LOMBARD

Lombard Bank Malta p.l.c.

2010

ANNUAL REPORT

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Lombard Bank Malta p.l.c.

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ANNUAL REPORT
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Chairman's Statement to the Members

In 2010 our Group, principally consisting of Lombard Bank Malta p.l.c. ('the Bank') and MaltaPost p.l.c., registered a consolidated profit of €9.0 million representing an increase of 12 per cent over the financial year 2009. Given the continued challenging financial and economic conditions globally, the Board of your Bank is very satisfied with this result. While the profit of MaltaPost p.l.c. was up by 7 per cent, Lombard Bank Malta p.l.c. saw its profit increase by 3 per cent to €7.7 million in the past year – and this despite considerable costs incurred in respect of new projects from which the Bank is expected to benefit in the years to come. All sectors of the Bank's activities contributed to this increase: net interest margin was up 11 per cent, fees and commissions increased by a healthy 15 per cent. Shareholders' funds increased further by 11 per cent while the total of the statement of financial position of the Group experienced an increase of 4 per cent to €567.8 million.

While 2010 fortunately saw an upward trend of the world economy in general, most countries have not seen a recovery to pre-recession levels. The increase of economic activity is somewhat unevenly spread with China and other emerging countries showing remarkably high growth rates while in Europe the picture is a mixed one with Germany, Sweden and Switzerland rebounding particularly strongly. Fortunately, Malta's economic situation has improved although the sentiment is still cautious when compared to the statistics. According to Central Bank of Malta, the country's GDP in the third quarter of 2010 exceeded the pre-recession figures. This bodes well for further economic dynamism and an improvement in sentiment from which our business also stands to benefit.

Of course it would be wrong to ignore the dark clouds which still hang over a number of parts of the world. The Greek debt crisis was a warning shot and a reminder that sovereign debt simply cannot exceed sustainable levels. After Greece, other member countries of the European Monetary Union came into the focus of the rating agencies and financial market participants, resulting in unexpectedly strong pressure on the euro - something not seen since its introduction in 1999. This forced a number of countries to cut back on spending to an unparalleled extent resulting in various incidents of social unrest. The austerity measures introduced come at a time when a reduction in government spending will most likely reduce economic activity further. It is vital for these countries to implement measures to improve their international competitiveness.

The debt problems of the European countries concerned have raised the question, in some quarters, as to whether the euro will break apart. We believe that this must, and should not be allowed to happen. Various European entities are taking all necessary steps to avoid this. While the pressure on the euro has brought to light certain inadequacies of the Maastricht treaty, it has also highlighted the need for enhanced Europe-wide financial and economic policies and, more importantly, on more responsible and prudent housekeeping by individual European states. We are hopeful that the present problems facing the euro will be overcome and that the euro will, over time, be seen as a strong currency of a strong European Union of which Malta is happy to be a member. It should not be left unmentioned that other countries outside the European Monetary Union are faced with unsustainable, and still increasing, debt levels which could, over time, attract the same attention the euro is currently receiving from the markets.

Having mentioned the need for responsible and prudent housekeeping at national levels, we at Lombard Bank Malta p.l.c. are mindful of the importance that we too embrace such principles. We are fully aware that, as a financial institution, we have a special responsibility in this respect. This is why we had taken measures, a number of years ago, to continuously strengthen the base of the Bank's shareholders' funds which have grown from €38.8 million in 2005 to €70.5 million at the end of 2010. In the same period, total assets of the Bank have increased from €438.0 million to €556.5 million. Many of you, as shareholders, have contributed to the strengthening of the Bank's capital base by having chosen to receive their dividend in shares rather than in cash. Our capital adequacy ratio now stands at 18 per

Chairman's Statement to the Members

cent - comfortably above the required 8 per cent as per Basel II. Additionally we have purposely maintained a very strong and prudent Loan to Deposit ratio which now stands at 71 per cent - a level which is considered in the banking industry as very conservative. Especially in times of financial turmoil, as we have witnessed over the past few years, the financial strength and solidity which these two ratios represent are of importance to our ability to service our customers and to produce good results.

In his Review of Operations, the Chief Executive Officer of your Bank has listed, amongst other things, the various projects the Bank has worked on and from which we, and our customers, will benefit over the years to come. He has also mentioned the rehabilitation works in a former palace at Frederick Street, which is the rear part of Palazzo Spinola. The Bank is grateful for his personal initiative regarding this building which is now securely part of Malta's heritage and a state-of-the-art workplace for a number of our staff.

We see our participation in MaltaPost p.l.c. with continued enthusiasm and are satisfied with the investment the Bank has made in Malta's major postal operator. MaltaPost p.l.c. contributes well towards the Group's profit and the cooperation between MaltaPost p.l.c. and the Bank has been enhanced further and is rewarding for both parties.

This year the Board is recommending a Gross Dividend of €0.115 per share. This represents an increase of 15 per cent over previous years. In view of the very satisfactory and strong level of shareholders' funds mentioned earlier the Board does not recommend the option of a scrip dividend this year. Despite upheavals in the markets the Bank continues to pay dividends at consistent levels and it is the Bank's intention to continue doing so. As far as the business prospects for this year are concerned, we feel that we are well placed to take advantage of the business opportunities which a growing economy may present from time to time.

I would like to thank you, Lombard Bank Malta p.l.c.'s shareholders, for your continued support and for your interest in the Bank's developments. I would also like to thank our customers for their loyalty, for their trust in us and the business they give us and for the many personal relationships which have developed between them and the members of our team.

The Bank has an asset it is particularly proud of: the loyal, well-trained and enthusiastic staff on whom we receive many favourable comments from our customers. This is an appropriate occasion to thank them and the Bank's Chief Executive Officer and his team for making Lombard Bank Malta p.l.c. the financial institution that it is today.

Christian Lemmerich
Chairman

Chief Executive Officer's Review of Operations

The 2010 consolidated financial performance for the Lombard Bank Group combines the results of Lombard Bank Malta p.l.c. and its subsidiaries: Redbox Limited (the company holding the Group's shares in MaltaPost p.l.c.), MaltaPost p.l.c. and Lombard Asset Managers Limited. Lombard Funds SICAV p.l.c. discontinued its operations in 2010.

The Bank had adopted a cautious strategy to see it through the recessionary pressures in the aftermath of the international financial and economic crisis. Concurrently it continued to build long-term business relationships with selected corporate clients while also providing services that cover the full range of traditional commercial and retail banking activities.

MaltaPost p.l.c., the main subsidiary of the Bank, is the major postal operator in Malta and provides potential synergies with the Bank. MaltaPost p.l.c. closed its financial year in September 2010 and reported another successful year with record profits.

Loans and advances to customers increased slightly to €333.7 million. As the adverse effect from the international economic downturn continued to impact local industry, the Bank remained selective by accepting to finance sound credit proposals. The loan to deposit ratio of 71% at year-end was within the prudential parameters set by the Bank.

Competition for local customer deposits remained intense as a number of alternative products were made available on the market during the year. Our Bank successfully met these challenges by offering customers competitive interest rates across its product range. Term deposits remained important to the Bank's strategy of maintaining long-term relationships with customers. Total deposits increased by 6% to €472.7 million.

The Group's Earnings per Share (EPS) for 2010 stood at 23.2 cents, an increase of 2.4 cents. The Bank's post tax Return on Equity (ROE) remained stable at 12%. Return on Assets (ROA) at 1.5% remained practically at the same level of the previous year. Net Asset Value (NAV) per share at year-end stood at €2.

Review of Financial Performance

The Group's Net Interest Income increased by 10% to €16.1 million as a result of interest expense on customer deposit products having decreased at a faster rate than interest receivable following re-pricing of term deposits in line with market developments. New business in wealth management and corporate advisory contributed to an increase of 7% in fee and commission income while postal sales and similar revenue increased to reach €19.8 million. Total operating income at €38.8 million was also higher than that of the previous year. Cost containment continued to be well managed within the Group and in line with targets established.

Profit after taxation was up by 12% from the previous year to €9.0 million.

Liquidity and Own Funds

In 2010, the share capital of the Bank increased by a further 479,111 Ordinary Shares as a number of shareholders opted to receive their dividend for 2009 in shares rather than in cash. The Group's equity attributable to shareholders rose by €7.4 million (12%) to €71.7 million, thus providing increased capacity to take advantage of new business opportunities within established prudential limits. As at 31 December 2010 the Capital Adequacy Ratio stood at 18% (2009: 17%) and the Bank's statutory Own Funds increased to €69.3 million (2009: €65.3 million). This increased the Bank's ability to potentially assume larger credit exposures while also strengthening the Bank's statement of financial position.

The Bank held eligible liquid assets at 74% of short-term liabilities in terms of Banking Rule 5 and thus well over the statutory minimum of 30%.

Chief Executive Officer's Review of Operations

Treasury

The European Central Bank maintained its view on interest rates and there was no change to the main interest rate since it was lowered by 25 basis points, to 1%, in May 2009. The overall economic and financial situation is still fraught with risk. The main source of concern stems from the interplay between sovereign debt problems and vulnerabilities in segments of the euro area banking sector. Money-market deposits with selected high-grade counterparty banks were maintained predominantly on short-term basis with particular care underlining regional selection. The Bank stressed capital security as being a main priority in all its transactions during the year. Malta Government Treasury paper and well-diversified inter-bank deposits remained the preferred Treasury short-term instruments. Active management of the Bank's interest spread remained crucial to overall profitability.

Risk Management

The Bank addressed all key elements of capital planning in its Internal Capital Adequacy Assessment Process (ICAAP) review and in line with the requirements under Pillar II of the Capital Requirements Directive. This involved the use of risk management techniques to the satisfaction of the Regulator to ensure that an adequate amount of capital was allocated against identified risks. Tests were carried out, in terms of internal governance, on the arrangements and processes adopted to reduce risks inherent in operations and commensurate to the nature, scale and complexity of the Bank's business. The exercise confirmed that the Bank maintained enough liquidity and a comfortable capital buffer to be able to implement its strategy even under challenging and uncertain market conditions. There is a continual measurement, assessment and monitoring of all identified risks within the Bank to anticipate any adverse events and mitigate their impact whilst maintaining suitable, and sustainable, returns to shareholders.

Human Resources

During the year the Group was engaged in developing and implementing human resource policies and objectives aimed at attracting and retaining excellent employees, promoting effective management practices as well as ensuring fair and equitable treatment of staff. This was accomplished as much as possible through a process of communication and consultation at all levels. Rewards and recognition throughout the year are believed to have fostered positive employee morale and motivation. Staff is encouraged to undertake personal and professional development for the benefit of the individual as well as the Group and in-house training courses were complemented with local and overseas external training. At the year end, the staff complement of the Bank and Group was 163 and 804 respectively.

Projects

During Q1 a new ATM network was installed throughout the Bank's branch network. Towards the end of the year, the credit card services system was upgraded to provide customers with an increased range of products and improved service reliability and security. In parallel to these projects, an internet banking platform was developed with the latest, most innovative user interface and security features which should be fully operational early in 2011.

We introduced enhanced Trade Finance services, providing business and corporate customers with tailor-made advice in managing the financing of their trade flows.

Restoration works in a former palace at Frederick Street in Valletta were completed during the year and the Bank's credit operations are now based there. The restoration project was awarded the Prix D'Honneur as well as the Silver Medal in the 'Din l-Art Ħelwa Award for Architectural Heritage'. It was considered to be an 'outstanding and significant contribution to Maltese cultural heritage and to the achievement of architectural excellence in Malta

Chief Executive Officer's Review of Operations

through admirable conservation and re-use of the Palazzo – a work of the highest standards of restoration, conservation and re-use'.

Refurbishment of MaltaPost branch outlets continued throughout the year and works, including upgraded security features, on a number of these offices has been completed. A project for the expansion of the MaltaPost Head Office in Marsa is at an advanced stage of completion, which will provide customers with considerably improved facilities, particularly at the Parcel Office.

Community Involvement

The anti-smoking project for secondary schools remains the Bank's hallmark initiative. This project is endorsed by the Directorate for Educational Services and supported by the Malta Cancer Foundation. Presentations were made in over 50 schools. Financial contributions were also made to projects and causes considered to be of practical benefit to the community.

Outlook

The Bank's results over past years attest to the resilience of our institution. We have achieved all of our 2010 strategic and financial objectives and can look to the future with very positive, yet cautious, optimism. We intend to continue to pursue initiatives such as improving margins, rigorously controlling expenses, improving customer satisfaction and developing other areas so as to create optimal opportunities for business advancement. By moving forward with such initiatives, the Group will continue to be able to steadily strengthen its profit-earning capabilities, achieve satisfactory results and add value for the benefit of all its stakeholders.

Joseph Said
Chief Executive Officer

Directors' Report

For the Year Ended 31 December 2010

The Group

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

Principal Activities

The Bank was registered in Malta in 1969 and listed on the Malta Stock Exchange 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 in terms of the Investment Services Act, 1994. It is a member of the Deposit Guarantee Scheme and the Investor Compensation Scheme set up under the Laws of Malta. The Bank has also been accepted as a member of the Malta Stock Exchange (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.

Lombard Asset Managers Limited held a Category 2 Investment Services licence issued by the Malta Financial Services Authority in terms of the Investment Services Act, 1994 and was authorised to provide management and administrative services to Collective Investment Schemes. The Bank holds 100 per cent of the ordinary share capital of the company.

Redbox Limited was registered in 2006 and is fully owned by the Bank. Redbox Limited did not undertake any other business during 2010. Redbox Limited owns 66.5 per cent of the ordinary share capital of MaltaPost p.l.c.; the remaining 33.5 per cent are 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.

Review of Performance

The Chief Executive Officer submits a review of operations elsewhere in this Annual Report.

Results for 2010

Profit after taxation of €9.040 million and €8.064 million for the Group and the Bank respectively, were registered for the twelve months ended 31 December 2010.

A gross dividend of €0.115 per nominal €0.25 share for the twelve months ended 31 December 2010 is being proposed for approval by the shareholders. A resolution to this effect will be proposed to the Annual General Meeting of shareholders.

Capital

As at the Annual General Meeting held on the 22 April 2010, the Authorised Share Capital of the Bank is Euro twenty million (€20,000,000) made up of 80,000,000 Ordinary Shares of a nominal value of €0.25 each. The Issued and Fully Paid-Up Share Capital of the Bank is Euro eight million, nine hundred and three thousand, three hundred and ninety five (€8,903,395) divided into thirty five million, six hundred and thirteen thousand, five hundred and eighty one (35,613,581) Ordinary Shares of a nominal value of €0.25 each, all of one class.

On the 30 April 2010 an additional four hundred and seventy nine thousand, one hundred and eleven (479,111) Ordinary Shares of €0.25 each were admitted to listing on the Malta Stock Exchange. This addition was in respect of the Scrip Dividend approved at the said Annual General Meeting. The Issued and Paid-Up Share Capital is now therefore made up of thirty six million, ninety two thousand, six hundred and ninety two (36,092,692) Ordinary Shares of €0.25 each all of which carry the same voting rights. Equity attributable to shareholders as at 31 December 2010 stood at €71.7 million.

Board of Directors, Officers and Senior Management

The composition of the Board of Directors, Officers and Senior Management is further shown in the section on Company Information and further information is given in the Statement of Compliance with the Principles of Good Corporate Governance.

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;
- 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 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, 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 Lombard Bank Malta p.l.c. for the year ended 31 December 2010 are included in the Annual Report 2010, which is published in hard-copy printed form and may be made available on the parent company'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 company'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.

Standard Licence Conditions

In accordance with SLC 7.35 of the Investment Services Rules for Investment Service Providers regulated by the Malta Financial Services Authority, licence holders are required to disclose any regulatory breaches of standard licence conditions in this Annual Report. Accordingly, the directors confirm that no breaches of the standard licence conditions and no other breach of regulatory requirements, which were subject to an administrative penalty or regulatory sanction, were reported.

Going Concern

In compliance with the Listing Rules 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 (previously 9.43), the directors are required to disclose the following information.

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:

a. directors may be authorised by the Company to issue shares subject to the provisions of the Memorandum and Articles of Association and the Companies Act;
b. 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;
c. directors may decline to recognise any instrument of transfer, unless accompanied by the certificate of the shares to which it relates, and/or such other evidence;
d. 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;
e. the Company 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:

a. holders of any securities with special rights;
b. employee share schemes;
c. restrictions on voting rights or relevant agreements thereto;
d. agreements pertaining to the change in control of the Bank;
e. agreements providing for compensations on termination of Board Members or employees.

The Bank's capital structure, direct and indirect shareholding in the Bank in excess of 5 per cent and the rules governing the changes to Board members are contained in other parts of this Annual Report.

Shareholders holding 5 per cent or more of the share capital of the Bank:

	at 31 December 2010	at 9 March 2011
Marfin Popular Bank Public Co Ltd	48.9%	48.9%
First Gemini p.l.c.	5.3%	5.3%

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 entities as follows:

	Shares in Lombard Bank Malta p.l.c. at 31 December 2010	Shares in Lombard Bank Malta p.l.c. at 9 March 2011
Safaco Ltd	34,377	34,377
First Gemini p.l.c.	1,910,126	1,910,126

	Shares in MaltaPost p.l.c. at 31 December 2010	Shares in MaltaPost p.l.c. at 9 March 2011
Safaco Ltd	34,774	36,286
First Gemini p.l.c.	28,243	29,471

In addition Joseph Said has a minority shareholding in Safaco Ltd.

Audit Committee

This committee is made up 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 willingness to continue in office as auditors of the Bank and a resolution proposing their reappointment will be put to the forthcoming Annual General Meeting.

Approved by the Board of Directors on 10 March 2011 and signed on its behalf by:

Christian Lemmerich	**Joseph Said**
Chairman	Chief Executive Officer

Introduction

In compliance with the Listing Rules of the Malta Financial Services Authority (MFSA) which were applicable during the current financial year, the Bank is obliged to include in its Annual Report a Statement of Compliance detailing the extent to which the Bank has adopted the Principles of Good Corporate Governance, as specified in the Listing Rules, throughout the relative accounting period.

In this report, the Bank explains the measures which have been taken to ensure compliance with the Principles of Good Corporate Governance.

Board of Directors

The Board is made up of seven (7) members most of whom are non-executive members as listed below:

		First appointed:
Executive:	Joseph Said (Chief Executive Officer)	2000
Non-Executive:	Joseph M Demajo	1999
	Graham A Fairclough	2003
	Christian Lemmerich (Chairman)	1998
	Dimitris Spanodimos	2008
	Christos J Stylianides	2008
	Michael Zammit	1995

Whilst the non-executive directors are able to bring independent judgement to bear on the various issues brought before the Board, they are also free from any business or other relationship which could interfere materially with the exercise of their judgement. Each and every member of the Board is considered fit and proper to direct the business of the Bank and is competent as well as solvent.

In terms of the Bank's Articles of Association, the Chairman of the Board is elected by the directors from amongst themselves at the first Board Meeting following the Annual General Meeting.

Distinct roles

There is a clear distinction between the function and responsibility of the Board and that of the executive team with respect to responsibility for managing the Bank's business. Accordingly, the Board has first level responsibility for executing the following basic roles: accountability, monitoring, strategy formulation as well as policy development.

The Board therefore focuses primarily on the review and evaluation of the Bank's strategy, projections, major operational and financial plans, Risk Management and Compliance plans as well as performance objectives. It is able to do this by performing the following:

1. defining in clear and concise terms, the Bank's strategy, management performance criteria and business policies;
2. establishing a clear internal and external reporting system so that the Board has continuous access to accurate, relevant and timely information;
3. continuously assess and monitor the present and future operations' opportunities, threats and risks;
4. recognising and supporting enterprise and innovation within management;
5. seeking to establish an effective decision-making process in order to develop the Bank's business efficiently;
6. evaluating the management's implementation of corporate strategy and financial objectives;
7. ensuring 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;
8. recognising 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;
9. striking a balance between enterprise and control in the Bank; and
10. developing a succession policy for the future composition of the Board and particularly the executive component thereof.

The duties and responsibilities of the Chairman and those of the Chief Executive Officer are separate and distinct. Furthermore, the Board's and the directors' performance is under the scrutiny of the competent authorities as well as the shareholders of the Bank. It is for this reason that the Board does not consider it necessary to appoint a committee to carry out a performance evaluation of the Board, its directors and committees. However, the Board of Directors is entrusted with the evaluation process on an ongoing basis with respect to the performance of the Board itself and of the different committees constituted.

Practices

The Board meets at regular intervals in order to discharge the duties and responsibilities entrusted to them. Notice of all meetings is invariably given well in advance of the meetings and supporting documentation on all agenda items is also provided in a timely manner so as to adequately permit all directors to consider the issues to be discussed. All the directors were given an equal opportunity to discuss matters affecting the business.

Board Meetings

During the period under review the Board met five (5) times, and at least once every quarter, with attendance as detailed below:

Joseph M Demajo	3
Graham A Fairclough	5
Christian Lemmerich	5
Joseph Said	5
Dimitris Spanodimos	2
Christos J Stylianides	5
Michael Zammit	5

Following upon each and every meeting and well before the next meeting, minutes that record proceedings and attendance were prepared and made available to each director. The Minutes provide a detailed record of all decisions reached as well as important deliberations on strategy and policy issues in particular. On first joining the Board, every member is provided with suitable information relative to the Bank and its subsidiaries and is at the same time referred to the Bank's statute as well as the relevant legislation, rules and bye-laws. In addition to being able to seek independent professional advice at the Bank's expense, in the furtherance of their duties, the directors have access to the services of the Company Secretary, who also informs them, on a regular basis, of their obligations when dealing in securities of the Bank, in terms of the Prevention of Financial Markets Abuse Legislation. The Group ensures that any required additional training on a needs basis, is made available to directors on an ongoing basis.

If and when a potential conflict of interest arises, it is the established practice of the Board to declare and record such a conflict and the directors concerned refrain from the proceedings in relation to the matter of decision.

Appointment and Election of the Board Directors

Prior to being elected directors, it is required that nominees undergo a due diligence process by the Malta Financial Services Authority in order to establish that they are fit and proper persons pursuant to the requirements of Banking Act, 1994 (Chapter 371) and the Investment Services Act, 1994 (Chapter 370).

The process by which directors are appointed is transparent and usually conducted at properly constituted General Meetings.

In accordance with the provisions of the Bank's Articles of Association, at every Annual General Meeting, one-third (1/3) of the serving directors retire from office by rotation and, being eligible, may offer themselves for re-election. The Directors' Report shows all the appointments and resignations of directors.

The Bank's Articles of Association also provide for every shareholder holding in aggregate at least fifteen per cent

(15%) of the Bank's Ordinary Issued Share Capital the entitlement to appoint one (1) director for each and every fifteen per cent (15%) of the Ordinary Issued Share Capital owned by him. Any fractional shareholding in excess of fifteen per cent (15%) not applied in appointing a director, and only that fraction, shall be entitled to vote in the election of the remaining directors together with the remaining body of shareholders.

Emoluments

The maximum aggregate directors' emoluments are established from time to time by the shareholders in General Meeting. The 2010 Annual General Meeting established €70,000 as the aggregate maximum amount of fees that may be received by the Board for their service. The aggregate amount of the directors' emoluments is disclosed in note 32 to the Financial Statements. No disclosure is made of the remuneration of each director separately but information on individual figures is provided in this Report.

The Chief Executive Officer is on a contract of employment with the Bank and his remuneration as employee, as well as his employment, is independent of his office as Director of the Bank.

The total remuneration of the Chief Executive Officer is approved by the Board of Directors and Management approves the remuneration and bonuses of all other staff members. Bonuses are based on individual performance criteria but not on the Group's or Bank's performance. It has been decided that the particular circumstances of the Bank do not justify the setting up of a separate Remuneration Committee as set out by the Code of Principles of Good Corporate Governance. This notwithstanding, it is declared that the remuneration of the directors is such that it is meant to attract and retain the directors needed to run the Bank successfully as provided by the said Code. The remuneration of directors is reviewed and formally approved by the Board of Directors. A director would not be present when his individual remuneration is being discussed at Board level.

Involvements

All Board members have provided written declarations of their beneficial and non-beneficial shareholdings in the Bank as well as particulars of any material interest, directly or indirectly, in any material contract with the Bank or any of its subsidiaries.

Internal Control System

Whilst the Board is ultimately responsible for the Bank's internal controls as well as their effectiveness, 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. However, such controls cannot completely eliminate the possibility of material error or fraud. As outlined previously, 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:

1. reviewing the Bank's strategy on an on-going basis as well as setting the appropriate business objectives in order to enhance value for all stakeholders;

2. appointing and monitoring the Chief Executive Officer whose function is to manage the operations of the Bank;

3. identifying and ensuring that significant risks are managed satisfactorily; and

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

As stated earlier, 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 vested accountability for the Bank's day-to-day business in the Asset-Liability Committee, Credit Committee and in the management team comprising the:

1. Chief Executive Officer; and
2. Chief Officers together with other Senior Managers.

The Board frequently actively participates in asset allocation decisions as well as credit proposals above a certain threshold, after the appropriate recommendations have been made. This, is mainly attributable to the limited scope of the Bank's asset spread.

The Bank's internal control systems aim at mitigating, but not eliminating, the various risks faced by the Bank and provide reasonable, but not absolute assurance that material loss will not be incurred.

Board Committees

The Board has established a number of Committees as follows:

Asset-Liability Committee

The Asset-Liability Committee (ALCO) monitors the Bank's financial performance, considers investment policy and oversees monitoring of adherence to counterparty limits. ALCO also oversees risk management practices in the Bank's Finance, Treasury and International Divisions, amongst others. Membership of this Committee is made up of a number of Chief Officers and Senior Managers including managers from Finance and Treasury. The Chief Executive Officer is the Chairman of ALCO and retains primary responsibility for asset and liability management.

Credit Committee

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 Credit Committee considers the development of general lending principles and oversees risk management practices in lending operations. The Credit Committee met seven (7) times during the period under review.

Audit Committee

The Terms of Reference of the Audit Committee, which were approved by the Listing Authority of the Malta Financial Services Authority, are modelled on the principles set out in the Listing Rules. The Audit 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 Bank's independent Internal Audit Department reviews the adequacy and proper operation of internal controls in individual areas of operation and reports its findings directly to the Audit Committee. The Committee met six (6) times during 2010 and its composition was made up of the following non-executive Board Directors:

Christian Lemmerich (Chairman)
Joseph M Demajo
Dimitris Spanodimos
Christos J Stylianides
Michael Zammit

Christian Lemmerich is an independent member who the Board considers to be competent in accounting and/or auditing in terms of the Listing Rules, having previously also served in various senior positions within another banking institution. The Bank's Internal Auditor is normally asked to attend meetings of the Audit Committee and the External Auditors are also invited to attend. Members of Senior Management are also invited to attend Audit Committee meetings as deemed necessary by the Committee.

The main role and responsibility of the Audit Committee include:

1. the monitoring of the financial reporting process;

2. the monitoring of the effectiveness of the Bank's internal control, internal audit and risk management systems;

3. the monitoring of the audit of the annual consolidated financial statements;

4. the maintenance of communication on matters referred to above between the Board, management, the independent external auditors and the internal auditors;

5. the making of recommendations to the Board in relation to the appointment of the external auditor and the approval of the remuneration and terms of engagement of the external auditor following appointment by the shareholders in General Meeting;

6. the monitoring and reviewing of the external auditor's independence, and in particular the provision of additional services to the Bank;

7. the development and implementation of a policy on the engagement of the external auditor to supply non-audit services; and

8. the scrutiny, monitoring and approval of related party transactions.

Relationships with Shareholders

The Bank fully recognises the importance of maintaining effective communication with its shareholders in order to ensure that its policies and strategies as well as performance are appropriately understood.

Communication with shareholders is principally effected during the Bank's Annual General Meeting. Fourteen (14) days' notice is given prior to these meetings and shareholders may appoint proxies as necessary. Together with the notice of such meetings, shareholders also receive all the resolutions proposed for approval at that meeting.

Business at the Annual General Meeting typically includes the approval of the Annual Report as well as the audited financial statements for the preceding financial year both of which would have been circulated with the notice to each shareholder. The other items which feature in the Annual General Meeting are the appointment of directors and approval of their remuneration, the appointment of external auditors and their fees together with the approval of the final dividend. Shareholders are given every opportunity to ask questions on every resolution being presented for approval.

In addition, the Bank provides the market with regular, timely, accurate, comprehensive and comparable information in order to enable investors make informed investment decisions. It is the Bank's policy to inform investors, analysts and other interested parties openly and fully about the Bank's circumstances, always in accordance with legal requirements and on the basis of good corporate governance standards and recommendations from relevant entities. It is therefore the Bank's policy:

- to publish information (that can have a significant effect on the Bank's share price) through the Malta Stock Exchange and immediately afterwards on the website;
- to make other published information available to the public on the website;
- to strive for open, transparent communications;

- to ensure continuity and high quality in the information disclosed; and
- to be accessible to all stakeholders.

With regard to the rights of the minority shareholders, the Bank is guided by the relevant legislation. Minority shareholders are therefore granted the power to call special meetings on matters of importance to the Bank, should a minimum threshold of share ownership be established according to the Bank's Statute. In addition, minority shareholders may formally present an issue to the Board if they own the predefined minimum threshold of shares.

Conflicts of Interest

A director's primary responsibility is always to act in the interests of the Bank and its stakeholders as a whole irrespective of who appointed him to the Board. A director is not considered independent if he has any involvement or relationship with a company or business or other relationship with a significant shareholder of the Bank which could materially impede the exercise of impartial and objective judgement.

Directors are to avoid conflicts of interest at all times and not accept a nomination if they are aware that there is an actual conflict of interest. Therefore, personal interests are not to take precedence over Bank interests and should a director having a continuing material interest that conflicts with the interests of the Bank, should take effective steps to eliminate the grounds for conflict. A director shall inform the Board immediately in relation to any actual or potential conflicts of interest.

Dealings in Securities

Formal procedures are in place for dealing with potentially price-sensitive information in order to ensure the proper conduct of its officers and staff in this regard. The 'Code of Conduct for Dealing in Securities by Directors, Executives and Employees' was adopted by the Bank and implemented in line with the Prevention of Financial Markets Abuse Legislation. In accordance with the Code, directors and employees are periodically reminded of their obligations when dealing in securities of the Bank.

Training and Development

The Bank implements a programme of training and development of staff right across the board in full recognition that the Bank is operating in a fast changing and developing market place. It is, of course, recognised that the Bank's competitive edge can only be maintained through the training and ongoing development of its staff.

Corporate Social Responsibility

The Board is mindful of and seeks to adhere to sound Principles of Corporate Social Responsibility in their day-to-day management practices of the Bank. There is a continuing commitment to behave ethically at all times at the same time as contributing to economic development whilst improving the quality of life of the work force and their families together with the local community and society at large.

Good and responsible relations with all the Bank's stakeholders are a basis for long-term development as well as value creation. In particular, Lombard continues to adopt core values that urge all its employees to conduct themselves properly and with integrity.

Approved by the Board of Directors on 10 March 2011 and signed on its behalf by:

Christian Lemmerich	**Joseph Said**
Chairman	Chief Executive Officer

Statement of the Directors pursuant to Listing Rule 9.44c

For the Year Ended 31 December 2010

We, the undersigned, declare that to the best of our knowledge, the financial statements prepared in accordance with the requirements of International Financial Reporting Standards as adopted by the EU give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and the Bank and that this report includes a fair review of the development and performance of the business and the position of the Group and the Bank together with a description of the principal risks and uncertainties that they face.

Signed on behalf of the Board of Directors on 10 March 2011 by:

Christian Lemmerich
Chairman

Joseph Said
Chief Executive Officer

Company Information

As at 31 December 2010 and 9 March 2011 there were no directors' beneficial and non beneficial interests in the share capital of the Bank or in any related company.

Number of shareholders at 31 December 2010 analysed by range:

Range	Shareholders	Shares
1 – 500	172	33,142
501 – 1000	113	89,551
1001 – 5000	507	1,477,448
5001 and over	656	34,492,551
Total	**1,448**	**36,092,692**

Number of shareholders at 9 March 2011 analysed by range:

Range	Shareholders	Shares
1 – 500	173	33,851
501 – 1000	113	89,361
1001 – 5000	507	1,475,700
5001 and over	655	34,493,780
Total	**1,448**	**36,092,692**

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

Company Information

Board Of Directors

Christian Lemmerich (Chairman)
Joseph M Demajo
Graham A Fairclough
Joseph Said
Dimitris Spanodimos
Christos J Stylianides
Michael Zammit

Company Secretary

Graham A Fairclough

Senior Management

Joseph Said	Chief Executive Officer
Joseph P Azzopardi	Chief Officer - Operations
Anthony Bezzina	Chief Officer - Credit
Anthony E Bezzina	Chief Officer - Gozo Operations
Julius M Bozzino	Chief Officer - Private Banking and Corporate Services
Paul Debono	Chief Officer - Legal Services
Eugenio Farrugia	Chief Officer - ICT
Aurelio Theuma	Chief Financial Officer

Heads of Departments

Joan Aquilina	Internal Audit
Robert Aquilina	Treasury
Victoria Azzopardi	Human Resources
Moira Balzan	Finance
Peter Bonnici	Organisation and Methods
Josianne Formosa	Risk Management
George Gusman	Support Services
Edward Pirotta	Premises
Geoffrey Tedesco Triccas	Information Technology
Carmel Vassallo	Data Processing Management

Company Information

Registered Office

67 Republic Street, Valletta VLT 1117
Tel: 25581 117

Branches

67 Republic Street, Valletta VLT 1117
Tel: 25581 117

Balzan Valley Road, Balzan BZN 1409
Tel: 25581 500

4 Main Street, Qormi QRM 1100
Tel: 25581 300

Ninu Cremona Street, Victoria VCT 2561
Tel: 25581 600

Graham Street, Sliema SLM 1711
Tel: 25581 200

Paceville Avenue, St. Julian's STJ 3103
Tel: 25581 400

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

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

Wealth Management

59 Republic Street, Valletta VLT 1117
Tel: 25581 114

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

Report on the Financial Statements

We have audited the consolidated and stand-alone parent company financial statements of Lombard Bank Malta p.l.c. (together the 'financial statements') on pages 25 to 110 which comprise the consolidated and parent company statements of financial position as at 31 December 2010, and the consolidated and parent company statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

As explained more comprehensively in the Statement of directors' responsibilities for the financial statements on page 9, the directors are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU and the requirements of the Maltese Banking Act, 1994 and the Maltese Companies Act, 1995, 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.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the internal control relevant to the entity's preparation of financial statements that give a true and fair view 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements:
- give a true and fair view of the financial position of the Group and the Bank as at 31 December 2010, and of their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU; and
- have been properly prepared in accordance with the requirements of the Maltese Banking Act, 1994 and the Maltese Companies Act, 1995.

Report on Other Legal and Regulatory Requirements

Opinion on other matters prescribed by the Maltese Banking Act, 1994

In our opinion:

i) 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;
ii) proper books of account have been kept by the Bank, so far as appears from our examination of those books;
iii) the Bank's financial statements are in agreement with the books of account; and
iv) 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.

Matters on which we are required to report by exception

We also read other information contained in the Annual Report and considered whether it is consistent with the audited financial statements. The other information comprises the Chairman's statement to the members, the Chief Executive Officer's Review of Operations, the Directors' Report, other Company Information and the additional Regulatory Disclosures. Our responsibilities do not extend to any other information.

We also have responsibilities under:

- The Maltese Companies Act, 1995 to report to you if, in our opinion:
  - the information given in the directors' report is not consistent with the financial statements.
  - proper returns adequate for our audit have not been received from branches not visited by us.
  - if certain disclosures of directors' remuneration specified by law are not made in the financial statements, giving the required particulars in our report.
- The Listing Rules to review the statement 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.

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

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 12 to 17 has been properly prepared in accordance with the requirements of the Listing Rules issued by the Malta Listing Authority.

PRICEWATERHOUSECOOPERS

167 Merchants Street
Valletta
Malta

F Axisa

Fabio Axisa
Partner

10 March 2011

LOMBARD

FINANCIAL STATEMENTS

for the period 1 January 2010 to 31 December 2010

2010

Statements of Financial Position

At 31 December 2010

	Note	Group		Bank	
		2010	2009	**2010**	2009
		€ 000	€ 000	**€ 000**	€ 000
Assets					
Balances with Central Bank of Malta,					
treasury bills and cash	5	**109,314**	116,357	**108,774**	115,993
Cheques in course of collection		**750**	811	**750**	811
Investments	6	**46,332**	45,025	**41,101**	39,357
Loans and advances to banks	7	**44,975**	22,383	**43,477**	18,460
Loans and advances to customers	8	**333,731**	327,802	**334,012**	327,956
Investment in subsidiaries	9	**-**	-	**8,034**	7,634
Intangible assets	10	**1,295**	1,238	**3**	3
Property, plant and equipment	11	**14,740**	13,878	**12,299**	11,654
Investment property	12	**745**	745	**745**	745
Assets classified as held for sale	8	**109**	109	**109**	109
Current tax assets		**2,683**	1,171	**2,378**	1,731
Deferred tax assets	13	**1,585**	1,993	**1,084**	1,551
Inventories	14	**714**	671	**143**	247
Trade and other receivables	15	**7,503**	6,545	**385**	31
Accrued income and other assets	16	**3,324**	4,113	**3,247**	4,622
Total assets		**567,800**	542,841	**556,541**	530,904

LOMBARD

Statements of Financial Position *(continued)*

At 31 December 2010

	Note	Group 2010 € 000	Group 2009 € 000	Bank 2010 € 000	Bank 2009 € 000
Equity and Liabilities					
Equity					
Share capital	17	**9,023**	8,903	**9,023**	8,903
Share premium	18	**17,746**	16,409	**17,746**	16,409
Property revaluation reserve	18	**2,043**	2,288	**2,043**	2,288
Investment revaluation reserve	18	**566**	290	**360**	186
Other reserves	18	**2,397**	-	**2,397**	-
Retained earnings		**39,932**	36,395	**38,891**	35,861
Equity attributable to equity holders of the Bank		71,707	64,285	70,460	63,647
Non-controlling interests		4,336	3,917	-	-
Total equity		76,043	68,202	70,460	63,647
Liabilities					
Amounts owed to banks	19	**149**	3,675	**149**	3,675
Amounts owed to customers	20	**472,697**	446,209	**475,085**	449,436
Provisions for liabilities and other charges	21	**2,652**	2,520	**636**	577
Other liabilities	22	**7,907**	12,586	**5,679**	8,594
Accruals and deferred income	23	**8,352**	9,649	**4,532**	4,975
Total liabilities		491,757	474,639	486,081	467,257
Total equity and liabilities		567,800	542,841	556,541	530,904
Memorandum items					
Contingent liabilities	24	**7,067**	10,484	**7,067**	10,484
Commitments	24	**82,246**	98,611	**82,246**	98,611

The notes on pages 35 to 110 are an integral part of these financial statements.

These financial statements on pages 25 to 110 are approved and authorised for issue by the Board of Directors on 10 March 2011 and signed on its behalf by:

Christian Lemmerich
Chairman

Joseph Said
Chief Executive Officer

LOMBARD

Income Statements
For the Year Ended 31 December 2010

	Note	Group		Bank	
		2010 € 000	2009 € 000	**2010 € 000**	2009 € 000
Interest receivable and similar income					
- on loans and advances, balances with Central Bank of Malta and treasury bills	25	**23,846**	25,404	**23,838**	25,347
- on debt and other fixed income instruments	25	**2,507**	2,746	**2,267**	2,553
Interest expense	25	**(10,287)**	(13,560)	**(10,326)**	(13,632)
Net interest income		**16,066**	14,590	**15,779**	14,268
Fee and commission income	26	**2,292**	2,157	**1,390**	1,220
Fee and commission expense	26	**(63)**	(67)	**(63)**	(66)
Net fee and commission income		**2,229**	2,090	**1,327**	1,154
Postal sales and other revenues	27	**19,808**	19,393	**342**	122
Dividend income	28	**157**	122	**1,326**	1,941
Net trading income	29	**583**	266	**364**	262
Net losses on disposal of non-trading financial instruments		**(23)**	(53)	**(23)**	(53)
Other operating (expenses)/income		**(35)**	33	**35**	37
Operating income		**38,785**	36,441	**19,150**	17,731
Employee compensation and benefits	30	**(14,322)**	(13,643)	**(4,180)**	(4,039)
Other operating costs	32	**(9,002)**	(8,758)	**(2,518)**	(2,025)
Depreciation and amortisation		**(1,195)**	(1,065)	**(277)**	(227)
Provisions for liabilities and other charges		**(139)**	(173)	**(22)**	(20)
Net impairment (losses)/gains	31	**(186)**	125	**(215)**	190
Profit before taxation	32	**13,941**	12,927	**11,938**	11,610
Income tax expense	33	**(4,901)**	(4,863)	**(4,222)**	(4,129)
Profit for the year		**9,040**	8,064	**7,716**	7,481
Attributable to:					
Equity holders of the Bank		**8,332**	7,377	**7,716**	7,481
Non-controlling interests		**708**	687	**-**	-
Profit for the year		**9,040**	8,064	**7,716**	7,481
Earnings per share	34	**23c2**	20c8		

The notes on pages 35 to 110 are an integral part of these financial statements.

Statements of Comprehensive Income

For the Year Ended 31 December 2010

Group

	2010 € 000	2009 € 000
Profit for the year	**9,040**	8,064
Other comprehensive income		
Fair valuation of available-for-sale financial assets:		
Net changes in fair value arising during the year, before tax	**423**	365
Reclassification adjustments - net amounts reclassified		
to profit or loss, before tax	**(2)**	45
Income tax relating to components of other comprehensive income	**(313)**	(88)
Other comprehensive income for the year, net of income tax	**108**	322
Total comprehensive income for the year, net of income tax	**9,148**	8,386
Attributable to:		
Equity holders of the Bank	**8,389**	7,644
Non-controlling interests	**759**	742
Total recognised income and expense for the year, net of income tax	**9,148**	8,386

Bank

	2010 € 000	2009 € 000
Profit for the year	**7,716**	7,481
Other comprehensive income, net of income tax		
Fair valuation of available-for-sale financial assets:		
Net changes in fair value arising during the year, before tax	**271**	206
Reclassification adjustments - net amounts reclassified		
to profit or loss, before tax	**(2)**	45
Income tax relating to components of other comprehensive income	**(314)**	(88)
Other comprehensive income for the year, net of income tax	**(45)**	163
Total comprehensive income for the year, net of income tax	**7,671**	7,644

The notes on pages 35 to 110 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2010

Group	Attributable to equity holders of the Bank							
	Share capital	Share premium	Property revaluation reserve	Investment revaluation reserve	Retained earnings	Total	Non-controlling interests	Total equity
	€ 000	€ 000	€ 000	€ 000	€ 000	€ 000	€ 000	€ 000
At 1 January 2009	8,762	15,137	2,288	23	31,518	57,728	3,401	61,129
Comprehensive income								
Profit for the year	-	-	-	-	7,377	7,377	687	8,064
Other comprehensive income								
Fair valuation of available-for-sale financial assets:								
Net changes in fair value arising during the year	-	-	-	238	-	238	55	293
Reclassification adjustments - net amounts reclassified to profit or loss	-	-	-	29	-	29	-	29
Total other comprehensive income for the year	-	-	-	267	-	267	55	322
Total comprehensive income for the year	-	-	-	267	7,377	7,644	742	8,386
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Dividends to equity holders	-	-	-	-	(2,278)	(2,278)	(405)	(2,683)
Rights issue of ordinary shares	141	1,272	-	-	-	1,413	-	1,413
Changes in ownership interests in subsidiaries that do not result in a loss of control								
Change in non-controlling interests in subsidiary	-	-	-	-	(222)	(222)	179	(43)
Total transactions with owners	141	1,272	-	-	(2,500)	(1,087)	(226)	(1,313)
At 31 December 2009	8,903	16,409	2,288	290	36,395	64,285	3,917	68,202

The notes on pages 35 to 110 are an integral part of these financial statements.

LOMBARD

Statements of Changes in Equity

For the Year Ended 31 December 2010

Group	Attributable to equity holders of the Bank								
	Share capital € 000	Share premium € 000	Property revaluation reserve € 000	Investment revaluation reserve € 000	Other reserves € 000	Retained earnings € 000	Total € 000	Non-controlling interests € 000	Total equity € 000
At 1 January 2010	8,903	16,409	2,288	290	-	36,395	64,285	3,917	68,202
Comprehensive income									
Profit for the year	-	-	-	-	-	8,332	8,332	708	9,040
Other comprehensive income									
Fair valuation of available-for-sale financial assets:									
Net changes in fair value arising during the year	-	-	-	278	-	-	278	51	329
Reclassification adjustments - net amounts reclassified to profit or loss	-	-	-	(2)	-	-	(2)	-	(2)
Transfers and other movements	-	-	-	-	2,397	(2,371)	26	-	26
Movement in deferred tax liability on revalued land and buildings determined on the basis applicable to capital gains	-	-	(245)	-	-	-	(245)	-	(245)
Total other comprehensive income for the year	-	-	(245)	276	2,397	(2,371)	57	51	108
Total comprehensive income for the year	-	-	(245)	276	2,397	5,961	8,389	759	9,148
Transactions with owners, recorded directly in equity									
Contributions by and distributions to owners									
Dividends to equity holders	-	-	-	-	-	(2,315)	(2,315)	(405)	(2,720)
Rights issue of ordinary shares	120	1,337	-	-	-	-	1,457	-	1,457
Changes in ownership interests in subsidiaries that do not result in a loss of control									
Change in non-controlling interests in subsidiary	-	-	-	-	-	(109)	(109)	65	(44)
Total transactions with owners	120	1,337	-	-	-	(2,424)	(967)	(340)	(1,307)
At 31 December 2010	9,023	17,746	2,043	566	2,397	39,932	71,707	4,336	76,043

The notes on pages 35 to 110 are an integral part of these financial statements.

LOMBARD

Statements of Changes in Equity

For the Year Ended 31 December 2010

Bank

	Share capital € 000	Share premium € 000	Property revaluation reserve € 000	Investment revaluation reserve € 000	Retained earnings € 000	Total € 000
At 1 January 2009	8,762	15,137	2,288	23	30,658	56,868
Comprehensive income						
Profit for the year	-	-	-	-	7,481	7,481
Other comprehensive income						
Fair valuation of available-for-sale financial assets:						
Net changes in fair value arising during the year	-	-	-	134	-	134
Reclassification adjustments - net amounts reclassified to profit or loss	-	-	-	29	-	29
Total other comprehensive income for the year	-	-	-	163	-	163
Total comprehensive income for the year	-	-	-	163	7,481	7,644
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Dividends to equity holders	-	-	-	-	(2,278)	(2,278)
Rights issue of ordinary shares	141	1,272	-	-	-	1,413
Total transactions with owners	141	1,272	-	-	(2,278)	(865)
At 31 December 2009	8,903	16,409	2,288	186	35,861	63,647

The notes on pages 35 to 110 are an integral part of these financial statements.

LOMBARD

Statements of Changes in Equity

For the Year Ended 31 December 2010

Bank

	Share capital € 000	Share premium € 000	Property revaluation reserve € 000	Investment revaluation reserve € 000	Other reserves € 000	Retained earnings € 000	Total € 000
At 1 January 2010	**8,903**	**16,409**	**2,288**	**186**	**-**	**35,861**	**63,647**
Comprehensive income							
Profit for the year						**7,716**	**7,716**
Other comprehensive income							
Fair valuation of available-for-sale financial assets:							
Net changes in fair value arising during the year	-	-	-	176	-	-	176
Reclassification adjustments - net amounts reclassified to profit or loss	-	-	-	(2)	-	-	(2)
Transfers and other movements	-	-	-	-	2,397	(2,371)	26
Movement in deferred tax liability on revalued land and buildings determined on the basis applicable to capital gains	-	-	(245)	-	-	-	(245)
Total other comprehensive income for the year	-	-	(245)	174	2,397	(2,371)	(45)
Total comprehensive income for the year	-	-	(245)	174	2,397	5,345	7,671
Transactions with owners, recorded directly in equity							
Contributions by and distributions to owners							
Dividends to equity holders	-	-	-	-	-	(2,315)	(2,315)
Rights issue of ordinary shares	120	1,337	-	-	-	-	1,457
Total transactions with owners	120	1,337	-	-	-	(2,315)	(858)
At 31 December 2010	9,023	17,746	2,043	360	2,397	38,891	70,460

The notes on pages 35 to 110 are an integral part of these financial statements.

Statements of Cash Flows

For the Year Ended 31 December 2010

	Note	Group		Bank	
		2010	2009	**2010**	2009
		€ 000	€ 000	**€ 000**	€ 000
Cash flows from operating activities					
Interest and commission receipts		**25,465**	24,685	**25,489**	24,739
Receipts from customers relating to postal sales and other revenue		**107,008**	85,005	**300**	122
Interest and commission payments		**(10,762)**	(13,585)	**(10,800)**	(13,656)
Payments to employees and suppliers		**(113,385)**	(89,009)	**(6,730)**	(6,150)
Cash flows from operating profit before changes in operating assets and liabilities		**8,326**	7,096	**8,259**	5,055
Decrease/(increase) in operating assets:					
Treasury bills		**12,608**	(16,671)	**12,608**	(16,671)
Deposits with Central Bank of Malta		**(2,039)**	365	**(2,039)**	365
Loans and advances to banks and customers		**(8,979)**	(2,892)	**(9,108)**	(3,046)
Other receivables		**(231)**	1,940	**(239)**	1,949
Increase/(decrease) in operating liabilities:					
Amounts owed to banks and to customers		**22,930**	9,907	**22,091**	9,615
Other payables		**(2,916)**	2,123	**(2,916)**	2,123
Net cash from/(used in) operations		**29,699**	1,868	**28,656**	(610)
Income tax paid		**(6,268)**	(5,892)	**(4,254)**	(4,294)
Net cash from/(used in) operating activities		**23,431**	(4,024)	**24,402**	(4,904)
Cash flows from investing activities					
Dividends received		**157**	122	**157**	122
Interest received from investments		**3,074**	4,867	**2,742**	4,524
Proceeds on maturity/disposal of investments		**5,954**	8,632	**6,263**	8,625
Purchase of investments		**(3,642)**	(1,779)	**(3,447)**	(784)
Purchase of property, plant and equipment		**(1,681)**	(1,892)	**(921)**	(1,331)
Acquisition of non-controlling interests		**(133)**	(156)	**-**	-
Net cash flows from investing activities		**3,729**	9,794	**4,794**	11,156
Cash flows from financing activities					
Dividends paid to equity holders of the Bank		**(858)**	(865)	**(858)**	(865)
Dividends paid to non-controlling interests		**(213)**	(249)	**-**	-
Cash used in financing activities		**(1,071)**	(1,114)	**(858)**	(865)
Net increase in cash and cash equivalents		**26,089**	4,656	**28,338**	5,387
Cash and cash equivalents at beginning of year		**69,426**	64,770	**65,139**	59,752
Cash and cash equivalents at end of year	36	**95,515**	69,426	**93,477**	65,139

The notes on pages 35 to 110 are an integral part of these financial statements.

LOMBARD

Notes to the Financial Statements

For the Year Ended 31 December 2010

1 **Summary of significant accounting policies**

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

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 Maltese Banking Act, 1994 and the Maltese Companies Act, 1995. 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), investment property 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 Bank's accounting policies (see note 3 – Critical accounting estimates, and judgments in applying accounting policies).

1.2 *Standards, interpretations and amendments to published standards effective in 2010*

During the financial year ended 31 December 2010, the Bank adopted new standards, amendments and interpretations to existing standards that are mandatory for the Bank's accounting period beginning on 1 December 2010. The adoption of these revisions to the requirements of IFRSs as adopted by the EU did not result in substantial changes to the Group's and Bank's accounting policies.

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

Certain new standards, amendments and interpretations to existing standards have been published by the date of authorisation for issue of these financial statements but are mandatory for accounting periods beginning after 1 January 2010. The Bank has not early adopted these revisions to the requirements of IFRSs as adopted by the EU and the Bank's management is of the opinion that, with the exception of IFRS 9, 'Financial instruments', there are no requirements that will have a possible significant impact on the Bank's financial statements in the period of initial application.

IFRS 9, 'Financial instruments', addresses the classification and measurement of financial assets, and replaces the multiple classification and measurement models in IAS 39 with a single model that has only two classification categories: amortised cost and fair value. Classification under IFRS 9 is driven by the entity's business model for managing the financial assets and the contractual characteristics of the financial assets. Subject to adoption by the EU, IFRS 9 is effective for financial periods beginning on, or after, 1 January 2013. The Bank is considering the implications of the standard together with its impact on the Bank's financial results and position, and also the timing of its adoption taking cognisance of the endorsement process by the European Commission.

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

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. Information about the Group's fund management is set out in note 9.

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 Group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated unless the transaction provides evidence of an impairment of the asset transferred. 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 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.

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

1.6 *Foreign currency translation*

The financial statements are presented in Euro (€), which is the Bank's functional 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.

1.7.1 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 asset 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.

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

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 the profit or loss. Gains and losses arising from changes in fair value are included directly in the 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.

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:

(a) 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;
(b) those that the Group upon initial recognition designates as available-for-sale; or
(c) 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 and 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'.

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

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 gains/(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:

(a) those that the Group upon initial recognition designates as at fair value through profit or loss;
(b) those that the Group designates as available-for-sale; and
(c) 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's held-to-maturity investments comprise corporate bonds.

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, 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. However, interest is calculated using the effective interest method, and foreign currency gains and losses on monetary assets classified as available-for-sale are recognised in profit or loss. 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.

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

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.

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.

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

(a) significant financial difficulty of the issuer or obligor;
(b) a breach of contract, such as a default or delinquency in interest or principal payments;
(c) 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;
(d) it becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
(e) the disappearance of an active market for that financial asset because of financial difficulties; or
(f) 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:
  (i) adverse changes in the payment status of borrowers in the portfolio; and
  (ii) 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 local 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.

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

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 (that is, 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.

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

1.8.2 Assets classified as available-for-sale

The Group assesses at each date of the consolidated statement of financial position whether there is objective evidence that a financial asset or a group of financial assets is impaired.

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 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.

1.9 *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 *Intangible assets*

1.10.1 Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable 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.

1.10.2 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 4 years.

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

1.10.3 Postal license

The postal license represents the amount paid for the right to operate postal services in Malta. Separately acquired licenses are shown at historical cost. The licence has a definite useful life and is measured at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of the license. The estimated useful life of the postal license is fifteen years.

1.11 *Property, plant and equipment*

All property, plant and equipment used by the Bank or its subsidiaries is initially recorded at historical cost. Land and buildings comprise mainly branches and offices. Land and buildings are shown at fair value based on periodic, but at least triennial, 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.

All other property, plant and equipment is stated at historical cost less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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
Leasehold property	Over period of lease
Computer equipment	4
Other	4 – 8

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

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 1.13).

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.

1.12 *Investment property*

Properties that are held for long-term rental yields or for capital appreciation or both, and that are not occupied by the entities within the Group, are classified as investment properties.

Recognition of investment properties takes place only when it is probable that the future economic benefits that are associated with the investment property will flow to the Group and the cost can be measured reliably. This is usually the day when all risks are transferred.

Investment properties are measured initially at historical cost, including transaction costs and borrowing costs. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Borrowing costs that are incurred for the purpose of acquiring or constructing a qualifying investment property 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.

The carrying amount includes the cost of replacing parts of an existing investment property at the time the cost has been incurred if the recognition criteria are met; and excludes the costs of day-to-day servicing of an investment property.

Subsequent to initial recognition, investment properties are stated at fair value, representing open market value determined annually, which reflects market conditions at the end of the reporting period.

Gains or losses arising from changes in the fair value of investment properties are included in profit or loss in the year in which they arise. Subsequent expenditure is capitalised to the asset's carrying amount 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. All other repairs and maintenance costs are charged to the profit or loss during the financial period in which they are incurred.

The fair value of investment properties is based on the nature, location and condition of the specific asset. The fair value is calculated by discounting the expected net rentals at a rate that reflects the current market conditions as of the valuation date adjusted, if necessary, for any difference in the nature, location or condition of the specific asset. The fair value of investment property does not reflect future capital expenditure that will improve or enhance the property and does not reflect the related future benefits from this future expenditure. These valuations are performed annually by external appraisers.

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

1.13 *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 cost 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.

1.14 *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.

1.15 *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.

1.16 *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 substantially 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.

1.17 *Inventories*

Inventories are stated at the lower of cost and net realisable value. The cost of postal stationery is determined using the standard cost method, the cost of inventories held for resale is determined on a weighted average cost basis and the cost of other inventory items is determined on a first-in first-out basis. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

1.18 *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.

1.19 *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)*

1.20 *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 to customers, trade and other payables (note 1.22) together with other liabilities.

1.21 *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.

1.22 *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.

1.23 *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)*

1.23.1 Provision for pension obligations

A subsidiary of the Bank provides for the obligation arising in terms of Article 8A of the Pensions Ordinance, Cap 93 of the laws of Malta, covering those former Government employees who opted to become full-time employees of the Company, 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 Company'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. All actuarial gains and losses are spread over the average remaining service lives of employees.

1.24 *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.

1.25 *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 draw-down 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)*

1.26 *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 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.

1.27 *Dividend income*

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

1.28 *Leases*

1.28.1 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.

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

1.30 *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.

1.31 *Dividend distribution*

Dividend distribution to the company's shareholders is recognised as a liability in the group's financial statements in the period in which the dividends are approved by the company'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 risk management function. 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 II Accord, corresponding Directives of the European Union (Capital Requirements Directive) and the Malta Financial Services Authority (MFSA) Banking Rules, as well as contemporary international banking practices. The Bank has adopted the Standardised Approach 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 **Financial risk management** *(continued)*

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.

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 Asset-Liability Committee, Credit Committee, Internal Audit Committee and, for the Group's day-to-day operations, in an Executive Team comprising the Chief Executive Officer and Chief Officers. Through the Board Committees, the Board reviews the processes and procedures to ensure the effectiveness of the Group's system of internal control.

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 of its operations. Group policies and procedures are in place for the reporting and addressing of fraudulent activities.

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

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

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/Advances
- 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 perception of the component in question. The following are the key risk components:

- Financial strength
- Earnings robustness
- 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 **Financial risk management** *(continued)*

2.2 *Risk exposures*

In terms of MFSA Banking Rule 02: Large Exposures of Credit Institutions authorised under the Banking Act, 1994, '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:

(a) 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;

(b) 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

(c) 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. 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.

  - 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 damage 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, the system 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 credit, market and liquidity risks is addressed in this note.

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

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 Group'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 graded 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 both in terms of the exposure to the Bank and to ensure that collateral still covers the entity.

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 credit asset. In order to examine a counterparty's creditworthiness, country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates are considered. 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, 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 daily.

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

2.3.3 Maximum exposure to credit risk

The Group's main exposures to credit risk 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, other investments, trade and other receivables, and loans and advances. 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**	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Credit risk exposures relating to on-balance sheet assets:				
Loans and receivables:				
Balances with Central Bank of Malta	**38,680**	24,457	**38,680**	24,457
Cheques in course of collection	**750**	811	**750**	811
Loans and advances to banks	**44,975**	22,383	**43,477**	18,460
Loans and advances to customers	**333,731**	327,802	**334,012**	327,956
Trade and other receivables	**7,503**	6,545	**385**	31
Accrued income and other assets	**3,324**	4,113	**3,247**	4,622
Available-for-sale financial assets:				
Debt securities	**8,079**	7,894	**2,848**	2,651
Held-to-maturity financial assets:				
Malta Government treasury bills	**67,193**	88,742	**67,193**	88,742
Debt securities	**30,891**	34,633	**30,891**	34,633
	535,126	517,380	**521,483**	502,363
Credit risk exposures relating to off-balance sheet instruments:				
Contingent liabilities	**7,067**	10,484	**7,067**	10,484
Commitments	**82,246**	98,611	**82,246**	98,611
	89,313	109,095	**89,313**	109,095

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

The exposures set out in the note 2.3.3 are based on carrying amounts as reported in the Statement of Financial Position. The table represents a worse case scenario of credit risk exposure to the Group and Bank at 31 December 2010 and 2009.

2.3.4 Malta Government treasury bills, debt securities and other fixed income instruments

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 highlighted above, 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.

At the end of the reporting period, the Group had no past due or impaired financial assets within this category.

The table below analyses the credit quality of debt securities and Malta Government treasury bills as determined by credit ratings applicable to issuers based on Fitch's ratings:

Group

	Treasury bills € 000	**Debt securities € 000**	**Total € 000**
At 31 December 2010			
A- to AA-	**67,193**	**32,667**	**99,860**
Lower than A-	**-**	**926**	**926**
Unrated	**-**	**5,377**	**5,377**
	67,193	**38,970**	**106,163**
At 31 December 2009			
A- to AA-	88,742	37,243	125,985
Lower than A-	-	315	315
Unrated	-	4,969	4,969
	88,742	42,527	131,269

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

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

The Malta Government treasury bills and debt securities in this note are held by the Bank with the exception of debt securities with a carrying amount of €2,643,000 (2009: €2,756,000) rated between A- to AA-, €123,000 (2009: €135,000) rated lower than A- and unrated debt securities amounting to €2,465,000 (2009: €2,352,000).

The Group's investment debt securities are analysed by sector as follows:

	2010	2009
	€ 000	€ 000
Government	**32,451**	33,665
Corporate:		
Financial services	**2,083**	2,358
Real estate and construction	**784**	513
Tourism	**1,436**	1,215
Wholesale and retail trade	**1,905**	1,033
Others	**311**	3,743
	38,970	42,527

The debt securities disclosed above include government debt securities with a carrying amount of €2,528,000 (2009: €2,617,000) and corporate debt securities amounting to €2,703,000 (2009: €2,626,000) which are held by the Bank's subsidiaries.

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

2.3.5 Loans and advances to customers

The Bank ensures that it has a reasonable sectorial mix of loans, charging the higher risk industries with higher interest rates. The following industry concentrations relating to loans and advances to customers, gross of impairment allowances, are considered significant:

	Group		**Bank**	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Transport, storage and communication	**8,886**	7,177	**9,167**	7,331
Financial services	**1,770**	300	**1,770**	300
Agriculture	**2,373**	2,343	**2,373**	2,343
Manufacturing	**17,270**	12,535	**17,270**	12,535
Construction	**140,061**	111,542	**140,061**	111,542
Hotel and restaurants, excluding related construction activities	**7,824**	8,515	**7,824**	8,515
Wholesale and retail trade	**41,826**	38,858	**41,826**	38,858
Community, recreational and personal service activities	**10,818**	11,170	**10,818**	11,170
Education	**3,179**	3,328	**3,179**	3,328
Health and social work	**149**	173	**149**	173
Mining and quarrying	**709**	468	**709**	468
Electricity, gas and water supply	**-**	35	**-**	35
Real estate, renting and business activities	**72,283**	103,349	**72,283**	103,349
Households and individuals	**32,116**	34,037	**32,116**	34,037
Gross amount granted to customers	**339,264**	333,830	**339,545**	333,984

2.3.6 Information on credit quality of loans and advances to customers

The Bank reviews and grades advances using the criteria laid down in the requirements of Banking Rule 09: Credit and Country Risk Provisioning of Credit Institutions authorised under the Banking Act, 1994. Accordingly, advances are graded in five categories:

- Regular
- Watch
- Substandard
- Doubtful
- Loss

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

The following table provides a detailed analysis of the credit quality of the Group's lending portfolio.

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Gross loans and advances:				
Impaired	**14,301**	22,346	**14,301**	22,346
Past due but not impaired	**171,490**	148,576	**171,490**	148,576
Neither past due nor impaired	**153,473**	162,908	**153,754**	163,062
	339,264	333,830	**339,545**	333,984
Analysis of past due but not impaired:				
Watch	**53,976**	59,345	**53,976**	59,345
Substandard	**7,973**	2,882	**7,973**	2,882
Doubtful but fully collateralised	**109,541**	86,349	**109,541**	86,349
	171,490	148,576	**171,490**	148,576
Analysis of neither past due nor impaired:				
Regular	**153,473**	162,908	**153,754**	163,062

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

The Group's loans and advances to customers which are categorised as 'Regular' are principally debts in respect of which there are no past due amounts and no recent history of customer default. Management does not expect any losses from non-performance by these customers.

As at 31 December 2010, no loans and advances to customers were deemed to be prohibited large exposures, prior to any eligible exemptions, in accordance with the requirements of the Banking Rule BR 02: Large Exposures of Credit Institutions authorised under the Banking Act, 1994. 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, these exposures are monitored and reported more frequently and rigorously. These customers are deemed by management to have positive credit standing, usually taking cognisance of the performance history without defaults.

a) 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.

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

The main components of this allowance are specific loss allowances that relate to individually significant exposures, and a collective loss allowance established for groups of loans and advances in respect of losses that have not been individually identified and subjected to individual assessment for impairment. 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.

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 tourism sectors and relate to advances which are past due by more than ninety days. 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 note 8 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.

b) 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 tables. Related credit losses which have been incurred but are not yet identified are partly covered by collective impairment allowances.

These past due exposures mainly relate to independent customers for whom there is no recent history of default. Categorisation of assets as past due is determined by the Bank on the basis of the nature of the terms and conditions in place.

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

Group/Bank

	2010	2009
	€ 000	€ 000
Past due up to 30 days	**51,643**	52,078
Past due between 31 and 60 days	**2,333**	7,267
Past due between 61 and 90 days	**7,973**	2,882
Past due over 90 days	**109,541**	86,349
	171,490	148,576

2.3.7 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 Group 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 and personal guarantees.

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

The following is an analysis of the fair value of collateral held as security and other credit enhancements. The amounts disclosed in the table represent the lower of the fair value of the collateral and the carrying amount of the respective secured loans.

Group/Bank

	2010 € 000	2009 € 000
Against individually impaired		
Immovable property	**13,374**	16,725
Cash or quasi cash	**27**	-
Personal guarantees	**-**	354
Other security	**-**	699
	13,401	17,778

	2010 € 000	2009 € 000
Against past due but not impaired		
Immovable property	**137,241**	118,297
Cash or quasi cash	**2,529**	1,227
Personal guarantees	**-**	6,239
Prime bank guarantees	**3,604**	-
Other security	**76**	1,160
	143,450	126,923

	2010 € 000	2009 € 000
Against neither past due nor impaired		
Immovable property	**104,607**	113,744
Cash or quasi cash	**6,134**	6,168
Prime bank guarantees	**517**	463
Personal guarantees	**-**	417
Other security	**1,878**	1,351
	113,136	122,143
Total fair value of collateral held as security and other credit enhancements	**269,987**	266,844

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

2.3.8 Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Once the loan is restructured it remains within this category independent of satisfactory performance after restructuring. The total value of loans with renegotiated terms which would otherwise be past due or impaired as at 31 December 2010 amounted to €18,534,000 (2009: €32,202,000).

2.3.9 Loans and advances to banks

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 2010, loans and advances to banks consisted primarily of term placements maturing within one month and the credit rating of all counterparties was at least A.

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 Country risks are limited to bank balances and money market placements with a total carrying amount of €24,008,000 (2009: €18,172,000) at the end of the reporting period.

2.3.10 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 company'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 company's standard payment and service delivery terms and conditions are offered. The entity's review includes external creditworthiness databases when available. The company 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 €1,040,000 (2009: €1,763,000) but were not impaired.

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

The company'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.

2.3.11 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 Group on behalf of a customer authorising a third party to draw drafts on the Group 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 Group 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 risks, 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.

Accordingly, market risk for the Group consists of four 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;
- Equity price risk, which is the risk of losses because of changes in investment prices; and
- Credit spread risk, which is the risk of losses because of changes in credit spreads.

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.

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

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 Group 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 giving rise 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.

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 tables below summarise the Group's exposures to interest rate risks. These analyse the entity's financial instruments, which are interest-bearing at their carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

Group

At 31 December 2010	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	109,314	0.67	76,555	29,318	-	-	3,441
Debt and other fixed income instruments classified as:							
- available-for-sale investments	8,079	5.59	357	-	3,369	4,353	-
- held-to-maturity investments	30,891	6.53	3,532	-	24,862	2,497	-
Loans and advances to banks	44,975 `	0.44	41,841	-	-	-	3,134
Loans and advances to customers	333,731	6.85	332,086	-	-	-	1,645
Total financial assets	526,990		454,371	29,318	28,231	6,850	8,220
Financial liabilities							
Amounts owed to banks	149	-	-	-	-	-	149
Amounts owed to customers	472,697	2.14	223,398	108,251	87,801	38,833	14,414
Total financial liabilities	472,846		223,398	108,251	87,801	38,833	14,563
Interest repricing gap			230,973	(78,933)	(59,570)	(31,983)	(6,343)
Cumulative gap			230,973	152,040	92,470	60,487	

The financial assets reflected in the table above which are not held by the Bank, comprise principally available-for-sale debt investments with a carrying amount of €358,000 maturing within three months, €1,591,000 maturing between one and five years and €3,282,000 that mature after more than five years.

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

Group

At 31 December 2009	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	116,357	1.30	89,435	23,764	-	-	3,158
Debt and other fixed income instruments classified as:							
- available-for-sale investments	7,894	5.86	139	1,652	2,553	3,550	-
- held-to-maturity investments	34,633	6.34	-	3,879	23,394	7,360	-
Loans and advances to banks	22,383	0.39	17,588	-	-	-	4,795
Loans and advances to customers	327,802	7.01	313,388	7,900	6,514	-	-
Total financial assets	509,069		420,550	37,195	32,461	10,910	7,953
Financial liabilities							
Amounts owed to banks	3,675	1.03	-	3,558	-	-	117
Amounts owed to customers	446,209	2.41	223,422	111,301	69,103	28,516	13,867
Total financial liabilities	449,884		223,422	114,859	69,103	28,516	13,984
Interest repricing gap			197,128	(77,664)	(36,642)	(17,606)	(6,031)
Cumulative gap			197,128	119,464	82,822	65,216	

The financial assets reflected in the table above which are not held by the Bank, comprise principally available-for-sale debt investments with a carrying amount of €380,000 maturing between three months and one year, €1,707,000 that mature between one and five years and €3,156,000 maturing after more than five years.

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 is:

	Fixed rate instruments		Variable rate instruments	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Interest earning assets				
Balances with Central Bank of Malta and treasury bills	**30,282**	18,098	**75,591**	95,101
Debt and other fixed income instruments classified as:				
- available-for-sale investments	**8,079**	7,894	**-**	-
- held-to-maturity investments	**30,891**	34,633	**-**	-
Loans and advances to banks	**39,287**	13,184	**2,555**	4,404
Loans and advances to customers	**1,562**	14,414	**330,523**	313,388
	110,101	88,223	**408,669**	412,893
Interest bearing liabilities				
Amounts owed to banks	**-**	3,558	**-**	-
Amounts owed to customers	**353,639**	344,967	**104,644**	87,375
	353,639	348,525	**104,644**	87,375

Interest-bearing financial assets and liabilities held by the Bank's subsidiaries principally consist of available-for-sale investments amounting to €5,231,000 (2009: €5,243,000) that are subject to fixed interest rates.

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, 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 **Financial risk management** *(continued)*

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 at the end of the reporting periods:

	(+) 100bp € 000	**(-) 100bp € 000**
At 31 December 2010	**3,040**	**(3,040)**
At 31 December 2009	3,255	(3,255)

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. 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 Group 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 Asset and Liability Committee (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.

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 by entering into offsetting 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's outstanding foreign currency forward contracts at the end of the reporting period with a notional amount of €316,000 (2009: €314,000) had an insignificant fair value.

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

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

Group

At 31 December 2010	Total € 000	EUR € 000	GBP € 000	USD € 000	Other € 000
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	109,314	101,641	65	7,568	40
Investments classified as:					
- held-to-maturity investments	30,891	30,891	-	-	-
- available-for-sale investments	15,441	14,807	-	634	-
Loans and advances to banks	44,975	5,160	13,501	20,177	6,137
Loans and advances to customers	333,731	326,471	24	7,236	-
Other assets	11,577	8,751	441	1,949	436
Total financial assets	545,929	487,721	14,031	37,564	6,613
Financial liabilities					
Amounts owed to banks	149	149	-	-	-
Amounts owed to customers	472,697	418,784	13,413	34,411	6,089
Other liabilities	16,259	14,753	386	1,010	110
Total financial liabilities	489,105	433,686	13,799	35,421	6,199
Net on-balance sheet position		54,035	232	2,143	414
Off-balance sheet net notional position		316	-	(316)	-
Net currency exposure		54,351	232	1,827	414
Commitments	82,246	81,702	7	537	-

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

Group

At 31 December 2009	**Total € 000**	**EUR € 000**	**GBP € 000**	**USD € 000**	**Other € 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	116,357	98,072	11,239	7,038	8
Investments classified as:					
- held-to-maturity investments	34,633	34,633	-	-	-
- available-for-sale investments	10,392	9,648	-	744	-
Loans and advances to banks	22,383	6,292	3,455	7,944	4,692
Loans and advances to customers	327,802	321,552	27	6,223	-
Other assets	11,469	8,903	420	1,726	420
Total financial assets	523,036	479,100	15,141	23,675	5,120
Financial liabilities					
Amounts owed to banks	3,675	3,675	-	-	-
Amounts owed to customers	446,209	406,387	14,061	21,118	4,643
Other liabilities	20,838	19,577	360	783	118
Total financial liabilities	470,722	429,639	14,421	21,901	4,761
Net on-balance sheet position		49,461	720	1,774	359
Off-balance sheet net notional position		314	(314)	-	-
Net currency exposure		49,775	406	1,774	359
Commitments	98,611	98,303	2	306	-

The Group's exposures to financial assets and financial liabilities denominated in foreign currencies attributable to the Bank's subsidiaries comprise trade and other receivables from international postal operators presented within 'Other assets' above amounting to €2,567,000 (2009: €2,518,000).

Under the scenario that all currencies move adversely against the euro by 20 per cent the effect would be a decrease of €412,000 (2009: €423,000) in the carrying amount of financial instruments with the adverse impact recognised in profit or loss. Should all currencies move in favour of the euro by 20 per cent, the effect would be a gain of €412,000 (2009: €423,000) 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 limited to 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 sought 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 arguing 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 loan to deposit ratio of 71% 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 2010 is 74%, which is significantly higher than the prudential parameters set by the MFSA.

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

Thus, 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 referred to above.

As at 31 December 2010, the Group and Bank had outstanding guarantees on behalf of third parties amounting to €7,067,000 (2009: €10,484,000), 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 2010	**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	**76,554**	**29,319**	**-**	**-**	**3,441**	**109,314**
Available-for-sale investments	**357**	**-**	**3,369**	**4,353**	**7,362**	**15,441**
Held-to-maturity investments	**3,532**	**-**	**24,862**	**2,497**	**-**	**30,891**
Loans and advances to banks	**44,975**	**-**	**-**	**-**	**-**	**44,975**
Loans and advances to customers	**65,450**	**45,206**	**93,591**	**129,484**	**-**	**333,731**
Other assets	**10,305**	**746**	**-**	**-**	**526**	**11,577**
Total financial assets	**201,173**	**75,271**	**121,822**	**136,334**	**11,329**	**545,929**
Financial liabilities						
Amounts owed to banks	**149**	**-**	**-**	**-**	**-**	**149**
Amounts owed to customers	**237,812**	**108,251**	**87,801**	**38,833**	**-**	**472,697**
Other liabilities	**7,461**	**1,193**	**942**	**417**	**6,246**	**16,259**
Total financial liabilities	**245,422**	**109,444**	**88,743**	**39,250**	**6,246**	**489,105**
Maturity gap	**(44,249)**	**(34,173)**	**33,079**	**97,084**	**-**	**-**
Cumulative gap	**(44,249)**	**(78,422)**	**(45,343)**	**51,741**	**-**	**-**
At 31 December 2009						
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	89,435	23,764	-	-	3,158	116,357
Available-for-sale investments	139	1,652	2,553	3,550	2,498	10,392
Held-to-maturity investments	-	3,879	23,394	7,360	-	34,633
Loans and advances to banks	22,383	-	-	-	-	22,383
Loans and advances to customers	29,137	44,942	114,953	138,770	-	327,802
Other assets	9,803	1,482	-	-	184	11,469
Total financial assets	150,897	75,719	140,900	149,680	5,840	523,036
Financial liabilities						
Amounts owed to banks	117	3,558	-	-	-	3,675
Amounts owed to customers	237,289	111,301	69,103	28,516	-	446,209
Other liabilities	7,173	1,386	838	346	12,492	22,235
Total financial liabilities	244,579	116,245	69,941	28,862	12,492	472,119
Maturity gap	(93,682)	(40,526)	70,959	120,818	-	-
Cumulative gap	(93,682)	(134,208)	(63,249)	57,569	-	-

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

The financial assets reflected in this note which are not held by the Bank, comprise principally available-for-sale debt investments with a carrying amount of €358,000 (2009: €380,000) maturing within three months, €1,591,000 (2009: €1,707,000) maturing between one and five years and €3,282,000 (2009: €3,156,000) that mature after more than five years.

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. The Group does not have material derivative financial liabilities.

Group

At 31 December 2010	**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	**149**	**-**	**-**	**-**	**149**
Amounts owed to customers	**239,396**	**110,304**	**97,771**	**51,658**	**499,129**
Total financial liabilities	**239,545**	**110,304**	**97,771**	**51,658**	**499,278**
At 31 December 2009					
Financial liabilities					
Amounts owed to banks	117	3,575	-	-	3,692
Amounts owed to customers	237,793	113,246	78,423	40,215	469,677
Total financial liabilities	237,910	116,821	78,423	40,215	473,369

2.6 *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 Malta Financial Services Authority (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.

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

Capital adequacy and the use of regulatory capital are monitored 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 European Union Directive on Capital Requirements ('CRD'). 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 whilst Pillar III deals with market discipline and sets forth disclosure requirements for risk and capital management. 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:

	2010	2009
	€ 000	€ 000
Total original own funds	**65,552**	61,173
Additional own funds:		
Property revaluation reserve	**1,833**	2,288
Investment revaluation reserve	**424**	-
Collective impairment allowances	**1,442**	1,859
Total own funds	**69,251**	65,320

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 items 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 exposures, 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 items according to their asset class and credit assessment. 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 per cent) and adding the resulting figures to the sum of risk-weighted assets for credit risk.

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

The tables below summarise the regulatory capital requirements and the capital adequacy ratio computations of the Bank as at the end of the reporting periods. During the 2010 and 2009 financial years, the Bank complied with all of the externally imposed capital requirements to which it is subject.

Bank

At 31 December 2010	**Carrying amount € 000**	**Weighted amount € 000**	**Capital requirement € 000**
On-balance sheet assets			
Balances with Central Bank of Malta and cash	41,581	-	-
Malta Government treasury bills	67,193	-	-
Cheques in course of collection	750	150	12
Equity shares	7,362	6,556	524
Debt securities	33,739	3,765	301
Loans and advances to banks	43,477	8,780	704
Loans and advances to customers	334,012	297,050	23,764
Investment in subsidiaries	8,034	8,034	642
Intangible assets	3	3	-
Property, plant and equipment	12,299	12,299	984
Current tax assets	2,378	-	-
Accrued income	3,103	3,103	248
Other assets	2,610	2,610	209
	556,541	342,350	27,388
Off-balance sheet items			
Contingent liabilities and commitments	89,313	11,602	928
Credit risk		353,952	28,316
Foreign exchange risk		921	73
Operational risk		32,385	2,591
Total		387,258	30,980

Own funds	
Original own funds	65,552
Additional own funds	3,699
Gross own funds	69,251
Deductions	-
Total own funds	69,251
Capital Adequacy Ratio	17.9%

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

Bank

At 31 December 2009	Carrying amount € 000	Weighted amount € 000	Capital requirement € 000
On-balance sheet assets			
Balances with Central Bank of Malta and cash	27,251	-	-
Malta Government treasury bills	88,742	-	-
Cheques in course of collection	811	162	13
Equity shares	2,073	1,208	97
Debt securities	37,284	2,818	225
Loans and advances to banks	18,460	6,029	482
Loans and advances to customers	327,956	292,667	23,413
Investment in subsidiaries	7,634	7,634	611
Intangible assets	3	3	-
Property, plant and equipment	11,654	11,654	932
Current tax assets	1,731	-	-
Accrued income	4,478	4,478	359
Other assets	2,827	2,827	226
	530,904	329,480	26,358
Off-balance sheet items			
Contingent liabilities and commitments	109,095	14,710	1,177
Credit risk		344,190	27,535
Foreign exchange risk		663	53
Operational risk		32,384	2,591
Total		377,237	30,179

Own funds	
Original own funds	61,173
Additional own funds	4,147
Gross own funds	65,320
Deductions	-
Total own funds	65,320
Capital Adequacy Ratio	17.3%

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

2.7 *Fair values of financial assets and liabilities*

2.7.1 Financial instruments not measured at fair value

Investments – Debt and other fixed income instruments held-to-maturity

This category of financial assets, composed entirely of listed securities, is carried at amortised cost and is measured at the amount of €30,891,000 as at 31 December 2010 (2009: €34,633,000). The investments' fair value, based on quoted market prices at the end of the reporting period without any deduction for transaction costs, amounts to €33,667,000 (2009: €37,824,000).

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 2010, the Group's aggregate carrying amount in this respect was €378,706,000 (2009: €350,185,000). The loans and advances to customers, which are principally subject to floating interest rates, are measured at the amount of €333,731,000 (2009: €327,802,000). 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 €44,975,000 (2009: €22,383,000). Rates on these 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.

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 €472,846,000 as at 31 December 2010 (2009: €449,884,000). 2.8 per cent (2009: 3.1 per cent) of this liability is non-interest bearing, 36.0 per cent (2009: 31.0 per cent) of the liability has a contractual repricing term of three months or less, 30.7 per cent (2009: 40.4 per cent) reprices within three months and one year, 19.8 per cent (2009: 16.9 per cent) reprices within one year and five years whilst 10.7 per cent (2009: 8.6 per cent) 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.

Other financial instruments

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

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

2.7.2 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) and its derivative contracts. 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 based on quoted market prices. Fair values for the Bank's derivative contracts are determined utilising valuation techniques, involving primarily the use of discounted cash flow techniques based on the present value of the estimated future cash flows. The valuation techniques used are supported by observable market prices or rates since their variables include only data from observable markets.

As at 31 December 2010 and 2009, the main financial instruments that are measured at fair value, comprising the Group's available-for-sale investments, were valued using Level 1 inputs. The fair value of the derivative contracts is deemed insignificant at the end of the reporting period.

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.

3.2 *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 and 8).

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.

Postal Services comprise the Group's postal services activities, being the sole licensed Universal Service Provider of postal services in Malta.

The Group's internal reporting to the Board of Directors and senior executives is analysed according to the above segments.

Information about reportable segments:

	Banking services		**Postal services**		**Total**	
	2010	2009	**2010**	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000	**€ 000**	€ 000
Interest receivable	**26,066**	27,828	**287**	322	**26,353**	28,150
Interest expense	**(10,287)**	(13,560)	**-**	-	**(10,287)**	(13,560)
Postal sales and other revenue	**302**	89	**19,506**	19,304	**19,808**	19,393
Net fee and commission income	**1,334**	1,174	**895**	916	**2,229**	2,090
Other	**532**	368	**150**	-	**682**	368
Segment operating income	**17,947**	15,899	**20,838**	20,542	**38,785**	36,441
Depreciation and amortisation	**(278)**	(227)	**(917)**	(838)	**(1,195)**	(1,065)
Impairment allowances	**(215)**	190	**29**	(65)	**(186)**	125
Employee compensation and benefits	**(4,180)**	(4,039)	**(10,142)**	(9,604)	**(14,322)**	(13,643)
Other costs	**(2,533)**	(2,083)	**(6,608)**	(6,848)	**(9,141)**	(8,931)
Profit before taxation	**10,741**	9,740	**3,200**	3,187	**13,941**	12,927
Income tax expense	**(3,813)**	(3,650)	**(1,088)**	(1,213)	**(4,901)**	(4,863)
Profit for the year	**6,928**	6,090	**2,112**	1,974	**9,040**	8,064
Segment total assets	**546,778**	520,776	**21,022**	22,065	**567,800**	542,841
Capital expenditure during the year	**921**	1,332	**1,263**	543	**2,184**	1,875
Segment total liabilities	**483,663**	463,451	**8,094**	11,188	**491,757**	474,639

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

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 12.1% (2009: 11.8%) of its revenue for 2010 internationally.

The Group's reliance on major customers is not considered significant for disclosure purposes.

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

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Balances with Central Bank of Malta	**38,680**	24,457	**38,680**	24,457
Malta Government treasury bills	**67,193**	88,742	**67,193**	88,742
Cash in hand	**3,441**	3,158	**2,901**	2,794
	109,314	116,357	**108,774**	115,993

The balances with the Central Bank of Malta include a reserve deposit amounting to €7,438,000 (2009: €6,359,000) 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 €7,407,000.

At 31 December 2010, the Bank has also pledged a deposit with the Central Bank of Malta amounting to €959,000 in favour of the Depositor Compensation Scheme to comply with local regulatory requirements.

The Bank's investments in Malta Government treasury bills are categorised as held-to-maturity financial assets.

6 **Investments**

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Debt and other fixed income instruments				
- available-for-sale	**8,079**	7,894	**2,848**	2,651
- held-to-maturity	**30,891**	34,633	**30,891**	34,633
Equity instruments available-for-sale	**7,362**	2,498	**7,362**	2,073
	46,332	45,025	**41,101**	39,357

6 **Investments** *(continued)*

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

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Issued by public bodies:				
- local government	**2,528**	2,617	**-**	-
Issued by public issuers:				
- local banks	**2,083**	2,086	**904**	1,000
- local others	**3,468**	3,191	**1,944**	1,651
	8,079	7,894	**2,848**	2,651

Debt and other fixed income instruments classified as held-to-maturity investments which are entirely listed on the Malta Stock Exchange comprise:

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Issued by public bodies:				
- local government	**30,076**	33,818	**30,076**	33,818
Issued by public issuers:				
- local corporate	**815**	815	**815**	815
	30,891	34,633	**30,891**	34,633

The Bank has pledged €13,115,000 (2009: €13,115,000) Malta Government Stocks classified as held-to-maturity investments in favour of the Central Bank of Malta as security for a facility that was not utilised at the end of the reporting period. At 31 December 2010, the Bank has also pledged Malta Government Stocks classified as held-to-maturity investments amounting to €1,438,000 in favour of the Depositor Compensation Scheme to comply with local regulatory requirements.

Equity instruments classified as available-for-sale investments comprise equities listed on the Malta Stock Exchange, except for investments with a carrying amount of €133,000 (2009: €162,000) which are measured at cost in view of the absence of a reliable fair valuation of these investments.

6 **Investments** *(continued)*

Equity instruments classified as available-for-sale investments include equities listed on the Malta Stock Exchange amounting to €3,302,775, which are the subject of a call option arrangement whereby a third party has the option to purchase back these shares from the Bank subject to the terms and conditions, including pre-determined exercise prices, specified in the agreement. The option may be exercised at any time up to, and including, 31 July 2013. At the end of the reporting period, the directors deem the exercise of this option to be remote. Accordingly, the substantive risks and rewards pertaining to the shares have been transferred to the Bank and the asset is reflected as an available-for-sale investment rather than loans and advances.

The movement in investments is summarised as follows:

	Group			Bank		
	Available-for-sale € 000	**Held-to-maturity € 000**	**Total € 000**	**Available-for-sale € 000**	**Held-to-maturity € 000**	**Total € 000**
At 1 January 2010	**10,392**	**34,633**	**45,025**	**4,724**	**34,633**	**39,357**
Foreign exchange movement	**35**	**-**	**35**	**35**	**-**	**35**
Amortisation	**(10)**	**(65)**	**(75)**	**-**	**(65)**	**(65)**
Acquisitions	**6,814**	**194**	**7,008**	**6,622**	**194**	**6,816**
Redemptions/disposals	**(2,213)**	**(3,871)**	**(6,084)**	**(1,442)**	**(3,871)**	**(5,313)**
Fair value movement	**423**	**-**	**423**	**271**	**-**	**271**
At 31 December 2010	**15,441**	**30,891**	**46,332**	**10,210**	**30,891**	**41,101**
At 1 January 2009	8,681	42,946	51,627	4,153	42,946	47,099
Foreign exchange movement	(15)	-	(15)	(15)	-	(15)
Amortisation	(25)	(63)	(88)	-	(63)	(63)
Acquisitions	1,796	-	1,796	784	-	784
Redemptions/disposals	(410)	(8,250)	(8,660)	(404)	(8,250)	(8,654)
Fair value movement	365	-	365	206	-	206
At 31 December 2009	10,392	34,633	45,025	4,724	34,633	39,357

7 **Loans and advances to banks**

	Group		Bank	
	2010 € 000	2009 € 000	**2010 € 000**	2009 € 000
Repayable on call and at short notice	**43,238**	22,231	**41,740**	18,460
Term loans and advances	**1,737**	152	**1,737**	-
	44,975	22,383	**43,477**	18,460

8 Loans and advances to customers

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Repayable on call and at short notice	**95,215**	98,321	**95,215**	98,321
Term loans and advances	**244,049**	235,509	**244,330**	235,663
Gross loans and advances to customers	**339,264**	333,830	**339,545**	333,984
Impairment allowances	**(5,533)**	(6,028)	**(5,533)**	(6,028)
Net loans and advances to customers	**333,731**	327,802	**334,012**	327,956
Impairment allowances				
Specific impairment allowances	**4,091**	4,169	**4,091**	4,169
Collective impairment allowances	**1,442**	1,859	**1,442**	1,859
	5,533	6,028	**5,533**	6,028

Group/Bank

	Specific impairment allowances	Collective impairment allowances	Total
	€ 000	**€ 000**	**€ 000**
At 1 January 2010	**4,169**	**1,859**	**6,028**
Additions	**636**	**-**	**636**
Reversals	**(714)**	**(417)**	**(1,131)**
At 31 December 2010	**4,091**	**1,442**	**5,533**
At 1 January 2009	4,275	1,638	5,913
Additions	1,666	221	1,887
Reversals	(1,772)	-	(1,772)
At 31 December 2009	4,169	1,859	6,028

The aggregate amount of impaired loans and advances to customers amounted to €14,301,000 (2009: €22,346,000).

Assets acquired in settlement of debt amounting to €109,000 (2009: €109,000) are classified as assets classified as held-for-sale.

8 **Loans and advances to customers** *(continued)*

At 31 December 2010, loans and advances to customers amounting to €1,645,195 represent an asset in respect of which unquoted equities were transferred to the Bank subject to a call option arrangement whereby a third party has the option to purchase back these shares from the Bank subject to the terms and conditions, including pre-determined exercise prices, specified in the agreement. The exercise of this option may occur at any time up to, and including, 31 December 2013. The asset is still being presented within loans and advances on the basis that the customer has retained substantially all risks and rewards of these unquoted equities and accordingly at the end of the reporting period, management are not in a position to determine whether this option will be exercised.

9 **Investment in subsidiaries**

Name of company	Country of incorporation	Nature of business	Equity interest		Carrying amount	
			2010	2009	**2010**	2009
			%	%	**€ 000**	€ 000
Redbox Limited	Malta	Holding Company	**100**	100	**7,690**	6,304
Lombard Funds SICAV p.l.c.	Malta	Collective Investment Scheme	**-**	87.98	**-**	986
Lombard Asset Managers Limited	Malta	Management of Collective Investment Schemes	**100**	100	**344**	344
					8,034	7,634

At 31 December 2010, Redbox Limited held 66.5 per cent (2009: 65.2 per cent) of the equity share capital of MaltaPost p.l.c.. The remaining 33.5 per cent (2009: 34.8 per cent) is held by the general public.

The end of the reporting period reflected in the audited financial statements of MaltaPost p.l.c. utilised in the preparation of these consolidated financial statements is 30 September 2010.

Lombard Asset Managers Limited was the investment manager of Lombard Enterprise Fund, which was a sub-fund of Lombard Funds SICAV p.l.c. At 31 December 2009, the Bank owned 87.98 per cent of the units of the fund.

Lombard Asset Managers Limited was placed into liquidation on 31 December 2010 whereas Lombard Funds SICAV p.l.c. was placed into voluntary liquidation on 15 June 2010.

10 **Intangible assets**

	Group				Bank	
	Goodwill € 000	Computer software € 000	Postal license € 000	Total € 000	Computer software € 000	Total € 000
At 1 January 2009						
Cost	857	2,026	1,159	4,042	1,455	1,455
Accumulated amortisation	-	(1,929)	(811)	(2,740)	(1,442)	(1,442)
Net book amount	857	97	348	1,302	13	13
Year ended 31 December 2009						
At 1 January 2009	857	97	348	1,302	13	13
Additions	-	57	-	57	1	1
Amortisation for the year	-	(44)	(77)	(121)	(11)	(11)
At 31 December 2009	857	110	271	1,238	3	3
At 31 December 2009						
Cost	857	2,083	1,159	4,099	1,456	1,456
Accumulated amortisation	-	(1,973)	(888)	(2,861)	(1,453)	(1,453)
Net book amount	857	110	271	1,238	3	3
Year ended 31 December 2010						
At 1 January 2010	**857**	**110**	**271**	**1,238**	**3**	**3**
Additions	**-**	**183**	**-**	**183**	**4**	**4**
Amortisation for the year	**-**	**(49)**	**(77)**	**(126)**	**(4)**	**(4)**
At 31 December 2010	**857**	**244**	**194**	**1,295**	**3**	**3**
At 31 December 2010						
Cost	**857**	**2,266**	**1,159**	**4,282**	**1,460**	**1,460**
Accumulated amortisation	**-**	**(2,022)**	**(965)**	**(2,987)**	**(1,457)**	**(1,457)**
Net book amount	**857**	**244**	**194**	**1,295**	**3**	**3**

The intangible asset relating to the Postal licence is the amount paid by MaltaPost p.l.c. for the right to operate the postal services in Malta. This right has a useful life of 15 years and is amortised over this definite period.

10 **Intangible assets** *(continued)*

10.1 *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. At 31 December 2010 these amounted to €857,000 and is attributable 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 €1 as at 31 December 2010 (2009: €0.70). On this basis, the recoverable amount of the cash-generating unit is higher than its carrying amount.

11 **Property, plant and equipment**

Group	**Land and buildings € 000**	**Computer equipment € 000**	**Other € 000**	**Total € 000**
At 1 January 2009				
Cost	13,827	2,063	4,624	20,514
Accumulated depreciation	(2,062)	(1,845)	(3,598)	(7,505)
Net book amount	11,765	218	1,026	13,009
Year ended 31 December 2009				
At 1 January 2009	11,765	218	1,026	13,009
Additions	1,180	374	264	1,818
Disposals	(10)	(1)	(1)	(12)
Charge for the year	(496)	(96)	(352)	(944)
Released on disposals	5	1	1	7
At 31 December 2009	12,444	496	938	13,878
At 31 December 2009				
Cost	14,997	2,436	4,887	22,320
Accumulated depreciation	(2,553)	(1,940)	(3,949)	(8,442)
Net book amount	12,444	496	938	13,878
Year ended 31 December 2010				
At 1 January 2010	**12,444**	**496**	**938**	**13,878**
Additions	**1,286**	**373**	**342**	**2,001**
Revaluation of land and buildings:				
- effect on cost or valuation	**(138)**	**-**	**-**	**(138)**
- effect on accumulated depreciation	**138**	**-**	**-**	**138**
Disposals	**(100)**	**-**	**-**	**(100)**
Charge for the year	**(600)**	**(142)**	**(327)**	**(1,069)**
Released on disposals	**30**	**-**	**-**	**30**
At 31 December 2010	**13,060**	**727**	**953**	**14,740**
At 31 December 2010				
Cost	**16,045**	**2,809**	**5,229**	**24,083**
Accumulated depreciation	**(2,985)**	**(2,082)**	**(4,276)**	**(9,343)**
Net book amount	**13,060**	**727**	**953**	**14,740**

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

Bank	**Land and buildings € 000**	**Computer equipment € 000**	**Other € 000**	**Total € 000**
At 1 January 2009				
Cost	10,421	1,164	2,201	13,786
Accumulated depreciation	(456)	(1,095)	(1,696)	(3,247)
Net book amount	9,965	69	505	10,539
Year ended 31 December 2009				
At 1 January 2009	9,965	69	505	10,539
Additions	912	326	93	1,331
Disposals	-	(1)	(1)	(2)
Charge for the year	(71)	(29)	(116)	(216)
Released on disposals	-	1	1	2
At 31 December 2009	10,806	366	482	11,654
At 31 December 2009				
Cost	11,333	1,489	2,293	15,115
Accumulated depreciation	(527)	(1,123)	(1,811)	(3,461)
Net book amount	10,806	366	482	11,654
Year ended 31 December 2010				
At 1 January 2010	**10,806**	**366**	**482**	**11,654**
Additions	**486**	**303**	**128**	**917**
Revaluation of land and buildings:				
- effect on cost or valuation	**(138)**	**-**	**-**	**(138)**
- effect on accumulated depreciation	**138**	**-**	**-**	**138**
Charge for the year	**(79)**	**(73)**	**(120)**	**(272)**
At 31 December 2010	**11,213**	**596**	**490**	**12,299**
At 31 December 2010				
Cost	**11,681**	**1,792**	**2,421**	**15,894**
Accumulated depreciation	**(468)**	**(1,196)**	**(1,931)**	**(3,595)**
Net book amount	**11,213**	**596**	**490**	**12,299**

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

The Bank's land and buildings were revalued on 31 December 2010 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. 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 2010 no adjustments were deemed necessary to the property's carrying amounts.

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

	Group		**Bank**	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Cost	**13,562**	12,376	**9,200**	8,714
Accumulated depreciation	**(3,322)**	(2,688)	**(810)**	(666)
Net book amount	**10,240**	9,688	**8,390**	8,048

Commitments in relation to capital expenditure:

	Group		**Bank**	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Contracted but not provided for in the financial statements	-	184	-	184

12 **Investment property**

Investment property comprises assets acquired in settlement of an advance to a customer and is analysed as follows:

	Group		**Bank**	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Fair value at 31 December	**745**	745	**745**	745

The fair value of investment property is determined on the basis of the capitalisation of the sub-ground rent receivable from the investment property at the rate of five per cent by reference to Article 1501 (2) of the Civil Code (Chapter 16, Laws of Malta).

13 **Deferred tax assets**

Deferred tax assets and liabilities are attributable to the following:

Group

	Assets 2010 € 000	**Liabilities 2010 € 000**	**Net 2010 € 000**	Assets 2009 € 000	Liabilities 2009 € 000	Net 2009 € 000
Excess of depreciation over capital allowances	**310**	**-**	**310**	285	-	285
Provisions for liabilities and charges	**339**	**-**	**339**	322	-	322
Loan impairment allowances	**1,964**	**-**	**1,964**	2,152	-	2,152
Revaluation of property	**-**	**(823)**	**(823)**	-	(578)	(578)
Fair value movements on investments	**-**	**(205)**	**(205)**	-	(188)	(188)
	2,613	**(1,028)**	**1,585**	2,759	(766)	1,993

Bank

	Assets 2010 € 000	**Liabilities 2010 € 000**	**Net 2010 € 000**	Assets 2009 € 000	Liabilities 2009 € 000	Net 2009 € 000
Excess of depreciation over capital allowances	**-**	**(47)**	**(47)**	5	-	5
Provisions for liabilities and charges	**223**	**-**	**223**	202	-	202
Loan impairment allowances	**1,936**	**-**	**1,936**	2,110	-	2,110
Revaluation of property	**-**	**(823)**	**(823)**	-	(578)	(578)
Fair value movements on investments	**-**	**(205)**	**(205)**	-	(188)	(188)
	2,159	**(1,075)**	**1,084**	2,317	(766)	1,551

Deferred tax assets have not been recognised in the Group in respect of the following items:

	2010 € 000	2009 € 000
Tax losses carried forward	**179**	179

13 **Deferred tax assets** *(continued)*

Movement in temporary differences relating to:

Group

	At 1 January 2009 € 000	Recognised in profit or loss € 000	Recognised in other comprehensive income € 000	**At 31 December 2009 € 000**	**Recognised in profit or loss € 000**	**Recognised in other comprehensive income € 000**	**At 31 December 2010 € 000**
Excess of depreciation over capital allowances	260	25	-	**285**	**25**	**-**	**310**
Provisions for liabilities and charges	295	27	-	**322**	**17**	**-**	**339**
Loan impairment allowances	2,096	56	-	**2,152**	**(188)**	**-**	**1,964**
Revaluation of property	(578)	-	-	**(578)**	**-**	**(245)**	**(823)**
Fair value movements on investments	(100)	-	(88)	**(188)**	**-**	**(17)**	**(205)**
	1,973	108	(88)	**1,993**	**(146)**	**(262)**	**1,585**

Bank

	At 1 January 2009 € 000	Recognised in profit or loss € 000	Recognised in other comprehensive income € 000	**At 31 December 2009 € 000**	**Recognised in profit or loss € 000**	**Recognised in other comprehensive income € 000**	**At 31 December 2010 € 000**
Excess of depreciation over capital allowances	44	(39)	-	**5**	**(52)**	**-**	**(47)**
Provisions for liabilities and charges	198	4	-	**202**	**21**	**-**	**223**
Loan impairment allowances	2,070	40	-	**2,110**	**(174)**	**-**	**1,936**
Revaluation of property	(578)	-	-	**(578)**	**-**	**(245)**	**(823)**
Fair value movements on investments	(100)	-	(88)	**(188)**	**-**	**(17)**	**(205)**
	1,634	5	(88)	**1,551**	**(205)**	**(262)**	**1,084**

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 to the revaluation of property, plant and equipment and the fair valuation of available-for-sale investments.

14 Inventories

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Postal supplies and materials	**123**	123	**-**	-
Merchandise	**448**	301	**-**	-
Other stock items	**143**	247	**143**	247
	714	671	**143**	247

15 Trade and other receivables

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Trade receivables - net of impairment allowances	**7,121**	6,505	**-**	-
Others	**382**	40	**385**	31
	7,503	6,545	**385**	31

The movement in the impairment allowance in respect of trade receivables arising during the year was as follows:

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
At 1 January	**118**	53	**-**	-
Impairment loss/(reversal) recognised	**(39)**	65	**-**	-
At 31 December	**79**	118	**-**	-

16 Accrued income and other assets

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Accrued income	**3,180**	3,969	**3,103**	4,478
Other assets	**144**	144	**144**	144
	3,324	4,113	**3,247**	4,622

17 **Share capital**

Bank

	2010		2009	
	No. of shares 000s	**€ 000**	No. of shares 000s	€ 000
Authorised				
Ordinary shares of 25 cents each	**80,000**	**20,000**	80,000	20,000
Issued				
Ordinary shares of 25 cents each	**36,093**	**9,023**	35,614	8,903

Bank

	Ordinary shares	
	2010	2009
	000s	000s
On issue at 1 January	**35,614**	35,048
Rights issue	**479**	566
On issue at 31 December	**36,093**	35,614

During the year ended 31 December 2010, the share capital of the Bank increased by 479,000 shares as a result of the rights issue approved by the shareholders during the Annual General Meeting held on 22 April 2010.

18 Reserves

These reserves are non-distributable.

18.1 *Share premium*

The increase in the share premium account during the current financial year represents the premium attributable to the rights issue of 479,000 ordinary shares approved by the shareholders during the Annual General Meeting held on 22 April 2010.

18.2 *Property revaluation reserve*

The 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.

18.3 *Investment revaluation reserve*

This represents the cumulative net change in fair values of available-for-sale financial assets held by the Group, net of related deferred tax impacts.

18.4 *Other reserves*

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	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Term deposits with agreed maturity dates or periods of notice	**-**	3,558	**-**	3,558
Repayable on demand	**149**	117	**149**	117
	149	3,675	**149**	3,675

20 Amounts owed to customers

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Term deposits	**353,639**	344,967	**354,714**	346,105
Repayable on demand	**119,058**	101,242	**120,371**	103,331
	472,697	446,209	**475,085**	449,436

21 Provisions for liabilities and other charges

Provisions	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Obligation to Government	**1,683**	1,600	**-**	-
Legal	**969**	920	**636**	577
	2,652	2,520	**636**	577

These provisions are predominantly non-current in nature.

Group	**2010**			2009		
	Obligation to Government	**Legal**	**Total**	Obligation to Government	Legal	Total
	€ 000	**€ 000**	**€ 000**	€ 000	€ 000	€ 000
At 1 January	**1,600**	**920**	**2,520**	1,569	844	2,413
Exchange differences recognised in profit or loss	**-**	**37**	**37**	-	(9)	(9)
Charge for the year	**127**	**12**	**139**	88	85	173
Crystallised obligations	**(44)**	**-**	**(44)**	(57)	-	(57)
At 31 December	**1,683**	**969**	**2,652**	1,600	920	2,520

The obligation to Government arises in terms of Article 8A of the Pensions Ordinance (Chapter 93, 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.

Obligation to Government recognised in the Statement of Financial Position is arrived at as follows:

	2010	2009
	€ 000	€ 000
Present value of unfunded obligations	**2,647**	2,520
Crystallised obligation	**(265)**	(221)
Fair value of obligations to be reimbursed by Government	**(699)**	(699)
	1,683	1,600

21 **Provisions for liabilities and other charges** *(continued)*

The movement for the year is made up of:

	2010 € 000	2009 € 000
Charge to the income statement	**127**	88
Crystallised obligation	**(44)**	(57)
	83	31

The amount recognised in the income statement is as follows:

	2010 € 000	2009 € 000
Interest cost	**80**	16
Net actuarial losses recognised during the year	**47**	72
Total amount charged to the income statement	**127**	88

In computing the Obligation to Government, the Group used a discount rate of 4.46% (2009: 4.47%), whereas the future salary increases were based on inflation rates and past salary increases.

Bank

	2010 Legal € 000	2009 Legal € 000
Year ended 31 December		
At 1 January	**577**	566
Exchange differences recognised in profit or loss	**37**	(9)
Charge for the year	**22**	20
At 31 December	**636**	577

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**	
	2010 € 000	2009 € 000	**2010 € 000**	2009 € 000
Trade payables	**1,841**	1,475	**-**	-
Bills payable	**2,594**	2,378	**2,594**	2,378
Cash collateral	**2**	224	**2**	224
Other payables	**3,470**	8,509	**3,083**	5,992
	7,907	12,586	**5,679**	8,594

23 Accruals and deferred income

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Accrued interest	**3,826**	4,229	**3,861**	4,272
Other	**4,526**	5,420	**671**	703
	8,352	9,649	**4,532**	4,975

24 Commitments and contingent liabilities

Group/Bank

	2010	2009
	€ 000	€ 000
Contingent liabilities		
Guarantee obligations incurred on behalf of third parties	**7,067**	10,484
Commitments		
Documentary credits	**1,718**	1,368
Credit facilities and other commitments to lend	**80,528**	97,243
	82,246	98,611

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

The future minimum lease payments for the Group under non-cancellable operating leases are as follows:

	2010	2009
	€ 000	€ 000
Within 1 year	**262**	213
Between 2 and 5 years	**322**	383
	584	596

The Group is also committed to pay a licence fee of 0.75% of its total gross revenue from postal services within the scope of the universal services.

25 Net interest income

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Interest income				
On loans and advances to banks	**136**	136	**128**	79
On loans and advances to customers	**22,894**	23,050	**22,894**	23,050
On balances with Central Bank of Malta	**112**	159	**112**	159
On Malta Government treasury bills	**704**	2,059	**704**	2,059
	23,846	25,404	**23,838**	25,347
On debt and other fixed income instruments	**2,583**	2,839	**2,332**	2,620
Net amortisation of premiums and discounts	**(76)**	(93)	**(65)**	(67)
	2,507	2,746	**2,267**	2,553
Total interest income	**26,353**	28,150	**26,105**	27,900
Interest expense				
On amounts owed to banks	**(10)**	(11)	**(10)**	(11)
On amounts owed to customers	**(10,277)**	(13,549)	**(10,316)**	(13,621)
Total interest expense	**(10,287)**	(13,560)	**(10,326)**	(13,632)
Net interest income	**16,066**	14,590	**15,779**	14,268

26 **Net fee and commission income**

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Fee and commission income				
Retail banking customer fees	**673**	634	**673**	634
Brokerage	**197**	59	**197**	59
Other	**1,422**	1,464	**520**	527
Total fee and commission income	**2,292**	2,157	**1,390**	1,220
Fee and commission expense				
Inter bank transaction fees	**(47)**	(56)	**(47)**	(56)
Other	**(16)**	(11)	**(16)**	(10)
Total fee and commission expense	**(63)**	(67)	**(63)**	(66)
Net fee and commission income	**2,229**	2,090	**1,327**	1,154

27 **Postal sales and other revenues**

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Stamps, parcel post and postal stationery including income from foreign inbound mail	**18,755**	18,755	**-**	-
Collectibles and philatelic sales	**930**	586	**342**	122
Other	**123**	52	**-**	-
	19,808	19,393	**342**	122

28 **Dividend income**

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Subsidiary company	**-**	-	**1,169**	1,819
Available-for-sale equity shares	**157**	122	**157**	122
	157	122	**1,326**	1,941

29 **Net trading income**

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Gains on foreign exchange activities	**583**	266	**364**	262

30 **Employee compensation and benefits**

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Staff costs				
- wages, salaries and allowances	**13,312**	12,691	**3,935**	3,800
- social security costs	**1,010**	952	**245**	239
	14,322	13,643	**4,180**	4,039

	Group		Bank	
	2010	2009	**2010**	2009
Average number of employees				
Managerial	**69**	71	**39**	38
Others	**678**	678	**118**	120
	747	749	**157**	158

31 **Net impairment (losses)/gains**

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Write-downs				
Loans and advances to customers				
- specific allowances	**(636)**	(1,316)	**(636)**	(1,316)
- collective allowances	**-**	(221)	**-**	(221)
Trade receivables-specific allowances	**-**	(65)	**-**	-
	(636)	(1,602)	**(636)**	(1,537)
Reversals of write-downs				
Loans and advances to customers				
- specific allowances	**4**	1,727	**4**	1,727
- collective allowances	**417**	-	**417**	-
Trade receivables-specific allowances	**29**	-	**-**	-
	450	1,727	**421**	1,727
Net impairment (losses)/gains	**(186)**	125	**(215)**	190

32 Profit before taxation

Profit before taxation is stated after crediting and charging the following:

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
After charging				
Directors' emoluments				
- fees	**89**	81	**63**	56
- other emoluments	**303**	292	**303**	292
After crediting				
Net income from investment services	**269**	96	**269**	96
Rental income from investment property	**37**	37	**37**	37

Other operating costs are analysed as follows:

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Foreign outbound mail	**2,703**	2,841	**-**	-
Utilities and insurance	**586**	445	**304**	201
IT support and telecommunication costs	**855**	841	**293**	283
Repairs and maintenance	**836**	703	**213**	200
Operating lease rental charges	**911**	966	**222**	225
Other administrative expenses	**3,111**	2,962	**1,486**	1,116
Total other operating costs	**9,002**	8,758	**2,518**	2,025

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	Other non-assurance services
	€ 000	**€ 000**	**€ 000**	**€ 000**
Auditors of the parent				
2010	**40**	**-**	**-**	**5**
2009	38	-	1	1
Auditors of subsidiary companies				
2010	**24**	**11**	**10**	**4**
2009	22	9	2	-

33 **Income tax expense**

Recognised in profit or loss:

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Current taxation				
Current tax expense	**4,792**	4,747	**4,017**	3,952
Adjustment to prior years' current tax expense	**(37)**	224	**-**	182
	4,755	4,971	**4,017**	4,134
Deferred taxation				
Deferred tax expense/(income) (note 13)	**146**	(108)	**205**	(5)
	4,901	4,863	**4,222**	4,129

The tax on the profit before tax differs from the theoretical amount that would arise using the tax rate applicable as follows:

	Group		Bank	
	2010	2009	**2010**	2009
	€ 000	€ 000	**€ 000**	€ 000
Profit before income tax	**13,941**	12,927	**11,938**	11,610
Tax on profit at 35%	**4,879**	4,524	**4,178**	4,064
Tax effect of:				
Expenses non-deductible for tax purposes	**79**	93	**11**	8
Income taxed at different tax rates	**(63)**	(33)	**-**	(157)
Depreciation expense not deductible by way of capital allowances	**33**	32	**33**	32
Adjustment to prior years' current tax expense	**(37)**	224	**-**	182
Other differences	**10**	23	**-**	-
	4,901	4,863	**4,222**	4,129

33 **Income tax expense** *(continued)*

The tax effect, which is entirely attributable to deferred taxation, relating to components of other comprehensive income and accordingly presented directly in equity is as follows:

Group	**2010**			2009		
	Before tax	**Tax credit /(charge)**	**Net of tax**	Before tax	Tax credit /(charge)	Net of tax
	€ 000	**€ 000**	**€ 000**	€ 000	€ 000	€ 000
Fair valuation of available-for-sale financial assets:						
- Net changes in fair value	**423**	**(68)**	**355**	365	(72)	293
- Reclassification adjustments to profit or loss	**(2)**	**-**	**(2)**	45	(16)	29
Revaluation of property	**-**	**(245)**	**(245)**	-	-	-
	421	**(313)**	**108**	410	(88)	322

Bank						
Fair valuation of available-for-sale financial assets:						
- Net changes in fair value	**271**	**(69)**	**202**	206	(72)	134
- Reclassification adjustments to profit or loss	**(2)**	**-**	**(2)**	45	(16)	29
Revaluation of property	**-**	**(245)**	**(245)**	-	-	-
	269	**(314)**	**(45)**	251	(88)	163

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	
	2010	2009
Net profit attributable to equity holders of the Bank (€ 000)	**8,332**	7,377
Weighted average number of ordinary shares in issue	**35,935,176**	35,432,352
Earnings per share (€)	**23c2**	20c8

The increase in the weighted average number of ordinary shares in issue is attributable to the rights issue approved by the shareholders during the Annual General Meeting held on 22 April 2010.

35 Dividends

	2010	2009
Dividends declared and paid by the Bank (€ 000)	**2,315**	2,278
€ per share – gross	**0.10**	0.10

Subsequent to the end of the reporting period, a gross dividend of €0.115 per share (net dividend of €0.07475 for a total amount of €2,698,000), with a nominal amount of €0.25, for the twelve months ended 31 December 2010 is being proposed for approval by the shareholders. A resolution to that effect will be proposed to the Annual General Meeting of shareholders.

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**	
	2010 € 000	2009 € 000	**2010 € 000**	2009 € 000
Malta Government treasury bills (note 5)	**16,965**	25,905	**16,965**	25,905
Loans and advances to banks (notes 5 and 7)	**75,258**	40,480	**73,760**	36,557
Cash (note 5)	**3,441**	3,158	**2,901**	2,794
Amount owed to banks (note 19)	**(149)**	(117)	**(149)**	(117)
Cash and cash equivalents	**95,515**	69,426	**93,477**	65,139

37 Related parties

37.1 *Identity of related parties*

The Bank has a related party relationship with its subsidiaries, its major shareholder Marfin 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 with key management personnel, being the directors, and entities controlled by such individuals as highlighted below:

Year ended 31 December	**Loans and advances 2010 € 000**	**Commitments 2010 € 000**	Loans and advances 2009 € 000	Commitments 2009 € 000
At 1 January	**1,232**	**697**	786	10
Additions	**434**	**-**	694	687
Repayments	**(306)**	**-**	(248)	-
Drawn commitments	**-**	**(165)**	-	-
At 31 December	**1,360**	**532**	1,232	697

The above banking facilities are part of long-term commercial relationships and were made in the ordinary course of business and 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:

	2010 € 000	2009 € 000
Income statement		
Other income	**9**	12
Interest payable	**39**	72
Administrative expenses	**40**	33
Statement of financial position		
Loans and advances to customers	**281**	154
Amounts owed to customers	**2,389**	3,227
Other liabilities	**3**	46

Moreover, during the year, a subsidiary received gross dividends from its subsidiary company amounting to €1,169,000 (2009: €858,000).

37 **Related parties** *(continued)*

37.4.2 Major shareholder

Information with respect to transactions conducted by the Bank with its major shareholder during the year:

	2010	2009
	€ 000	€ 000
Income statement		
Interest receivable and similar income	**11**	14
Statement of financial position		
Loans and advances to banks	**-**	7,573
Accruals and deferred income	**41**	-

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, 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.

LOMBARD

ADDITIONAL REGULATORY DISCLOSURES

for the period 1 January 2010 to 31 December 2010

2010

1 **Risk management**

1.1 *Overview of risk disclosures*

The Additional Regulatory Disclosures seek to increase public disclosure relative to a Bank's capital structure and adequacy as well as its risk management policies and practices. These disclosures have been prepared for the Bank in accordance with the Pillar 3 quantitative and qualitative disclosure requirements as governed by Banking Rule 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 will be published by the Bank on an annual basis as part of the Annual Report. The Rule follows the disclosure requirements of the EU Directive 2006/48/EC; more specifically to the disclosure requirements of Chapter 5 of the Directive (Articles 145 to 149 – Disclosures by credit institutions) and Annex XII (Technical criteria on disclosure).

As per banking regulations, this report is not subject to an external audit, except to the extent that any disclosures are equivalent to those made in the Financial Statements which adhere to 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 Asset and Liability Committee (ALCO) and the Credit Committee that are responsible for developing and monitoring 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 shareholders by supporting the Bank in achieving its goals and objectives, and ultimately ensuring that the risks are commensurate with the rewards.

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 body. The Bank'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 global framework. This framework is based on local and international guidelines, such as the Basel II Accord and corresponding Directives of the European Union (Capital Requirements Directive), as well as on contemporary international banking practices. The Bank implemented and adopted the Basel II (Pillar I), the Capital Requirements Directive of the EU and the Malta Financial Services Authority (MFSA) Rules. The Bank has adopted the Standardised Approach with respect to the calculation of capital requirements and management of credit and market risk and the Basic Indicator Approach with respect to operational risk.

1 **Risk management** *(continued)*

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.

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 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 their performance.

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 Asset-Liability Committee, Credit Committee, Internal Audit Committee and, for the Bank's day to day operations, in an Executive Team comprising the Chief Executive Officer and Chief Officers. Through the Board Committees, the Board reviews the processes and procedures to ensure the effectiveness of the Bank's system of internal control.

The Asset-Liability Committee (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. The Chief Executive Officer is Chairman of ALCO and retains primary responsibility for 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 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 Committee is 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 Committee is assisted in these functions by the Internal Audit function.

1 **Risk management** *(continued)*

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 Committee. The internal audit function carries out both regular and ad-hoc reviews of risk management controls and procedures, as well as reporting their findings to the Audit Committee.

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.

1.4 *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 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 perception of the component in question.

In terms of MFSA Banking Rule 02: Large exposures of Credit Institutions authorised under the Banking Act, 1994, '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:

(a) 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;

(b) 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

(c) other on and off-balance sheet financial assets and commitments.

1 **Risk management** *(continued)*

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. 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 change that affect the country in which the loan is booked. 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 change 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 damage resulting from the lack of skilful management or good governance within the Bank and the inadequacy of proper control, which might involve internal operations, personnel, the system 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.

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 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, the 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.

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 pledged, 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, country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates are considered. The Bank has set limits of authority and has segregated duties so as to maintain impartiality and independence during the approval process and control new and existing credit facilities.

The Bank's maximum exposure to credit risk to on and off-balance sheet financial instruments, 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 balances with Central Bank of Malta, treasury bills, cheques in course of collection, available-for-sale financial assets, loans and advances and acceptances and endorsements. 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 exposures relating to on-balance sheet assets and off-balance sheet instruments, reflecting the maximum exposure to credit risk before collateral held or other credit enhancements, are as follows:

	2010 **€ 000**
Credit risk exposures relating to on-balance sheet assets	
Balances with Central Bank of Malta	38,680
Cheques in course of collection	750
Loans and advances to banks	43,477
Loans and advances to customers	334,012
Available-for-sale financial assets	10,210
Held-to-maturity financial assets	98,084
Other assets	13,515
	538,728
Credit risk exposures relating to off-balance sheet assets	
Contingent liabilities	7,067
Commitments	82,246
	89,313

The exposures set out in the table above are based on carrying amounts as reported in the statement of financial position. The table represents a worse case scenario of credit risk exposure to the Bank at 31 December 2010.

The company's cash is placed with quality financial institutions. Credit risk in respect of concentration of investments is not considered by the directors to be significant in view of the credit standing of the issuers.

Concentration risk arises as a result of the concentration of exposures within the same category, whether it is geographical locations, industry sector or counterparty type. These risks are managed through adherence to Board approved lending criteria.

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

The Group's loans and advances to customers which are categorised as 'Regular' are principally debts in respect of which there are no past due amounts and no recent history of customer default. Management does not expect any losses from non-performance by these customers.

As at 31 December 2010, no loans and advances to customers were deemed to be prohibited large exposures, prior to any eligible exemptions, in accordance with the requirements of the Banking Rule BR 02: Large Exposures of Credit Institutions authorised under the Banking Act, 1994. 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, these exposures are monitored and reported more frequently and rigorously. These customers are deemed by management to have positive credit standing, usually taking cognisance of the performance history without defaults.

2 **Credit risk** *(continued)*

2.2.1 Exposures analysed by location

The Bank monitors concentrations of credit risk by location. An analysis of concentrations of credit risk at the end of the reporting period is shown below.

At 31 December 2010	**Carrying amount**	**Malta**	**Eurozone**	**Other European countries**	**Other**
	€ 000	**€ 000**	**€ 000**	**€ 000**	**€ 000**
On-balance sheet assets					
Central Government or central banks	135,797	135,797	-	-	-
Institutions	45,839	21,831	13,785	7,385	2,838
Corporates	64,871	64,858	-	-	13
Retail	20,174	19,770	-	404	-
Secured by real estate property	169,506	169,506	-	-	-
Past due items	96,310	91,354	4,516	-	440
Other items	6,231	6,231	-	-	-
	538,728	509,347	18,301	7,789	3,291
Off-balance sheet assets					
Corporates	1,206	1,206	-	-	-
Retail	524	524	-	-	-
Secured by real estate property	7,054	7,054	-	-	-
Other items	80,529	80,529	-	-	-
	89,313	89,313	-	-	-

2.2.2 Exposures analysed by industry

The Bank ensures that it has a reasonable sectorial mix of loans, charging the higher risk industries with higher interest rates thereto. The following were industry concentrations relating to loans and advances to customers, gross of impairment allowances:

	2010
	€ 000
Transport, storage and communication	9,167
Financial services	1,770
Agriculture	2,373
Manufacturing	17,270
Construction	140,061
Hotel and restaurants, excluding related construction activities	7,824
Wholesale and retail trade	41,826
Community, recreational and personal service activities	10,818
Education	3,179
Health and social work	149
Mining and quarrying	709
Real estate, renting and business activities	72,283
Households and individuals	32,116
Gross amount granted to customers	339,545

2 **Credit risk** *(continued)*

The Bank holds debt instruments that are either issued by local government, local banks or other corporate entities. All such counterparties are listed on the Malta Stock Exchange, the only locally-based recognised investment exchange (RIE) in Malta, as regulated by MFSA.

Investment debt securities are analysed by industry as follows:

	2010
	€ 000
Corporate:	
Financial services	904
Real estate and construction	321
Tourism	800
Wholesale and retail trade	1,479
Others	311
Government	29,924
	33,739

2.2.3 Exposures analysed by residual maturity

The residual maturity breakdown of all exposure is presented in the following table:

At 31 December 2010	**Carrying amount**	**Less than 1 year**	**Over 1 but less than 5 years**	**Over 5 years**
	€ 000	**€ 000**	**€ 000**	**€ 000**
On-balance sheet assets				
Central Government or central banks	135,797	109,404	24,141	2,252
Institutions	45,839	44,936	803	100
Corporates	64,871	34,631	13,534	16,706
Retail	20,174	11,902	5,044	3,228
Secured by real estate property	169,506	100,009	42,376	27,121
Past due items	96,310	96,310	-	-
Other items	6,231	6,231	-	-
	538,728	403,423	85,898	49,407
Off-balance sheet assets				
Corporates	1,206	1,206	-	-
Retail	524	524	-	-
Secured by real estate property	7,054	7,054	-	-
Other items	80,529	80,529	-	-
	89,313	89,313	-	-

2 **Credit risk** *(continued)*

2.3 *Asset quality*

The credit quality of debt securities and treasury bills as determined by the rating agency (Fitch Ratings) is as follows:

At 31 December 2010

	Treasury bills	Debt securities	Total
	€ 000	€ 000	€ 000
A- to AA-	67,193	30,024	97,217
Lower than A-	-	804	804
Unrated	-	2,911	2,911
	67,193	33,739	100,932

Advances are graded in five categories:

- Regular
- Watch
- Substandard
- Doubtful
- Loss

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

	2010 € 000
Gross loans and advances	
Impaired	14,301
Past due but not impaired	171,490
Neither past due nor impaired	153,754
	339,545
Analysis of past due but not impaired	
Watch	53,976
Substandard	7,973
Doubtful but fully collateralised	109,541
	171,490
Analysis of neither past due nor impaired	
Regular	153,754

2.3.1 Impaired loans and advances

Impaired loans and advances are advances 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 and collective basis 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.

2 **Credit risk** *(continued)*

The Bank reviews and grades advances using the criteria laid down in the Banking Rule 09: Credit and Country Risk Provisioning of Credit Institutions authorised under the Banking Act, 1994. 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. This table analyses the impaired and the past due but not impaired loans by industry:

At 31 December 2010

	Impaired	**Past due but not impaired**
	€ 000	**€ 000**
Gross loans and advances by industry		
Construction	11,061	106,585
Manufacturing	551	5,196
Personal	835	17,848
Tourism	1,282	2,519
Trade	467	5,769
Professional	-	2,021
Other	105	31,552
	14,301	171,490

The majority of the impaired and past due but not impaired loans and advances are concentrated within Malta.

2.3.2 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. The past due ageing analysis is shown in the following table. Related credit losses which may arise are partly covered by collective impairment allowances.

	2010
	€ 000
Past due up to 30 days	51,643
Past due between 31 and 60 days	2,333
Past due between 61 and 90 days	7,973
Past due over 90 days	109,541
	171,490

2.3.3 Collateral

The Bank holds collateral against loans and advances to customers 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 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 most important instruments utilised to reduce risk are charges against real property and personal guarantees.

2 **Credit risk** *(continued)*

The following is an analysis of the fair value of collateral held as security and other credit enhancements. Based on expert valuations obtained on an ongoing basis. The amounts disclosed in the table represent the lower of the fair value of the collateral and the carrying amount of the respective secured loans.

At 31 December 2010

	Collateral against		
	Individually impaired	**Past due but not impaired**	**Neither past due nor impaired**
	€ 000	**€ 000**	**€ 000**
Immovable property	13,374	137,241	104,607
Cash or quasi cash	27	2,529	6,134
Personal guarantees	-	-	517
Prime bank guarantees	-	3,604	-
Other security	-	76	1,878
	13,401	143,450	113,136

2.3.4 Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Rescheduling is one of the management tools to adjust maturity structures of principal and interest payments to the new payment capacity of customers. A rigorous assessment is undertaken to ensure that restructuring is only allowed in the cases where the underlying fundamentals are sound. It is restricted to viable operations and only to customers which have the intention and ability to pay. Once the loan is restructured it remains in this category independent of satisfactory performance after restructuring. The total value of loans with renegotiated terms which would otherwise be past due or impaired as at 31 December 2010 amounted to €18,534,000.

2.3.5 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 loss allowances that relate to individually significant exposures, and a collective loss allowance established for groups of loans and advances in respect of losses that have not been identified and subjected to individual assessment for impairment.

Year ended 31 December 2010

	Specific impairment allowances	**Collective impairment allowances**	**Total**
	€ 000	**€ 000**	**€ 000**
At 1 January	4,169	1,859	6,028
Additions	636	-	636
Reversals	(714)	(417)	(1,131)
At 31 December	4,091	1,442	5,533

2 **Credit risk** *(continued)*

2.3.6 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.

2.3.7 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 institution's credit rating being within controlled parameters. The positions are checked against the limits on a daily basis and in real time.

2.3.8 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 exposure is predominantly in Malta. Other country risks are limited to bank balances and money market placements with a total carrying amount of €24,008,000.

3 **Market risk**

Market risk for the Bank consists of four 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;
- Investments price risk, which is the risk of losses because of changes in investments prices; and
- Credit spread risk, which is the risk of losses because of changes in credit spreads.

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 reprice 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 dates on assets and liabilities as much as it is practicable. However, the Bank seeks to manage its net interest spread, over considering the cost of capital by investing funds in a portfolio of securities and loans and receivables with a longer tenure than the liabilities (therefore carrying a negative maturity gap position) through the effective management of shorter term liabilities over the medium to longer term.

3 **Market risk** *(continued)*

Interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for re-pricing bands. ALCO is the monitoring body for compliance with these limits and is assisted by Treasury in its day-to-day monitoring 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.

3.1.1 Interest rate profile

At the end of the reporting period the interest rate profile of the Bank's interest bearing financial instruments is as follows:

At 31 December 2010

	Rate Instruments	
	Fixed	**Variable**
	€ 000	**€ 000**
Interest earning assets		
Balances with Central Bank of Malta and treasury bills	30,282	75,591
Debt and other fixed income instruments classified as:		
- available-for-sale investments	2,848	-
- held-to-maturity investments	30,891	-
Loans and advances to banks	39,287	-
Loans and advances to customers	1,562	330,804
	104,870	406,395
Interest bearing liabilities		
Amounts owed to banks	-	-
Amounts owed to customers	354,714	105,561
	354,714	105,561

3 **Market risk** *(continued)*

The table below summarises the Bank's exposure to interest rate risks. It includes the entity's financial instruments at carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

At 31 December 2010

	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	108,774	0.67	76,555	29,318	-	-	2,901
Debt and other fixed income instruments classified as:							
- available-for-sale investments	2,849	6.19	-	-	1,777	1,072	-
- held-to-maturity investments	30,891	6.53	3,532	-	24,862	2,497	-
Loans and advances to banks	43,477	0.40	39,287	-	-	-	4,190
Loans and advances to customers	334,012	6.85	332,365	-	-	-	1,647
	520,003		451,739	29,318	26,639	3,569	8,738
Financial liabilities							
Amounts owed to banks	149	-	-	-	-	-	149
Amounts owed to customers	475,085	2.14	225,391	108,251	87,801	38,833	14,809
	475,234		225,391	108,251	87,801	38,833	14,958
Maturity gap			226,348	(78,933)	(61,162)	(35,264)	(6,220)
Cumulative gap			226,348	147,415	86,253	50,989	

3 **Market risk** *(continued)*

3.1.2 Fair value sensitivity analysis for fixed rate instruments

The Bank does not account for any fixed rate financial assets and liabilities at fair value through profit or loss, and the Bank does not designate derivatives as hedging instruments under a hedge accounting model. Therefore a change in interest rates at the end of the reporting period would not affect the profit or loss. Considering the nature and the carrying amount of the investments, a sensitivity analysis disclosing how equity would have been effected by changes in interest rates that were reasonably possible at the end of the reporting period is not deemed necessary.

3.1.3 Cash flow sensitivity analysis for variable rate instruments

At the end of the reporting period, 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, in particular foreign currency rates, the pre-tax result for the year would change by:

	(+) 100bp	**(-) 100bp**
	€ 000	**€ 000**
At 31 December 2010	3,008	(3,008)

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 using various techniques. In the majority of cases, the Bank covers this risk by ensuring that its foreign currency denominated liabilities are matched with corresponding assets in the same currency.

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. The Bank also takes a deposit margin of the nominal value from the customer thereby reducing its credit risk should the client default. The fair value of the open foreign currency forward contract at reporting date with a notional amount of €316,000 was not material.

3 **Market risk** *(continued)*

The following table summarises the Bank's currency position:

At 31 December 2010

	Total	EUR	GBP	USD	Other
	€ 000	**€ 000**	**€ 000**	**€ 000**	**€ 000**
Assets					
Balances with Central Bank of Malta, treasury bills and cash	108,774	101,101	65	7,568	40
Investments:					
- held-to-maturity	30,891	30,891	-	-	-
- available-for-sale	10,210	9,576	-	634	-
Loans and advances to banks	43,477	3,954	13,500	19,886	6,137
Loans and advances to customers	334,012	326,752	24	7,236	-
Other assets	29,177	29,155	6	16	-
Total assets	556,541	501,429	13,595	35,340	6,177
Liabilities					
Amounts owed to banks	149	149	-	-	-
Amounts owed to customers	475,085	421,172	13,413	34,411	6,089
Other liabilities	10,847	9,892	177	740	38
Total liabilities	486,081	431,213	13,590	35,151	6,127
Total equity	70,460	70,460	-	-	-
Total liabilities and equity	556,541	501,673	13,590	35,151	6,127
Net on-balance sheet currency position		(244)	5	189	50
Net notional position of derivative financial instrument		316	-	(316)	-
Net currency position		72	5	(127)	50
Contingent liabilities and commitments	89,313	88,575	17	721	-

The Bank maintains its exposure to foreign currencies within prescribed limits set by the Bank's ALCO. The Bank's currency risk is not significant in view of the limited foreign currency exposure at the end of the reporting period.

3.3 *Investment price risk*

The exposure of the Bank to this risk is not significant given the low equity holding by the Bank. Such holdings are limited to local well known corporate issuers. Frequent management reviews are carried out to ensure high quality of the portfolio.

3 **Market risk** *(continued)*

3.4 *Credit spread risk*

Credit spread is the difference in yield between different securities due to different credit quality. The credit spread reflects the additional net yield an investor can earn from a security with more credit risk relative to one with less credit risk. The Bank maintains a high proportion of its investments in government securities. Most of the remaining investments are liquid securities quoted on the Malta Stock Exchange which are regularly monitored by management.

	2010
	%
Investments:	
- issued by local government	73
- issued by corporate	27
	100
Debt and other fixed income instruments:	
- issued by local government	89
- issued by corporate	11
	100

4 **Liquidity risk**

Liquidity risk is defined as the risk of losses due to:
- the Bank's funding costs increasing disproportionately;
- lack of funding prevents the Bank from establishing new business; and
- lack of funding will ultimately prevent 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 draw-downs 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 sought 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). The Bank holds significant liquid assets in the form of treasury bills and money market placements as part of its liquidity risk management strategy. 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. Unmatched positions potentially enhance profitability, but also increase the risk of losses. ALCO monitors the Bank's Liquidity Gap analysis on a monthly basis. In addition, ALCO maintains an ongoing oversight of forecast and actual cash flows, by monitoring the availability of funds to meet commitments associated with financial instruments.

4 Liquidity risk *(continued)*

The following table analyses the Bank'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.

At 31 December 2010

	Less than 3 months	Between 3 months and 1 year	Between 1 year and 5 years	More than 5 years	No maturity date	Total
	€ 000	**€ 000**	**€ 000**	**€ 000**	**€ 000**	**€ 000**
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	76,554	29,319	-	-	2,901	108,774
Available-for-sale investments	-	-	1,777	1,071	7,362	10,210
Held-to-maturity investments	3,531	-	24,862	2,498	-	30,891
Loans and advances to banks	43,478	-	-	-	-	43,478
Loans and advances to customers	65,450	45,488	93,591	129,483	-	334,012
Other assets	3,185	3,351	-	-	529	7,065
	192,198	78,158	120,230	133,052	10,792	534,430
Financial liabilities						
Amounts owed to banks	149	-	-	-	-	149
Amounts owed to customers	240,201	108,251	87,801	38,832	-	475,085
Other liabilities	5,655	1,193	942	417	2,640	10,847
	246,005	109,444	88,743	39,249	2,640	486,081

As at 31 December 2010, the Bank had outstanding guarantees on behalf of third parties amounting to €7,067,000, which are cancellable upon the request of third parties.

The following table analyses 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.

At 31 December 2010

	Less than 3 months	Between 3 months and 1 year	Between 1 year and 5 years	More than 5 years	Total
	€ 000	**€ 000**	**€ 000**	**€ 000**	**€ 000**
Financial liabilities					
Amounts owed to banks	149	-	-	-	149
Amounts owed to customers	241,392	110,304	97,771	51,658	501,125
	241,541	110,304	97,771	51,658	501,274

5 Operational risk

Operational risk is the risk of direct or indirect losses arising from a variety of causes associated with the Bank's processes such as:
- 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
- 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 overseen by the Risk Management Department.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity while maintaining risk taking within a tolerable limit.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. Operations risks are measured by both quantitative and qualitative methods consisting of both ex-post and ex-ante consideration of events and risks, coupled with an early warning system.

A financial measurement of this risk is arrived at by the Bank for the purpose of allocating risk capital using the Basic Indicator Approach under the CRD rules. The capital requirement for operational risk under this method was calculated at €2,591,000.

6 Capital management

The Bank is a licensed financial services provider and must therefore comply with the capital requirements under the relevant capital requirements laws and regulations. Maltese law and regulations on capital adequacy are based on EU capital requirements directives.

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 management** *(continued)*

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 European Union Directive on Capital Requirements ('CRD'). The Standardised Approach, to calculate the capital requirement, was formally adopted by the Bank on 1 April 2007. 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 whilst Pillar III deals with market discipline and sets forth disclosure requirements for risk and capital management.

6.1 *Own funds*

Own funds represents 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, usually 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 2010, the Bank complied with all of the externally imposed capital requirements to which it was subject.

The sum of the capital requirement calculated under Pillar I and the additional requirement identified under Pillar II represents the total capital required under the CRD. The following is the Bank's Capital Base in accordance with CRD rules. The Bank's capital base is divided into two categories, as defined in Banking Rule 03: Own Funds of Credit Institutions authorised under the Banking Act, 1994, being Original own funds and Additional own funds.

	2010
	€ 000
Original own funds – Tier 1	
Share capital (note a)	9,023
Share premium (note b)	17,746
Retained earnings (note c)	38,891
Less: Intangible assets	(3)
Less: Unrealised net losses on available-for-sale investments	(105)
Total original own funds	65,552
Additional own funds – Tier 2	
Property revaluation reserve (note d)	1,833
Investment revaluation reserve (note e)	424
Collective impairment allowances	1,442
Total own funds	69,251

6 **Capital management** *(continued)*

(a) Share capital

The Bank's share capital as at 31 December is analysed as follows:

	2010	
	No. of shares 000s	€ 000
Authorised		
Ordinary shares of 25 cents each	80,000	20,000
Issued		
Ordinary shares of 25 cents each	36,093	9,023

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.

(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.

(c) Retained earnings

The share premium represents the premium on the rights issue approved by the shareholders during the Annual General Meetings.

(d) 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.

(e) 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.

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.

6 **Capital management** *(continued)*

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, but 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 minimum capital requirements are calculated for the credit, market and operational risk. During the year, the Bank continued to use the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk in order to calculate the Pillar 1 minimum capital requirements. For credit risk, under the Standardised Approach, risk weights are determined according to credit ratings provided by Fitch or by using the applicable regulatory risk weights for unrated exposures. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15 per cent of the average gross income of the preceding three years.

The capital ratio is calculated using the definition of regulatory capital and risk-weighted assets. In terms of the current MFSA Banking Rule 04: Capital Requirements of Credit Institutions authorised under the Banking Act, 1994, the minimum level of the Capital Requirements Ratio stands at 8 per cent. The Capital Requirements Ratio expresses own funds as a proportion of risk-weighted assets and off-balance sheet items, 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 per cent) and adding the resulting figures to the sum of risk-weighted assets for credit risk.

6 **Capital management** *(continued)*

Below is the Bank's capital requirements and capital adequacy ratio computation.

At 31 December 2010

	Exposure value	Average amount	Weighted amount	Capital Requirement amount
	€ 000	€ 000	€ 000	€ 000
On-balance sheet assets by exposure classes				
Government or central banks	135,797	135,099	-	-
Institutions	45,839	47,147	10,285	823
Corporates	64,871	60,830	64,871	5,190
Retail	20,174	22,114	15,131	1,210
Secured by real estate property	169,506	170,788	147,134	11,771
Past due items	96,310	83,129	86,765	6,941
Other items	24,044	24,013	18,165	1,453
	556,541	543,120	342,351	27,388
Off-balance sheet assets by exposure classes				
Corporates	1,206	1,174	1,206	96
Retail	524	600	393	31
Secured by real estate property	7,054	7,295	6,466	517
Other items	80,529	81,504	3,537	284
Credit risk			353,953	28,316
Foreign exchange risk			921	73
Operational risk			32,385	2,591
Total			387,259	30,980
Own funds				
Original own funds				65,552
Additional own funds				3,699
Gross own funds				69,251
Deductions				-
Total own funds				69,251
Capital Adequacy Ratio				17.9%

6 **Capital management** *(continued)*

6.2 *Internal Capital Adequacy Assessment Process (ICAAP)*

The Bank considers the Internal Capital Adequacy Assessment Process (ICAAP) embedded in Pillar II as a tool that will ensure a proper measurement of material risks and capital and will allow better capital management and an improvement in risk management. Therefore it will facilitate 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 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.

The Board and senior management take overall responsibility of the conceptual design and technical details of the ICAAP capital document. Apart from the responsibility of the conceptual design, the Board discussed, approved, endorsed and delivered the yearly ICAAP submission.

The ICAAP is a revolving management circuit which starts with defining risk strategy, identifying, quantifying and aggregating risks, determining risk-bearing ability, allocating capital, establishing limits and lead to ongoing risk monitoring. The individual elements of the circuit are performed with varying regularity. All the activities described in the circuit 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 involved 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 used 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 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 plan and the associated risks.

The Bank 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.

6 **Capital management** *(continued)*

6.3 *Basel III*

The planned regulations under Basel III will require banks to hold significant liquidity reserves that, as the rules are rolled out globally, may lead to local regulators requiring significant pools of liquidity to be held in their respective territories. These could disrupt the funding arrangements operated by a bank and lead to trapped pools of liquidity in the major territories in which a given bank operates. Linked to these quantitative requirements, banks will be required to significantly improve their funding and liquidity management framework – measuring, monitoring and managing liquidity more proactively.

The Bank is already considering the estimated impact of the Basel III on capital adequacy. Management envisage that the Bank will be in excess of the new minimum capital requirements and is expected to be able to meet the additional capital conservation and counter-cyclical buffers without having to resort to any capital raising or dividend constraint measures in the short-term.

Five Year Summary
Statements of Financial Position

Group

	31/12/2010	31/12/2009	31/12/2008	31/12/2007	31/12/2006
	€ 000	€ 000	€ 000	€ 000	€ 000
Assets					
Balances with Central Bank of Malta, treasury bills and cash	**109,314**	116,357	68,576	75,181	102,956
Cheques in course of collection	**750**	811	2,748	2,229	1,379
Derivative financial instruments	**-**	-	-	-	5
Investments	**46,332**	45,025	51,627	54,894	54,677
Loans and advances to banks	**44,975**	22,383	49,214	88,975	95,984
Loans and advances to customers	**333,731**	327,802	325,025	260,284	210,142
Investment in equity accounted investee	**-**	-	-	-	2,662
Intangible assets	**1,295**	1,238	1,302	1,400	-
Property, plant and equipment	**14,740**	13,878	13,009	10,352	7,063
Investment property	**745**	745	745	745	352
Assets classified as held for sale	**109**	109	-	-	247
Current tax assets	**2,683**	1,171	234	-	-
Deferred tax assets	**1,585**	1,993	1,973	2,055	927
Inventories	**714**	671	821	804	107
Trade and other receivables	**7,503**	6,545	4,438	3,937	5
Accrued income and other assets	**3,324**	4,113	5,022	3,606	2,926
Total assets	**567,800**	542,841	524,734	504,462	479,432
Equity and liabilities					
Equity					
Share capital	**9,023**	8,903	8,762	5,024	4,969
Share premium	**17,746**	16,409	15,137	13,590	12,495
Property revaluation reserve	**2,043**	2,288	2,288	2,288	2,287
Investment revaluation reserve	**566**	290	23	587	620
Other reserves	**2,397**	-	-	-	-
Retained earnings	**39,932**	36,395	31,518	29,550	24,093
Equity attributable to equity holders of the Bank	**71,707**	64,285	57,728	51,039	44,464
Non-controlling interests	**4,336**	3,917	3,401	3,460	68
Total equity	**76,043**	68,202	61,129	54,499	44,532
Liabilities					
Amounts owed to banks	**149**	3,675	130	736	508
Amounts owed to customers	**472,697**	446,209	439,860	418,206	420,680
Current tax liabilities	**-**	-	-	1,640	1,139
Provision for liabilities and other charges	**2,652**	2,520	2,413	2,262	554
Other liabilities	**7,907**	12,586	12,416	20,431	7,999
Accruals and deferred income	**8,352**	9,649	8,786	6,688	4,020
Total liabilities	**491,757**	474,639	463,605	449,963	434,900
Total equity and liabilities	**567,800**	542,841	524,734	504,462	479,432
Memorandum items					
Contingent liabilities	**7,067**	10,484	6,624	6,508	7,522
Commitments	**82,246**	98,611	79,948	60,592	80,496

Five Year Summary
Income Statements

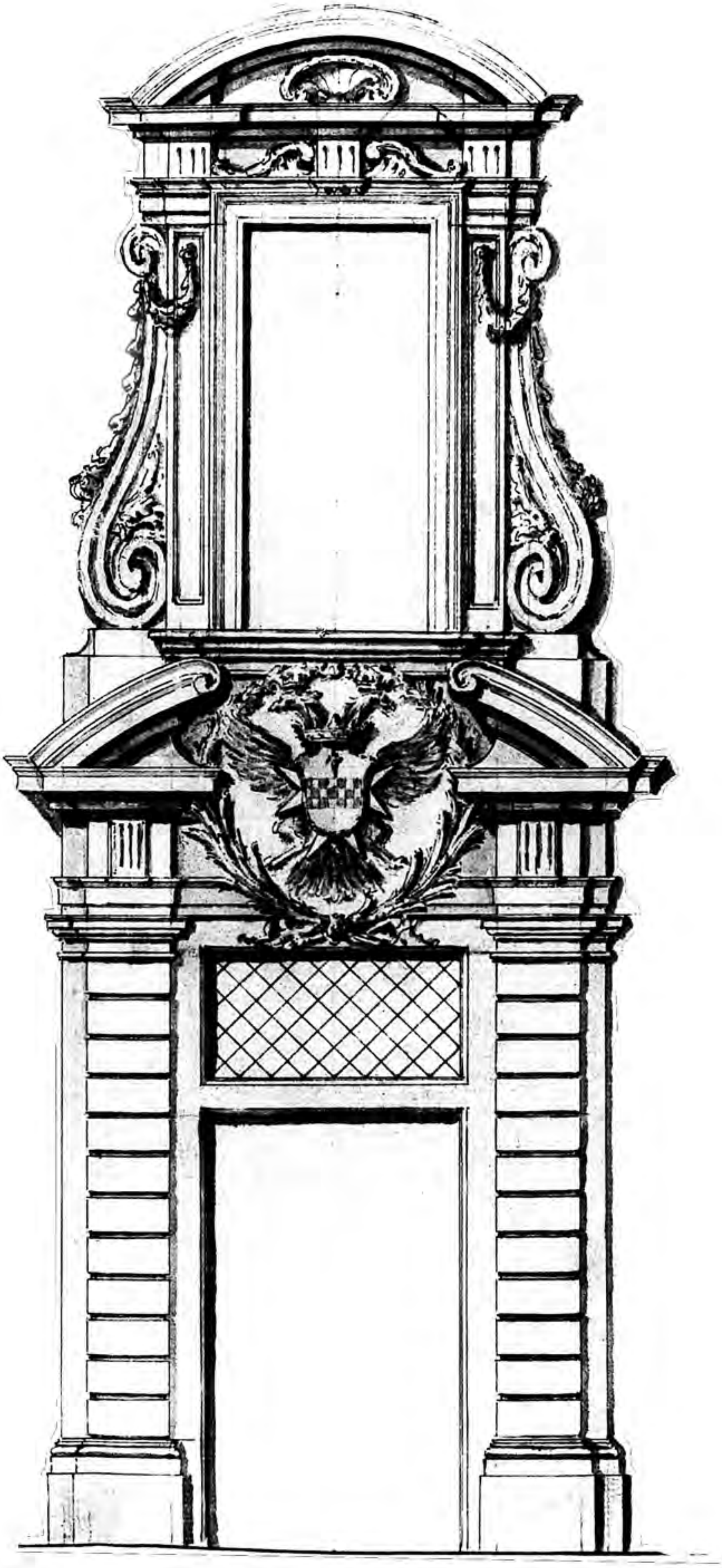
Group

	01/01/2010 to 31/12/2010	01/01/2009 to 31/12/2009	01/01/2008 to 31/12/2008	01/01/2007 to 31/12/2007	01/01/2006 to 31/12/2006
	€ 000	€ 000	€ 000	€ 000	€ 000
Interest receivable and similar income	**26,353**	28,150	29,061	29,404	23,373
Interest expense	**(10,287)**	(13,560)	(14,493)	(13,871)	(11,111)
Net interest income	**16,066**	14,590	14,568	15,533	12,262
Other operating income	**22,840**	21,971	22,359	3,699	2,075
Other operating charges	**(24,779)**	(23,759)	(24,174)	(7,099)	(5,057)
Net impairment (losses)/gains	**(186)**	125	1,387	(1,863)	(284)
Shares of profit of equity accounted investee (net of tax)	**-**	-	-	366	12
Profit before taxation	**13,941**	12,927	14,140	10,636	9,008
Income tax expense	**(4,901)**	(4,863)	(5,057)	(3,552)	(3,173)
Profit for the year	**9,040**	8,064	9,083	7,084	5,835
Attributable to:					
Equity holders of the Bank	**8,332**	7,377	8,402	7,065	5,833
Non-controlling interests	**708**	687	681	19	2
	9,040	8,064	9,083	7,084	5,835

Five Year Summary
Statements of Cash Flows

Group

	01/01/2010 to 31/12/2010	01/01/2009 to 31/12/2009	01/01/2008 to 31/12/2008	01/01/2007 to 31/12/2007	01/01/2006 to 31/12/2006
	€ 000	€ 000	€ 000	€ 000	€ 000
Net cash from/(used in) operating activities	**23,431**	(4,024)	(73,009)	(46,667)	19,208
Cash flows from investing activities					
Dividends received	**157**	122	65	93	51
Interest received from investments	**3,074**	4,867	4,683	4,461	4,815
Proceeds on maturity/disposal of investments	**5,954**	8,632	4,238	4,635	4,256
Purchase of investments	**(3,642)**	(1,779)	(1,673)	(1,479)	(4,193)
Investment in equity accounted investee	**-**	-	-	-	(2,651)
Purchase of property, plant and equipment	**(1,681)**	(1,892)	(3,554)	(943)	(196)
Acquisition of interest in subsidiary (net of cash acquired)	**-**	-	-	2,632	-
Acquisition of non-controlling interests	**(133)**	(156)	(916)	-	-
Net cash flows from investing activities	**3,729**	9,794	2,843	9,399	2,082
Cash flows from financing activities					
Dividends paid to equity holders of the Bank	**(858)**	(865)	(564)	(464)	(89)
Dividends paid to non-controlling interests	**(213)**	(249)	(559)	-	-
Cash used in financing activities	**(1,071)**	(1,114)	(1,123)	(464)	(89)



Portal of Spinola Palace, Valletta designed by Romano Carapecchia (1666-1738)
(Sources: The Courtauld Gallery - London & Denis De Lucca -
Carapecchia: Master of Baroque Architecture in Early Eighteenth Century Malta, Malta, 1999)

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