities within the area of risk management. One of the main tasks of the Group's executive management is to set the framework for this area. An understanding of risk-taking and transparency in risk-taking are key elements in the Group's business strategy and thus in its ambition to be a strong financial entity. The Group's internal risk management processes support this objective.

Risk management within the Bank is mainly carried out on a unified basis, using an integrated and entity-wide framework. This framework is based on local and international guidelines, such as the Basel III Accord, corresponding Directives and Regulations of the European Union, including technical standards, as well as contemporary international banking practices. The Bank has adopted the Standardised Approach and the Basic Method with respect to the calculation of capital requirements in relation to, and management of, credit and market risks, and the Basic Indicator Approach with respect to operational risk. The Bank regularly updates its Internal Capital Adequacy Assessment Process (ICAAP), that is approved by the Board of Directors.

2.1.2 Organisation

The Bank's Board of Directors is responsible for ensuring that adequate processes and procedures exist to ensure effective internal control systems for the Group. These internal control systems ensure that decision-making capability and the accuracy of the reporting and financial results are maintained at a high level at all times. The Board assumes responsibility for:

- setting business objectives, goals and the general strategic direction for Management with a view to maximise value;
- selecting and appointing the Chief Executive Officer who is entrusted with the day-to-day operations of the Group;
- management of the Group's operations;
- ensuring that significant business risks are identified and appropriately managed; and
- setting the highest business standards and code for ethical behaviour, and monitoring adherence with these.

2 **Financial risk management** *(continued)*

In deciding how best to discharge its responsibilities, the Board upholds a policy of clear demarcation between its role and responsibilities and those of Management. It has defined the level of authority that it retains over strategy formulation and policy determination, and delegated authority and vested accountability for the Bank's day-to-day business in the Assets & Liabilities Committee and Credit Committee, and, for the Group's day-to-day operations, in an Executive Team comprising the Chief Executive Officer and Chief Officers. The Audit & Risk Committee reviews the processes and procedures to ensure the effectiveness of the Group's system of internal control, as well as the implementation of the Board's risk strategy by management. The Audit & Risk Committee is supported by the Internal Audit and the Bank's Risk Management functions.

Authority to operate the Bank and its subsidiaries is delegated to the Chief Executive Officer within the limits set by the Board. The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide only reasonable, and not absolute, assurance against material misstatement or loss.

The Group is committed to the highest standards of business conduct and seeks to maintain these standards across all operations. Group policies and procedures are in place for the reporting and addressing of fraudulent activities.

The Group has an appropriate organisational structure for planning, executing, controlling and monitoring business operations in order to achieve Group objectives.

2.1.3 Risk policies

The Bank's Board of Directors is empowered to set out the overall risk policies and limits for all material risk types. The Board also decides on the general principles for managing and monitoring risks. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments.

Internal controls, procedures and processes are managed within the following areas:

- Finance
- Treasury
- Credit
- Internal Audit
- Risk Management
- Compliance
- Anti-Money Laundering

2.1.4 Risk appetite

The risk appetite determines the maximum risk that the Group is willing to assume to meet business targets. To ensure coherence between the Group's strategic considerations regarding risk-taking and day-to-day decisions, from time to time, the Group formulates and updates its risk appetite for the purposes of strategic direction. The Group's risk appetite is set in a process based on a thorough analysis of its current risk profile. The Group identifies a number of key risk components and for each, determines a target that represents the Group's view of the component in question. The following are the key risk components:

- Financial strength
- Earnings robustness

2 **Financial risk management** *(continued)*

- Core markets
- Credit risk
- Concentration risk
- Market risk
- Liquidity risk
- Operational risk
- Compliance

2.1.5 Reporting

The Group allocates considerable resources to ensure the ongoing compliance with approved limits and to monitor its asset portfolio. In particular, the Bank has a fixed reporting cycle to ensure that the relevant management bodies, including the Board of Directors and the Executive Team, are kept informed on an ongoing basis of developments in the asset portfolio, such matters as non-performing loans and other relevant information.

2.2 *Risk exposures*

In terms of the CRR, 'an exposure' is the amount at risk arising from the reporting credit institution's assets and off-balance sheet items. Consistent with this, an exposure would include the amount at risk arising from the Bank's:

- claims on a customer including actual and potential claims which would arise from the drawing down in full of undrawn advised facilities, which the Bank has committed itself to provide;

- contingent liabilities arising in the normal course of business, and those contingent liabilities which would arise from the drawing down in full of undrawn advised facilities which the Bank has committed itself to provide; and

- other on and off-balance sheet financial assets and commitments.

The Group is exposed to a number of risks, which it manages at different organisational levels.

The main categories of risk are:

- *Credit risk*: Credit risk stems from the possible non-prompt repayment or non-payment of existing and contingent obligations by the Group's counterparties, resulting in the loss of equity and profit. It is the risk that deterioration in the financial condition of a borrower will cause the asset value to decrease or be extinguished. Country risk and settlement risk are included in this category. Country risk refers to the risk of losses arising from economic or political changes that affect the country from which the asset originates. Settlement risk refers to the risk of losses through failure of the counterparty to settle outstanding dues on the settlement date owing to bankruptcy or other causes.

- *Market risk*: Risk of losses arising from unfavourable changes in the level and volatility of interest rates, foreign exchange rates or investment prices.

- *Liquidity risk*: Liquidity risk may be divided into two sub-categories:

    - Market (product) liquidity risk: Risk of losses arising from difficulty in accessing a product or market at the required time, price and amount.

2 **Financial risk management** *(continued)*

- Funding liquidity risk: Risk of losses arising from a timing mismatch between investing, placements and fund raising activities resulting in obligations missing the settlement date or satisfied at higher than normal rates.

- *Operational risk*: Risk of loss resulting from the lack of skilful management or good governance within the Group and the inadequacy of proper control, which might involve internal operations, personnel, systems or external occurrences that in turn affect the income and capital funds of financial institutions. The Bank has adopted an operational risk management framework and procedures, which provide for the identification, assessment, management, monitoring and reporting of the Bank's operational risks.

The Bank's approach to management of the above risks is addressed in this note.

2.3 *Credit risk*

2.3.1 Introduction

Credit risk is the risk of suffering financial loss, should any of the Group's customers, clients or market counterparties fail to fulfil their contractual obligations to the Group. Credit risk arises mainly from consumer loans and advances and loan commitments arising from such lending activities, but can also arise from credit enhancement provided, such as financial guarantees and letters of credit.

The Group is also exposed to other credit risks arising from investments in debt securities and other exposures arising from its investing activities.

Credit risk constitutes the Bank's largest risk in view of its significant lending and securities portfolios, which is monitored in a structured and formal manner through several mechanisms and procedures. The credit risk management and control functions are centralised.

2.3.2 Credit risk management

The granting of a credit facility (including loans and advances, loan commitments and guarantees) is based on the Bank's insight into the customer's financial position, which is reviewed regularly to assess whether the basis for the granting of credit has changed. Furthermore, the customer must be able to demonstrate, in all probability, the ability to repay the debt. Internal approval limits are in place starting from Bank operational managers leading up to the Credit Committee and the Board of Directors depending on the magnitude and the particular risks attached to the facility. Facilities are generally adequately secured either by property and/or guarantees and are reviewed periodically by management in terms of the exposure to the Bank and to ensure that collateral still covers the facility.

In order to minimise the credit risk undertaken, counterparty credit limits are defined with respect to investment activities, which limits consider a counterparty's creditworthiness, the value of collateral and guarantees pledged, which can reduce the overall credit risk exposure, as well as the type and the duration of the asset. In order to examine a counterparty's creditworthiness, the following are considered: country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates.

The Group has set limits of authority and has segregation of duties so as to maintain impartiality and independence during the approval process and control new and existing assets or credit facilities.

The Group manages, limits and controls concentrations of credit risk wherever they are identified – in particular, to individual counterparties and groups, and to industries and countries. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers,

2 **Financial risk management** *(continued)*

and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review, when considered necessary. Limits on the level of credit risk by product, industry sector and country are approved regularly by the Board of Directors. The exposure to any one borrower including banks and brokers is further restricted by sublimits covering on and off-balance sheet exposures. Actual exposures against limits are monitored at end of day on a daily basis and on a real-time basis too.

2.3.3 Maximum exposure to credit risk

The Group's main exposures to credit risk with respect to on and off-balance sheet financial instruments can be classified in the following categories:

- Financial assets recognised on-balance sheet comprising principally balances with Central Bank of Malta, Malta Government treasury bills, available-for-sale financial assets, trade and other receivables, and loans and advances to banks and customers. The maximum exposure to credit risk of these financial assets equals their carrying amount.
- Guarantee obligations incurred on behalf of third parties. The maximum exposure to credit risk is the full amount that the Group would have to pay as disclosed in note 24 if the guarantees are called upon.
- Loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities as disclosed in note 24.

The Group's credit risk exposures relating to on-balance sheet assets by IAS 39 categorisation and off-balance sheet instruments, reflecting the maximum exposure to credit risk before collateral held or other credit enhancements, are analysed as follows:

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Credit risk exposures relating to on-balance sheet assets				
Loans and receivables				
Balances with Central Bank of Malta	**130,303**	44,255	**130,303**	44,255
Cheques in course of collection	**1,755**	1,374	**1,755**	1,374
Loans and advances to banks	**97,048**	161,728	**90,258**	155,966
Loans and advances to customers	**428,611**	343,487	**428,611**	344,456
Trade and other receivables	**10,949**	8,136	**3,649**	3,312
Accrued income and other assets	**1,911**	2,340	**1,866**	2,287
Available-for-sale financial assets				
Debt securities	**66,512**	71,109	**62,899**	66,952
Malta Government treasury bills	**80,090**	169,244	**80,090**	169,244
	817,179	801,673	**799,431**	787,846
Credit risk exposures relating to off-balance sheet instruments				
Contingent liabilities	**9,078**	8,775	**9,093**	8,887
Commitments	**247,737**	182,919	**247,737**	182,919

2 **Financial risk management** *(continued)*

The exposures set out in this note are based on carrying amounts as reported in the statement of financial position. The table represents a worst case scenario of credit risk exposure to the Group and Bank at 31 December 2017 and 2016.

2.3.4 Investment debt securities by industry sector

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Government	**55,735**	60,165	**53,496**	57,806
Corporate				
Tourism	**806**	816	**479**	485
Trade	**236**	386	**-**	-
Property and construction	**789**	661	**285**	182
Financial institutions	**5,926**	6,139	**5,618**	5,537
Other sectors	**3,020**	2,942	**3,021**	2,942
	66,512	71,109	**62,899**	66,952

2.3.5 Loans and advances to customers by industry sector

The following industry concentrations relate to loans and advances to customers before deducting impairment allowances (Gross advances to customers):

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Manufacturing	**18,414**	15,533	**18,414**	15,533
Tourism	**12,547**	10,471	**12,547**	10,471
Trade	**47,873**	47,898	**47,873**	47,898
Property and construction	**223,219**	173,148	**223,219**	173,148
Personal, professional and home loans	**53,607**	45,459	**53,607**	45,459
Financial institutions	**77,578**	52,962	**77,578**	52,962
Other sectors	**18,221**	21,574	**18,221**	22,543
Gross advances to customers	**451,459**	367,045	**451,459**	368,014

2 **Financial risk management** *(continued)*

The majority of the Bank's loans and advances to customers comprise exposures to corporates.

As at 31 December 2017, no loans and advances to customers were deemed to be prohibited large exposures, prior to any eligible exemptions, in accordance with the requirements of Part Four: Large Exposures, of the CRR. A limited number of customers account for a certain percentage of the Bank's loans and advances. Whilst no individual customer or group of dependent customers is considered by management as a significant concentration of credit risk in the context of the CRR, these exposures are monitored and reported more frequently and rigorously.

2.3.6 Information on credit quality of balances with banks, investments and treasury bills

The Group holds debt instruments that are issued by local government, local banks and other local corporate entities. All such counterparties are listed on the Malta Stock Exchange, which is currently the only locally-based Recognised Investment Exchange (RIE) in Malta. The Bank acquires debt securities and similar instruments issued by counterparties having strong financial background. These issuers are approved and regularly reviewed considering the process previously highlighted, focusing on market developments. The Group's investments include a significant amount of treasury bills and other debt securities issued by the Government of Malta.

Within its daily operations the Bank transacts with banks and other financial institutions. The Bank primarily places short-term funds with pre-approved banks subject to limits in place and subject to the respective institution's credit rating being within controlled parameters. By conducting these transactions the Bank is running the risk of losing funds due to the possible delays in the repayment to the Bank of the existing and future obligations of the counterparty banks. Actual exposures are monitored against the limits on a daily basis and in a real-time manner. The credit status of the pre-authorised banks is monitored on an ongoing basis. At 31 December 2017, loans and advances to banks consisted primarily of term placements maturing within one month.

The Bank runs the risk of loss of funds due to the possible political, economic and other events in a particular country where funds have been placed or invested with several counterparties domiciled in the same country or region. Countries are assessed according to their size, economic data and prospects together with credit ratings issued by international rating agencies. Existing country credit risk exposures, based on groupings of individual counterparties, are monitored and reviewed periodically. The Bank's assets are predominantly in Malta. The Group's exposures to other countries are mainly limited to bank balances and money market placements with a total carrying amount of €90,258,000 (2016: €155,966,000) at the end of the reporting period.

At the end of the reporting period, the Group had no past due or impaired financial assets within these asset categories.

2 **Financial risk management** *(continued)*

The tables below analyse the credit quality of these financial assets as determined by credit ratings applicable to issuers or counterparties based on Fitch's ratings:

Group	**AA- to A-**	**Lower than A-**	**Unrated**	**Total**
	€ 000	**€ 000**	**€ 000**	**€ 000**
At 31 December 2017				
Loans and receivables				
Balances with Central Bank of Malta	**130,303**	**-**	**-**	**130,303**
Loans and advances to banks	**59,668**	**25,801**	**11,579**	**97,048**
Available-for-sale financial assets				
Debt securities	**55,735**	**5,926**	**4,851**	**66,512**
Malta Government treasury bills	**80,090**	**-**	**-**	**80,090**
	325,796	**31,727**	**16,430**	**373,953**

Group	**AA- to A-**	**Lower than A-**	**Unrated**	**Total**
	€ 000	**€ 000**	**€ 000**	**€ 000**
At 31 December 2016				
Loans and receivables				
Balances with Central Bank of Malta	44,255	-	-	44,255
Loans and advances to banks	141,460	14,506	5,762	161,728
Available-for-sale financial assets				
Debt securities	60,165	5,851	5,093	71,109
Malta Government treasury bills	169,244	-	-	169,244
	415,124	20,357	10,855	446,336

Bank	**AA- to A-**	**Lower than A-**	**Unrated**	**Total**
	€ 000	**€ 000**	**€ 000**	**€ 000**
At 31 December 2017				
Loans and receivables				
Balances with Central Bank of Malta	**130,303**	**-**	**-**	**130,303**
Loans and advances to banks	**59,668**	**25,587**	**5,003**	**90,258**
Available-for-sale financial assets				
Debt securities	**53,496**	**5,618**	**3,785**	**62,899**
Malta Government treasury bills	**80,090**	**-**	**-**	**80,090**
	323,557	**31,205**	**8,788**	**363,550**

2 **Financial risk management** *(continued)*

Bank	**AA- to A-**	**Lower than A-**	**Unrated**	**Total**
	€ 000	**€ 000**	**€ 000**	**€ 000**
At 31 December 2016				
Loans and receivables				
Balances with Central Bank of Malta	44,255	-	-	44,255
Loans and advances to banks	141,460	14,506	-	155,966
Available-for-sale financial assets				
Debt securities	57,806	5,536	3,610	66,952
Malta Government treasury bills	169,244	-	-	169,244
	412,765	20,042	3,610	436,417

The exposures at 31 December 2017 reflected within the above tables, categorised as Lower than A-, are predominantly rated as BBB+ by Fitch.

After the end of the reporting period there were no significant changes in credit ratings reflected in the tables above which have a material impact on the credit quality of the financial assets.

2.3.7 Information on credit quality of loans and advances to customers

The Bank manages the credit quality of its loans and advances to customers by using internal risk grades, which provide a progressively increasing risk profile ranging from 'P1' (best quality, less risky) to 'NP'. The nomenclature of the internal risk grades applied has been modified during the current financial year. These risk grades are an essential tool for the Bank to identify both non-performing exposures and better-performing customers. The internal risk grades used by the Bank are as follows:

- Performing: Internal grades ranging from 'P1' to 'P3'; and
- Non-performing: Internal grade 'NP'.

P1

The Bank's loans and advances to customers which are categorised as 'P1' are principally debts in respect of which the payment of interest and/or capital is not overdue by 30 days and no recent history of customer default exists. Management does not expect any losses from non-performance by these customers.

P2

Loans and advances which attract a 'P2' grading are those which are receiving the close attention of the Bank's management and are being reviewed periodically in order to determine whether such advances should be reclassified to either the 'P1' or the 'P3' classification. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 30 days and over but not exceeding 60 days.

2 **Financial risk management** *(continued)*

P3

Loans and advances which attract a 'P3' grading are those having the weaknesses inherent in those loans and advances classified as 'P2' with the added characteristics that repayment is inadequately protected by the current sound worth and paying capacity of the borrower. Loans and advances so graded have a well-defined weakness or weaknesses that could jeopardise the repayment of the debt. They are characterised by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 60 days and over but not exceeding 90 days.

NP

Loans and advances which attract a 'NP' grading are those facilities where the Bank deems the recoverability of principal to be remote as a result of worsening conditions of loans and advances classified as 'P3'. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 90 days and over. This category comprises loans and advances which are deemed specifically impaired in accordance with the requirements of IFRSs as adopted by the EU. The Bank's non-performing forborne loans (refer to note 2.3.8) are also classified within this category.

Impaired loans and advances

Impaired loans and advances are advances in respect of which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loans and receivables. The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses on its loans and advances portfolio. The main components of this allowance are specific impairment allowances, that relate to individually significant exposures and other individual exposures in respect of which impairment losses have been identified, and a collective impairment allowance established to cover losses which have been incurred but they have not yet been identified as loans subject to individual assessment or for groups of loans that are not considered individually significant. The Bank writes off loan or advance balances (and writes back any related allowances for impairment losses) when it determines that these are uncollectible. This decision is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

The individually impaired loans and advances mainly relate to a number of independent customers which are in unexpectedly difficult economic situations and which are accordingly not meeting repayment obligations. These exposures mainly arose in the Construction and Households sectors and relate to advances which are past due by more than ninety days and/or graded as 'NP'. Provisions for impairment in respect of balances with corporate customers relate to entities which are in adverse trading and operational circumstances. It was assessed that a significant portion of these advances is expected to be recovered. Provisions for impairment as at the end of the reporting period and movements in such provisions arising during the year are disclosed in notes 8 and 31 to the financial statements. Reversals of provisions for impairment arise in those situations where customers recover from unfavourable circumstances and accordingly start meeting repayment obligations including accrued interest.

2 **Financial risk management** *(continued)*

The amounts attributable to the Bank's loans and advances differ from the figures for Group's loans and advances in view of the Bank's exposure to its subsidiary, which exposure is deemed fully performing. Accordingly the amounts presented in the tables within this note and note 2.3.9 reflects the Bank's figures in respect of loans and advances.

Impaired loans and advances, gross of specific impairment allowances, are analysed by industry sector as follows:

	2017	2016
	€ 000	€ 000
Manufacturing	**4,268**	4,008
Tourism	**2,257**	2,123
Trade	**895**	2,777
Property and construction	**28,324**	29,620
Personal, professional and home loans	**3,880**	2,567
Financial institutions	**-**	72
Other sectors	**588**	1,063
Gross impaired advances to customers	**40,212**	42,230

2 **Financial risk management** *(continued)*

The following table provides a detailed analysis of the credit quality of the Bank's lending portfolio:

	Non-forborne exposures 2017 € 000	Forborne exposures 2017 € 000	Total 2017 € 000	Non-forborne exposures 2016 € 000	Forborne exposures 2016 € 000	Total 2016 € 000
Performing						
Neither past due nor impaired						
P1	**347,864**	**8,241**	**356,105**	241,995	257	242,252
P2	**15,365**	**-**	**15,365**	18,972	-	18,972
P3	**1,391**	**-**	**1,391**	-	-	-
	364,620	**8,241**	**372,861**	260,967	257	261,224
Past due by less than 90 days but not impaired						
P1	**2,209**	**754**	**2,963**	14,281	756	15,037
P2	**1,333**	**-**	**1,333**	2,139	153	2,292
P3	**1,229**	**-**	**1,229**	3,863	-	3,863
	4,771	**754**	**5,525**	20,283	909	21,192
Non-performing						
Impaired, gross of specific impairment allowances	**27,950**	**12,262**	**40,212**	30,503	11,727	42,230
Forborne (excluding impaired exposures)	**-**	**21,707**	**21,707**	-	28,542	28,542
Non-forborne past due by 90 days or more but not impaired	**11,154**	**-**	**11,154**	14,826	-	14,826
	39,104	**33,969**	**73,073**	45,329	40,269	85,598
Gross loans and advances	**408,495**	**42,964**	**451,459**	326,579	41,435	368,014
Specific impairment allowances applied to impaired exposures reflected above	**(13,652)**	**(4,382)**	**(18,034)**	(15,085)	(3,730)	(18,815)
Collective impairment allowances	**(3,635)**	**(1,179)**	**(4,814)**	(4,093)	(650)	(4,743)
Net loans and advances	**(391,208)**	**(37,403)**	**428,611**	307,401	37,055	344,456

Interest income recognised during the financial year ended 31 December 2017 in respect of forborne exposures amounted to €2,827,000 (2016: €3,201,000).

2 **Financial risk management** *(continued)*

2.3.8 Forbearance measures and forborne loans

The contractual terms of a loan may be revised for a number of reasons, including changes in market conditions, customer retention and other factors not related to the credit quality of a customer. Forbearance measures comprise concessions made on the contractual terms of a loan in response to a customer's financial difficulties. The Bank categorises loans on which concessions have been granted under conditions of financial difficulties as 'forborne loans' when their contractual payment terms have been revised, because of significant concerns about the borrowers' ability to meet contractual payments when due.

When considering whether there is significant concern regarding a customer's ability to meet contractual loan repayments when due, the Bank assesses the customer's delinquency status, account behaviour, repayment history, current financial situation and continued ability to repay. If the customer is not meeting contractual repayments or it is evident that the client will be unable to do so without the renegotiation, there will be a significant concern regarding the ability to meet contractual payments. Indicators of significant concerns regarding a borrower's ability to pay include:

- the debtor is currently in default on any of its debt;
- the debtor has declared or is in the process of declaring bankruptcy or entering into a similar process;
- there is significant doubt as to whether the debtor will continue to be a going concern; and
- the bank forecasts that the debtor's entity-specific cash flows will be insufficient to service the debt (both interest and principal) in accordance with the contractual terms of the existing agreement through maturity.

A range of forbearance measures is employed in order to improve the management of customer relationships, maximise collection opportunities and, if possible, avoid default or call-in of facilities. They include extended payment terms, a reduction in principal repayments, the deferral of call-in of facilities and other forms of loan modifications. The Bank's policies and practices in this area allow the Bank to provide a customer with terms and conditions that are more favourable than those provided initially. Loan forbearance is only granted in situations where the customer has shown a willingness to repay the loan and is expected to be able to meet the revised obligations. The Bank's credit risk management policy sets out restrictions on the number and frequency of forbearance measures and the minimum period an account must have been opened before any forbearance measure can be considered.

For the purposes of determining whether changes to a customer's agreement should be treated as forbearance the following types of modification are regarded as concessionary:

- reduction of the stated interest rate for the remaining original life of the debt;
- extension of the maturity date or dates at a stated interest rate lower than the current market rate for new debt with similar risk;
- reduction of the face amount or maturity amount of the debt; and
- reduction of accrued interest.

Term extension is the most common type of modification granted by the Bank. Other types of concession such as transfer to an interest-only arrangement or interest rate changes occur less often.

2 **Financial risk management** *(continued)*

In assessing whether forbearance is a sustainable strategy, the customer's entire exposures and facilities will be reviewed and the customer's ability to meet the terms in relation to the revised obligation and other unchanged credit facilities is considered. In all cases, forbearance is only granted when the customer is expected to be able to meet the revised terms. When considering acceptable modified terms the Bank considers the ability of the customer to be able to service the revised interest payments as a necessity. When principal payment modifications are utilised, the Bank requires the customer to be able to comply with the revised terms as a necessary pre-condition for the restructuring to proceed.

There were no material changes to the Bank's policies and procedures regarding forbearance or forborne loans in 2017.

2.3.9 Required disclosures in relation to loans and advances to customers

Past due but not impaired loans

Past due but not impaired loans comprise loans and advances where interest or principal payments are past due, but the Bank believes that impairment is not appropriate on the basis of the level of security available and/or the stage of collection of amounts owed to the Bank. The past due ageing analysis is shown in the following table. Related credit losses which have been incurred but are not yet identified are partly covered by collective impairment allowances.

Bank	**Non-forborne exposures 2017 € 000**	**Forborne exposures 2017 € 000**	Non-forborne exposures 2016 € 000	Forborne exposures 2016 € 000
Past due up to 30 days	**3,221**	**614**	16,649	872
Past due between 31 and 60 days	**996**	**140**	1,871	37
Past due between 61 and 90 days	**554**	**-**	1,763	-
Past due over 90 days	**11,154**	**21,707**	14,826	28,542
	15,925	**22,461**	35,109	29,451

2 **Financial risk management** *(continued)*

The movement in the carrying amount of forborne loans and advances, before specific impairment allowances, is analysed below:

Bank	**Forborne exposures 2017 € 000**	Forborne exposures 2016 € 000
At 1 January	**41,435**	68,795
Loans to which forbearance measures have been extended during the year	**7,361**	11,918
Repayments	**(2,365)**	(1,991)
Retired from forborne	**(3,467)**	(37,287)
At 31 December	**42,964**	41,435

During the current financial year, specific impairment allowances on forborne loans has increased marginally from €3,730,000 at 1 January 2017 to €4,382,000 at 31 December 2017. The movement reflects solely increases in allowances in respect of specific exposures.

Forborne loans, before specific impairment allowances, are analysed by industry sector as follows:

Bank	**Neither past due nor impaired € 000**	**Past due but not impaired € 000**	**Impaired € 000**	**Total € 000**
At 31 December 2017				
Manufacturing	-	**115**	**262**	**377**
Tourism	-	-	**110**	**110**
Trade	**1,050**	**4,035**	**723**	**5,808**
Property and construction	**5,958**	**8,878**	**7,960**	**22,796**
Personal, professional and home loans	**83**	**3,727**	**3,207**	**7,017**
Financial institutions	**1,150**	**5,283**	-	**6,433**
Other sectors	-	**423**	-	**423**
	8,241	**22,461**	**12,262**	**42,964**

2 **Financial risk management** *(continued)*

Bank	**Neither past due nor impaired € 000**	**Past due but not impaired € 000**	**Impaired € 000**	**Total € 000**
At 31 December 2016				
Manufacturing	40	145	251	436
Tourism	-	-	111	111
Trade	-	5,466	854	6,320
Property and construction	-	13,511	8,388	21,899
Personal, professional and home loans	-	4,015	1,730	5,745
Financial institutions	-	5,906	-	5,906
Other sectors	217	408	393	1,018
	257	29,451	11,727	41,435

Forborne loans mainly comprise exposures to corporate customers based in Malta.

2.3.10 Collateral

Collateral is an important mitigant of credit risk. Nevertheless, it is Bank's policy to establish that facilities are within the customer's capacity to repay rather than to place excess reliance on security. In certain cases, depending on the customer's standing and the type of product, facilities may be unsecured. The Bank applies various measures to reduce the risk on individual transactions, including collateral in the form of physical assets and guarantees. The most important instruments utilised to reduce risk are charges against real property.

The tables below show loans and advances to customers by level of collateral. The collateral measured in the tables below consists of fixed first charges on real estate and charges over cash and marketable financial instruments. The values in the tables represent the expected market value on an open market basis; no adjustment has been made to the collateral for any expected costs of recovery. Cash is valued at its nominal value and marketable securities at their fair value.

The LTV ratios presented are calculated by directly associating loans and advances with the collateral that individually and uniquely supports each facility.

Where collateral assets are shared by multiple loans and advances, the collateral value is pro-rated across the loans and advances protected by the collateral. Other types of collateral which are commonly taken for the business of lending such as unsupported guarantees and floating charges over the assets of a customer's business are not measured in the tables below. While such mitigants have value, often providing rights in insolvency, their assignable value is not sufficiently certain and they are therefore assigned no value for disclosure purposes.

The value of real estate collateral is determined by using a combination of professional and internal valuations and physical inspections. Revaluations are sought with greater frequency as concerns over the performance of the collateral or the direct obligor increase.

2 **Financial risk management** *(continued)*

	Non-forborne exposures 2017 € 000	**Forborne exposures 2017 € 000**	**Total 2017 € 000**	Non-forborne exposures 2016 € 000	Forborne exposures 2016 € 000	Total 2016 € 000
Performing						
Not collateralised	**73,615**	**42**	**73,657**	44,533	77	44,610
Fully collateralised						
Less than 50% LTV	**190,449**	**3,839**	**194,288**	146,635	282	146,917
51% to 75% LTV	**68,830**	**4,286**	**73,116**	51,413	116	51,529
76% to 90% LTV	**13,045**	**708**	**13,753**	12,104	691	12,795
91% to 100% LTV	**12,468**	**120**	**12,588**	4,232	-	4,232
	284,792	**8,953**	**293,745**	214,384	1,089	215,473
Partially collateralised						
Greater than 100% LTV	**10,984**	**-**	**10,984**	22,333	-	22,333
Total performing	**369,391**	**8,995**	**378,386**	281,250	1,166	282,416
Non-performing						
Not collateralised	**897**	**209**	**1,106**	1,725	179	1,904
Fully collateralised						
Less than 50% LTV	**7,549**	**16,520**	**24,069**	9,062	15,895	24,957
51% to 75% LTV	**9,356**	**8,082**	**17,438**	12,995	13,132	26,127
76% to 90% LTV	**1,045**	**2,317**	**3,362**	538	3,675	4,213
91% to 100% LTV	**618**	**-**	**618**	2,388	1,035	3,423
	18,568	**26,919**	**45,487**	24,983	33,737	58,720
Partially collateralised						
Greater than 100% LTV	**19,639**	**6,841**	**26,480**	18,621	6,353	24,974
Total non-performing	**39,104**	**33,969**	**73,073**	45,329	40,269	85,598
At 31 December	**408,495**	**42,964**	**451,459**	326,579	41,435	368,014

2 **Financial risk management** *(continued)*

2.3.11 Trade and other receivables

The Bank's subsidiary assesses the credit quality of its customers taking into account financial position, past experience and other factors. It has policies in place to ensure that sales of products and services are effected to customers with an appropriate credit history in the case of credit sales. The subsidiary monitors the performance of these financial assets on a regular basis to identify incurred collection losses which are inherent in the subsidiary's receivables taking into account historical experience in collection of accounts receivable.

Standard credit terms are in place for individual clients, however, wherever possible, new corporate customers are analysed individually for creditworthiness before the subsidiary's standard payment and service delivery terms and conditions are offered. The entity's review includes external creditworthiness databases when available. The subsidiary establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. This allowance represents specific provisions against individual exposures. The movement in provisions for impairment in respect of trade receivables is disclosed in note 15. Other overdue trade receivables amounted to €773,000 (2016: €817,000) but were not impaired.

The subsidiary's receivables, which are not impaired financial assets, are principally in respect of transactions with customers for whom there is no recent history of default. Management does not expect any material losses from non-performance by these customers.

2.3.12 Contingencies and commitments

Guarantees and standby letters of credit carry the same credit risk as loans. Documentary and commercial letters of credit – which are written undertakings by the Bank on behalf of a customer authorising a third party to draw drafts on the Bank up to a stipulated amount under specific terms and conditions – are collateralised by the underlying shipments of goods to which they relate and therefore carry less risk than a direct loan. Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments as most commitments to extend credit are contingent upon customers maintaining specific credit standards. These exposures are monitored in the same manner outlined above in respect of loans and advances.

2.4 *Market risk*

The Group takes on exposure to market risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

2 **Financial risk management** *(continued)*

Accordingly, market risk for the Group consists of three elements:

- Interest rate risk, which is the risk of losses because of changes in interest rates;
- Exchange rate risk, which is the risk of losses on the Group's positions in foreign currency because of changes in exchange rates; and
- Equity price risk, which is the risk of losses because of changes in investment prices.

2.4.1 Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Group, through its banking operations, takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but losses may occur in the event that unexpected movements arise.

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice within different time periods or on different terms. The Bank accepts deposits from customers at both fixed and floating rates and for varying terms. This poses a risk to the Bank, which risk is managed by monitoring on a continuous basis the level of mismatch of interest rate repricing taking cognisance of the terms of the Bank's principal assets, loans and advances to customers, that are repriceable at the Bank's discretion. The Bank also invests in highly liquid quality assets and other short-term instruments for the purposes of mitigating exposures to fluctuations in interest rates. The Bank is accordingly in a position to manage the interest rate terms of its financial assets and simultaneously to effect changes to interest terms of liabilities reflecting the Bank's strategy together with market developments. The Group seeks to manage its net interest spread, considering the cost of capital, by investing funds in a portfolio of assets with a longer term than the liabilities funding them (therefore normally giving rise to a negative maturity gap position) but with shorter repricing periods or terms. The Bank manages the shorter term nature of the liabilities funding the assets for the purposes of ensuring a steady base of deposits with differing terms over the medium to longer term. The Bank's Assets & Liabilities Committee is primarily responsible for oversight over the Bank's interest rate risk management process and monitors actively the interest rate risk measures utilised by the Bank.

Credit facilities and commitments to lend funds to customers are granted at prevailing market interest rates at drawdown date.

2 **Financial risk management** *(continued)*

The following tables summarise the Group's exposures to interest rate risks. These analyse the Group's financial instruments, which were interest-bearing at their carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates.

Group

At 31 December 2017	Carrying amount € 000	Effective interest rate %	Less than 3 months € 000	Between 3 months and 1 year € 000	Between 1 year and 5 years € 000	More than 5 years € 000	Non-interest bearing € 000
Financial assets							
Balances with Central Bank of Malta, treasury bills and cash	215,133	0.08	190,360	20,033	-	-	4,740
Debt and other fixed income instruments classified as available-for-sale investments	66,512	2.81	-	4,126	28,352	34,034	-
Loans and advances to banks	97,048	0.03	87,048	10,000	-	-	-
Loans and advances to customers	428,611	4.71	321,953	11,213	59,534	33,907	2,004
Total financial assets	807,304		599,361	45,372	87,886	67,941	6,744
Financial liabilities							
Amounts owed to banks	5,362	0.10	5,268	-	-	-	94
Amounts owed to customers	733,151	0.88	431,716	96,598	72,440	53,073	79,324
Total financial liabilities	738,513		436,984	96,598	72,440	53,073	79,418
Interest re-pricing gap			162,377	(51,226)	15,446	14,868	(72,674)
Cumulative gap			162,377	111,151	126,597	141,465	

2 **Financial risk management** *(continued)*

Group

At 31 December 2016	Carrying amount € 000	Effective interest rate %	Less than 3 months € 000	Between 3 months and 1 year € 000	Between 1 year and 5 years € 000	More than 5 years € 000	Non-interest bearing € 000
Financial assets							
Balances with Central Bank of Malta, treasury bills and cash	218,148	(0.40)	146,350	67,149	-	-	4,649
Debt and other fixed income instruments classified as available-for-sale investments	71,109	3.48	288	2,951	32,250	35,620	-
Loans and advances to banks	161,728	0.04	141,826	19,902	-	-	-
Loans and advances to customers	343,487	5.10	289,430	3,541	22,080	25,755	2,681
Total financial assets	794,472		577,894	93,543	54,330	61,375	7,330
Financial liabilities							
Amounts owed to banks	9,036	0.10	8,843	-	-	-	193
Amounts owed to customers	721,559	1.20	420,327	78,414	112,046	36,792	73,980
Total financial liabilities	730,595		429,170	78,414	112,046	36,792	74,173
Interest re-pricing gap			148,724	15,129	(57,716)	24,583	(66,843)
Cumulative gap			148,724	163,853	106,137	130,720	

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2 **Financial risk management** *(continued)*

Bank

At 31 December 2017	Carrying amount € 000	Effective interest rate %	Less than 3 months € 000	Between 3 months and 1 year € 000	Between 1 year and 5 years € 000	More than 5 years € 000	Non-interest bearing € 000
Financial assets							
Balances with Central Bank of Malta, treasury bills and cash	214,500	0.08	190,360	20,033	-	-	4,107
Debt and other fixed income instruments classified as available-for-sale investments	62,899	2.73	-	4,126	27,083	31,690	-
Loans and advances to banks	90,258	0.02	82,258	8,000	-	-	-
Loans and advances to customers	428,611	4.71	321,953	11,213	59,534	33,907	2,004
Total financial assets	796,268		594,571	43,372	86,617	65,597	6,111
Financial liabilities							
Amounts owed to banks	5,362	0.10	5,268	-	-	-	94
Amounts owed to customers	736,695	0.88	433,542	96,612	72,440	53,073	81,028
Total financial liabilities	742,057		438,810	96,612	72,440	53,073	81,122
Interest re-pricing gap			155,761	(53,240)	14,177	12,524	(75,011)
Cumulative gap			155,761	102,521	116,698	129,222	

2 **Financial risk management** *(continued)*

Bank

At 31 December 2016	Carrying amount € 000	Effective interest rate %	Less than 3 months € 000	Between 3 months and 1 year € 000	Between 1 year and 5 years € 000	More than 5 years € 000	Non-interest bearing € 000
Financial assets							
Balances with Central Bank of Malta, treasury bills and cash	217,398	(0.40)	146,350	67,149	-	-	3,899
Debt and other fixed income instruments classified as available-for-sale investments	66, 952	3.45	-	2,951	30,811	33,190	-
Loans and advances to banks	155,966	0.04	136,064	19,902	-	-	-
Loans and advances to customers	344,456	5.10	290,399	3,541	22,080	25,755	2,681
Total financial assets	784,772		572,813	93,543	52,891	58,945	6,580
Financial liabilities							
Amounts owed to banks	9,036	0.10	8,843	-	-	-	193
Amounts owed to customers	725,382	1.20	422,150	80,414	112,046	36,792	73,980
Total financial liabilities	734,418		430,993	80,414	112,046	36,792	74,173
Interest re-pricing gap			141,820	13,129	(59,155)	22,153	(67,593)
Cumulative gap			141,820	154,949	95,794	117,947	

2 **Financial risk management** *(continued)*

2.4.2 Interest rate profile

At the end of the reporting periods the interest rate profile of the Group's interest-bearing financial instruments was:

Group	**Fixed rate**		**Variable rate**	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Interest-earning assets				
Balances with Central Bank of Malta and treasury bills	**202,222**	206,244	**8,172**	7,255
Debt and other fixed income instruments classified as available-for-sale investments	**64,512**	69,109	**2,000**	2,000
Loans and advances to banks	**24,167**	92,582	**72,881**	69,146
Loans and advances to customers	**106,290**	51,910	**320,317**	288,896
	397,191	419,845	**403,370**	367,297
Interest-bearing liabilities				
Amounts owed to banks	**222**	351	**5,046**	8,492
Amounts owed to customers	**269,135**	275,638	**384,692**	371,941
	269,357	275,989	**389,738**	380,433

At the end of the reporting periods the interest rate profile of the Bank's interest-bearing financial instruments was:

Bank	**Fixed rate**		**Variable rate**	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Interest-earning assets				
Balances with Central Bank of Malta and treasury bills	**202,222**	206,244	**8,172**	7,255
Debt and other fixed income instruments classified as available-for-sale investments	**60,899**	64,952	**2,000**	2,000
Loans and advances to banks	**22,167**	92,582	**68,091**	63,384
Loans and advances to customers	**106,290**	51,910	**320,317**	289,865
	391,578	415,688	**398,580**	362,504
Interest-bearing liabilities				
Amounts owed to banks	**222**	351	**5,046**	8,492
Amounts owed to customers	**269,150**	277,638	**386,517**	373,764
	269,372	277,989	**391,563**	382,256

2 **Financial risk management** *(continued)*

2.4.3 Fair value sensitivity analysis for fixed rate instruments

The Group's instruments exposing the Bank to fair value interest rate risk consist of available-for-sale quoted debt securities (also refer to note 6) since these are fair valued with fair value changes recognised in other comprehensive income. Considering the nature and carrying amount of the investments, with the majority of investments comprising securities issued by the Government of Malta, a sensitivity analysis disclosing how equity would have been affected by changes in interest rates that were reasonably possible at the end of the reporting period is not deemed necessary.

2.4.4 Cash flow sensitivity analysis for variable rate instruments

At the end of the reporting periods, if interest rates had increased/decreased by 100 basis points (assuming a parallel shift of 100 basis points in yields) with all other variables held constant, the pre-tax result for the year would change by the following amounts determined by applying the shift to the net variable interest exposure of the Group/Bank at the end of the reporting periods:

Group	**2017**	2016
	€ 000	€ 000
(+) 100bp	**136**	(131)
(-) 100bp	**(136)**	131

Bank	**2017**	2016
	€ 000	€ 000
(+) 100bp	**70**	(198)
(-) 100bp	**(70)**	198

2.4.5 Currency risk

The Group takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows particularly within the Bank's operations. Foreign exchange risk to the Bank is the risk that earnings and values fluctuate as a result of changes in foreign exchange rates. The Bank's foreign exchange risk arises when financial assets or liabilities are denominated in currencies which are different from the Bank's functional currency.

The Bank essentially manages this risk by ensuring that foreign currency liabilities are utilised to fund assets denominated in the same foreign currency thereby matching asset and liability positions as much as is practicable. This mechanism is reflected in the figures reported in the tables below which present this matching process.

The Bank maintains its exposure to foreign currencies within prescribed limits set by the Bank's ALCO. ALCO sets limits on the level of exposure by currency and in aggregate for both overnight and intra-day positions which are monitored on a real-time basis.

2 **Financial risk management** *(continued)*

The Bank enters into forward foreign exchange contracts with customers in the normal course of its business. Generally, it is the Bank's policy to cover the exposure arising from forward contracts. As a result, the Group is not exposed to any significant exchange risk in respect of outstanding derivative financial instruments at the end of the reporting periods. The Bank also retains a deposit margin covering a portion of the notional amount of the respective contract from the customer thereby reducing the extent of credit risk should the derivative client default. The Bank did not have any derivative financial instruments as at 31 December 2017 and 2016.

The following tables summarise the Group's exposures to foreign currency risk. Included in the tables are the entity's financial instruments which are subject to foreign exchange risk at carrying amounts, categorised by currency.

Group

At 31 December 2017	**Total € 000**	**EUR € 000**	**GBP € 000**	**USD € 000**	**Other € 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	**215,133**	**151,633**	**21,589**	**41,842**	**69**
Investments classified as available-for-sale	**75,895**	**75,520**	**-**	**375**	**-**
Loans and advances to banks	**97,048**	**69,316**	**13,288**	**9,024**	**5,420**
Loans and advances to customers	**428,611**	**423,712**	**2,712**	**1,489**	**698**
Other assets	**14,615**	**12,654**	**272**	**1,167**	**522**
Total financial assets	**831,302**	**732,835**	**37,861**	**53,897**	**6,709**
Financial liabilities					
Amounts owed to banks	**5,362**	**5,162**	**-**	**-**	**200**
Amounts owed to customers	**733,151**	**637,506**	**37,525**	**52,164**	**5,956**
Other liabilities	**34,269**	**32,847**	**360**	**737**	**325**
Total financial liabilities	**772,782**	**675,515**	**37,885**	**52,901**	**6,481**
Net currency exposure in financial assets/liabilities	**-**	**57,320**	**(24)**	**996**	**228**
Commitments and contingent liabilities	**256,815**	**255,678**	**958**	**179**	**-**

2 **Financial risk management** *(continued)*

Group

At 31 December 2016	Total € 000	EUR € 000	GBP € 000	USD € 000	Other € 000
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	218,148	217,205	510	384	49
Investments classified as available-for-sale	80,515	80,084	-	431	-
Loans and advances to banks	161,728	51,718	49,342	55,272	5,396
Loans and advances to customers	343,487	337,636	1,353	3,270	1,228
Other assets	11,851	10,220	205	1,008	418
Total financial assets	815,729	696,863	51,410	60,365	7,091
Financial liabilities					
Amounts owed to banks	9,036	8,685	-	-	351
Amounts owed to customers	721,559	606,737	50,955	57,572	6,295
Other liabilities	24,206	22,026	440	1,336	404
Total financial liabilities	754,801	637,448	51,395	58,908	7,050
Net currency exposure in financial assets/liabilities		59,415	15	1,457	41
Commitments and contingent liabilities	191,694	190,728	835	131	-

Under the scenario that the euro appreciates by 20% against all currencies the effect would be a decrease of €240,000 (2016: €303,000) in the carrying amount of financial instruments with the adverse impact recognised in profit or loss. Should the euro depreciate against all currencies by 20%, the effect would be a gain of €240,000 (2016: €303,000) in the carrying amount of financial instruments and the favourable impact would be recognised in profit or loss.

2 **Financial risk management** *(continued)*

The following tables summarise the Bank's exposures to foreign currency risk. Included in the tables are the entity's financial instruments which are subject to foreign exchange risk at carrying amounts, categorised by currency.

Bank

At 31 December 2017	Total € 000	EUR € 000	GBP € 000	USD € 000	Other € 000
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	**214,500**	**151,000**	**21,589**	**41,842**	**69**
Investments classified as available-for-sale	**72,282**	**71,906**	**-**	**376**	**-**
Loans and advances to banks	**90,258**	**62,587**	**13,287**	**8,964**	**5,420**
Loans and advances to customers	**428,611**	**423,712**	**2,712**	**1,489**	**698**
Other assets	**7,271**	**7,233**	**17**	**21**	**0**
Total financial assets	**812,922**	**716,438**	**37,605**	**52,692**	**6,187**
Financial liabilities					
Amounts owed to banks	**5,362**	**5,162**	**-**	**-**	**200**
Amounts owed to customers	**736,695**	**641,039**	**37,525**	**52,175**	**5,956**
Other liabilities	**19,496**	**19,270**	**82**	**95**	**49**
Total financial liabilities	**761,553**	**665,471**	**37,607**	**52,270**	**6,205**
Net currency exposure in financial assets/liabilities	**-**	**50,967**	**(2)**	**422**	**(18)**
Commitments and contingent liabilities	**256,830**	**255,693**	**958**	**179**	**-**

2 **Financial risk management** *(continued)*

Bank

At 31 December 2016	**Total € 000**	**EUR € 000**	**GBP € 000**	**USD € 000**	**Other € 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	217,398	216,457	508	384	49
Investments classified as available-for-sale	76,358	75,927	-	431	-
Loans and advances to banks	155,966	46,324	49,342	54,904	5,396
Loans and advances to customers	344,456	338,605	1,353	3,270	1,228
Other assets	6,973	6,883	21	69	-
Total financial assets	801,151	684,196	51,224	59,058	6,673
Financial liabilities					
Amounts owed to banks	9,036	8,685	-	-	351
Amounts owed to customers	725,382	610,556	50,955	57,576	6,295
Other liabilities	13,093	12,291	266	509	27
Total financial liabilities	747,511	631,532	51,221	58,085	6,673
Net currency exposure in financial assets/liabilities		52,664	3	973	-
Commitments and contingent liabilities	191,806	190,840	835	131	-

Under the scenario that the euro appreciates by 20% against all currencies the effect would be a decrease of €80,000 (2016: €195,000) in the carrying amount of financial instruments with the adverse impact recognised in profit or loss. Should the euro depreciate against all currencies by 20%, the effect would be a gain of €80,000 (2016: €195,000) in the carrying amount of financial instruments and the favourable impact would be recognised in profit or loss.

2 **Financial risk management** *(continued)*

2.4.6 Equity price risk

The exposure of the Group to this risk is not significant in view of the extent of the Group's holdings of available-for-sale equity investments (refer to note 6) which are not deemed material in the context of the Group's statement of financial position. These investments are principally locally quoted equity instruments issued by local well known corporates. Frequent management reviews are carried out to ensure continued high quality of the portfolio.

2.5 *Liquidity risk*

Liquidity risk is defined as the risk of losses due to:

- the Group's funding costs increasing disproportionately;
- lack of funding preventing the Group from establishing new business; and
- lack of funding which will ultimately prevent the Group from meeting its obligations.

In relation to the Bank's operations, liquidity risk is the risk that the Bank is unable to meet its obligations when they fall due as a result of customer deposits being withdrawn, cash requirements from contractual commitments, or other cash outflows. The Group is exposed to daily calls on its available cash resources from overnight deposits, current and call deposits, maturing term deposits, loan draw-downs and guarantees together with other related off-balance sheet instruments. Such outflows would deplete available cash resources for client lending and investments. In extreme circumstances, lack of liquidity could result in sales of assets, or potentially an inability to fulfil lending commitments. The risk that the Group will be unable to do so is inherent in all banking operations and can be affected by a range of institution-specific and market-wide events including, but not limited to, credit events, systemic shocks and natural disasters.

The objective of the Group's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due. It is the Bank's objective to maintain a diversified and stable funding base with the objective of enabling it to respond quickly and smoothly to unforeseen liquidity requirements.

The Group manages this risk by ensuring that its assets and liabilities are matched in terms of maturities as much as is practicable. However, the Bank ought to manage its net interest spread by investing funds in a portfolio of assets with a longer term than the liabilities funding them (therefore giving rise to a negative maturity gap position). To mitigate exposures arising in this respect, the Bank holds significant liquid assets in the form of Malta Government treasury bills, money market placements and other short-term instruments for managing liquidity risk to support payment obligations and contingent funding in a stressed market environment.

The Bank's advances-to-deposit ratio of 58.2% (2016: 47.5%) at the end of the reporting period reflects management's prudent stance in the context of liquidity management. Also, the proportion of liquid-assets to short-term liabilities at 31 December 2017 is 65.3% (2016: 68.1%).

2 **Financial risk management** *(continued)*

Liquidity Coverage Ratio

The Liquidity Coverage Ratio (LCR) is designed to promote the short-term resilience of a bank's liquidity profile. This ratio became a minimum regulatory standard from 1 October 2015, under the European Commission Delegated Regulation 2015/61.

The LCR aims to ensure that a bank has adequate unencumbered high-quality liquid assets (HQLA) to meet its liquidity requirements within a 30-calendar-day liquidity stress scenario. Generally, HQLA consists of cash or assets that can be converted into cash at little or no loss of value in markets.

The Bank's LCR as at 31 December 2017 was 302.1% (2016: 476.6%).

Net Stable Funding Ratio

The Net Stable Funding Ratio (NSFR) is a metric showing how a bank is able to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (typically, with a term of more than one year).

The Bank calculates its NSFR ratio in line with the Basel Committee on Banking Supervision (publication 295), given that the European calibration is still subject to implementation by the European Commission.

The Bank's NSFR as at 31 December 2017 was 144.2% (2016: 166.4%).

The Bank's ALCO focuses on the Bank's management process with respect to market and funding liquidity risks.

The Group's liquidity management process, focusing on the liquidity of the Bank and that of its principal subsidiary, includes:

- management of day-to-day funding, by monitoring future cash flows to ensure that requirements can be met. This includes replenishment of funds as they mature or are borrowed by customers. The starting point for those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- monitoring the liquidity ratios of the Bank against internal and regulatory requirements; and
- managing the concentration and profile of debt maturities.

The Bank also monitors the level and type of undrawn lending commitments and the impact of contingent liabilities such as guarantees as part of the liquidity management process previously referred to.

As at 31 December 2017, the Bank had outstanding guarantees on behalf of third parties amounting to €5,649,000 (2016: €6,195,000), which are cancellable upon the request of the third parties. The Group's liquidity exposures arising from these commitments and contingencies are expected to expire principally within a period of twelve months from the end of the reporting period.

The following tables analyse the Group's principal financial assets and liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date.

2 **Financial risk management** *(continued)*

Group

At 31 December 2017	**Less than 3 months € 000**	**Between 3 months and 1 year € 000**	**Between 1 year and 5 years € 000**	**More than 5 years € 000**	**No maturity date € 000**	**Total € 000**
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	**190,360**	**20,033**	**-**	**-**	**4,740**	**215,133**
Available-for-sale investments	**-**	**4,126**	**28,552**	**34,034**	**9,183**	**75,895**
Loans and advances to banks	**87,048**	**10,000**	**-**	**-**	**-**	**97,048**
Loans and advances to customers	**89,835**	**28,044**	**144,539**	**166,193**	**-**	**428,611**
Other assets	**14,234**	**381**	**-**	**-**	**-**	**14,615**
Total financial assets	**381,477**	**62,584**	**173,091**	**200,227**	**13,923**	**831,302**
Financial liabilities						
Amounts owed to banks	**5,362**	**-**	**-**	**-**	**-**	**5,362**
Amounts owed to customers	**511,040**	**96,598**	**72,440**	**53,073**	**-**	**733,151**
Other liabilities	**29,539**	**550**	**655**	**1,773**	**1,752**	**34,269**
Total financial liabilities	**545,941**	**97,148**	**73,095**	**54,846**	**1,752**	**772,782**
Maturity gap	**(164,464)**	**(34,564)**	**99,996**	**145,381**		
Cumulative gap	**(164,464)**	**(199,028)**	**(99,032)**	**46,349**		

Group

At 31 December 2016						
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	146,350	67,149	-	-	4,649	218,148
Available-for-sale investments	288	2,951	32,250	35,620	9,406	80,515
Loans and advances to banks	141,776	19,952	-	-	-	161,728
Loans and advances to customers	103,520	15,839	124,451	99,677	-	343,487
Other assets	11,480	362	-	-	9	11,851
Total financial assets	403,414	106,253	156,701	135,297	14,064	815,729
Financial liabilities						
Amounts owed to banks	9,036	-	-	-	-	9,036
Amounts owed to customers	494,306	78,414	112,046	36,793	-	721,559
Other liabilities	19,690	392	1,002	1,462	1,660	24,206
Total financial liabilities	523,032	78,806	113,048	38,255	1,660	754,801
Maturity gap	(119,618)	27,447	43,653	97,042		
Cumulative gap	(119,618)	(92,171)	(48,518)	48,524		

2 **Financial risk management** *(continued)*

Bank

At 31 December 2017	Less than 3 months € 000	Between 3 months and 1 year € 000	Between 1 year and 5 years € 000	More than 5 years € 000	No maturity date € 000	Total € 000
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	**190,360**	**20,033**	**-**	**-**	**4,107**	**214,500**
Available-for-sale investments	**-**	**4,126**	**27,283**	**31,690**	**9,183**	**72,282**
Loans and advances to banks	**82,258**	**8,000**	**-**	**-**	**-**	**90,258**
Loans and advances to customers	**89,835**	**28,044**	**144,539**	**166,193**	**-**	**428,611**
Other assets	**6,889**	**382**	**-**	**-**	**-**	**7,271**
Total financial assets	**369,342**	**60,585**	**171,822**	**197,883**	**13,290**	**812,922**
Financial liabilities						
Amounts owed to banks	**5,362**	**-**	**-**	**-**	**-**	**5,362**
Amounts owed to customers	**514,570**	**96,612**	**72,440**	**53,073**	**-**	**736,695**
Other liabilities	**14,765**	**550**	**655**	**1,773**	**1,753**	**19,496**
Total financial liabilities	**534,697**	**97,162**	**73,095**	**54,846**	**1,753**	**761,553**
Maturity gap	**(165,355)**	**(36,577)**	**98,727**	**143,037**		
Cumulative gap	**(165,355)**	**(201,932)**	**(103,205)**	**39,832**		

Bank

At 31 December 2016	Less than 3 months € 000	Between 3 months and 1 year € 000	Between 1 year and 5 years € 000	More than 5 years € 000	No maturity date € 000	Total € 000
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	146,350	67,149	-	-	3,899	217,398
Available-for-sale investments	-	2,951	30,811	33,190	9,406	76,358
Loans and advances to banks	136,064	19,902	-	-	-	155,966
Loans and advances to customers	104,489	15,839	124,451	99,677	-	344,456
Other assets	6,602	362	-	-	9	6,973
Total financial assets	393,505	106,203	155,262	132,867	13,314	801,151
Financial liabilities						
Amounts owed to banks	9,036	-	-	-	-	9,036
Amounts owed to customers	496,129	80,414	112,046	36,793	-	725,382
Other liabilities	8,577	392	1,002	1,462	1,660	13,093
Total financial liabilities	513,742	80,806	113,048	38,255	1,660	747,511
Maturity gap	(120,237)	25,397	42,214	94,612		
Cumulative gap	(120,237)	(94,840)	(52,626)	41,986		

2 **Financial risk management** *(continued)*

The tables below analyse the Group's principal non-derivative financial liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash flows.

Group

At 31 December 2017	**Less than 3 months € 000**	**Between 3 months and 1 year € 000**	**Between 1 year and 5 years € 000**	**More than 5 years € 000**	**Total € 000**
Financial liabilities					
Amounts owed to banks	**5,362**	**-**	**-**	**-**	**5,362**
Amounts owed to customers	**511,454**	**98,329**	**77,359**	**62,036**	**749,178**
Total financial liabilities	**516,816**	**98,329**	**77,359**	**62,036**	**754,540**
At 31 December 2016					
Financial liabilities					
Amounts owed to banks	9,036	-	-	-	9,036
Amounts owed to customers	492,697	81,596	120,768	43,946	739,007
Total financial liabilities	501,733	81,596	120,768	43,946	748,043

The tables below analyse the Bank's principal non-derivative financial liabilities into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash flows.

Bank

At 31 December 2017	**Less than 3 months € 000**	**Between 3 months and 1 year € 000**	**Between 1 year and 5 years € 000**	**More than 5 years € 000**	**Total € 000**
Financial liabilities					
Amounts owed to banks	**5,362**	**-**	**-**	**-**	**5,362**
Amounts owed to customers	**514,984**	**98,344**	**77,359**	**62,036**	**752,723**
Total financial liabilities	**520,346**	**98,344**	**77,359**	**62,036**	**758,085**
At 31 December 2016					
Financial liabilities					
Amounts owed to banks	9,036	-	-	-	9,036
Amounts owed to customers	496,521	81,596	120,768	43,946	742,831
Total financial liabilities	505,557	81,596	120,768	43,946	751,867

2 **Financial risk management** *(continued)*

2.6 *Operational risk*

Operational risk is the risk of losses due to:

- deficient or erroneous internal procedures;
- human or system errors;
- external events, including legal events;
- internal and external fraud;
- employment practices and workplace safety;
- clients, products and business practices;
- damage to physical assets;
- business disruption and system failures; and
- execution, delivery and process management.

Operational risk is thus often associated with specific and one-off events, such as failure to observe business or working procedures, defects or breakdowns of the technical infrastructure, criminal acts, fire and storm damage or litigation. Operational risks are, thus, non-financial risks. Operational risk management relies on a framework of policies implemented by the different operational functions and which implementation is overseen by the Risk Management Function.

A financial measurement of this risk is arrived at by the Group for the purpose of allocating risk capital using the Basic Indicator Approach under the European Union Directive on Capital Requirements (CRD) rules. The capital requirement for operational risk under this method was calculated at €3,021,000 (2016: €2,854,000).

2.7 *Capital risk management*

The Group's objectives when managing capital, which is a broader concept than the 'equity' on the consolidated statement of financial position, are:
- to comply with the capital requirements set by the MFSA with respect to the Bank's operations;
- to safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders; and
- to maintain a strong capital base to support the development of its business.

Accordingly, the purpose of the Group's capital management is essentially that of ensuring efficient use of capital taking cognisance of the Group's risk appetite and profile as well as its objectives for business development. The Group is subject to externally imposed capital requirements only in respect of the Bank's activities as a credit institution. The Bank is a licensed financial services provider and must therefore comply with the capital requirements under the relevant laws and regulations.

The Bank's Executive Team and ALCO are predominately responsible for the Bank's capital risk management process. Capital adequacy and the use of regulatory capital are monitored regularly by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the European Union Directives, as implemented by the MFSA for supervisory purposes. The Bank's capital management is based on the regulatory requirements established by local laws and regulations which are modelled on the requisites of the CRD rules. The CRD consists of three pillars: Pillar I contains a set of rules for a mathematical calculation of the capital requirement; Pillar II describes the supervisory review process and contains requirements for the internal calculation of the capital requirement while Pillar III deals with market discipline and sets forth disclosure requirements for risk and capital management.

2 **Financial risk management** *(continued)*

The sum of the capital requirement calculated under Pillar I and the additional requirement identified under Pillar II represents the total capital actually required under the CRD.

The following is an analysis of the Bank's Capital Base in accordance with the CRD's requirements:

	2017	2016
	€ 000	€ 000
Common Equity Tier 1 (CET1) capital		
Share capital	**11,044**	11,044
Share premium	**18,530**	18,530
Revaluation and other reserves	**12,624**	13,434
Retained earnings	**51,887**	48,381
	94,085	91,389
Adjustments:		
Final dividend	**(1,149)**	(1,149)
Depositor Compensation Scheme	**(3,630)**	(3,438)
Intangible assets	**(480)**	(554)
Transfer of unrealised gains to Tier 2 capital	**(1,375)**	(3,158)
Total CET1 capital	**87,451**	83,090
Tier 2 capital		
Property revaluation reserve	**468**	935
Investment revaluation reserve	**907**	2,223
Total Tier 2 capital	**1,375**	3,158
Total own funds	**88,826**	86,248

Minimum capital requirements are computed for credit, market and operational risks. The MFSA requires a bank to maintain a ratio of total regulatory capital to risk-weighted assets and instruments (the Capital requirements ratio) at or above the prescribed minimum of 8%. The Capital requirements ratio expresses Own funds as a proportion of risk-weighted assets and off-balance sheet instruments in relation to Credit Risk together with notional risk-weighted assets in respect of Operational Risk and Market Risk.

The risk-weighted assets are measured by means of a hierarchy of risk weights classified according to the nature of – and reflecting an estimate of credit, market and other risks associated with – each asset and counterparty, taking into account any eligible collateral or guarantees. A similar treatment is adopted for off-balance sheet instruments, with some adjustments to reflect the more contingent nature of the potential losses. Risk-weighted assets are measured using the 'Standardised Approach' for credit risk with risk weights being assigned to assets and off-balance sheet instruments according to their asset class and credit risk mitigation. For the determination of credit assessments, independent rating agencies are nominated as required.

Total risk-weighted assets are determined by multiplying the capital requirements for market risk and operational risk by 12.5 (i.e. the reciprocal of the minimum capital ratio of 8%) and adding the resulting figures to the sum of risk-weighted assets for credit risk.

2 **Financial risk management** *(continued)*

2.8 *Fair values of financial assets and liabilities*

2.8.1 Financial instruments measured at fair value

The Group's financial instruments which are carried at fair value include the Group's available-for-sale financial assets (note 6). The Group is required to disclose fair value measurements by level of the following fair value measurement hierarchy for financial instruments that are measured in the statement of financial position at fair value:

- Quoted prices (unadjusted) in active markets for identical assets (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset either directly i.e. as prices, or indirectly i.e. derived from prices (Level 2).
- Inputs for the asset that are not based on observable market data i.e. unobservable inputs (Level 3).

The IFRS 7 hierarchy of valuation techniques is based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions.

The Bank considers only relevant and observable market prices in its valuations. Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations.

The fair value of the Bank's available-for-sale financial assets, which are principally traded in active markets, is mainly based on quoted market prices.

As at 31 December 2017 and 2016, the principal financial instruments that are measured at fair value, consisted of the available-for-sale investments, that were valued using principally Level 1 inputs. No transfers of financial instruments between different levels of the fair value hierarchy have occurred during the financial years ended 31 December 2017 and 2016.

2.8.2 Financial instruments not measured at fair value

Loans and advances to banks and customers

These categories of assets are presented net of impairment allowances to reflect the estimated recoverable amounts. As at 31 December 2017, the Group's aggregate carrying amount in this respect was €525,659,000 (2016: €505,215,000). The loans and advances to customers, which are principally subject to floating interest rates, are measured at the amount of €428,611,000 (2016: €343,487,000). This carrying value approximates to fair value in view of the fact that these loans and advances are repriceable at the Group's discretion. The loans and advances to banks, comprising mainly term placements maturing within one month from the end of the reporting period, are carried at the amount of €14,167,000 (2016: €62,224,000). Rates on advances reflect current market rates, and the Directors consider the carrying amounts to be a reasonable estimate of their fair value principally in view of the relatively short periods to repricing or maturity from the end of the reporting periods. The current market interest rates utilised for fair value estimation, which reflect essentially the respective instruments' contractual interest rates, are deemed observable and accordingly these fair value estimates have been categorised as Level 2.

2 **Financial risk management** *(continued)*

Trade and other receivables

This category principally represents short-term trade receivables arising from postal operations in respect of which the carrying amount is a reasonable approximation of its fair value.

Amounts owed to banks and customers

These categories of financial liabilities are carried at amortised cost and amount to €738,513,000 as at 31 December 2017 (2016: €730,595,000). 10.8% (2016: 10.2%) of this liability is non-interest bearing, 59.2% (2016: 58.7%) of the liability has a contractual repricing term of three months or less, 13.1% (2016: 10.7%) reprices between three months and one year, 9.8% (2016: 15.3%) reprices between one year and five years while 7.2% (2016: 5.0%) is repriceable after more than five years. Accordingly, in view of their profile, the fair value of these financial liabilities is not deemed to be significantly different from their carrying amounts. This applies to variable rate deposits in view of the short periods to repricing, but also applies to liabilities subject to fixed interest rates, based on discounting future contractual cash flows at current market interest rates, taking into account the short periods to maturity. The current market interest rates utilised for discounting purposes, which were almost equivalent to the respective instruments' contractual interest rates, are deemed observable and accordingly these fair value estimates have been categorised as Level 2.

Other financial instruments

The fair values of certain other financial assets, including balances with the Central Bank of Malta and accrued income, are considered to approximate their respective carrying values due to their short-term nature.

3 **Accounting estimates and judgements**

3.1 *Critical accounting estimates and judgements in applying the Group's accounting policies*

Estimates and judgements are continually evaluated and based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. These estimates and assumptions present a risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The Group's management also makes judgements, apart from those involving estimations, in the process of applying the entity's accounting policies that may have a significant effect on the amounts recognised in the financial statements.

3 **Accounting estimates and judgements** *(continued)*

3.2 *Impairment losses on loans and advances*

The Group reviews its loan portfolios to assess impairment on an ongoing basis as relevant generic data is observed concerning risks associated with groups of loans with similar risk characteristics. In determining whether an impairment loss should be recorded in the consolidated income statement, the Group makes judgements as to whether there is any observable data indicating an impairment trigger followed by a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

3.3 *Assessment of estimates and judgements*

In the opinion of the Directors, the accounting estimates and judgements made in the course of preparing these consolidated financial statements, which have been highlighted above, are not difficult, subjective or complex to a degree which would warrant their description as critical in terms of the requirements of IAS 1.

However, the Directors would like to draw attention to these accounting judgements, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In this respect these primarily comprise assumptions and estimates relating to the calculation of impairment allowances in respect of loans and advances to customers (see notes 2.3, 8 and 31).

4 **Segmental information**

The Group has two reporting segments, as described below, which are the Group's strategic business units and cash-generating units. The strategic business units offer different services and are managed separately because they require different technology and marketing strategies. For each of the strategic business units, the Board of Directors reviews internal management reports. The following summary describes the operations in each of the Group's reportable segments:

- Banking services comprise the Group's banking services and other activities carried out as a licensed credit institution, an authorised currency dealer and financial intermediary. Stockbroking activities may also be carried out since the Bank is a member of the Malta Stock Exchange; and
- Postal services comprise the Group's postal services activities, being the sole licensed Universal Service Provider of postal services in Malta.

4 **Segmental information** *(continued)*

The Group's internal reporting to the Board of Directors and senior executives is analysed according to the below segments. Information about reportable segments:

	Banking services		Postal services		Total	
	2017	2016	**2017**	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000	**€ 000**	€ 000
Interest receivable	**21,281**	20,736	**145**	169	**21,426**	20,905
Interest expense	**(5,992)**	(6,703)	**-**	-	**(5,992)**	(6,703)
Postal sales and other revenue	**12**	-	**37,359**	26,772	**37,371**	26,772
Net fee and commission income	**3,054**	2,704	**1,079**	1,102	**4,133**	3,806
Other	**1,026**	2,572	**(81)**	(98)	**945**	2,474
Segment operating income	**19,381**	19,309	**38,502**	27,945	**57,883**	47,254
Depreciation and amortisation	**(622)**	(559)	**(789)**	(849)	**(1,411)**	(1,408)
Impairment allowances	**(2,831)**	(4,025)	**(4)**	75	**(2,835)**	(3,950)
Employee compensation and benefits	**(6,115)**	(5,576)	**(13,830)**	(12,143)	**(19,945)**	(17,719)
Other costs	**(3,893)**	(3,835)	**(20,825)**	(12,142)	**(24,718)**	(15,977)
Operating profit	**5,920**	5,314	**3,054**	2,886	**8,974**	8,200
Share of (loss)/profit of investment accounted for using the equity method, net of tax	**(106)**	35	**-**	-	**(106)**	35
Profit before taxation	**5,814**	5,349	**3,054**	2,886	**8,868**	8,235
Income tax expense	**(2,124)**	(2,034)	**(1,041)**	(871)	**(3,165)**	(2,905)
Profit for the year	**3,690**	3,315	**2,013**	2,015	**5,703**	5,330
Segment total assets	**841,234**	826,403	**41,512**	36,328	**882,746**	862,731
Capital expenditure during the year	**1,398**	3,504	**1,534**	1,297	**2,932**	4,801
Segment total liabilities	**762,000**	748,279	**17,872**	14,104	**779,872**	762,383

There are no material inter-segment transactions.

The Group mainly provides banking and postal services within the local market and economic sectors. From a customers' perspective, MaltaPost p.l.c. generated 38.9% (2016: 21.2%) of its revenue for 2017 internationally.

The Group's reliance on any single customer is not considered significant for disclosure purposes.

5 Balances with Central Bank of Malta, treasury bills and cash

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Balances with Central Bank of Malta	**130,303**	44,255	**130,303**	44,255
Malta Government treasury bills	**80,090**	169,244	**80,090**	169,244
Cash in hand	**4,740**	4,649	**4,107**	3,899
	215,133	218,148	**214,500**	217,398

The balances with the Central Bank of Malta include a reserve deposit amounting to €5,363,000 (2016: €4,446,000) held in terms of Regulation (EC) No. 1745/2003 of the European Central Bank. The average reserve deposit balance held for the relevant maintenance period amounted to €5,562,000 (2016: €4,595,000).

At 31 December 2017, the Bank had pledged a deposit with the Central Bank of Malta amounting to €2,809,000 (2016: €2,809,000) in favour of the Depositor Compensation Scheme to comply with local regulatory requirements.

6 Investments

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Debt and other fixed income instruments				
- available-for-sale	**66,512**	71,109	**62,899**	66,952
Equity instruments				
- available-for-sale	**9,383**	9,406	**9,383**	9,406
	75,895	80,515	**72,282**	76,358

Debt and other fixed income instruments classified as available-for-sale investments which are listed on the Malta Stock Exchange comprise:

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Issued by public bodies:				
- local government	**55,735**	60,165	**53,496**	57,806
Issued by public issuers:				
- local banks	**5,926**	6,139	**5,618**	5,537
- local corporates	**4,851**	4,805	**3,785**	3,609
	66,512	71,109	**62,899**	66,952

6 **Investments** *(continued)*

At 31 December 2016, the Bank held Malta Government Stocks classified as available-for-sale investments amounting to €365,000 that were pledged in favour of the Depositor Compensation Scheme to comply with local regulatory requirement.

At 31 December 2017, the Bank held Malta Government Stocks classified as available-for-sale investments pledged with the Central Bank of Malta amounting to €8,852,000 (2016: €9,340,000) in terms of Directive No.8 (Chapter 204 of the Central Bank of Malta Act) as security for a facility that was not utilised during the reporting period.

The Bank's holdings of equity instruments classified as available-for-sale investments as at 31 December 2017 include a carrying amount of €3,617,000 (2016: €3,628,000) in relation to investments in shares of MIDI p.l.c. The original cost of these investments amounted to €4,717,000. At 31 December 2017 the Bank carried a negative investment revaluation reserve amounting to €1,099,000 (2016: €1,089,000), gross of deferred tax impacts, in respect of these investments in view of the decline in the equity's quoted market price. The Bank's management has carried out an impairment review in relation to these investments to determine whether there is objective evidence that impairment exists. Based on the information available, the Bank's Directors are of the view that at 31 December 2017 no impairment indicators existed, taking cognisance of the investee's most recent published historical and projected financial information, the stage of the different project phases of the investee and the expected short-term development in this respect. The decline in the fair value of the investments in MIDI p.l.c.'s equity below cost was not deemed by the Directors to be significant by reference to the requirements of IFRSs as adopted by the EU and is not deemed prolonged in view of the specific nature, characteristics and life cycle of the activities carried out by the investee.

Equity instruments classified as available-for-sale investments include equities listed on the Malta Stock Exchange, except for investments with a carrying amount of €560,500 (2016: €609,000) which are measured at cost in view of the absence of a reliable fair valuation of these investments.

The movement in available-for-sale investments is summarised as follows:

	Group		**Bank**	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
At 1 January	**80,515**	76,246	**76,358**	72,465
Exchange differences	**(52)**	1	**(52)**	1
Amortisation	**(516)**	(507)	**(513)**	(504)
Acquisitions	**905**	6,212	**879**	5,678
Redemptions/disposals	**(3,366)**	(3,004)	**(2,930)**	(2,771)
Fair value movement	**(1,591)**	1,567	**(1,460)**	1,489
At 31 December	**75,895**	80,515	**72,282**	76,358

During the year ended 31 December 2015, Visa Inc. announced its proposed acquisition of Visa Europe Limited, subject to regulatory approval. The Bank was a member of Visa Europe Limited and held one ordinary share of €10, although only limited value was attached to the share. Voting and any economic rights relating to the shares were broadly based on the sales volumes of the particular member. The said announcement by Visa Inc. indicated that there would be an up-front consideration receivable on completion of the transaction which comprised cash and preferred stock convertible into Visa Inc. class A common stock as well as additional deferred cash consideration.

6 **Investments** *(continued)*

Prior to the announcement of the proposed transaction, the Directors believed that there was no value to assign to the membership because there were no rights to consideration and accordingly the fair value attributable for the membership was not evident. Prior to 31 December 2015, the Group recognised the membership share at its nominal value.

As at 31 December 2015, the Group increase the carrying amount of its €10 share in Visa Europe Limited by €985,000 to reflect the value emanating from the proposed transaction. The fair value of the interest in Visa Europe Limited had been assessed on the basis of the expected consideration to be received from the proposed sale to Visa Inc. which transaction was expected to be completed during 2016.

The amount of €1,479,000 represents the gain on the disposal of the membership interest in Visa Europe Limited.

On 21 June 2016 (the transaction closing date), Visa Inc. completed its purchase of Visa Europe Limited. The Group's share of consideration was made up as follows:

- Cash consideration of €1,050,000;
- Deferred cash consideration of €91,000 to be paid out on expiry of a three-year period from the transaction closing date; and
- Preferred stock of Visa Inc. with face value of €338,000.

The purpose of the preferred stock is to provide Visa Inc. protection against potential litigation risk associated with multilateral interchange fees linked to the activity of Visa Europe Limited. The preferred stock was converted into freely tradeable class A common stock of Visa Inc. (or an equivalent class of shares) over time. The preferred stock has no maturity and represent a residual interest in the issuer's net assets. The conversion rate will be periodically adjusted to reflect any change in the litigation risk.

Each share of the Company's preferred stock was convertible into 13,952 shares of Visa Inc. class A common stock. Upon announcement of the transaction, the Group attributed a fair value of €393,000 to its share of preferred stock in Visa Inc.

Accordingly, the investment was fair valued at €1,479,000 reflecting the above mentioned terms secured upon completion of the transaction. The investment was in substance disposed of upon completion, and the revaluation reserve amounting to €1,479,000 was classified to income upon disposal. The remaining interest, subsequent to completion, in respect of the preferred stock and deferred cash consideration elements, was recognised at the amount of €393,000, reflecting the fair value upon completion.

7 Loans and advances to banks

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Repayable on call and at short notice	**82,048**	86,062	**77,258**	80,300
Term loans and advances	**15,000**	75,666	**13,000**	75,666
	97,048	161,728	**90,258**	155,966

8 Loans and advances to customers

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Repayable on call and at short notice	**76,986**	67,983	**76,986**	68,952
Term loans and advances	**374,473**	299,062	**374,473**	299,062
Gross loans and advances to customers	**451,459**	367,045	**451,459**	368,014
Impairment allowances	**(22,848)**	(23,558)	**(22,848)**	(23,558)
Net loans and advances to customers	**428,611**	343,487	**428,611**	344,456
Impairment allowances				
Specific impairment allowances	**18,034**	18,815	**18,034**	18,815
Collective impairment allowances	**4,814**	4,743	**4,814**	4,743
	22,848	23,558	**22,848**	23,558

The aggregate gross amount of impaired loans and advances to customers amounted to €40,211,000 (2016: €42,230,000). The balance of individually assessed allowances at the end of the reporting period includes €677,000 (2016: €842,000), reflected in the table above, in respect of interest in suspense.

Assets acquired in settlement of debt amounting to €822,000 (2016: €883,000) are presented as assets classified as held for sale.

9 **Investment in subsidiaries**

Name of company	Country of incorporation	Nature of business	Equity interest		Carrying amount	
			2017	2016	**2017**	2016
			%	%	**€ 000**	€ 000
Redbox Limited	Malta	Holding Company	**100**	100	**15,732**	13,186

At 31 December 2017, Redbox Limited held 71.5% (2016: 70.7%) of the equity share capital and voting rights of MaltaPost p.l.c., a listed company incorporated and operating in Malta, comprising the Group's postal services reportable segment (see note 4). The remaining 28.5% (2016: 29.3%) is held by the general public.

The profit or loss allocated to non-controlling interests of MaltaPost p.l.c. during the financial year under review, accumulated non-controlling interests of the subsidiary at the end of the reporting period and dividends paid to non-controlling interests are presented within the Group's statement of changes in equity. The effects of the change in the Group's ownership interest in MaltaPost p.l.c. during the year on the equity attributable to the owners of the Bank are also presented within the Group's statement of changes in equity. Financial information about the assets, liabilities, revenues, profit or loss, total comprehensive income and cash flows of the subsidiary are disclosed within the annual report and financial statements of MaltaPost p.l.c., which are publicly available in view of the company's listed status. Financial information about the subsidiary is also disclosed within note 4 to these financial statements dealing with segmental information.

The end of the reporting period of the audited financial statements of MaltaPost p.l.c. that have been utilised in the preparation of these consolidated financial statements is 30 September 2017, since the financial statements prepared as of this date constitute the most recent audited financial statements of MaltaPost p.l.c.

10 **Investment in associate**

Name of company	Country of incorporation	Nature of business	Equity interest		Carrying amount	
			2017	2016	**2017**	2016
			%	%	**€ 000**	€ 000
Gozo Hotels Company Limited	Malta	Accommodation	**33.3**	33.3	**1,575**	1,681

With effect from 31 December 2015 financial asset with a carrying amount of €1,645,000 has been recognised as an investment in associate on the basis that the Bank controls 33.3% of the shares (and holds an equivalent amount of voting rights) of Gozo Hotels Company Limited. The Group is deemed to have significant influence over the investee in accordance with the requirements of IAS 28 'Investments in Associates'.

Gozo Hotels Company Limited is an unlisted company incorporated and operating in Malta. Its principal activity is the operation of the Hotel Calypso in Marsalforn, Gozo, and its registered address is 'Calypso', Ghar Qawqla Street, Zebbug, Gozo.

The investment in associate is measured using the equity method of accounting. The decrease in the carrying amount of the investment in Gozo Hotels Company Limited is attributable to the share of the investee's loss.

The Group's associate is not deemed material to Lombard Bank Malta p.l.c. as a reporting entity in terms of the requirements of IFRS 12 'Disclosure of interest in other entities' and the disclosure of summarised financial information of the associate and other information is accordingly not deemed necessary.

11 **Intangible assets**

	Group			Bank
	Goodwill € 000	**Computer software € 000**	**Total € 000**	**Computer software € 000**
At 1 January 2016				
Cost	857	4,093	4,950	2,401
Accumulated amortisation	-	(3,460)	(3,460)	(1,992)
Net book amount	857	633	1,490	409
Year ended 31 December 2016				
At 1 January 2016	857	633	1,490	409
Acquisitions	-	713	713	363
Amortisation for the year	-	(394)	(394)	(218)
At 31 December 2016	857	952	1,809	554
At 31 December 2016				
Cost	857	4,806	5,663	2,764
Accumulated amortisation	-	(3,854)	(3,854)	(2,210)
Net book amount	857	952	1,809	554
Year ended 31 December 2017				
At 1 January 2017	**857**	**952**	**1,809**	**554**
Acquisitions	**-**	**254**	**254**	**183**
Amortisation for the year	**-**	**(415)**	**(415)**	**(257)**
At 31 December 2017	**857**	**791**	**1,648**	**480**
At 31 December 2017				
Cost	**857**	**5,063**	**5,920**	**2,948**
Accumulated amortisation	**-**	**(4,272)**	**(4,272)**	**(2,468)**
Net book amount	**857**	**791**	**1,648**	**480**

11 **Intangible assets** *(continued)*

11.1 *Impairment test for the cash-generating unit to which goodwill has been allocated*

The recognised goodwill represents payments made by the Group in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised. As at 31 December 2017 and 2016 the recognised goodwill amounted to €857,000 and related to the acquisition of MaltaPost p.l.c.

In applying the requirements of IAS 36, 'Impairment of assets', in relation to goodwill arising in business combinations, the Directors carried out an impairment test at the end of the reporting period to obtain comfort that the recoverable amount of the cash-generating unit to which goodwill has been allocated is at least equal to its carrying amount.

The recoverable amount of the cash-generating unit is based on fair value less costs to sell.

This calculation takes into account the market capitalisation of MaltaPost p.l.c. based on the quoted price of its equity on the Malta Stock Exchange at a price per share of €2.12 as at 31 December 2017 (2016: €2.03). On this basis, the recoverable amount of the cash-generating unit is higher than its carrying amount.

12 **Property, plant and equipment**

Group	**Land and buildings € 000**	**Computer equipment € 000**	**Other € 000**	**Total € 000**
At 1 January 2016				
Cost or valuation	28,081	3,439	7,273	38,793
Accumulated depreciation	(3,311)	(3,153)	(5,398)	(11,862)
Net book amount	24,770	286	1,875	26,931
Year ended 31 December 2016				
At 1 January 2016	24,770	286	1,875	26,931
Acquisitions	3,292	563	233	4,088
Disposals	-	(6)	-	(6)
Other movements	193	-	-	193
Charge for the year	(394)	(237)	(383)	(1,014)
Depreciation released on disposals	-	6	-	6
At 31 December 2016	27,861	612	1,725	30,198
At 31 December 2016				
Cost or valuation	31,566	3,996	7,506	43,068
Accumulated depreciation	(3,705)	(3,384)	(5,781)	(12,870)
Net book amount	27,861	612	1,725	30,198
Year ended 31 December 2017				
At 1 January 2017	**27,861**	**612**	**1,725**	**30,198**
Acquisitions	**1,665**	**319**	**694**	**2,678**
Disposals	**-**	**(35)**	**(142)**	**(177)**
Other movements	**(4,078)**	**-**	**4,078**	**-**
Charge for the year	**(353)**	**(231)**	**(412)**	**(996)**
Depreciation released on disposals	**-**	**23**	**27**	**50**
Other movements	**2,563**	**-**	**(2,563)**	**-**
At 31 December 2017	**27,658**	**688**	**3,407**	**31,753**
At 31 December 2017				
Cost or valuation	**29,153**	**4,280**	**12,133**	**45,566**
Accumulated depreciation	**(1,495)**	**(3,592)**	**(8,726)**	**(13,813)**
Net book amount	**27,658**	**688**	**3,407**	**31,753**

12 **Property, plant and equipment** *(continued)*

Bank	**Land and buildings € 000**	**Computer equipment € 000**	**Other € 000**	**Total € 000**
At 1 January 2016				
Cost or valuation	13,859	1,760	2,552	18,171
Accumulated depreciation	(687)	(1,622)	(2,029)	(4,338)
Net book amount	13,172	138	523	13,833
Year ended 31 December 2016				
At 1 January 2016	13,172	138	523	13,833
Acquisitions	2,893	202	46	3,141
Disposals	-	(6)	-	(6)
Charge for the year	(116)	(88)	(137)	(341)
Depreciation released on disposals	-	6	-	6
Other movements	193	-	-	193
At 31 December 2016	16,142	252	432	16,826
At 31 December 2016				
Cost or valuation	16,945	1,956	2,598	21,499
Accumulated depreciation	(803)	(1,704)	(2,166)	(4,673)
Net book amount	16,142	252	432	16,826
Year ended 31 December 2017				
At 1 January 2017	**16,142**	**252**	**432**	**16,826**
Acquisitions	**1,044**	**118**	**53**	**1,215**
Disposals	**-**	**(24)**	**(26)**	**(50)**
Charge for the year	**(119)**	**(110)**	**(136)**	**(365)**
Depreciation released on disposals	**-**	**24**	**26**	**50**
At 31 December 2017	**17,067**	**260**	**349**	**17,676**
At 31 December 2017				
Cost or valuation	**17,990**	**2,050**	**2,625**	**22,665**
Accumulated depreciation	**(923)**	**(1,790)**	**(2,276)**	**(4,989)**
Net book amount	**17,067**	**260**	**349**	**17,676**

12 **Property, plant and equipment** *(continued)*

12.1 *Fair valuation of land and buildings*

The Bank's land and buildings were revalued on 31 December 2015 by management on the basis of advice from independent property valuers having appropriate recognised professional qualifications and experience in the location and category of the property being valued. The subsidiary's land and buildings were revalued on 30 September 2015 by an independent firm of property valuers having appropriate recognised professional qualifications and experience in the location and category of the property being valued. The Directors have reviewed the carrying amounts of the Group's properties, on the basis of the valuations carried out by the independent property valuers. Adjustments to the carrying amounts were deemed necessary and accordingly recognised during the year ended 31 December 2015.

Valuations were made on the basis of open market value taking cognisance of the specific location of the properties, the size of the sites, the availability of similar properties in the area, and whenever possible, having regard to recent market transactions for similar properties in the same location. As at 31 December 2015, the carrying values of the properties, classified within property, plant and equipment, have been adjusted to the valuations and the net resultant adjustment comprised an increase of €1,433,000 in the carrying values for the Group's to reflect the property's estimated open market value on an individual asset level. This increase was recognised in other comprehensive income as a property revaluation reserve.

The revaluation surplus net of applicable deferred income taxes is accordingly shown in 'other reserves' in shareholders' equity (note 18).

The Group is required to analyse non-financial assets carried at fair value by level of the fair value hierarchy within which the recurring fair value measurements are categorised in their entirety (Level 1, 2 or 3). The different levels of the fair value hierarchy have been defined as fair value measurements using:

- Quoted prices (unadjusted) in active markets for identical assets (Level 1);
- Inputs other than quoted prices included within Level 1 that are observable for the asset, either directly (i.e. as prices) or indirectly (i.e. derived from prices) (Level 2);
- Inputs for the asset that are not based on observable market data (i.e. unobservable inputs) (Level 3).

The Bank's land and buildings comprise various offices and operational premises, including the Bank's head office. The subsidiary's land and buildings, within property, plant and equipment, comprises the head office, mail delivery hubs and retail outlets. All the Group's recurring property fair value measurements use significant unobservable inputs and are accordingly categorised within Level 3 of the fair valuation hierarchy.

The Group's policy is to recognise transfers into and out of fair value hierarchy levels as of the beginning of the reporting period. There were no transfers between different levels of the fair value hierarchy during the years ended 31 December 2017 and 2016.

A reconciliation from the opening balance to the closing balance of land and buildings for recurring fair value measurements categorised within Level 3 of the value hierarchy, is reflected in the table above. The principal movements reflect changes in fair value, additions and depreciation charge for the years ended 31 December 2017 and 2016.

For all Group properties, their current use equates to the highest and best use.

12 **Property, plant and equipment** *(continued)*

12.2 *Valuation processes*

The valuations of the properties are performed on a periodic basis taking into consideration the valuation reports prepared by independent and qualified valuers. These reports are based on both:

- information provided by the Bank such as current terms and conditions of lease agreements. This information is derived from the Bank's systems and is subject to the Bank's overall control environment; and
- assumptions and valuation models used by the valuers – the assumptions are typically market related, such as rental yields, discount rates and sales prices. These are based on professional judgement and market observation.

The information provided to the valuers – and the assumptions and the valuation models used by the valuers – are reviewed by management.

When management considers that the valuation report is appropriate, the valuation report is recommended to the Audit & Risk Committee. The Audit & Risk Committee considers the valuation report as part of its overall responsibilities.

12.3 *Valuation techniques*

The Level 3 fair valuation of the Bank's property was determined using discounted cash flow (DCF) projections based on significant unobservable inputs. These inputs include estimated rental values per square metre, estimated growth rate in rental values and the discount rate applied.

The external valuations of the subsidiary's Level 3 property have been performed using an adjusted sales comparison approach for the land component and the replacement cost approach for the buildings component. In view of a limited number of similar sales in the local market, the valuations have predominately been performed using unobservable inputs. The significant input to the adjusted sales comparison approach is generally a sales price per square metre related to transactions in comparable properties located in proximity to the subsidiary's property, with significant adjustments for differences in size, age, exact location and condition of the property. The significant input to the replacement cost approach is the estimated development costs per square metre.

12.4 *Information about fair value measurements using significant unobservable inputs (Level 3)*

			Range of significant unobservable inputs		
Description by class based on highest and best use	**Fair value € 000**	**Valuation technique**	**Rental value €/sqm**	**Growth rate %**	**Discount rate %**
Current use as Bank's offices and operational premises	11,660	Discounted cash flows	100 - 300	2	5

12 **Property, plant and equipment** *(continued)*

	Fair value € 000	Valuation technique	Significant unobservable input	Range of unobservable inputs (weighted average) €
Description by class based on highest and best use				
Current use as subsidiary's office premises, retail outlets and mail delivery hubs	9,715	Adjusted sales comparison approach	Sales price per square metre	300 – 12,600 (750)
		Replacement cost approach	Development costs per square metre	200 – 600 (250)

The higher the rental value or the growth rate, the higher the resultant fair value. Conversely, the lower the discount rate, the higher the resultant fair value.

The higher the sales price per square metre or the development costs per square metre, the higher the resultant fair valuation.

12.5 *Historical cost of land and buildings*

If the land and buildings were stated on the historical cost basis, the carrying amounts would be as follows:

	Group		Bank	
	2017 € 000	2016 € 000	**2017 € 000**	2016 € 000
Cost	**25,247**	23,965	**15,286**	14,243
Accumulated depreciation	**(2,621)**	(2,434)	**(1,680)**	(1,544)
Net book amount at 31 December	**22,626**	21,531	**13,606**	12,699

13 **Deferred tax assets and liabilities**

Deferred tax assets and liabilities are attributable to the following:

Group

	Assets 2017 € 000	**Liabilities 2017 € 000**	**Net 2017 € 000**	Assets 2016 € 000	Liabilities 2016 € 000	Net 2016 € 000
Differences between depreciation and capital allowances	**207**	**(76)**	**131**	281	(71)	210
Provisions for liabilities and charges	**740**	**-**	**740**	412	-	412
Loan impairment allowances	**8,033**	**-**	**8,033**	8,280	-	8,280
Revaluation of property	**-**	**(1,798)**	**(1,798)**	-	(1,798)	(1,798)
Fair value movements on investments	**-**	**(2,040)**	**(2,040)**	-	(2,580)	(2,580)
Other temporary differences	**-**	**-**	**-**	-	-	-
	8,980	**(3,914)**	**5,066**	8,973	(4,449)	4,524

Bank

	Assets 2017 € 000	**Liabilities 2017 € 000**	**Net 2017 € 000**	Assets 2016 € 000	Liabilities 2016 € 000	Net 2016 € 000
Differences between depreciation and capital allowances	**-**	**(75)**	**(75)**	-	(71)	(71)
Provisions for liabilities and charges	**372**	**-**	**372**	390	-	390
Loan impairment allowances	**7,997**	**-**	**7,997**	8,244	-	8,244
Revaluation of property	**-**	**(1,021)**	**(1,021)**	-	(1,021)	(1,021)
Fair value movements on investments	**-**	**(2,040)**	**(2,040)**	-	(2,579)	(2,579)
	8,369	**(3,136)**	**5,233**	8,634	(3,671)	4,963

13 **Deferred tax assets and liabilities** *(continued)*

Movement in temporary differences relate to:

Group

	At 1 January 2016 € 000	Recognised in profit or loss € 000	Recognised in other comprehensive income € 000	**At 31 December 2016 € 000**	**Recognised in profit or loss € 000**	**Recognised in other comprehensive income € 000**	**At 31 December 2017 € 000**
Differences between depreciation and capital allowances	250	(40)	-	**210**	**(79)**	**-**	**131**
Provisions for liabilities and charges	259	153	-	**412**	**(17)**	**304**	**699**
Loan impairment allowances	7,129	1,151	-	**8,280**	**(247)**	**-**	**8,033**
Revaluation of property	(1,798)	-	-	**(1,798)**	**-**	**-**	**(1,798)**
Fair value movements on investments	(2,429)	-	(151)	**(2,580)**	**-**	**540**	**(2,040)**
Other temporary differences	(93)	93	-	**-**	**41**	**-**	**41**
	3,318	1,357	(151)	**4,524**	**(302)**	**844**	**5,066**

Bank

	At 1 January 2016 € 000	Recognised in profit or loss € 000	Recognised in other comprehensive income € 000	**At 31 December 2016 € 000**	**Recognised in profit or loss € 000**	**Recognised in other comprehensive income € 000**	**At 31 December 2017 € 000**
Differences between depreciation and capital allowances	(57)	(14)	-	**(71)**	**(4)**	**-**	**(75)**
Provisions for liabilities and charges	224	166	-	**390**	**(18)**	**-**	**372**
Loan impairment allowances	7,067	1,178	-	**8,245**	**(248)**	**-**	**7,997**
Revaluation of property	(1,021)	-	-	**(1,021)**	**-**	**-**	**(1,021)**
Fair value movements on investments	(2,429)	-	(151)	**(2,580)**	**-**	**540**	**(2,040)**
	3,784	1,330	(151)	**4,963**	**(270)**	**540**	**5,233**

The recognised deferred tax assets and liabilities are expected to be recovered or settled principally after more than twelve months from the end of the reporting period. The deferred tax liabilities reflected in other comprehensive income relate principally to the revaluation of property, plant and equipment and the fair valuation of available-for-sale investments.

14 **Inventories**

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Postal supplies and materials	**254**	261	**-**	-
Merchandise	**503**	538	**-**	-
Stocks for resale	**383**	379	**383**	379
Other stock items	**24**	19	**24**	19
	1,164	1,197	**407**	398

15 **Trade and other receivables**

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Trade receivables - net of impairment allowances	**7,496**	5,011	**-**	-
Others	**3,453**	3,125	**3,649**	3,312
	10,949	8,136	**3,649**	3,312

The impairment allowances in respect of trade receivables are analysed as follows:

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
At 1 January	**99**	178	**-**	-
Reversals of impairment losses	**4**	(79)	**-**	-
At 31 December	**103**	99	**-**	-

16 **Accrued income and other assets**

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Accrued income	**1,911**	2,340	**1,866**	2,287
Other assets	**3,945**	2,122	**229**	268
	5,856	4,462	**2,095**	2,555

17 **Share capital**

Bank

	2017		2016	
	No. of shares 000s	**€ 000**	No. of shares 000s	€ 000
Authorised				
Ordinary shares of 25 cent each	**80,000**	**20,000**	80,000	20,000
Issued				
Ordinary shares of 25 cent each	**44,178**	**11,044**	44,178	11,044

By virtue of a resolution dated 6 April 2016, the shareholders of the Bank declared a final gross dividend of 4 cent (net dividend of 2.6 cent) per share, representing a final gross payment of €1,750,863, to be distributed either in cash or by the issue of new shares at the option of each individual shareholder. This resulted in a scrip issue of 406,341 ordinary shares that was allotted to shareholders on 10 May 2016, and thereby increased the issued and fully paid share capital to 44,177,914 shares of 25 cent each, resulting in a paid up share capital of €11,044,479.

18 **Reserves**

These reserves are non-distributable.

18.1 *Share premium*

The increase in the share premium account during 2016 represents the premium attributable to the scrip issue of 406,341 ordinary shares, amounting to €1.93 per share, approved by the shareholders during the Annual General Meeting held on 6 April 2016. Utilisation of the share premium account is governed by the requirements of Article 114 within the Companies' Act, Chapter 386 of the Laws of Malta.

18 **Reserves** *(continued)*

18.2 *Revaluation and other reserves*

The Group and the Bank had the following reserves as at end of the reporting period:

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Property revaluation reserve	**2,420**	2,420	**2,338**	2,338
Investment revaluation reserve	**4,113**	5,204	**3,753**	4,755
Reserve for General Banking Risks	**2,903**	2,903	**2,903**	2,903
Other reserve	**3,226**	3,196	**3,630**	3,438
	12,662	13,723	**12,624**	13,434

The property revaluation reserve relates to the fair valuation of the land and buildings component of property, plant and equipment, and the balance represents the cumulative net increase in fair value of such property, net of related deferred tax.

The investment revaluation reserve represents the cumulative net change in fair values of available-for-sale financial assets held by the Group and by the Bank, net of related deferred tax impacts.

Banking Rule BR/09 'Measures addressing credit risks arising from the assessment of the quality of asset portfolios of credit institutions authorised under the Banking Act 1994', issued by the MFSA, requires banks in Malta to hold additional reserves for general banking risks in respect of non-performing loans. This reserve is required to be funded from planned dividends. As at the reporting date, this reserve amounted to €2,903,000 (representing 100% of the total estimated amount).

The other reserve represents amounts set aside by the Bank from its retained earnings in relation to the Depositor Compensation Scheme reflecting the carrying amount of assets pledged in favour of the Scheme to comply with local regulatory requirements.

19 **Amounts owed to banks**

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Term deposits with agreed maturity dates or periods of notice	**222**	351	**222**	351
Repayable on demand	**5,140**	8,685	**5,140**	8,685
	5,362	9,036	**5,362**	9,036

20 **Amounts owed to customers**

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Term deposits with agreed maturity dates	**269,135**	275,638	**269,149**	277,638
Repayable on demand	**464,016**	445,921	**467,546**	447,745
	733,151	721,559	**736,695**	725,383

21 **Provisions for liabilities and other charges**

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Obligation to Government	**2,047**	1,646	**-**	-
Legal	**1,130**	1,177	**1,064**	1,114
	3,177	2,823	**1,064**	1,114

These provisions are predominantly non-current in nature.

Group	**2017**			2016		
	Obligation to Government	**Legal**	**Total**	Obligation to Government	Legal	Total
	€ 000	**€ 000**	**€ 000**	€ 000	€ 000	€ 000
At 1 January	**1,646**	**1,177**	**2,823**	1,637	741	2,378
Exchange differences recognised in profit or loss	**-**	**(63)**	**(63)**	-	16	16
Charge - recognised in other comprehensive income	**528**	**-**	**528**	74	-	74
Charge - recognised in profit or loss	**-**	**23**	**23**	59	462	521
Crystallised obligations	**(127)**	**(7)**	**(134)**	(124)	(42)	(166)
At 31 December	**2,047**	**1,130**	**3,177**	1,646	1,177	2,823

The obligation to Government arises in terms of Article 8A of the Pensions Ordinance (Chapter 93 of the Laws of Malta), covering former Government employees who opted to become full-time employees of MaltaPost p.l.c., and who continued to be entitled to pension benefits which go beyond the National Insurance Scheme. The pension benefits scheme is a final salary defined benefit plan and is unfunded.

21 **Provisions for liabilities and other charges** *(continued)*

Obligation to Government recognised in the statement of financial position is arrived at as follows:

	2017	2016
	€ 000	€ 000
Present value of unfunded obligations	**3,731**	3,203
Crystallised obligations	**(985)**	(858)
Fair value of obligations to be reimbursed by Government	**(699)**	(699)
	2,047	1,646

The movement for the year is made up of:

	2017	2016
	€ 000	€ 000
Charge to profit or loss	**-**	59
Charge to other comprehensive income	**528**	74
Crystallised obligations	**(127)**	(124)
	401	9

The amount recognised in profit or loss is as follows:

	2017	2016
	€ 000	€ 000
Interest cost	**-**	59

The amount recognised in other comprehensive income is as follows:

	2017	2016
	€ 000	€ 000
Net actuarial loss - attributable to financial assumptions	**528**	74

In computing the Obligation to Government, the Group used a discount rate of 1.75% (2016: 1.43%), whereas the future salary increases were based on inflation rates and past salary increases.

21 **Provisions for liabilities and other charges** *(continued)*

Assumptions regarding future mortality experience are based on published mortality tables in Malta, which translate into an average life expectancy of 80 depending on age and gender of the beneficiaries. These factors are deemed to be the key assumptions used in the computation of the liability. The sensitivity of the obligation to changes in the key assumptions is considered immaterial for disclosure purposes.

Bank

	2017	2016
	Legal	Legal
	€ 000	€ 000
At 1 January	**1,114**	639
Exchange differences recognised in profit or loss	**(63)**	17
Charge - recognised in profit or loss	**22**	462
Crystallised obligations	**(9)**	(4)
At 31 December	**1,064**	1,114

In addition, the Bank is also a defendant in legal actions by other customers as a result of which the Directors are of the opinion that no liability will be incurred.

22 **Other liabilities**

	Group		**Bank**	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Trade payables	**6,815**	4,826	**-**	-
Bills payable	**3,209**	3,085	**3,209**	3,084
Cash collateral	**102**	112	**102**	112
Other payables	**13,091**	8,077	**11,765**	5,633
	23,217	16,100	**15,076**	8,829

23 **Accruals and deferred income**

	Group		**Bank**	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Accrued interest	**3,330**	3,266	**3,330**	3,268
Other	**7,492**	4,840	**1,090**	995
	10,822	8,106	**4,420**	4,263

24 Commitments and contingent liabilities

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Contingent liabilities				
Guarantee obligations incurred on behalf of third parties	**5,635**	6,083	**5,650**	6,195
Documentary credits	**3,443**	2,692	**3,443**	2,692
	9,078	8,775	**9,093**	8,887
Commitments				
Credit facilities and other commitments to lend	**247,737**	182,919	**247,737**	182,919

Credit facilities and commitments to lend funds to customers are granted at prevailing market interest rates at draw down date. At 31 December 2017, the Group was party to non-cancellable operating lease agreements of properties, in respect of which the future minimum lease payments extended over a number of years. The leases run for an initial period of up to one hundred and fifty years. Specific lease arrangements include an option to renew the lease after the original term but the amounts presented in the table below do not reflect lease charges applicable to the renewal period.

Total future minimum lease net payments under non-cancellable property operating leases:

	2017	2016
	€ 000	€ 000
Current		
Within 1 year	**125**	140
Non-current		
Between 1 and 2 years	**215**	120
Between 2 and 5 years	**45**	91
	385	351

The Group is also committed to pay a licence fee of 0.75% (2016: 0.75%) of its total gross revenue from postal services within the scope of the universal services.

25 Net interest income

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Interest income				
On loans and advances to banks	**399**	338	**371**	320
On loans and advances to customers	**19,544**	18,888	**19,544**	18,888
On balances with Central Bank of Malta	**(145)**	20	**(145)**	20
On Malta Government treasury bills	**(308)**	(311)	**(308)**	(311)
	19,490	18,935	**19,462**	18,917
On debt and other fixed income instruments	**2,452**	2,482	**2,336**	2,336
Net amortisation of premiums and discounts	**(516)**	(512)	**(513)**	(509)
	1,936	1,970	**1,823**	1,827
Total interest income	**21,426**	20,905	**21,285**	20,744
Interest expense				
On amounts owed to banks	**(3)**	(9)	**(3)**	(9)
On amounts owed to customers	**(5,989)**	(6,694)	**(5,994)**	(6,702)
Total interest expense	**(5,992)**	(6,703)	**(5,997)**	(6,711)
Net interest income	**15,434**	14,202	**15,288**	14,033

26 Net fee and commission income

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Fee and commission income				
Retail banking customer fees	**2,542**	2,244	**2,542**	2,244
Brokerage	**14**	19	**14**	19
Other	**1,875**	1,776	**801**	678
Total fee and commission income	**4,431**	4,039	**3,357**	2,941
Fee and commission expense				
Inter bank transaction fees	**(294)**	(225)	**(294)**	(225)
Other	**(4)**	(8)	**(5)**	(7)
Total fee and commission expense	**(298)**	(233)	**(299)**	(232)
Net fee and commission income	**4,133**	3,806	**3,058**	2,709

27 Postal sales and other revenues

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Stamps, parcel post and postal stationery including income from foreign inbound mail	**33,942**	26,060	**-**	-
Collectibles and philatelic sales	**583**	525	**172**	75
Other	**2,846**	187	**-**	-
	37,371	26,772	**172**	75

28 Dividend income

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Subsidiary company	**-**	-	**1,554**	1,379
Available-for-sale equity shares	**326**	361	**326**	361
	326	361	**1,880**	1,740

29 Net trading income

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Gains on foreign exchange activities	**619**	634	**699**	731

30 Employee compensation and benefits

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Staff costs				
Wages, salaries and allowances	**18,716**	16,531	**5,960**	5,442
Social security costs	**1,229**	1,188	**309**	286
	19,945	17,719	**6,269**	5,728

	Group		Bank	
	2017	2016	**2017**	2016
Average number of employees				
Managerial	**99**	85	**56**	50
Others	**710**	704	**110**	107
	809	789	**166**	157

31 Net impairment losses

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Write-downs				
Loans and advances to customers				
- specific allowances	**(9,088)**	(4,305)	**(9,088)**	(4,305)
- collective allowances	**(72)**	(743)	**(72)**	(743)
- bad debts written off	**(3,375)**	(399)	**(3,375)**	(399)
Trade receivables	**(4)**	-	**-**	-
	(12,539)	(5,447)	**(12,535)**	(5,447)
Reversals of write-downs				
Loans and advances to customers				
- specific allowances	**9,704**	1,421	**9,704**	1,421
- bad debts recovered	**-**	-	**-**	-
Trade receivables – specific allowances	**-**	76	**-**	-
	9,704	1,497	**9,704**	1,421
Net impairment losses	**(2,835)**	(3,950)	**(2,831)**	(4,026)

32 Profit before taxation

Profit before taxation is stated after charging and crediting the following:

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
After charging				
Directors' emoluments				
- fees	**63**	66	**49**	52
- other emoluments	**335**	335	**335**	335
After crediting				
Net income from investment services	**147**	146	**147**	146

Other operating costs are analysed as follows:

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Foreign outbound mail	**15,265**	6,307	**-**	-
Utilities and insurance	**1,164**	755	**775**	491
IT support and telecommunication costs	**388**	317	**188**	180
Repairs and maintenance	**1,517**	1,235	**447**	351
Operating lease rental charges	**803**	1,125	**475**	417
Other administrative expenses	**5,558**	5,717	**2,167**	2,072
Total other operating costs	**24,695**	15,456	**4,052**	3,511

32 **Profit before taxation** *(continued)*

Other administrative expenses mainly comprise professional expenses, subcontracted services and other services or expense items which are incurred in the course of the operations of the Group and the Bank.

Fees charged by the auditors for services rendered during the financial year related to the following:

	Audit	Other assurance services	Tax advisory services
	€ 000	**€ 000**	**€ 000**
Auditors of the parent			
2017	**56**	**40**	**4**
2016	55	50	4
Auditors of subsidiary companies			
2017	**30**	**68**	**1**
2016	19	47	1

33 **Income tax expense**

Recognised in profit or loss:

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Current taxation				
Current tax expense	**2,887**	4,276	**2,381**	3,739
Adjustment to prior years' current tax expense	**(24)**	(14)	**(19)**	(14)
	2,863	4,262	**2,362**	3,725
Deferred taxation				
Deferred tax expense/(income) (note 13)	**302**	(1,357)	**270**	(1,330)
	3,165	2,905	**2,632**	2,395

33 **Income tax expense** *(continued)*

The tax on the profit before income tax differs from the theoretical amount that would arise using the tax rate applicable as follows:

	Group		Bank	
	2017	2016	**2017**	2016
	€ 000	€ 000	**€ 000**	€ 000
Profit before income tax	**8,868**	8,235	**7,478**	6,647
Tax on profit at 35%	**3,103**	2,882	**2,617**	2,327
Tax effect of:				
Non-taxable income	**(17)**	(1)	**(53)**	(124)
Expenses non-deductible for tax purposes	**40**	30	**38**	22
Income taxed at different tax rates	**(22)**	(34)	**-**	-
Depreciation expense not deductible by way of capital allowances	**58**	67	**48**	47
Adjustment to prior years' current tax expense	**13**	(175)	**(18)**	(14)
Other differences	**(10)**	136	**-**	137
	3,165	2,905	**2,632**	2,395

33 **Income tax expense** *(continued)*

The tax impacts, which are entirely attributable to deferred taxation, relating to components of other comprehensive income and accordingly presented directly in equity are as follows:

Group	**2017**			2016		
	Before tax	**Tax (charge) /credit**	**Net of tax**	Before tax	Tax (charge) /credit	Net of tax
	€ 000	**€ 000**	**€ 000**	€ 000	€ 000	€ 000
Fair valuation of available-for-sale financial assets:						
- Net changes in fair value	**(1,591)**	**511**	**(1,080)**	1,989	(669)	1,320
- Reclassification adjustments to profit or loss	**(81)**	**29**	**(52)**	(1,479)	518	(961)
Remeasurements of defined benefit obligations	**(528)**	**304**	**(224)**	(74)	-	(74)
	(2,200)	**844**	**(1,356)**	436	(151)	285

Bank						
Fair valuation of available-for-sale financial assets:						
- Net changes in fair value	**(1,460)**	**511**	**(949)**	1,911	(669)	1,242
- Reclassification adjustments to profit or loss	**(81)**	**29**	**(52)**	(1,479)	518	(961)
	(1,541)	**540**	**(1,001)**	432	(151)	281

34 **Earnings per share**

Earnings per share is based on the net profit for the year divided by the weighted average number of ordinary shares in issue during the year.

	Group	
	2017	2016
Net profit attributable to equity holders of the Bank (€ 000)	**5,129**	4,726
Number of ordinary shares in issue	**44,177,914**	44,177,914
Earnings per share (€ cent)	**11c6**	10c7

The Bank has no instruments or arrangements which give rise to dilutive potential ordinary shares, and accordingly diluted earnings per share is equivalent to basic earnings per share.

35 Dividends

	2017	2016
Dividends declared and paid by the Bank (€ 000)	**1,149**	1,138
€ cent per share – gross	**4c0**	4c0

Subsequent to the end of the reporting period, a gross dividend of 4 cent per nominal 25 cent share (net dividend of 2.6 cent for a total amount of €1,149,000) for the twelve months ended 31 December 2017 is being proposed for approval by the shareholders to be distributed. A resolution to this effect will be proposed to the Annual General Meeting.

36 Cash and cash equivalents

Cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

	Group		Bank	
	2017 € 000	2016 € 000	**2017 € 000**	2016 € 000
Malta Government treasury bills (note 5)	**60,056**	102,094	**60,056**	102,094
Loans and advances to banks (notes 5 and 7)	**209,180**	198,679	**204,390**	192,966
Cash (note 5)	**4,740**	4,649	**4,107**	3,899
Amounts owed to banks (note 19)	**(5,340)**	(9,036)	**(5,340)**	(9,036)
Cash and cash equivalents	**268,636**	296,386	**263,213**	289,923

37 Related parties

37.1 *Identity of related parties*

The Bank has a related party relationship with its subsidiaries, its major shareholder Cyprus Popular Bank Public Co Ltd, the Bank's Directors (key management personnel) and other related parties, primarily entities controlled by key management personnel.

37 **Related parties** *(continued)*

37.2 *Transaction arrangements and agreements involving key management personnel*

Information on transactions, arrangements and agreements entered into by the Bank with key management personnel, being the Directors, and entities controlled by such individuals as highlighted below:

	Loans and advances 2017 € 000	**Commitments 2017 € 000**	Loans and advances 2016 € 000	Commitments 2016 € 000
At 1 January	**1,393**	**-**	1,017	-
Additions	**1,049**	**(5,214)**	1,036	-
Repayments	**(1,350)**	**-**	(660)	-
At 31 December	**1,092**	**(5,214)**	1,393	-

The above banking facilities are part of long-term commercial relationships and were made in the ordinary course of business on substantially the same terms, including rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

37.3 *Compensation to key management personnel*

Details of Directors' fees and emoluments are stated in note 32.

37.4 *Transactions with other related parties*

37.4.1 Subsidiaries

Information relating to transactions undertaken by the Bank with its subsidiary companies during the year:

	2017 € 000	2016 € 000
Income statement		
Other income	**213**	175
Interest payable	**5**	7
Administrative expenses	**127**	117
Statement of financial position		
Loans and advances to customers	**-**	969
Trade and other receivables	**197**	186
Inventories	**1**	-
Amounts owed to customers	**3,544**	3,824
Accruals and deferred income	**15**	9
Contingent liabilities	**14**	111

37 **Related parties** *(continued)*

During the year, the Bank made payments in settlement of transactions carried out by subsidiaries amounting to €14,800 (2016: €128,000).

During the year, the Bank received gross dividends of €1,544,000 (2016: €1,379,000).

37.4.2 Associates

Information relating to transactions undertaken by the Bank with its associates during the year:

	2017	2016
	€ 000	€ 000
Income statement		
Interest receivable and similar income	**23**	23
Administrative expenses	**5**	7
Net impairment reversals	**239**	151
Statement of financial position		
Loans and advances to customers	**1,900**	1,647
Investment in associate	**1,645**	1,645
Prepayments and accrued income	**10**	-
Accruals and deferred income	**4**	5

37.4.3 Major shareholder

The Bank entered into no material transactions with its major shareholder during the financial year (2016: nil).

38 **Investor Compensation Scheme**

In accordance with the requirements of the Investor Compensation Scheme Regulations, 2003 issued under the Investment Services Act, 1994 (Chapter 370 of the Laws of Malta) licence holders are required to transfer a variable contribution to an Investor Compensation Scheme Reserve and place the equivalent amount with a bank, pledged in favour of the Scheme. Alternatively licence holders can elect to pay the amount of variable contribution directly to the Scheme. Lombard Bank Malta p.l.c. has elected to pay the amount of the variable contribution directly to the Scheme.

39 **Statutory information**

Lombard Bank Malta p.l.c. is a limited liability company domiciled and incorporated in Malta.

1 Risk management

1.1 *Overview of risk disclosures*

The Additional Regulatory Disclosures seek to increase public disclosure with respect to a bank's capital structure and adequacy as well as its risk management policies and practices. These disclosures have been prepared by the Bank in accordance with the Pillar III quantitative and qualitative disclosure requirements as governed by Banking Rule BR/07: Publication of Annual Report and Audited Financial Statements of Credit Institutions authorised under the Banking Act, 1994, issued by the Malta Financial Services Authority. These disclosures are published by the Bank on an annual basis as part of the Annual Report. The rule follows the disclosure requirements of Directive 2013/36/EU (Capital Requirements Directive) and EU Regulation No 575/2013 (Capital Requirements Regulation) of the European Parliament and of the Council of 26 June 2013.

Consistent with the requirements of banking regulations, these disclosures are not subject to an external audit, except to the extent that any disclosures are equivalent to those made in the Financial Statements which have been prepared in accordance with the requirements of International Financial Reporting Standards (IFRS) as adopted by the EU. The Bank is satisfied that internal verification procedures ensure that these Additional Regulatory Disclosures are presented fairly.

1.2 *Risk management framework*

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Bank has the Assets & Liabilities Committee (ALCO) and the Credit Committee that are responsible for developing the Bank's risk management policies in their specific areas. The Bank also has an independent Risk Management function. The aim of risk management is to create value for stakeholders by supporting the Bank in achieving its goals and objectives, and ultimately ensuring that the risks are commensurate with the rewards.

To enhance its risk oversight efforts, the Board of Directors established a Risk committee with a mandate to monitor the Bank's compliance with its risk management policies and procedures, and to review the adequacy of the Bank's risk management framework, including its risk appetite and strategy. This committee was combined with the previous Audit Committee, which committee was renamed as the Audit & Risk Committee.

The Bank considers risk management a core competency that helps produce consistently high returns for its various stakeholders. The Bank's business involves taking on risks in a targeted manner and managing them professionally. The Bank aims to manage all major types of risk by applying methods that meet best practice. The Bank considers it important to have a clear distribution of responsibilities within risk management. One of the main tasks of the Bank's executive management is to set the framework for this area. The core functions of the Bank's risk management are to identify all key risks for the Bank, measure these risks, manage the risk positions and determine capital allocations. The Bank regularly reviews its risk management policies and systems to reflect changes in markets, products and best market practice.

An understanding of risk-taking and transparency in risk-taking are key elements in the Bank's business strategy and thus in its ambition to be a strong financial institution. The Bank's internal risk management processes support this objective.

1 **Risk management** *(continued)*

Risk management within the Bank is mainly carried out on a unified basis, using an integrated and global framework. This framework is based on local and international guidelines, such as the Basel III Accord and corresponding Directives and Regulations of the European Union, including technical standards, as well as on contemporary international banking practices guided by the Basel Committee on Banking Supervision.

The Bank has adopted the Standardised Approach and the Basic Method with respect to the calculation of capital requirements and management of credit and foreign exchange risk respectively, as well as the Basic Indicator Approach with respect to operational risk.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Board deems the risk management framework adopted by the Bank to be adequate and gives assurance to the Bank's stakeholders that the risk management systems are appropriate in relation to the Bank's risk profile and strategy.

The Bank's different operational functions, on an entity-wide basis, are primarily responsible for risk management procedures and activities in their respective areas. All the operational functions have a primary role in risk management at bank-wide level. The Risk Management Function provides oversight, independently from operations. The Bank's risk management is implemented and handled properly by the operational functions. The Bank's Internal Audit Function, through verification, ensures that effective risk management procedures and activities are adequately designed and operating as prescribed.

1.3 *Board and Senior Management Committees*

The Bank's Board of Directors is responsible for ensuring that adequate processes and procedures exist to ensure effective internal control systems for the Bank. These internal control systems ensure that decision-making capability and the accuracy of the reporting and financial results are maintained at a high level at all times. The Board assumes responsibility for:

- setting business objectives, goals and the general strategic direction for Management with a view to maximise value;
- selecting and appointing the Chief Executive Officer who is entrusted with the day-to-day operations of the Bank;
- management of the Bank's operations, as well as appointment of members of Management;
- ensuring that significant business risks are identified and appropriately managed; and
- setting the highest business standards and code for ethical behaviour, and monitoring performance in this respect.

1 **Risk management** *(continued)*

In deciding how best to discharge its responsibilities, the Board upholds a policy of clear demarcation between its role and responsibilities and those of Management. It has defined the level of authority that it retains over strategy formulation and policy determination, and delegated authority and vested accountability for the Bank's day-to-day business in the Assets & Liabilities Committee and Credit Committee and, for the Bank's day-to-day operations, in an Executive Team comprising the Chief Executive Officer and Chief Officers. The Audit & Risk Committee reviews the processes and procedures to ensure the effectiveness of the Bank's system of internal control, as well as the implementation of the Board's risk strategy by Management. The Audit & Risk Committee is supported by the Internal Audit and the Bank's Risk Management Function. Internal Audit is one of the principal internal control mechanisms within the Bank.

The ALCO monitors the Bank's financial performance, considers investment policy and overseas counterparty limits. Membership of this Committee is made up of a number of Chief Officers and Senior Managers including managers from Finance and Treasury Departments. The Chief Executive Officer is Chairman of ALCO and retains primary responsibility for asset and liability management. The ALCO oversees risk management practices in relation to asset and liability management.

The Credit Committee considers the development of general lending principles and oversees risk management practices in lending operations. The Credit Committee is chaired by the Chief Executive Officer and is composed of other Chief Officers as well as other Senior Officers engaged in lending.

The Audit & Risk Committee assists the Board in fulfilling its supervisory and monitoring responsibility by reviewing the financial statements and disclosures, the system of internal control established by management as well as the external and internal audit processes. The Audit & Risk Committee is also responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit & Risk Committee is assisted by the Internal Audit Function and the Bank's independent Risk Management Function.

The Bank's independent Internal Audit Department reviews the adequacy and proper operation of internal controls in individual areas of operation and reports its findings to the Audit & Risk Committee. The Internal Audit Function carries out both regular and *ad hoc* reviews of risk management controls and procedures, in both cases reporting its findings.

The Bank's independent Risk Management Function was composed of senior officers during the year under review, with reporting lines to the Audit & Risk Committee. This Function focuses on overseeing the manner in which the different operational functions and activities of the Bank implement and monitor risk policies and limits in their respective areas. The overall objective is ensuring that the Bank's intended risk management framework has been structured effectively and is proving to be effective at operational level in mitigating exposures to the Bank. Frequent reviews are carried out by this Function and regular reporting to the Audit & Risk Committee is in place.

The Bank has an appropriate organisational structure for planning, executing, controlling and monitoring business operations in order to achieve the Bank's objectives.

Authority to operate the Bank and its subsidiaries is delegated to the Chief Executive Officer within the limits set by the Board. The Board is ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can provide only reasonable, and not absolute, assurance against material misstatement or loss.

The Bank is committed to the highest standards of business conduct and seeks to maintain these standards across all of its operations. Bank policies and procedures are in place for the reporting and resolution of fraudulent activities.

1 **Risk management** *(continued)*

1.4 *Key risk components*

The Bank's Board of Directors is empowered to set out the overall risk policies and limits for all material risk types. The Board also decides on the general principles for managing and monitoring risks.

To ensure coherence between the Bank's strategic considerations regarding risk-taking and day-to-day decisions, from time to time, the Bank establishes its risk appetite as a strategic tool. Risk appetite is the maximum risk that the Bank is willing to assume to meet business targets. The Bank's risk appetite is set in a process based on a thorough analysis of its current risk profile. The Bank identifies a number of key risk components and for each determines a target that represents the Bank's views on the component in question.

In terms of the Capital Requirements Regulation (CRR), an 'exposure' is the amount at risk arising from the reporting credit institution's assets and off-balance sheet instruments. Consistent with this, an exposure would include the amount at risk arising from the Bank's:

- claims on a customer including actual and potential claims which would arise from the drawing down in full of undrawn advised facilities, which the Bank has committed itself to provide;
- contingent liabilities arising in the normal course of business, and those contingent liabilities which would arise from the drawing down in full of undrawn advised facilities which the Bank has committed itself to provide; and
- other on and off-balance sheet financial assets and commitments.

The Bank is exposed to a number of risks, which it manages at different organisational levels.

The main categories of risk are:

- *Credit risk:* Credit risk stems from the possible non-prompt repayment or non-payment of existing and contingent obligations by the Bank's counterparties, resulting in the loss of equity and profit. It comprises the risk that deterioration in the financial condition of a borrower will cause the asset value to decrease or be extinguished. Country risk and Settlement risk are included in this category. Country risk refers to the risk of losses arising from economic or political changes that affect the country from which the asset originates. Settlement risk refers to the risk of losses through failure of the counterparty to settle outstanding dues on the settlement date owing to bankruptcy or other causes.

- *Market risk:* Risk of losses arising from unfavourable changes in the level and volatility of interest rates, foreign exchange rates or investment prices.

- *Liquidity risk:* Liquidity risk may be divided into two sub-categories:

  - Market (product) liquidity risk: Risk of losses arising from difficulty in accessing a product or market at the required time, price and volume.

  - Funding liquidity risk: Risk of losses arising from a timing mismatch between investing, placements and fund raising activities resulting in obligations missing the settlement date or satisfied at higher than normal rates.

- *Operational risk:* Risk of loss resulting from the lack of skilful management or good governance within the Bank and the inadequacy of internal control, which might involve internal operations, staff, systems or external occurrences that in turn affect the income and capital funds of financial institutions. The Bank has adopted an operational risk management framework and procedures, which provide for the identification, assessment, management, monitoring and reporting of the Bank's operational risks.

1 **Risk management** *(continued)*

1.5 *Risk statement by the Board of Directors*

The Bank's business model throughout the years has been that of retaining a stable deposit base and granting credit principally to the commercial real estate sector, particularly because the Board strongly believes that despite the increased capital requirements introduced by the CRR, an active commercial real estate market is a fundamental source of employment and economic growth in Malta. Nonetheless, the Bank is conscious of the risks involved in commercial real estate lending, and thus ensures it prices loans by reference to underlying risks. In this respect, the Bank's return on assets, expressed as a percentage of profit after tax to average total assets, for the reporting period ended 31 December 2017 amounts to 0.56%.

The Bank manages its credit risk in this respect by selecting its customers and the projects it finances with prudence and caution, and by actively monitoring the value of collateral in relation to its exposure amounts such that in the event of default, the Bank would have sufficient collateral to secure recoverability.

In this respect, the loan loss coverage ratio, calculated as total provisions for impairment to total non-performing exposures, which as at 31 December 2017, amounted to 30.5% differs from that experienced within the sector, which generally tends to fluctuate between 50% to 55%. This clearly illustrates the robustness of the Bank's risk management practices particularly in respect of credit risk.

2 **Credit risk**

2.1 *Introduction to Credit risk*

Credit risk is the risk of suffering financial loss, should any of the Bank's customers, clients or market counterparties fail to fulfil their contractual obligations to the Bank. Credit risk arises mainly from commercial and consumer loans and advances and loan commitments arising from such lending activities, but can also arise from credit enhancement provided, such as financial guarantees, letters of credit, endorsements and acceptances.

Credit risk constitutes the Bank's largest risk in view of its significant lending and securities portfolios, which are monitored in several ways. The Bank is fully aware of such risk and places great importance on its effective management.

The Bank allocates considerable resources in ensuring the ongoing compliance with approved credit limits and to monitor its credit portfolio. In particular, the Bank has a fixed reporting cycle to ensure that the relevant management bodies, including the Board of Directors and the Executive Team, are kept informed on an ongoing basis of developments in the credit portfolio, non-performing loans and other relevant information.

2 **Credit risk** *(continued)*

2.2 *Credit risk management*

The Board of Directors has delegated the responsibility for the monitoring of management of credit risk to the Credit Committee. The granting of a credit facility is based on the Bank's insight into the customer's financial position, which is reviewed regularly to assess whether the basis for the granting of credit has changed. Furthermore, the customer must be able to demonstrate a reasonable ability to repay the debt. Approval limits are graded starting from managers and leading up to the Credit Committee and the Board of Directors depending on the size and the particular risk attached to the loan. Facilities are generally adequately secured either by property and/or guarantees and are reviewed periodically by Management both in terms of the exposure to the Bank and to ensure that security is still valid.

The Bank's Credit Department is responsible for undertaking and managing credit risk in relation to the entity's lending activities; covering all the stages in the lending cycle comprising credit proposal, loan approval, effecting advances, credit and collateral monitoring, processing repayments and credit recovery procedures. The Bank manages, limits and controls concentrations of credit risk arising from loans and advances wherever they are identified – in particular, to individual customers and groups, and to industry sectors. Hence, the Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subject to frequent review, as considered necessary. Limits on the level of credit risk by product and industry sector are approved by the Board of Directors. The exposure to any one borrower is further restricted by sublimits covering on and off-balance sheet exposures. Actual exposures against limits are monitored at end of day on a daily basis and on a real-time basis too. As highlighted previously, the Bank's reporting framework with respect to lending credit risk is comprehensive with regular reporting by the Credit Department to the Board, Credit Committee and Executive Team on adherence to limits, activity levels, performance measures and specific credit risk events.

In order to minimise the credit risk undertaken, counterparty credit limits may be defined, which consider a counterparty's creditworthiness, the value of collateral and guarantees which can reduce the overall credit risk exposure, as well as the type and the duration of the credit facility. In order to examine a counterparty's creditworthiness, the following are considered: country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates. The Bank has set limits of authority and has segregated duties so as to maintain impartiality and independence during the approval process and control for new and existing credit facilities.

The Bank's maximum exposure amount to credit risk before taking account of any collateral held or other credit enhancements can be classified in the following categories:

- Financial assets recognised on-balance sheet comprising principally balances with Central Bank of Malta, Malta Government treasury bills, cheques in course of collection, available-for-sale financial assets as well as loans and advances to banks and customers. The maximum exposure of these financial assets to credit risk equals their carrying amount.

- Guarantee obligations incurred on behalf of third parties. The maximum exposure to credit risk is the full amount that the Bank would have to pay if the guarantees are called upon.

- Loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities.

2 **Credit risk** *(continued)*

The Bank's credit risk exposure amounts reflect the maximum exposure to credit risk before collateral held or other credit enhancements in accordance with the regulatory information submitted to the MFSA and are as follows:

	2017 Average value	2017 Year end Exposure value
	€ 000	€ 000
Central governments or central banks	254,923	265,447
Institutions	131,094	96,806
Corporates	82,213	96,610
Retail	16,702	18,238
Secured by mortgages on immovable property	181,229	235,042
Exposures in default	16,375	20,386
Items associated with particularly high risk	122,131	79,467
Equity	22,461	23,142
Other items	35,795	35,744
	862,923	**870,882**

The exposures set out in the table above are based on the sum of on-balance sheet exposures and off-balance sheet exposures adjusted for the credit conversion factors stipulated in Article 166(10) of the CRR.

The following is an analysis of the Bank's exposure to credit risk split by on-balance sheet assets and off-balance sheet instruments:

	2017
	€ 000
On-balance sheet assets	856,702
Deduction for intangible assets	(480)
Off-balance sheet instruments	14,660
	870,882

2.3 *Concentration risk*

Concentration risk arises as a result of the concentration of exposures within the same category, whether the category relates to geographical location, industry sector or counterparty type. These risks are managed through adherence to Board approved lending criteria and limits.

As at 31 December 2017, no loans and advances to customers were deemed to be prohibited large exposures, prior to any eligible exemptions, in accordance with the requirements of Part Four of the CRR, Large Exposures. A limited number of customers account for a certain percentage of the Bank's loans and advances.

2 **Credit risk** *(continued)*

Credit risk attributable to concentration of investments is not considered by the Directors to be significant in view of the credit standing of the issuers.

The following tables analyse the concentration of credit risk by geographical region, industry sector and residual maturity at the end of the reporting period.

2.3.1 Credit risk exposures analysed by geographical region

The Bank monitors concentration of credit risk by geographical region. The following table summarises the country of risk by exposure class:

At 31 December 2017	Total € 000	Malta € 000	Eurozone € 000	Other European countries € 000	Other € 000
Central governments or central banks	265,447	265,447	-	-	-
Institutions	96,806	11,538	65,008	15,134	5,126
Corporates	96,610	96,610	-	-	-
Retail	18,238	18,238	-	-	-
Secured by mortgages on immovable property	235,042	235,042	-	-	-
Exposures in default	20,386	20,386	-	-	-
Items associated with particularly high risk	79,467	79,467	-	-	-
Equity	23,142	22,766	-	-	376
Other items	35,744	35,744	-	-	-
	870,882	**785,238**	**65,008**	**15,134**	**5,502**

2 **Credit risk** *(continued)*

2.3.2 Credit risk exposures analysed by industry sector

The following are the exposure amounts split by exposure class according to the respective industry concentration:

At 31 December 2017	**Total € 000**	**Manufacturing € 000**	**Tourism € 000**	**Trade € 000**	**Property and construction € 000**	**Personal, professional and home loans € 000**	**Financial institutions € 000**	**Other sectors € 000**
Central governments or central banks	265,447	-	-	-	-	-	265,447	-
Public sector entities	-	-	-	-	-	-	-	-
Institutions	96,806	-	-	-	-	-	96,806	-
Corporates	96,610	6,269	605	24,338	24,868	412	32,537	7,581
of which: SME	*28,828*	*121*	*11*	*7,454*	*11,618*	*11*	*8,022*	*1,591*
Retail	18,238	1,455	1,502	1,496	6,536	5,170	193	1,886
of which: SME	*11,877*	*1,386*	*1,480*	*1,092*	*5,818*	*130*	*180*	*1,791*
Secured by mortgages on immovable property	235,042	6,223	7,196	23,905	96,683	46,610	43,233	11,192
of which: SME	*74,646*	*5,163*	*1,667*	*12,637*	*35,420*	-	*10,702*	*9,057*
Exposures in default	20,386	3,208	1,585	1,329	11,663	1,408	144	1,049
of which: SME	*15,545*	*3,102*	*1,086*	*779*	*9,882*	-	*144*	*552*
Items associated with particularly high risk	79,467	242	-	-	78,882	343	-	-
of which: SME	*36,152*	*242*	-	-	*35,910*	-	-	-
Equity	23,142	229	1,645	-	-	-	2,979	18,289
Other items	35,744	-	-	-	17,890	-	11,671	6,183
	870,882	**17,626**	**12,533**	**51,068**	**236,522**	**53,943**	**453,010**	**46,180**

2 **Credit risk** *(continued)*

2.3.3 Credit risk exposures analysed by residual maturity

The residual maturity breakdown by exposure class at the end of the reporting period was as follows:

At 31 December 2017	Total € 000	Less than 1 year € 000	Over 1 but less than 5 years € 000	Over 5 years € 000
Central governments or central banks	265,447	216,077	26,004	23,366
Institutions	96,806	91,188	618	5,000
Corporates	96,610	31,753	32,333	32,524
Retail	18,238	10,932	2,422	4,884
Secured by mortgages on immovable property	235,042	44,230	63,728	127,084
Exposures in default	20,386	15,716	4,281	389
Items associated with particularly high risk	79,467	32,596	42,236	4,635
Equity	23,142	22,942	200	-
Other items	35,744	35,744	-	-
	870,882	**501,178**	**171,822**	**197,882**

2.3.4 Counterparty banks' risk

The Bank runs the risk of loss of funds due to the possible delay in the repayment of existing and future obligations by counterparty banks.

Within its daily operations, the Bank transacts with banks and other financial institutions. By conducting these transactions, the Bank is running the risk of losing funds due to the possible delays in the repayment to the Bank of the existing and future obligations of the counterparty banks. The Bank primarily places short-term funds with pre-approved banks subject to the limits in place and subject to the respective institutions' credit rating being within controlled parameters. The positions are checked against the limits in real time and at end of day on a daily basis.

2.3.5 Country risk

The Bank runs the risk of loss of funds due to the possible political, economic and other events in a particular country where funds have been placed or invested with several counterparties. Countries are assessed according to their size, economic data and prospects and their credit ratings from international rating agencies. Existing country credit risk exposures are monitored and reviewed periodically. The Bank's exposures are predominantly in Malta as reflected within the table in section 2.3.1 which discloses country risk by exposure class. Other country risks are mainly to bank balances and money market placements with a total carrying amount of €90,258,000.

2 **Credit risk** *(continued)*

2.4 *Use of External Credit Assessment Institutions*

In calculating its risk-weighted exposure amounts, the Bank uses an External Credit Assessment Institution (ECAI) for Central governments, Institutions, Corporates and Items associated with particularly high risk for which a credit assessment is available. The credit quality of such exposures is determined by reference to credit ratings applicable to issuers published by Fitch Ratings. The Bank maps the external ratings to the credit quality steps prescribed in the CRR as required by CEBS publication *'Standardised approach: Mapping of ECAIs' credit assessments to credit quality steps'*.

The following are the exposure values for which an ECAI is used:

At 31 December 2017	**Credit quality step**	**Central governments or central banks € 000**	**Institutions € 000**	**Total € 000**
AAA to AA-	1	-	10,005	10,005
A+ to A-	2	265,447	49,663	315,110
BBB+ to BBB-	3	-	31,212	31,212
BB+ to BB-	4	-	-	-
B+ to B-	5	-	7	7
CCC+ and below	6	-	5,919	5,919
		265,447	**96,806**	**326,253**

2.5 *Credit quality of the Bank's lending portfolio*

The Bank manages the credit quality of its loans and advances to customers by using internal risk grades, which provide a progressively increasing risk profile ranging from 'P1' (best quality, less risky) to 'NP'. These risk grades are an essential tool for the Bank to identify both non-performing exposures and better-performing customers. The internal risk grades used by the Bank are as follows:

- Performing: Internal grades ranging from 'P1' to 'P3'; and
- Non-performing: Internal grade 'NP'.

P1

The Bank's loans and advances to customers which are categorised as 'P1' are principally debts in respect of which the payment of interest and/or capital is not overdue by 30 days and with no recent history of customer default. Management does not expect any losses from non-performance by these customers.

P2

Loans and advances which attract a 'P2' grading are those which are receiving the close attention of the Bank's Management and are being reviewed periodically in order to determine whether such advances should be reclassified to either 'P1' or 'P3' classification. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 30 days and over but not exceeding 60 days.

2 **Credit risk** *(continued)*

P3

Loans and advances which attract a 'P3' grading are those having the weaknesses inherent in those loans and advances classified as 'P2' with the added characteristics that repayment is inadequately protected by the current sound worth and paying capacity of the borrower. Loans and advances so graded have a well-defined weakness or weaknesses that could jeopardise the repayment of the debt. They are characterised by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 60 days and over but not exceeding 90 days.

NP

Loans and advances which attract a 'NP' grading are those facilities where the Bank deems the recoverability of principal to be remote as a result of worsening conditions of loans and advances classified as 'P3'. Credit facilities that attract this category include those where the payment of interest and/or capital becomes overdue by 90 days and over. This category comprises loans and advances which are deemed specifically impaired in accordance with the requirements of IFRSs as adopted by the EU. The Bank's forborne loans (refer to note 2.3.8) are also classified within this category.

The following table provides a detailed analysis of the credit quality of the Bank's lending portfolio.

	2017 **€ 000**
Gross loans and advances to customers	
Performing:	
P1	359,068
P2	16,698
P3	2,620
Non-performing:	
NP	73,073
	451,459

2.5.1 Impaired loans and advances to customers

Impaired loans and advances are advances which are either more than 90 days past due, or for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loans and advances agreement(s).

The Bank reviews all material credit exposures on a case by case basis and also on a collective basis, if not deemed individually impaired, in order to consider the likelihood that the Bank may be exposed to losses on loans and advances and with a view to taking early recovery action.

The individually impaired loans and advances mainly relate to a number of independent customers which are accordingly not meeting repayment obligations.

2 **Credit risk** *(continued)*

2.5.2 Past due but not impaired loans

Past due but not impaired loans comprise loans and advances where contractual interest or principal payments are past due, but the Bank believes that impairment is not appropriate on the basis of the level of security available and/or the stage of collection of amounts owed to the Bank. Related credit losses, which may arise, are partly covered by collective impairment allowances.

Loans and advances to customers are analysed into impaired, past due and other exposures as follows:

	2017
	€ 000
Gross loans and advances to customers	
Impaired	40,212
Past due but not impaired	38,386
Neither past due nor impaired	372,861
	451,459

The table below analyses the impaired and the past due but not impaired gross loans and advances to customers by industry sector.

At 31 December 2017	**Impaired € 000**	**Past due but not impaired € 000**
Manufacturing	4,268	1,362
Tourism	2,257	1,302
Trade	895	5,509
Property and construction	28,324	15,510
Personal, professional and home loans	3,880	7,440
Financial institutions	-	6,138
Other sectors	588	1,125
	40,212	**38,386**

The majority of the impaired and past due but not impaired loans and advances to customers were concentrated within Malta.

2 **Credit risk** *(continued)*

2.5.3 Collateral

The Bank holds collateral against exposures in the form of hypothecs over property, other registered securities over assets and guarantees. The nature and level of collateral required depends on a number of factors, including, but not limited to, the amount of the exposure, the type of facility provided, the term of the facility, the amount of the counterparty's contribution and an evaluation of the level of the credit risk or probability of default involved. Collateral is an important mitigant of credit risk. Nevertheless, it is the Bank's policy to establish that facilities are within the customer's capacity to repay rather than to over rely on security. In certain cases, depending on the customer's standing and the type of product, facilities may be unsecured. The Bank applies various measures to reduce the risk on individual transactions, including collateral in the form of physical assets and guarantees.

The principal collateral types used as credit risk mitigants are mortgages on residential properties and commercial real estate. For regulatory purposes, none of the Bank's collateral in the form of commercial real estate qualifies as eligible collateral, as these properties fail to meet the conditions of Article 126(2) of the CRR.

Out of the €428.6 million exposures arising from the Bank's lending, €233.1 million are secured by mortgages on immovable property, while €71.7 million are secured by mortgages on immovable property but are classified within high risk exposures since these are associated with speculative immovable property financing. From the €233.1 million exposures secured by mortgages on immovable property, €51.0 million qualify as fully and completely secured by mortgages on residential immovable property, and accordingly attract a risk-weight of 35%.

2 **Credit risk** *(continued)*

2.5.4 Allowances for impairment

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses on its loans and advances portfolio. The main components of this allowance are specific impairment allowances that relate to individually significant exposures and other individual exposures in respect of which impairment losses have been identified, and a collective impairment allowance established to cover losses which have been incurred but they have not yet been identified as loans subject to individual assessment or for groups of loans that are not considered individually significant.

Specific impairment allowances	**Total € 000**	**Manufacturing € 000**	**Tourism € 000**	**Trade € 000**	**Property and construction € 000**	**Personal, professional and home loans € 000**	**Financial institutions € 000**	**Other sectors € 000**
At 1 January 2017	18,815	736	1,180	1,312	13,808	1,506	73	200
Additions	9,124	292	522	3	7,752	525	-	30
Reversals	(9,905)	(62)	(62)	(827)	(8,419)	(317)	(73)	(145)
At 31 December 2017	**18,034**	**966**	**1,640**	**488**	**13,141**	**1,714**	**-**	**85**

Collective impairment allowances	**Total € 000**	**Manufacturing € 000**	**Tourism € 000**	**Trade € 000**	**Property and construction € 000**	**Personal, professional and home loans € 000**	**Financial institutions € 000**	**Other sectors € 000**
At 1 January 2017	4,743	102	705	1,191	646	1,347	352	400
Additions	3,185	277	150	277	1,766	400	274	41
Reversals	(3,114)	(60)	(240)	(883)	(349)	(1,202)	(71)	(309)
At 31 December 2017	**4,814**	**319**	**615**	**585**	**2,063**	**545**	**555**	**132**

2.5.5 Write-off policy

The Bank writes off loan or advance balances (and any related allowances for impairment losses) when it determines that these are uncollectible. This decision is reached after considering information such as the occurrence of significant changes in the borrower's financial position, such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

3 **Market risk**

The Bank takes on exposure to market risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements and changes in the level of volatility of market rates or prices such as interest rates, credit spreads, foreign exchange rates and equity prices.

3 **Market risk** *(continued)*

Accordingly, market risk for the Bank consists of three elements:

- Interest rate risk, which is the risk of losses because of changes in interest rates;
- Exchange rate risk, which is the risk of losses on the Bank's positions in foreign currency because of changes in exchange rates; and
- Equity price risk, which is the risk of losses because of changes in investment prices.

3.1 *Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or re-price at different times or at different amounts. The Bank accepts deposits from customers at both fixed and floating rates and for varying maturity periods. This risk is managed through the matching of the interest resetting on repricing dates on assets and liabilities as much as it is practicable. The Bank monitors on a continuous basis the level of mismatch of interest rate repricing taking cognisance of the terms of the Bank's principal assets, comprising loans and advances to customers, that are repriceable at the Bank's discretion. Accordingly, the Bank is in a position to manage the interest rate terms of its financial assets and simultaneously modify the interest terms of its liabilities. The Bank seeks to manage its net interest spread, taking cognisance of the cost of capital, by investing funds in a portfolio of loans and advances and securities with a longer tenure than the funding liabilities (therefore normally giving rise to a negative maturity gap position) through the effective management of shorter term deposit liabilities with a view to securing steady base deposits with differing terms over the medium to longer term.

Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands which are set by ALCO. ALCO is the monitoring body for compliance with these limits and is assisted by Treasury through its day-to-day operational activities. The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to interest rate movements.

Accordingly, the Bank's ALCO is primarily responsible for the interest rate risk management process and for monitoring actively the interest rate risk measures utilised by the Bank. Reporting of interest rate risk measures exposures vis-à-vis limits flows to the ALCO and Board on a regular systematic basis. The Bank's independent Risk Management Function provides oversight in respect of the interest rate risk management process ensuring that it is designed in an appropriate manner and is functioning properly.

The Bank's repricing gaps at 31 December 2017 are disclosed in the tables within note 2.4.1 to the financial statements. The measures applied for the monitoring of the fair value sensitivity of the fixed rate instruments and the cash flow sensitivity for variable rate instruments are disclosed within notes 2.4.3 and 2.4.4 to the financial statements.

3.2 *Currency risk*

The Bank takes on exposure to the effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. Foreign exchange risk is the risk to earnings and value caused by a change in foreign exchange rates. Foreign exchange risk arises when financial assets or liabilities are denominated in currencies which are different from the Bank's functional currency.

The Bank manages this risk principally by ensuring that its foreign currency denominated liabilities are matched with corresponding assets in the same currency.

3 **Market risk** *(continued)*

Accordingly, foreign currency liabilities are utilised to fund assets denominated in the same foreign currency thereby matching asset and liability positions as much as is practicable. This mechanism is reflected in the figures reported in the table below which presents this matching process.

The Bank's foreign exchange risks are managed actively and monitored by the Treasury Function, which process ensures that the Bank maintains its exposure to foreign currencies within prescribed limits set by the Bank's ALCO. ALCO sets limits on the level of exposure by currency and in aggregate for both overnight and intra-day positions which are monitored on a real-time basis. Reporting of exposures vis-à-vis limits flows to the ALCO and Board on a regular systematic basis. The Bank's independent Risk Management Function is responsible for assuring that the foreign exchange risk management process is designed in an appropriate manner and is functioning effectively.

The Bank enters into forward foreign currency exchange contracts with customers in the normal course of its business. Generally, it is the Bank's policy to cover these contracts by other forward positions. As a result, the Bank is not open to any significant exchange risk in respect of derivative contracts. The Bank also takes a deposit margin of the nominal value from the customer thereby reducing its credit risk should the client default. The Bank had no open forward foreign currency contracts at the end of the reporting period.

The following table summarises the Bank's net exchange position by currency taking into account the Bank's financial assets and liabilities as well as off-balance sheet instruments exposing the Bank to foreign exchange risk.

Bank

At 31 December 2017	**Total € 000**	**EUR € 000**	**GBP € 000**	**USD € 000**	**Other € 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	214,500	151,000	21,589	41,842	69
Investments classified as available-for-sale	72,282	71,906	-	376	-
Loans and advances to banks	90,258	62,587	13,287	8,964	5,420
Loans and advances to customers	428,611	423,712	2,712	1,489	698
Other assets	7,271	7,233	17	21	-
Total financial assets	812,922	716,438	37,605	52,692	6,187
Financial liabilities					
Amounts owed to banks	5,362	5,162	-	-	200
Amounts owed to customers	736,695	641,039	37,525	52,175	5,956
Other liabilities	19,496	19,270	82	95	49
Total financial liabilities	761,553	665,471	37,607	52,270	6,205
Net currency exposure in financial assets/liabilities	-	50,967	(2)	422	(18)
Commitments and contingent liabilities	256,830	255,693	958	179	-

3 **Market risk** *(continued)*

3.3 *Equity price risk*

The exposure of the Bank to this risk is not significant given the low holdings of equity instruments by the Bank, which are not deemed material in the context of the Bank's statement of financial position. Such holdings are limited to locally quoted equity instruments issued by local well-known corporate issuers. Frequent management reviews are carried out to obtain comfort on the high quality of the portfolio.

4 **Liquidity risk**

4.1 *Management of liquidity risk*

Liquidity risk is defined as the risk of losses due to:

- the Bank's funding costs increasing disproportionately;
- lack of funding preventing the Bank from establishing new business; and
- lack of funding ultimately preventing the Bank from meeting its obligations.

Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value. The Bank is exposed to daily calls on its available cash resources from overnight deposits, current and call deposits, maturing term deposits, loan drawdowns and guarantees.

The objective of the Bank's liquidity and funding management is to ensure that all foreseeable funding commitments and deposit withdrawals can be met when due. It is the Bank's objective to maintain a diversified and stable funding base with the objective of enabling the Bank to respond quickly and smoothly to unforeseen liquidity requirements.

The Bank manages this risk by ensuring that its assets and liabilities are matched in terms of maturities as much as is practicable. However, the Bank ought to manage its net interest spread by investing funds in a portfolio of assets with a longer term than the liabilities funding them. To mitigate exposures arising in this respect, the Bank holds significant liquid assets in the form of Malta Government treasury bills, money market placements and other short-term instruments for managing liquidity risk to support payment obligations and contingent funding in a stressed market environment.

The Bank maintains internal liquidity buffers established by ALCO made up of cash and financial assets which are also eligible for collateral against borrowing from the European Central Bank. In order to ensure that maturing funds are always available to meet unexpected demand for cash, the Board sets parameters within which maturities of assets and liabilities may be mismatched in line with the stance referred to previously. Unmatched positions potentially enhance profitability, but also increase risks. The Bank's ALCO focuses on the entity's management process with respect to market and funding liquidity risks. ALCO maintains ongoing oversight of forecast and actual cash flows, by monitoring the availability of funds to meet commitments associated with financial instruments. ALCO is supported by the Bank's Executive Team and Treasury Function in this respect, at operational level. ALCO monitors the Bank's Liquidity Gap analysis on a monthly basis. The Bank's liquidity management process comprises management of day-to-day funding, by monitoring future cash flows to ensure that requirements can be met and that funds are replenished as they mature or are borrowed by customers. This implies a structured ongoing analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets. The Bank's liquidity management focuses on maintaining a portfolio of highly marketable assets, subject to pre-established limits, that can easily be liquidated in case of any unforeseen interruption to cash flow; and monitoring the liquidity ratios of the Bank against internal and regulatory requirements. In this respect, the Bank's advances-to-deposit ratio of 58.2% at the end of the reporting period reflects management's prudent stance in the context of liquidity management. Also, the proportion of liquid-assets to short-term liabilities at 31 December 2017 is 65.3%, which is significantly higher than the prudential parameters set by the MFSA.

4 **Liquidity risk** *(continued)*

Reporting of measures of liquidity risk and liquidity ratios vis-à-vis internal limits flows to the ALCO and Board on a regular basis. The Bank's Risk Management Function provides oversight in respect of the liquidity risk management process ensuring that it is functioning effectively.

The Bank also monitors the level and type of undrawn lending commitments and the impact of contingent liabilities such as guarantees as part of the liquidity management process previously referred to.

As at 31 December 2017, the Bank had outstanding guarantees on behalf of third parties amounting to €5,649,000, which are cancellable upon the request of the third parties. The Bank's liquidity exposures arising from these commitments and contingencies are expected to expire principally within a period of twelve months from the end of the reporting period.

4.2 *Asset Encumbrance*

The disclosure on asset encumbrance is a requirement introduced in Banking Rule 07 transposing the provisions of the EBA Guidelines on Disclosure of Encumbered and Unencumbered Assets (EBA/GL/2014/03).

The objective of this disclosure is to facilitate an understanding of available and unrestricted assets that could be used to support potential future funding and collateral needs. An asset is defined as encumbered if it has been pledged as collateral against an existing liability, and as a result is no longer available to the Bank to secure funding, satisfy collateral needs or be sold to reduce the funding requirement.

The disclosure is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

In accordance with the EBA 'Guidelines on disclosure of encumbered and unencumbered assets', the amounts disclosed in the table below represent median values, being the rolling quarterly amounts over the previous 12 months.

At 31 December 2017	**Carrying amount of encumbered assets € 000**	**Fair value of encumbered assets € 000**	**Carrying amount of unencumbered assets € 000**	**Fair value of unencumbered assets € 000**
Assets of the reporting institution	11,961	-	840,599	-
Loans on demand	2,809	-	211,077	-
Equity instruments	-	-	9,061	9,061
Debt securities	9,152	9,152	119,582	119,582
Loans and advances	-	-	448,175	-
Other assets	-	-	53,387	-

4 **Liquidity risk** *(continued)*

The Bank does not encumber any of the collateral received. Moreover, as at 31 December 2017, the Bank did not have any outstanding liabilities associated with encumbered assets and collateral received.

The Bank undertakes encumbrance by pledging debt securities against the provision of credit lines by the Central Bank of Malta and in favour of the Depositor Compensation Scheme.

5 **Operational risk**

Operational risk is the risk of loss resulting from the lack of skilful management or good governance within the Bank and the inadequacy of internal control, which might involve internal operations, staff, systems or external occurrences that in turn affect the income and capital funds of financial institutions. The Bank has adopted an operational risk management framework and procedures, which provide for the identification, assessment, management, monitoring and reporting of the Bank's operational risks. Operational risk is also addressed through proper insurance cover.

Operational risk management relies on a framework of policies and procedures implemented by the different operational functions within the Bank through transaction processing and business execution. Regular reporting of operational risk events to the Board of Directors is carried out as required. The implementation of such policies and procedures by the Bank's operational functions is overseen by the Risk Management Function.

The Bank currently uses the Basic Indicator Approach to assess the operational risk capital requirements and accordingly allocates 15% of average gross income for a three year period in accordance with regulatory requirements. The operational risk capital regulatory requirement as at 31 December 2017 amounted to €3,021,000.

6 **Capital risk management**

The Bank is a licensed credit institution and must therefore comply with the capital requirements under the relevant capital requirements within laws and regulations. Maltese law and regulations on capital adequacy are naturally based on EU capital requirements.

The prudent and efficient management of capital remains one of the Bank's top priorities. The Bank must have sufficient capital to comply with regulatory capital requirements. The purpose of the Bank's capital management is to ensure an efficient use of capital in relation to risk appetite as well as business development. Capital management is managed primarily through the capital planning process that determines the optimal amount and mix of capital that should be held by the Bank, subject to regulatory limits.

6 **Capital risk management** *(continued)*

Capital adequacy and the use of regulatory capital are monitored regularly by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee, European Union Regulations and Directives, as implemented by the MFSA for supervisory purposes. The Bank's capital management is based on the regulatory requirements established within the CRR and by local regulations which are modelled on the requisites of the CRD rules.

The Bank's Executive Team and ALCO are predominately responsible for the Bank's capital risk management process. Capital adequacy ratios together with the level and quality of Own funds are reported on a regular basis to the Board and the ALCO by the Finance Function.

6.1 *Own funds*

Own funds represent the Bank's available capital and reserves for the purposes of capital adequacy. Capital adequacy is a measure of the financial strength of a bank, expressed as a ratio of its capital to its assets. The Bank adopts processes to ensure that the minimum regulatory requirements are met at all times, through the assessment of its capital resources and requirements given current financial projections. During the year ended 31 December 2017, the Bank complied with all of the externally imposed capital requirements to which it was subject.

In July 2013, the European Banking Authority (EBA) issued its final draft Implementing Technical Standards (ITS) on Own funds disclosures. The disclosure requirements of these technical standards have been integrated within the Bank's disclosures set out below.

For regulatory purposes, the Bank's capital base is divided into Common Equity Tier 1 (CET1) capital and Tier 2 capital.

The Bank's CET1 capital includes the following items:

- ordinary share capital;
- share premium;
- retained earnings;
- reserve for general banking risks; and
- other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes including deductions relating to amounts pledged in favour of the Depositor Compensation Scheme and any losses in the fair valuation of available-for-sale financial assets, net of deferred taxation.

The Bank's Tier 2 capital consists of a property revaluation reserve and an investment revaluation reserve, which represent gains in the fair valuation of property and available-for-sale financial assets respectively, net of deferred taxation.

6 **Capital risk management** *(continued)*

(a) Share capital

The Bank's share capital as at 31 December 2017 is analysed as follows:

	2017	
	No. of shares 000s	€ 000
Authorised		
Ordinary shares of 25 cent each	**80,000**	**20,000**
Issued		
Ordinary shares of 25 cent each	**44,178**	**11,044**

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Bank. All shares rank equally with regard to the Bank's residual assets.

The following table describes the terms and conditions of the ordinary share capital issued by the Bank.

Capital Instruments	**Ordinary share capital and share premium**
Unique Identifier	MT0000040106
Governing law(s) of the instrument	Maltese Law
Regulatory treatment	
Transitional CRR rules	Common Equity Tier 1
Post-transitional CRR rules	Common Equity Tier 1
Eligible at solo/(sub-)consolidated / solo &(sub-) consolidated	Solo
Amount recognised in regulatory capital	€11,044,479
Nominal amount of instrument	€11,044,479
Nominal amounts of each share	€0.25
Accounting classification	Share capital
Issuer call subject to prior supervisory approval	No
Position in subordination hierarchy in liquidation	Subordinated to creditors and depositors
Non-compliant transitioned features	No

(b) Share premium

The share premium represents the amounts at which ordinary shares were issued in excess of their nominal value, normally arising as a result of rights issues approved by the shareholders during the Annual General Meetings. The amount is not distributable by way of dividend to shareholders.

6 **Capital risk management** *(continued)*

(c) Retained earnings

The retained earnings represent earnings not paid out as dividends.

Retained earnings form part of Own funds only if those profits have been verified by the Bank's independent external auditor. The Bank has demonstrated to the satisfaction of the competent authority that any foreseeable charge or dividend has been deducted from the amount of those profits.

Subsequent to the end of the reporting period, a gross dividend of 4 cent per nominal 25 cent share (net dividend of 2.6 cent for a total amount of €1,149,000) for the twelve months ended 31 December 2017 is being proposed for approval by the shareholders to be distributed. A resolution to this effect will be proposed to the Annual General Meeting.

(d) Reserve for General Banking Risks

Banking Rule BR/09 'Measures addressing credit risks arising from the assessment of the quality of asset portfolios of credit institutions authorised under the Banking Act 1994', issued by the MFSA, requires banks in Malta to hold additional reserves for general banking risks in respect of non-performing loans. This reserve is required to be funded from planned dividends. As at the reporting date, this reserve amounted to €2,903,000 (representing 100% of the total estimated amount). The amount has not changed during the year under review.

(e) Property revaluation reserve

This represents the surplus arising on the revaluation of the Bank's freehold property net of related deferred tax effects. The revaluation reserve is not available for distribution.

(f) Investment revaluation reserve

This represents the cumulative net change in fair values of available-for-sale assets held by the Bank, net of related deferred tax effects.

6 **Capital risk management** *(continued)*

As described in the CRR published by the European Commission, banks are required to present a transitional disclosure template during the phasing in of regulatory adjustments from 1 January 2014 to 31 December 2017. The transitional disclosure template is set out below.

At 31 December 2017	**€ 000**
Common Equity Tier 1 (CET1) capital	
Common Equity Tier 1 (CET1) capital: instruments and reserves	
Capital instruments and the related share premium accounts	29,574
Retained earnings	50,738
Accumulated other comprehensive income (and other reserves)	6,091
Reserve for General Banking Risks	2,903
CET1 capital before regulatory adjustments	89,306
Common Equity Tier 1 (CET1) capital: regulatory adjustments	
Intangible assets	(480)
Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	(1,375)
Total regulatory adjustments to CET1	(1,855)
CET1 capital	**87,451**
Tier 2 capital	
Tier 2 capital before regulatory adjustments	-
Tier 2 capital: regulatory adjustments	
Amount to be deducted from or added to Tier 2 capital with regard to additional filters and deductions required pre CRR	1,375
Total Tier 2 capital	**1,375**
Total risk-weighted assets	**619,320**
Capital ratios	
CET1 capital	14.1%
Tier 1 capital	14.1%
Total capital	14.3%
Institution specific buffer requirement	5.75%
of which: capital conservation buffer requirement	*1.25%*
CET1 available to meet buffers	9.62%
	€ 000
Items not deducted from own funds in accordance with Article 48 of CRR	5,233

6 **Capital risk management** *(continued)*

6.2 *Capital requirements*

The allocation of capital between specific operations and activities is, to a large extent, driven by optimisation of the return achieved on the capital allocated. The amount of capital allocated to each operation or activity is based primarily upon the regulatory capital, though in some cases the regulatory requirements do not reflect differing risk profiles, subject to the overall level of capital to support a particular operation or activity not falling below the minimum required for regulatory purposes. The process of allocating capital to specific operations and activities is undertaken independently of those responsible for the operation.

Although maximisation of the return on risk-adjusted capital is the principal basis used in determining how capital is allocated within the Bank to particular operations or activities, it is not the sole basis used for decision-making. Account is also taken of synergies with other operations and activities, the availability of management and other resources, and the fit of the activity with the Bank's long term strategic objectives. The Bank's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors.

The Pillar I minimum capital requirements are calculated for credit, market and operational risks. During the year, the Bank continued to use the Standardised Approach for credit risk, the Basic Method for foreign exchange risk and the Basic Indicator Approach for operational risk in order to calculate the Pillar I minimum capital requirements. For credit risk, under the Standardised Approach, risk weights are determined according to the asset class, credit risk mitigation and credit ratings provided by Fitch or by using the applicable regulatory risk weights for unrated exposures. Capital charge for foreign exchange risk using the Basic Method is calculated at 8% of the higher of the sum of all the net short positions and the sum of all the net long positions in each foreign currency. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income of the preceding three years.

The Total Capital Ratio is calculated using the definition of regulatory capital and risk-weighted assets. As required by the CRR, the minimum level of the Capital Requirements Ratio stands at 8%. The Capital Requirements Ratio expresses Own funds as a proportion of risk-weighted assets and off-balance sheet instruments for credit risk purposes, together with notional risk-weighted assets in respect of operational risk and market risk. Total risk-weighted assets are determined by multiplying the capital requirements for market risk and operational risk by 12.5 (i.e. the reciprocal of the minimum capital ratio of 8%) and adding the resulting figures to the sum of risk-weighted assets for credit risk.

The Bank's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Bank recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Bank will be fully implementing the CRD IV capital requirements with effect from January 2019. Although it is not yet certain whether the Bank will be required to maintain an additional countercyclical capital buffer as required by the CRR, given that the Bank's exposures are mainly contained within Malta, this buffer is expected to be marginal, since the deviation of Malta's credit-to-GDP ratio is not expected to be significant taking cognisance of its long-term trend.

Additionally, the Bank will be required to maintain a capital conservation buffer of 2.5%, made up of CET1 capital, on the risk-weighted exposures of the Bank as from 1 January 2019. This buffer will be phased in over the period from 1 January 2016 to 31 December 2018.

6 **Capital risk management** *(continued)*

The Bank's capital requirements and Total Capital Ratio computation are as follows:

At 31 December 2017	Exposure value € 000	Risk-weighted assets € 000	Capital required € 000
Central governments or Central banks	265,447	8,345	668
Institutions	96,806	23,449	1,876
Corporates	96,610	96,610	7,729
Retail	18,238	13,678	1,094
Secured by mortgage on immovable property	235,042	200,614	16,049
Exposures in default	20,386	30,580	2,446
Items associated with particularly high risk	79,467	119,201	9,536
Equity	23,142	50,828	4,066
Other items	35,744	38,082	3,047
Credit risk	870,882	581,387	46,511
Foreign exchange risk		175	13
Operational risk		37,758	3,021
Total capital required		**619,320**	**49,545**
Own funds			
Common Equity Tier 1 capital			87,451
Tier 2 capital			1,375
Total own funds			**88,826**
Total capital ratio			**14.34%**

6.3 *Internal Capital Adequacy Assessment Process (ICAAP)*

The Bank considers the Internal Capital Adequacy Assessment Process (ICAAP) embedded in Pillar II as a tool that ensures the proper measurement of material risks and capital and allows for better capital management and improvements in risk management. Therefore, it facilitates a better alignment between material risks and regulatory capital in order to have better capital deployment and improvements in the risk management and mitigation techniques adopted by the Bank. The ICAAP as required by the MFSA Banking Rule BR/12: The Supervisory Review Process of Credit Institutions authorised under the Banking Act, 1994, is performed on an annual basis.

Therefore, ICAAP is a process that the Bank utilises to ensure that:

- there is adequate identification, measurement, aggregation and monitoring of the Bank's risks;
- adequate internal capital is held by the institution in relation to its risk profile; and
- the Bank uses sound risk management systems and there is the intention to develop them further.

6 **Capital risk management** *(continued)*

The Board and the Bank's Executive Team take overall responsibility for the conceptual design and technical details of the ICAAP document. Apart from the responsibility for the conceptual design, the Board discussed, approved, endorsed and delivered the yearly ICAAP submission. The Bank's independent Risk Management Function is involved in the ICAAP with a view to ensuring that the process reflects and takes cognisance of the Bank's risk management activities and processes.

The ICAAP is an ongoing process which starts with defining risk strategy followed by identifying, quantifying and aggregating risks, determining risk-bearing ability, allocating capital, establishing limits and ongoing risk monitoring. The individual elements of the process are performed with varying regularity. All the activities described are examined at least once a year to ensure that they are up to date, adequate and also adjusted to current underlying conditions when necessary.

The process involves a quantitative assessment of individual types of risk and an assessment of the existing methods and systems for monitoring and managing risk (qualitative assessment). The risk assessment concept is based on a scoring procedure, thus providing a comprehensive overview of the risk situation of the Bank.

The basis for the quantitative implementation of the ICAAP is the risk-bearing capacity calculation which demonstrates that adequate capital is in place at all times to provide sufficient cover for risks that have been entered into and which also ensures such cover is available for the future. The Bank's ICAAP is based upon a 'Pillar I Plus' approach whereby the Pillar I capital requirement for credit, market and operational requirements are supplemented by the capital allocation for other material risks not fully addressed within Pillar I. The risks considered for ICAAP include concentration, liquidity, reputational and strategic risks, interest rate risk in the banking book, and risks arising from the macroeconomic environment.

The Bank's ICAAP contains three year projections as well as the capital plan, and the Board monitors that there are adequate capital resources to support the corporate goals contained within the Bank's plan and the associated risks.

The Bank also covers Pillar II capital requirements through stress testing processes to forecast the Bank's projected capital requirements and resources in a range of stress scenarios. This enables the Bank to guarantee that it can meet its minimum regulatory capital requirements in a stressed environment. The results of the ICAAP once again show that the Bank maintains a comfortable level of excess capital and substantial liquidity that ensured the flexibility and resources needed to achieve the long-term strategic objectives of the Bank, even in situations of market stress.

7 **Leverage**

The leverage ratio is a regulatory and supervisory tool intended to provide a transparent and non-risk based measurement of an institution to supplement the risk-based capital requirements.

The leverage ratio is calculated on a three-month average of capital as a proportion of total exposures. Capital is defined as Tier 1 capital in line with Article 25 of the CRR, while total exposure relates to the total on and off-balance sheet exposures less the deductions applied to Tier 1 capital.

During 2016, the European Commission published a Proposal to amend Regulation 575/2013 (CRR), which included the introduction of a 3% leverage ratio as a binding Pillar I requirement. Although this Proposal is still in draft and further discussions are expected, the Bank complies with a 3% leverage ratio based on fully-transitioned Basel III standards.

7 **Leverage** *(continued)*

The following table represents the Bank's estimated leverage ratio determined in accordance with the requirements stipulated by Implementing Regulation EU 2016/200.

	2017
	€ 000
Tier 1 capital	87,451
Leverage ratio total exposure measure	893,505
Leverage ratio	**9.8%**

The table shown hereunder represents the amounts making up the leverage ratio exposures.

	2017
	€ 000
On-balance sheet exposures (excluding derivatives and SFTs)	
On-balance sheet items (excluding derivatives and SFTs, but including collateral)	856,702
Asset amounts deducted in determining Tier 1 capital	(480)
On-balance sheet exposures (excluding derivatives and SFTs)	**856,222**
Off-balance sheet exposures	
Off-balance sheet exposures at gross notional amount	256,830
Adjustments for conversion to credit equivalent amounts	(219,547)
Off-balance sheet exposures	**37,283**

The following table provides a reconciliation of accounting assets and leverage ratio exposures.

	2017
	€000
Total assets as per published financial statements	859,838
Adjustment for off-balance sheet items	37,283
Other adjustments:	(3,616)
Leverage ratio total exposure measure	**893,505**

7 **Leverage** *(continued)*

The table below shows the different on-balance sheet exposures in relation to the calculation of the leverage ratio

	2017 € 000
Total on-balance sheet exposures (excluding derivatives and SFTs), of which:	**856,222**
Exposures treated as sovereigns	265,447
Institutions	96,792
Secured by mortgages on immovable property	233,063
Retail	15,351
Corporate	90,990
Exposures in default	20,386
Other exposures	134,193

The leverage ratio is a regulatory and supervisory instrument used by Regulator to limit the build-up of excessive leverage. The leverage ratio has increased slightly between 2016 and 2017 to 9.8%.

As a result, the relative increase in the Group's CET1 capital of 5.3% surpassed the Bank's increase of 3.3% in the total exposure measure. While the Bank is currently not at risk at curtailing excessive leverage, the leverage ratio is expected to remain well above the mandatory requirement with the re-investment of profits leading to a greater increase in equity than the growth in assets. Board limits to the leverage ratio are set and reviewed annually and the ratio is monitored at every Audit and Risk Committee to ensure that it remains above the tolerance limit set by the Board of Directors. This limit supports the Bank's attitude towards finding a suitable balance between risk and returns provided to shareholders

8 **Remuneration policy**

Information on the Bank's remuneration policy and practices is disclosed in the Remuneration Report within the Annual Report located on page 24.

9 **Other Directorships**

In terms of Article 91 of Directive 2013/36/EU (CRD IV), directors of an institution that is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities shall not hold more than one of the following combinations of directorships at the same time:
(a) one executive directorship with two non-executive directorships;
(b) four non-executive directorships.

According to the 'Guide to banking supervision' issued by the European Central Bank in November 2014, a credit institution will be considered significant if any one of the following conditions is met:

- the total value of its assets exceeds €30 billion or – unless the total value of its assets is below €5 billion – exceeds 20% of national GDP;
- it is one of the three most significant credit institutions established in a Member State;
- it is a recipient of direct assistance from the European Stability Mechanism; or
- the total value of its assets exceeds €5 billion and the ratio of its cross-border assets/liabilities in more than one other participating Member State to its total assets/liabilities is above 20%.

9 Other Directorships *(continued)*

Lombard Bank Malta p.l.c. does not meet any of the above criteria, and therefore is currently not considered significant by banking supervisors. Accordingly, the Bank is exempt from the requirements of Article 91 of CRD IV.

The Bank is not disclosing the number of directorships held by the members of the Bank's Board of Directors on the basis of materiality in terms of Article 432 of the CRR.

10 Recruitment and Diversity policy

The Bank is aware that a vigorous and professional approach to recruitment and selection of prospective staff members within the Bank helps it to attract and appoint those individuals having the necessary skills and attributes compatible with achieving the Bank's overall objectives. Thus, the Bank ensures that appointments at all levels are based on each individual's knowledge, skills, expertise and merit, as required by laws, rules, regulations, etc. and in line with policy.

The Bank undertakes a rigorous selection process for all prospective staff members bearing in mind the key activities, tasks and skills required. As part of the selection process, multiple interviews are conducted, during which the individual's knowledge, experience, skills and competence are evaluated against those of other individuals.

The Bank continues to promote diversity with no discrimination as to gender, race, family, disability, sexual orientation, identity or preference etc.

Bearing its objectives in mind, the Bank, particularly by virtue of the Board appointed Suitabilities & Evaluations Committee, endeavours to have a Board of Directors composed of members possessing diverse skills and expertise that allow the Board to create value for shareholders by ensuring that the specific risks pursued by the Bank as well as risks that are intrinsic to banking business are appropriately managed and mitigated within the Bank's Risk appetite.

Five Year Summary
Statements of Financial Position
As at 31 December

Group

	2017	2016	2015	2014	2013
	€ 000	€ 000	€ 000	€ 000	€ 000
Assets					
Balances with Central Bank of Malta, treasury bills and cash	**215,133**	218,148	115,884	84,311	134,596
Cheques in course of collection	**1,755**	1,374	475	1,656	739
Investments	**75,895**	80,515	76,246	55,077	43,554
Loans and advances to banks	**97,048**	161,728	229,788	185,918	73,193
Loans and advances to customers	**428,611**	343,487	305,891	318,742	314,773
Investment in associate	**1,575**	1,681	1,645	-	-
Intangible assets	**1,648**	1,809	1,490	1,422	1,466
Property, plant and equipment	**31,753**	30,198	26,931	24,574	23,229
Investment property	**-**	-	-	-	745
Assets classified as held for sale	**822**	833	1,023	1,022	417
Current tax assets	**1,557**	190	533	1,665	1,907
Deferred tax assets	**8,980**	8,973	7,695	6,582	5,111
Inventories	**1,164**	1,197	1,106	996	862
Trade and other receivables	**10,949**	8,136	8,170	5,545	6,085
Accrued income and other assets	**5,856**	4,462	5,043	5,835	4,259
Total assets	**882,746**	862,731	781,920	693,345	610,936
Equity and liabilities					
Equity					
Share capital	**11,044**	11,044	10,943	10,422	9,925
Share premium	**18,530**	18,530	17,746	17,746	17,746
Property revaluation reserve	**2,420**	2,420	2,420	1,978	2,045
Investment revaluation reserve	**4,113**	5,204	4,865	1,827	363
Reserve for General Banking Risks	**2,903**	2,903	2,620	1,834	1,048
Other reserves	**3,226**	3,196	3,247	2,690	2,775
Retained earnings	**53,904**	50,541	47,557	46,291	45,372
Equity attributable to equity holders of the Bank	**96,140**	93,838	89,397	82,788	79,274
Non-controlling interests	**6,734**	6,510	6,101	5,519	5,127
Total equity	**102,874**	100,348	95,498	88,307	84,401
Liabilities					
Amounts owed to banks	**5,362**	9,036	1,059	73	2,563
Amounts owed to customers	**733,151**	721,559	650,516	573,946	493,901
Provisions for liabilities and other charges	**3,177**	2,823	2,378	2,258	2,284
Current tax liabilities	**229**	310	346	-	-
Deferred tax liabilities	**3,914**	4,449	4,377	1,818	1,095
Other liabilities	**23,217**	16,100	18,404	16,919	16,995
Accruals and deferred income	**10,822**	8,106	9,342	10,024	9,697
Total liabilities	**779,872**	762,383	686,422	605,038	526,535
Total equity and liabilities	**882,746**	862,731	781,920	693,345	610,936
Memorandum items					
Contingent liabilities	**9,078**	8,775	7,479	8,023	6,107
Commitments	**247,737**	182,919	106,925	72,115	62,887

Five Year Summary
Income Statements
For the Year Ended 31 December

Group

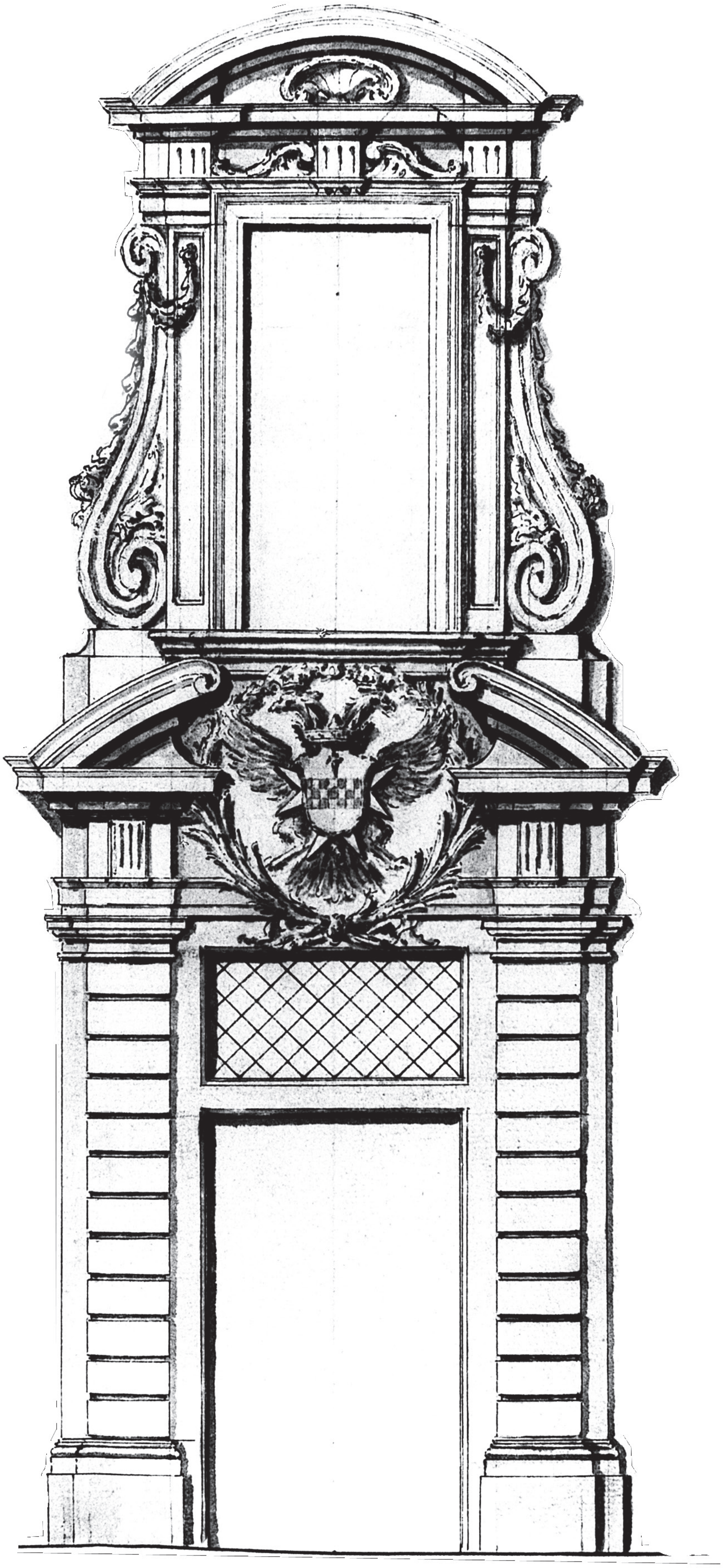
	2017	2016	2015	2014	2013
	€ 000	€ 000	€ 000	€ 000	€ 000
Interest receivable and similar income	**21,426**	20,905	20,742	23,608	24,173
Interest expense	**(5,992)**	(6,703)	(7,603)	(9,302)	(9,106)
Net interest income	**15,434**	14,202	13,139	14,306	15,067
Other operating income	**42,747**	33,285	29,348	26,364	23,490
Other operating charges	**(46,372)**	(35,337)	(31,569)	(29,812)	(27,344)
Net impairment losses	**(2,835)**	(3,950)	(3,081)	(4,618)	(4,181)
Share of (loss)/profit of investment accounted for using equity method	**(106)**	35	-	-	-
Profit before taxation	**8,868**	8,235	7,837	6,240	7,032
Income tax expense	**(3,165)**	(2,905)	(2,800)	(2,333)	(2,550)
Profit for the year	**5,703**	5,330	5,037	3,907	4,482
Attributable to:					
Equity holders of the Bank	**5,129**	4,726	4,382	3,362	4,094
Non-controlling interests	**574**	604	655	545	388
Profit for the year	**5,703**	5,330	5,037	3,907	4,482

Five Year Summary Statements of Cash Flows

For the Year Ended 31 December

Group

	2017	2016	2015	2014	2013
	€ 000	€ 000	€ 000	€ 000	€ 000
Net cash flows from/(used in) operating activities	**(27,882)**	(5,617)	92,464	96,097	37,515
Cash flows from investing activities					
Dividends received	**326**	361	240	159	186
Interest received from investments	**2,196**	2,157	2,274	2,359	2,314
Proceeds on maturity/disposal of investments	**3,285**	2,995	2,687	2,414	1,227
Purchase of investments	**(905)**	(5,873)	(19,353)	(11,982)	(11,323)
Purchase of property, plant and equipment	**(2,943)**	(4,604)	(3,174)	(2,210)	(1,684)
Proceeds from disposal of property, plant and equipment	-	-	-	4	-
Acquisition of non-controlling interests	**(429)**	(283)	-	(44)	(270)
Net cash flows (used in)/from investing activities	**1,530**	(5,247)	(17,326)	(9,300)	(9,550)
Cash flows from financing activities					
Dividends paid to equity holders of the Bank	**(1,149)**	(252)	(1,084)	(1,032)	(2,815)
Dividends paid to non-controlling interests	**(244)**	(228)	(218)	(217)	(236)
Net cash flows used in financing activities	**(1,393)**	(480)	(1,302)	(1,249)	(3,051)



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