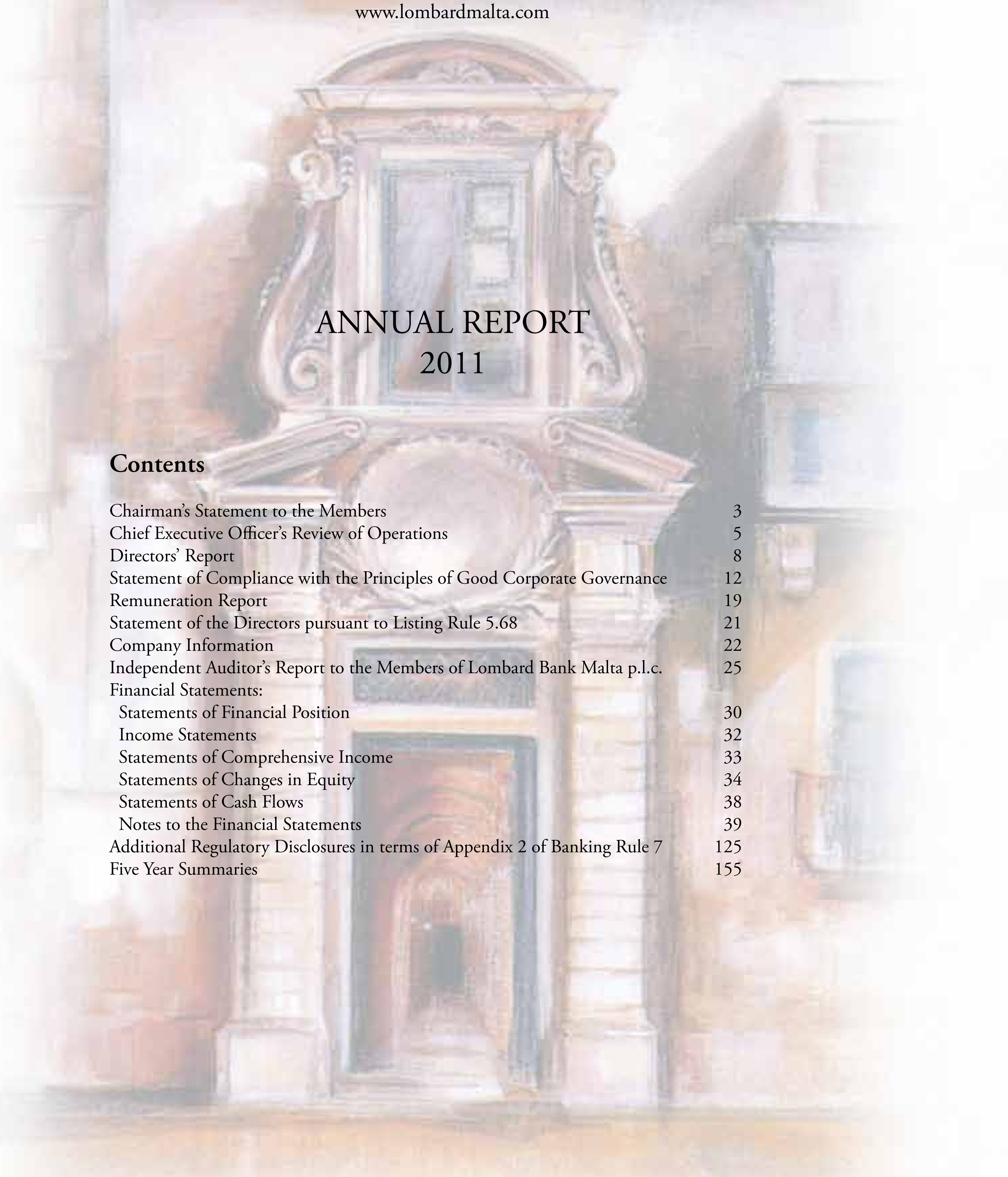
LOMBARD

Lombard Bank Malta p.l.c.

2011

ANNUAL REPORT



LOMBARD

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ANNUAL REPORT 2011

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Chairman's Statement to the Members

The year 2011 will be remembered for some time as the one of the European debt crisis which brought with it a high degree of uncertainty for many nations, the world economy and all market participants. Your Bank entered this extremely challenging year with very sound fundamentals even though it nevertheless had to pay some tribute to the resulting subdued business sentiment and to reduced interest margins.

In 2011 the Group, principally consisting of Lombard Bank Malta p.l.c. (the "Bank") and MaltaPost p.l.c. registered a consolidated profit of €7.2 million representing a decline of 20 per cent over the financial year 2010. The net profit of the Bank declined by 22 per cent to €6 million and MaltaPost p.l.c. registered a net profit of €1.9 million compared to €2.1 million in the year before.

The two main factors for the profit decline in 2011 were the following:

a. Interest margin was reduced by 12 per cent to €14.2 million on Group level. This was caused by continued competitive pressure on lending rates and the Bank's decision to reduce its investment portfolio. This decision was taken on the basis of the market sentiment as a result of the Eurozone problems.
b. Since the Eurozone crisis could well result in a renewed recession, the Bank considered it prudent and logical to increase its Specific Impairment Allowances by €1.8 million. Additionally Collective Impairment Allowances were increased further by €479,000.

For many years the Bank has pursued the policy of prudence in all aspects of its business strategy – namely:

a. A solid capital base. The Bank's Shareholders' funds as at the end of 2011 stood at €73.3 million. Capital Adequacy ratio now stands at 20 per cent compared to a required minimum of 8 per cent and this at a time when many banks in Europe struggle to improve the Capital ratio in a hostile environment. This strong capital base gives us the opportunity to grow our business further without having to ask our shareholders to make available fresh capital. At the same time it signals its robust foundations.
b. A prudent Loan to Deposit ratio. In 2011 this stood at 67 per cent. While this high level of liquidity contributed significantly to the reduced interest margin it has enabled the Bank to finance its entire lending through customer deposits.
c. A cautious approach to its treasury operations. Even before the eruption of the Eurozone debt crisis we had followed the principle of employing excess funds only with first class counterparties and on a short-term basis. In the eyes of many this might not have been the most profitable way. Our responsibility to our shareholders and to our depositors has stopped us to follow an aggressive approach. And as a result we are pleased that we have no exposure whatsoever to countries which are affected by the sovereign debt crisis.

Considering the challenging market conditions the Board and Management of the Bank feel that earnings per share of 18.3 cents and a post tax Return on Equity of 9.3 per cent indicate an overall positive performance. The Board is therefore recommending a Gross Dividend of €0.115 per share – the same as for 2010 when the dividend had been increased by 15 per cent. Your Board does not recommend the option of a scrip dividend as the Bank has very adequate shareholders' funds at its disposal.

A year ago we had expressed some optimism in respect of the Euro at a time when a number of politicians and economists had predicted its demise. We believe that the situation of the Euro has since improved considerably and it could well come out of this crisis stronger than before. It has to be remembered that this is not a Euro crisis but a European sovereign debt crisis. Since inception of the Euro the Eurozone has experienced lower inflation rates than the Deutschmark before and the exchange rate of the Euro against the US Dollar has strengthened since its introduction ten years ago. The crisis we still face came about by the overspending of a number of countries highlighting the fact that the original Maastricht treaty had certain shortcomings. These are now gradually being rectified by the introduction of drastic austerity programs and, perhaps more importantly,

Chairman's Statement to the Members

by the "Fiscal Compact" which will ensure that most EU member states follow financial discipline. Over time this should bring back international confidence in the Eurozone. Realistically speaking, it may take years before the Eurozone sovereign debt crisis is over and the austerity measures will be painful not just for the countries concerned but could well affect the world economy. It is precisely for this reason that we believe in exercising prudence in our business approach.

We feel well equipped to cope with the present challenges and to participate in an improvement of overall conditions as and when these come about.

One of our main strengths is that we are an independent bank with a very strong Maltese identity. Our policy and business strategy are fully geared to our Maltese customer base. We believe that our understanding of local market conditions is unparalleled. We are fully aware that our staff is the backbone of this strength and on behalf of the Board I take this opportunity to thank them and the Bank's Chief Executive Officer, Joseph Said, and his management team for their hard work and for having coped well with the present particularly challenging conditions.

Last but not least my thanks also go to you, the Bank's shareholders, for your continued support and your continued interest in the Bank's business and, of course, to all our customers for the business they entrust us with and their loyalty.

Christian Lemmerich
Chairman

Chief Executive Officer's Review of Operations

The 2011 consolidated financial performance for the Lombard Bank Group combines the results of Lombard Bank Malta p.l.c. and Redbox Limited (the company holding the Bank's shares in MaltaPost p.l.c.).

This was a financial year characterised by widespread economic uncertainty, increasing customer expectations and intense competition in our sector. European economic recovery remained elusive and the Bank continued to approach new business with caution and a view to establish sound long-term relationships. Despite a decrease in year-on-year profitability, the Bank still returned a good performance while our more important achievement has been that of maintaining strong balance sheet fundamentals.

MaltaPost p.l.c. the main subsidiary of the Bank remained the leading postal operator in Malta and provided opportunities to continue to exploit synergies within the Group. MaltaPost p.l.c. closed its financial year in September 2011 and reported encouraging results despite regulatory pricing constraints in its main lines of operation.

Review of Financial Performance

Group Profit Before Taxation for FYE 2011 was €11.3 million - a decrease of 19% from the figure for the previous year. Net Interest Income was down by 12% to €14.2 million as a result of intense market competition on interest rates combined with rationalisation of our advances portfolio. Customer deposits were managed so as to maintain a healthy level of liquidity commensurate with business requirements. Notwithstanding, fluctuations of customer deposit balances during the year resulted in a higher interest charge than in the previous year. In the postal sector the upward trend in international mail, especially that associated with e-commerce, continued to substitute traditional mail volumes. Consequently, postal sales and similar revenue increased by 3% to reach €20.4 million. The increase in Group costs of €933,000 was within the parameters established at the start of the year, with expenses not materially different from those of the previous year. Group Cost-to-Income ratio stood at 65% (2010: 63%) while that of the Bank was 38% (2010: 36%).

Early during 2011, the Bank took a view, based on financial market sentiment at the time, and decided to divest itself of certain investment portfolio assets. MaltaPost p.l.c. also liquidated some of its financial investments, with proceeds being invested in long-term fixed assets.

Loans and advances to customers contracted by 7% to €310.4 million. This reflects subdued sentiment especially in the property development and construction sector, as well as continuation of implementation of a policy aimed at maintaining a high quality customer advances portfolio. Specific Impairment Allowances increased by €1.8 million so as to provide a suitably prudent hedge against potential shortfalls in valuations of underlying collateral. Moreover, an additional €479,000 from this year's profits was put aside to the Collective Impairment Allowances increasing this to €1.9 million. As at year-end our Loan to Deposit ratio stood at a prudent 67%. This was the result of our careful decision given the prevailing uncertain climate.

Though our efforts to increase short-term deposits were kept to a minimum in view of our very adequate liquidity levels, rates of interest offered to customers during the year remained very competitive. Customer deposits were allowed to shrink by 2% to €462.3 million. Term deposits remained important to the Bank's strategy of maintaining long-term relationships with customers as well as a stable deposit base, even though this resulted in a higher interest expense.

Group Earnings per Share (EPS) for 2011 stood at 18.3 cents, a decrease of 4.9 cents over 2010. While the Group's post tax Return on Equity (ROE) was 9.3%. Return on Assets (ROA) at 1.3% was lower than the 1.6% level of the previous year. Net Asset Value (NAV) per share at year-end rose to €2.07.

Chief Executive Officer's Review of Operations

Liquidity and Own Funds

Group Equity Attributable to Shareholders increased by €3.2 million (4%) to €74.9 million. Resulting Own Funds also increased to €71.9 million (2010: €69.3 million) thus providing increased capability to take-on new, sensible business opportunities. Capital Adequacy Ratio stood at 20% (2010: 18%).

The Bank held eligible liquid assets at 83% of short-term liabilities in terms of Banking Rule 5 and thus well over the statutory minimum of 30%.

Treasury and Finance

During the course of 2011 the European Central Bank raised interest rates to 1.5%, only to then lower them again to 1%. This highlights the financial market tensions surrounding the euro sovereign debt crisis that dampened economic activity in the euro area. During 2011 the outlook remained subjected to a high degree of uncertainty and substantial downside risks. This situation is predicted to continue well into 2012 and possibly beyond. As indicated earlier, the Bank realigned its investment portfolios to its reduced risk appetite that was based on financial market developments and forecasts. Money-market deposits placed with selected high-grade counterparty banks remained predominantly on short-term basis with particular care to regional selection. Bank policy places emphasis on capital security as being the main priority in all transactions, and this principle has been adhered to throughout. Malta Government Treasury paper and inter-bank deposits were our preferred Treasury short-term instruments. Close management of the interest spread remained a priority.

Risk Management

The Bank addressed all key elements of capital planning in its Internal Capital Adequacy Assessment Process (ICAAP) review and in line with 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. The Risk Management function continued to develop and implement processes and procedures for the monitoring and assessment of risks inherent in operations and commensurate to the nature, scale and complexity of the Bank's business. The financial position of the Bank remained strong and with enough liquidity and capital buffer to be able to comfortably implement determined strategy even under challenging and uncertain market conditions. There was 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.

The Bank managed to identify risks associated with the European financial crises early on and chose to be selective in its counterparty and regional exposures. As at the end of the reporting period, the Bank did not hold any exposure to any form of non-Maltese sovereign or corporate securities.

Human Resources

Strategies and plans intended to reward and encourage excellent performance and initiatives were developed during the year. These should, in turn, strengthen the basis for attracting and retaining high quality staff members as well as ensuring fair and equitable interaction with staff through effective management practices. Communication and consultation remained the hallmark in the development and implementation of our human resources policy. Management continued to place value in activities that foster positive employee morale and motivation. In-house training was supplemented with local and overseas external training so to ensure that the personal and professional development of staff reached the required standards. At the year-end, staff complement of the Bank and Group was 156 and 758 respectively.

Chief Executive Officer's Review of Operations

Projects

Following upon the successful upgrading of credit card services system that provided customers with an increased range of products and improved service reliability, the Bank then launched its Internet Banking service. This provided customers with state of the art functionality deploying a user-friendly platform, at the same time providing ultimate security. Computer hardware and networking systems were upgraded throughout the Group to take advantage of the latest technological innovations.

Restoration and alteration works to the Bank's new flagship premises at Tower Road Sliema were at an advanced stage and planned to be finalised by Q3 of 2012. At the same time, substantial refurbishment works continued in various outlets and offices of the Group so as to enhance space utilisation for the benefit of both customers and staff.

A significant achievement during 2011 was the acquisition of the MaltaPost Head Office building in Marsa. Structural accretions to this building were completed within 2011 thus providing spacious working facilities to postal operations with improved possibilities for future business expansion. MaltaPost p.l.c. also invested in the acquisition of a central property in Valletta intended to house Malta's first postal museum, set to be a testimony to the Island's rich postal history.

MaltaPost p.l.c. embarked on a new branding strategy with a new logo that signified a return to its traditional former colours. The public received this very well.

Community Involvement

The anti-smoking project for Maltese schools remained the Group's characteristic initiative for the fifth consecutive year. This project is endorsed by the Directorate for Educational Services and supported by the Malta Cancer Foundation. Presentations were made during the 2011 scholastic year in schools throughout Malta and Gozo. Financial contributions were also made to projects and causes considered to be of practical benefit to the community such as the VolServ initiative.

Outlook

This year's performance may not have matched that of recent years - but then it must also be said that rarely before has the financial world been through such turmoil. For us, this result is merely a "*pause in the growth of our profits*" - until such time that the storm abates. We cannot but be satisfied that the Group has remained on a stable path despite the unprecedented economic and financial crisis besieging the euro-zone.

We firmly believe that our resilience shall serve us in good stead to grasp those opportunities that are bound to arise in the coming year(s). That having been said, we shall always and only assess proposals on their individual merits and shall not allow ourselves to be lured by the attraction of short-term profits. Lombard Bank Malta p.l.c. shall continue to embrace its policy of preferring to protect its capital rather than seek or chase unrealistically high yields.

By responding to the challenges of increased competition and improving its position in the market, the Bank has sought to place emphasis on customer needs and preferences. We strive for to be one's "*All Weather Friend*" and with our shareholders, customers and staff the Group is set to grow further in the coming years.

Joseph Said
Chief Executive Officer

Directors' Report

For the Year Ended 31 December 2011

The Group

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

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 Depositor Compensation 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.

Redbox Limited was registered in 2006 and is fully owned by the Bank. Redbox Limited did not undertake any other business during 2011. Redbox Limited owns 67.1 per cent of the ordinary share capital of MaltaPost p.l.c.; the remaining 32.9 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 2011

Profit after taxation of €7.23 million and €6.01 million for the Group and the Bank respectively, were registered for the twelve months ended 31 December 2011.

A gross dividend of €0.115 per nominal €0.25 share for the twelve months ended 31 December 2011 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 28 April 2011, the Authorised Share Capital of the Company 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 Company is Euro nine million, twenty three thousand, one hundred and seventy three (€9,023,173) divided into thirty six million, ninety two thousand, six hundred and ninety two (36,092,692) Ordinary Shares of a nominal value of €0.25 each, all of one class.

Equity attributable to shareholders as at 31 December 2011 stood at €74.89 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 2011 are included in the Annual Report 2011 which is being published in printed form and made available on the 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, 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; and
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; and
f. any material contracts to which the Bank or any one of its subsidiaries is a party and in which a director of the Bank is or was directly or indirectly interested.

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

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

	at 31 December 2011	at 14 March 2012
Marfin Popular Bank Public Co Limited	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 as follows:

	Shares in Lombard Bank Malta p.l.c.	
	at 31 December 2011	at 14 March 2012
Safaco Limited	34,377	34,377
First Gemini p.l.c.	1,910,126	1,910,126

	Shares in MaltaPost p.l.c.	
	at 31 December 2011	at 14 March 2012
Safaco Limited	36,286	37,767
First Gemini p.l.c.	29,471	30,674

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

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

Approved by the Board of Directors on 15 March 2012 and signed on its behalf by:

Christian Lemmerich
Chairman

Joseph Said
Chief Executive Officer

A. Introduction

In terms of the Listing Rules as issued by the Malta Financial Services Authority, Lombard Bank Malta p.l.c. (the Bank) is obliged to report on the extent to which it has adopted the "Code of Principles of Good Corporate Governance" (the Principles) contained in Appendix 5.1 to Chapter 5 of the same Listing Rules, as well as the measures which have been taken to ensure compliance with these Principles. In compliance, therefore, with the foregoing, the Bank is hereby reporting on the extent of its compliance with the Principles.

Even though the Code is not mandatory, the Board of Directors of the Bank has sought to uphold the Principles enshrined in the Code to the fullest extent possible also in the knowledge that Good Corporate Governance is beneficial to all the Bank's stakeholders. Where there was some departure from adherence to the Code, this has been explained under Section C – "Non-Compliance with the Code" as detailed below.

The Board of Directors, who are ultimately responsible for Good Corporate Governance, have carried out a review of the extent to which the Bank has been in compliance with the Code during the financial year ended 31 December 2011 and present their report accordingly as hereunder.

B. Compliance with the Code

Principle 1: The Board

The Board of Directors of the Bank consists of seven (7) directors, six (6) of whom are non-executive directors together with one (1) executive director, who is also Chief Executive Officer of the Bank. Three (3) of the non-executive directors hold positions with the shareholder company. All of the directors, individually and collectively, are fit and proper to direct the business of the Bank, having the necessary skills and experience to be able to do so.

The Board of Directors has set up a number of committees, i.e. the Audit Committee, Credit Committee and Asset Liability Committee, all having formal Terms of Reference approved by the Board, in order to assist the Board in the execution of its duties and responsibilities.

Principle 2: Chairman and Chief Executive Officer

There is a clear division of responsibilities between the running of the Board and the executive responsibility for the management of the Bank's business. The roles of Chairman and Chief Executive Officer are therefore vested in different individuals, with the Chairman assuming responsibility for leading the Board, as well as setting the agenda ensuring that the Board receives precise, timely and objective information, ensuring effective communication with shareholders and active engagement by all Board members for discussion of all important issues. The Chief Executive Officer assumes the responsibility for the execution of the approved policies.

Principle 3: Composition of the Board

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

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

Joseph M Demajo (1)
Graham A Fairclough (2)
Christian Lemmerich
Kimon Palamidis (3)
Joseph Said
Dimitris Spanodimos
Christos J Stylianides
Michael Zammit

(1) Deceased 26 April 2011
(2) Resigned 28 April 2011 and re-appointed 23 August 2011
(3) Appointed 28 April 2011

All of the Board members are non-executive directors with the exception of Joseph Said who is also Chief Executive Officer of the Bank. Furthermore, the Board considers Christian Lemmerich and Michael Zammit as independent directors despite the fact that both have served on the Board for more than twelve consecutive years. In determining their independence, the Board has taken into consideration the relevant Principles specified in the Code as well as what is generally considered sound, acceptable principles. All non-executive directors have declared in writing to the Board that they undertake:

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

It is to be noted that the composition and election of the Board of Directors is determined by the Bank's Articles of Association wherein it is the shareholders who appoint directors to serve on the Board. In addition, however, the Bank as well as the Malta Financial Services Authority undertake due diligence exercises in order to ensure that the fit and proper criteria are observed.

Principle 4: The Responsibility of the Board

In pursuing the four basic roles of corporate governance, namely, accountability, monitoring, strategy formulation and policy development, the Board of Directors perform the following functions:

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; and
9. striking a balance between enterprise and control in the Bank.

Furthermore, directors are informed on an ongoing basis, of their statutory and fiduciary duties, the Company's operations and prospects, the general business environment and competences of senior management. The Board reviews the key performance indicators, which are related to industry standards, on a regular basis.

Principle 5: Board Meetings

The Board met six (6) times during the period under review with attendance as follows:

Christian Lemmerich (Chairman)	6
Joseph M Demajo	0 (deceased 26 April 2011)
Graham A Fairclough	5 (out of 5)
Kimon Palamidis	4 (out of 4)
Joseph Said	6
Dimitris Spanodimos	3
Christos J Stylianides	5
Michael Zammit	6

The dates when the Board meetings are scheduled to be held are determined at the beginning of the year thus facilitating even further attendance at the meetings.

Well ahead of Board meetings but at least one week beforehand, an agenda accompanied with all supporting documentation is sent to all directors. The agenda includes both items of a long-term strategic nature, as well as performance related issues together with credit applications which fall within the discretionary limits of the Board. Soon after each meeting, minutes which record attendance as well as all decisions taken are circulated to all Board members.

Principle 6: Information and Professional Development

It is the Board of Directors that appoints the Chief Executive Officer and he, in liaison with the Board, appoints the Senior Management team. The Board continues to be mindful of the crucial importance to recruit, retain and motivate quality management. The ongoing training and development of staff at all levels is considered of the utmost importance and this also in the light of the need for orderly succession.

The Company Secretary provides each newly appointed director with a dossier containing reference to the more important relevant Legislation, Rules and Bye-Laws, the Bank Statute as well as policy documents. Board members are reminded that the Company Secretary is at their disposal to provide any advice or service that may be required in the discharge of their duties and responsibilities. In addition, all Board members may obtain independent professional advice at the Bank's expense.

Furthermore, directors have access to the advice and services of the external auditors who attend Board meetings at which the Company's financial statements are approved.

Principle 7: Evaluation of the Board's Performance

Although the Board did not appoint a committee to carry out an evaluation of its own performance, an assessment exercise was carried out through a "self examination" questionnaire and in which all Board members participated. This evaluation exercise did not reveal the need for any material changes in the Company's governance structures and organisation.

Principle 8: Committees

The Board has appointed the following committees:

Audit Committee

The Terms of Reference of the Audit Committee are modeled on the Principles specified in the Listing Rules of the Malta Financial Services Authority. Primarily, the Audit Committee assists the Board in fulfilling its supervisory and monitoring responsibility by reviewing the financial statements, the systems of internal control together with the internal and external audit processes. The Head of Internal Audit maintains a direct reporting line to the Audit Committee and attends the meetings. Members of senior management attend Audit Committee meetings by invitation.

The Committee is composed of the following non-executive directors:

Christian Lemmerich (Chairman)
Graham A Fairclough
Kimon Palamidis
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, is also considered to be independent taking into account the relevant criteria specified in the Listing Rules.

Asset-Liability Committee (ALCO)

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 chairs ALCO and its main objective is to manage risks within approved limits at the same time as maximising the Bank's returns by efficient and judicious management of the Bank's assets and liabilities.

Credit Committee

The Credit Committee is responsible for considering and approving credit decisions within delegated limits of authority and is composed of chief officers together with senior officers engaged in lending. The Chief Executive Officer chairs this committee.

Remuneration Committee

During the period under review, the functions of the Remuneration Committee were carried out by the Board of Directors in view of the fact that the remuneration of directors is not performance-related.

A separate "Remuneration Report" features elsewhere in the Annual Report in compliance with the relevant Code provisions of the Principles of Good Corporate Governance.

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

The Board considers that throughout the period under review the Bank has communicated appropriately with the market by means of regular company announcements as well as press releases.

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

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

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 after 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.

Minority shareholders are entitled to call special meetings should a minimum threshold of share ownership be established in accordance with the Bank's Memorandum and Articles of Association. Furthermore, minority shareholders may formally present an issue to the Board if they own the predefined minimum threshold of shares.

Principle 11: Conflicts of Interest

It is recognised that a director's primary responsibility is always to act in the interests of the Bank and its shareholders as a whole irrespective of who appointed him to the Board. Strict policies are in place to enable the management of conflict of interest, both actual as well as potential, should the occasion arise.

In addition, the "Code of Conduct for Dealing in Securities by Directors, Executives and Employees" was adopted and implemented inconformity with the Prevention of Financial Markets Abuse Legislation. Directors and employees are regularly reminded of their obligations when dealing in securities of the Bank.

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

	Shares in Lombard Bank Malta p.l.c.	
	at 31 December 2011	at 14 March 2012
Safaco Limited	34,377	34,377
First Gemini p.l.c.	1,910,126	1,910,126

	Shares in MaltaPost p.l.c.	
	at 31 December 2011	at 14 March 2012
Safaco Limited	36,286	37,767
First Gemini p.l.c.	29,471	30,674

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

Principle 12: Corporate Social Responsibility

Directors are fully aware of the need to adhere to accepted principles of corporate social responsibility. In fact, there is a continuing commitment to behave ethically at all times and to contribute to economic development while at the same time improving the quality of life of the work force and their families as well as of the local community and society at large.

The Bank seeks to go beyond the compliance parameters of its corporate social responsibility by investing "more" into human capital, the environment and its relations with stake holders.

C. Non-Compliance with the Code

Principle 4: (Code Provision 4.2.7)

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

In this connection it is to be noted that the appointment of directors to serve on the Board is a matter which is entirely reserved to the shareholders of the Bank in terms of its Memorandum and Articles of Association. Therefore, the Board does not consider it practical to develop a succession policy for the future composition of the Board. However the recommendation will be kept under review as appropriate.

Principle 7: (Code Provision 7.1)

The above Code Provision specifies: "The Board should appoint a committee chaired by a non-executive director in order to carry out a performance evaluation of its role".

As mentioned in Section B of this Statement, in carrying out a performance evaluation of its role the Board did not appoint a committee as above but involved all the directors in this task in order to gain more of a broadly based assessment.

The above evaluation did not include the Board committees.

Principle 8A: (Remuneration Committee)

During the period under review, the Board did not establish a Remuneration Committee as specified in Code Provision 8.A.1 and this, also, in view of the fact that the remuneration of directors is not performance-related (Code Provision 8.A.2).

The remuneration statement required under Code Provision 8.A.4 appears elsewhere in the Annual Report.

Principle 8B: (Nomination Committee)

The Board does not consider the setting up of a Nominations Committee as appropriate given that the appointment of directors to the Board is a matter which is reserved entirely to the Bank's shareholders in terms of the Memorandum and Articles of Association.

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

Principle 9: (Relations with Shareholders and with the Market)

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

D. Internal Control

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. 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 it 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 and 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.

E. General Meetings

General meetings are called and conducted in accordance with the provisions contained in the Bank's Articles of Association.

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

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

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

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

Approved by the Board of Directors on 15 March 2012 and signed on its behalf by:

Christian Lemmerich
Chairman

Joseph Said
Chief Executive Officer

Remuneration Report

The Board of Directors as mentioned in the Compliance Statement performs the functions of the Remuneration Committee. The Board of Directors approved the Remuneration Report on the 15 March 2012.

Remuneration Policy – Directors

In terms of the Bank's Memorandum and Articles of Association, it is the shareholders of the Company who determine the maximum annual aggregate remuneration of the directors for their services as directors. The maximum amount is determined by resolution at each Annual General Meeting of the Company and the aggregate amount fixed for the purpose during the last Annual General Meeting was seventy thousand euro (€ 70,000).

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

One of the directors has a service contract with the Bank while three (3) of the directors are employees of Marfin Popular Bank Public Co Limited, the single-largest shareholder in the Bank. Furthermore, it is confirmed that none of the directors, in their capacity as directors of the Company, are entitled to profit sharing, share options, pension benefits or any other remuneration from the Bank.

Total directors' remuneration for the financial year ended 2011 in respect of their office as directors, are as detailed below.

Fixed Remuneration	Variable Remuneration	Share Options	Others
€ 60,646	None	None	None

Directors' remuneration for the period under review were:

Christian Lemmerich (Chairman)	€ 20,960
Joseph M Demajo (1)	2,239
Graham A Fairclough (2)	4,766
Kimon Palamidis (3)	4,737
Joseph Said	6,986
Dimitris Spanodimos	6,986
Christos J Stylianides	6,986
Michael Zammit	6,986
Total	**€ 60,646**

(1) Deceased 26 April 2011
(2) Resigned 28 April 2011 and re-appointed 23 August 2011
(3) Appointed 28 April 2011

Remuneration Policy – Senior Management

The Board of Directors considers that the packages offered to senior management (enlisted on page 23) ensure that the Company attracts and retains management staff that is capable of fulfilling its duties and obligations. Furthermore, it is the Company's policy to engage its senior management staff on the basis of indefinite contracts of employment after a period of probation, rather than on fixed term contracts. Accordingly, the applicable notice periods, after probation, are those provided for in the relevant legislation.

The terms and conditions of employment of senior management are specified in their indefinite contracts of employment. Share options and profit sharing do not feature in the Bank's Remuneration Policy and the individual contracts of employment of senior management do not contain provisions for termination payments and/or other payments linked to early termination other than as determined by the Law. Currently no pension benefits are payable by the Company.

Senior management staff is eligible for annual salary increases but such increases are not directly performance related. An annual bonus is payable based on an assessment of one's overall performance during the previous financial year.

Non-cash benefits include health insurance as well as death-in-service benefits. The Chief Executive Officer is entitled to the use of a company car.

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

Fixed Remuneration	Variable Remuneration	Share Options	Others
€ 494,363	€ 255,000	None	Non-Cash Benefits referred to above

Statement of the Directors pursuant to Listing Rule 5.68

For the Year Ended 31 December 2011

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 15 March 2012 by:

Christian Lemmerich
Chairman

Joseph Said
Chief Executive Officer

Company Information

As at 31 December 2011 and 14 March 2012 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 2011 analysed by range:

Range	Shareholders	Shares
1 – 500	174	34,440
501 – 1000	117	92,617
1001 – 5000	505	1,477,307
5001 and over	644	34,488,328
Total	**1,440**	**36,092,692**

Number of shareholders at 14 March 2012 analysed by range:

Range	Shareholders	Shares
1 – 500	170	32,740
501 – 1000	123	98,511
1001 – 5000	510	1,489,327
5001 and over	648	34,472,114
Total	**1,451**	**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)
Graham A Fairclough
Kimon Palamidis
Joseph Said
Dimitris Spanodimos
Christos J Stylianides
Michael Zammit

Company Secretary

Graham A Fairclough

Senior Management

Joseph Said	Chief Executive Officer
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
Anthony Busuttil	Trade Finance
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

pwc

Independent Auditor's Report

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

Report on the Financial Statements for the year ended 31 December 2011

We have audited the consolidated and stand-alone parent company financial statements of Lombard Bank Malta p.l.c. (together with the "financial statements") on pages 29 to 124 which comprise the consolidated and parent company statements of financial position as at 31 December 2011, 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 about whether the financial statements are free from 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 2011, 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.

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

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, the Remuneration Report and 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; and
  - 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 - *continued*
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 18 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

15 March 2012

LOMBARD

FINANCIAL STATEMENTS

For the Year Ended 31 December 2011

2011

Statements of Financial Position

At 31 December 2011

	Notes	Group 2011 € 000	Group 2010 € 000	Bank 2011 € 000	Bank 2010 € 000
Assets					
Balances with Central Bank of Malta, treasury bills and cash	5	**164,175**	109,314	**163,445**	108,774
Cheques in course of collection		**456**	750	**456**	750
Derivative financial instruments	6	**-**	-	**179**	-
Investments	7	**16,328**	46,332	**12,565**	41,101
Loans and advances to banks	8	**35,570**	44,975	**33,983**	43,477
Loans and advances to customers	9	**310,354**	333,731	**310,752**	334,012
Investment in subsidiaries	10	**-**	-	**8,502**	8,034
Intangible assets	11	**1,518**	1,295	**244**	3
Property, plant and equipment	12	**21,373**	14,740	**12,504**	12,299
Investment property	13	**745**	745	**745**	745
Assets classified as held for sale	9	**111**	109	**111**	109
Current tax assets		**760**	2,683	**220**	2,378
Deferred tax assets	14	**2,572**	1,585	**2,181**	1,084
Inventories	15	**784**	714	**246**	143
Trade and other receivables	16	**8,361**	7,503	**906**	385
Accrued income and other assets	17	**4,847**	3,324	**3,100**	3,247
Total assets		**567,954**	567,800	**550,139**	556,541

Statements of Financial Position *(continued)*

At 31 December 2011

	Notes	Group 2011 € 000	Group 2010 € 000	Bank 2011 € 000	Bank 2010 € 000
Equity and Liabilities					
Equity					
Share capital	18	**9,023**	9,023	**9,023**	9,023
Share premium	19	**17,746**	17,746	**17,746**	17,746
Property revaluation reserve	19	**2,043**	2,043	**2,043**	2,043
Investment revaluation reserve	19	**(36)**	566	**(159)**	360
Other reserves	19	**2,556**	2,397	**2,556**	2,397
Retained earnings		**43,553**	39,932	**42,048**	38,891
Equity attributable to equity holders of the Bank		**74,885**	71,707	**73,257**	70,460
Non-controlling interests		**4,774**	4,336	**-**	-
Total equity		**79,659**	76,043	**73,257**	70,460
Liabilities					
Derivative financial instruments	6	**9**	-	**9**	-
Amounts owed to banks	20	**6,942**	149	**2,985**	149
Amounts owed to customers	21	**462,322**	472,697	**463,761**	475,085
Provisions for liabilities and other charges	22	**2,426**	2,652	**676**	636
Other liabilities	23	**6,245**	7,907	**4,149**	5,679
Accruals and deferred income	24	**10,351**	8,352	**5,302**	4,532
Total liabilities		**488,295**	491,757	**476,882**	486,081
Total equity and liabilities		**567,954**	567,800	**550,139**	556,541
Memorandum items					
Contingent liabilities	25	**6,314**	7,067	**6,314**	7,067
Commitments	25	**79,470**	82,246	**79,470**	82,246

The notes on pages 39 to 124 are an integral part of these financial statements.

These financial statements on pages 29 to 124 are approved and authorised for issue by the Board of Directors on 15 March 2012 and signed on its behalf by:

Christian Lemmerich
Chairman

Joseph Said
Chief Executive Officer

LOMBARD

Income Statements

For the Year Ended 31 December 2011

	Notes	Group 2011 € 000	Group 2010 € 000	Bank 2011 € 000	Bank 2010 € 000
Interest receivable and similar income					
- on loans and advances, balances with Central Bank of Malta and treasury bills	26	**23,464**	23,846	**23,452**	23,838
- on debt and other fixed income instruments	26	**1,453**	2,507	**1,252**	2,267
Interest expense	26	**(10,734)**	(10,287)	**(10,739)**	(10,326)
Net interest income		**14,183**	16,066	**13,965**	15,779
Fee and commission income	27	**2,068**	2,292	**1,113**	1,390
Fee and commission expense	27	**(76)**	(63)	**(74)**	(63)
Net fee and commission income		**1,992**	2,229	**1,039**	1,327
Postal sales and other revenues	28	**20,394**	19,808	**8**	342
Dividend income	29	**136**	157	**1,243**	1,326
Net trading income	30	**305**	583	**556**	364
Net gains/(losses) on disposal of non-trading financial instruments		**2,004**	(23)	**1,707**	(23)
Other operating income/(expenses)		**37**	(35)	**101**	35
Operating income		**39,051**	38,785	**18,619**	19,150
Employee compensation and benefits	31	**(14,475)**	(14,322)	**(4,457)**	(4,180)
Other operating costs	33	**(9,664)**	(9,002)	**(2,229)**	(2,518)
Depreciation and amortisation	11, 12	**(1,313)**	(1,195)	**(398)**	(277)
Provisions for liabilities and other charges	22	**(43)**	(139)	**(23)**	(22)
Net impairment losses	32	**(2,231)**	(186)	**(2,231)**	(215)
Profit before taxation	33	**11,325**	13,941	**9,281**	11,938
Income tax expense	34	**(4,098)**	(4,901)	**(3,272)**	(4,222)
Profit for the year		**7,227**	9,040	**6,009**	7,716
Attributable to:					
Equity holders of the Bank		**6,593**	8,332	**6,009**	7,716
Non-controlling interests		**634**	708	**-**	-
Profit for the year		**7,227**	9,040	**6,009**	7,716
Earnings per share	35	**18c3**	23c2		

The notes on pages 39 to 124 are an integral part of these financial statements.

LOMBARD

Statements of Comprehensive Income

For the Year Ended 31 December 2011

Group

	Note	**2011 € 000**	2010 € 000
Profit for the year		**7,227**	9,040
Other comprehensive income			
Fair valuation of available-for-sale financial assets:			
Net changes in fair value arising during the year, before tax		**(21)**	423
Reclassification adjustments - net amounts reclassified to profit or loss, before tax		**(900)**	(2)
Income tax relating to components of other comprehensive income	34	**284**	(313)
Other comprehensive income for the year, net of income tax		**(637)**	108
Total comprehensive income for the year, net of income tax		**6,590**	9,148
Attributable to:			
Equity holders of the Bank		**5,996**	8,389
Non-controlling interests		**594**	759
Total comprehensive income for the year, net of income tax		**6,590**	9,148

Bank

	Note	**2011 € 000**	2010 € 000
Profit for the year		**6,009**	7,716
Other comprehensive income			
Fair valuation of available-for-sale financial assets:			
Net changes in fair value arising during the year, before tax		**79**	271
Reclassification adjustments - net amounts reclassified to profit or loss, before tax		**(877)**	(2)
Income tax relating to components of other comprehensive income	34	**284**	(314)
Other comprehensive income for the year, net of income tax		**(514)**	(45)
Total comprehensive income for the year, net of income tax		**5,495**	7,671

The notes on pages 39 to 124 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2011

Group	Note	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
		Attributable to equity holders of the Bank								
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	36	-	-	-	-	-	(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 39 to 124 are an integral part of these financial statements.

Statements of Changes in Equity
For the Year Ended 31 December 2011

Group

	Note	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
		Attributable to equity holders of the Bank								
At 1 January 2011		**9,023**	**17,746**	**2,043**	**566**	**2,397**	**39,932**	**71,707**	**4,336**	**76,043**
Comprehensive income										
Profit for the year		-	-	-	-	-	**6,593**	**6,593**	**634**	**7,227**
Other comprehensive income										
Fair valuation of available-for-sale financial assets:										
Net changes in fair value arising during the year		-	-	-	**(10)**	-	-	**(10)**	**(40)**	**(50)**
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	-	**(592)**	-	-	**(592)**	-	**(592)**
Transfers and other movements		-	-	-	-	**159**	**(154)**	**5**	-	**5**
Total other comprehensive income for the year		-	-	-	**(602)**	**159**	**(154)**	**(597)**	**(40)**	**(637)**
Total comprehensive income for the year		-	-	-	**(602)**	**159**	**6,439**	**5,996**	**594**	**6,590**
Transactions with owners, recorded directly in equity										
Contributions by and distributions to owners										
Dividends to equity holders	36	-	-	-	-	-	**(2,698)**	**(2,698)**	**(410)**	**(3,108)**
Changes in ownership interests in subsidiaries that do not result in a loss of control										
Change in non-controlling interests in subsidiary		-	-	-	-	-	**(120)**	**(120)**	**254**	**134**
Total transactions with owners		-	-	-	-	-	**(2,818)**	**(2,818)**	**(156)**	**(2,974)**
At 31 December 2011		**9,023**	**17,746**	**2,043**	**(36)**	**2,556**	**43,553**	**74,885**	**4,774**	**79,659**

The notes on pages 39 to 124 are an integral part of these financial statements.

LOMBARD

Statements of Changes in Equity

For the Year Ended 31 December 2011

Bank

	Note	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	36	-	-	-	-	-	(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 39 to 124 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2011

Bank

	Note	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 2011		9,023	17,746	2,043	360	2,397	38,891	70,460
Comprehensive income								
Profit for the year		-	-	-	-	-	6,009	6,009
Other comprehensive income								
Fair valuation of available-for-sale financial assets:								
Net changes in fair value arising during the year		-	-	-	50	-	-	50
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	-	(569)	-	-	(569)
Transfers and other movements		-	-	-	-	159	(154)	5
Total other comprehensive income for the year		-	-	-	(519)	159	(154)	(514)
Total comprehensive income for the year		-	-	-	(519)	159	5,855	5,495
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Dividends to equity holders	36	-	-	-	-	-	(2,698)	(2,698)
Total transactions with owners		-	-	-	-	-	(2,698)	(2,698)
At 31 December 2011		9,023	17,746	2,043	(159)	2,556	42,048	73,257

The notes on pages 39 to 124 are an integral part of these financial statements.

Statements of Cash Flows

For the Year Ended 31 December 2011

	Notes	Group 2011 € 000	Group 2010 € 000	Bank 2011 € 000	Bank 2010 € 000
Cash flows from operating activities					
Interest and commission receipts		**24,097**	25,465	**24,167**	25,489
Receipts from customers relating to postal sales and other revenue		**104,867**	107,008	**9**	300
Interest and commission payments		**(9,940)**	(10,762)	**(9,946)**	(10,800)
Payments to employees and suppliers		**(108,754)**	(113,385)	**(6,842)**	(6,730)
Cash flows from operating profit before changes in operating assets and liabilities		**10,270**	8,326	**7,388**	8,259
Decrease/(increase) in operating assets:					
Treasury bills		**(17,074)**	12,608	**(17,074)**	12,608
Deposits with Central Bank of Malta		**996**	(2,039)	**996**	(2,039)
Loans and advances to banks and customers		**21,008**	(8,979)	**20,891**	(9,108)
Other receivables		**(513)**	(231)	**(512)**	(239)
Increase/(decrease) in operating liabilities:					
Amounts owed to banks and to customers		**(5,942)**	22,930	**(10,892)**	22,091
Other payables		**(1,520)**	(2,916)	**(1,520)**	(2,916)
Net cash from/(used in) operations		**7,225**	29,699	**(723)**	28,656
Income tax paid		**(2,880)**	(6,268)	**(1,636)**	(4,254)
Net cash from/(used in) operating activities		**4,345**	23,431	**(2,359)**	24,402
Cash flows from investing activities					
Dividends received		**136**	157	**136**	157
Interest received from investments		**2,975**	3,074	**2,676**	2,742
Proceeds on maturity/disposal of investments		**31,025**	5,954	**29,664**	6,263
Purchase of investments		**-**	(3,642)	**-**	(3,447)
Purchase of property, plant and equipment		**(8,495)**	(1,681)	**(844)**	(921)
Acquisition of non-controlling interests		**(72)**	(133)	**-**	-
Proceeds from liquidation of subsidiary		**-**	-	**116**	-
Net cash flows from investing activities		**25,569**	3,729	**31,748**	4,794
Cash flows from financing activities					
Dividends paid to equity holders of the Bank	36	**(2,698)**	(858)	**(2,698)**	(858)
Dividends paid to non-controlling interests		**(202)**	(213)	**-**	-
Cash used in financing activities		**(2,900)**	(1,071)	**(2,698)**	(858)
Net increase in cash and cash equivalents		**27,014**	26,089	**26,691**	28,338
Cash and cash equivalents at beginning of year		**95,515**	69,426	**93,477**	65,139
Cash and cash equivalents at end of year	37	**122,529**	95,515	**120,168**	93,477

The notes on pages 39 to 124 are an integral part of these financial statements.

Notes to the Financial Statements
For the Year Ended 31 December 2011

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 3.1 – Critical accounting estimates, and judgments in applying the Group's accounting policies).

1.2 *Standards, interpretations and amendments to published standards effective in 2011*

During the financial year ended 31 December 2011, the Bank adopted new standards, amendments and interpretations to existing standards that are mandatory for the Bank's accounting period beginning on 1 December 2011. 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 2011. The Bank has not early adopted these revisions to the requirements of IFRSs as adopted by the EU and the Bank's management are 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 2015. 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)*

IAS 19, "Employee Benefits" was amended in June 2011. The impact on the Group will be as follows: to eliminate the corridor approach and recognise all actuarial gains and losses in other comprehensive income as they occur; to immediately recognise all past service costs; and to replace interest cost and expected return on plan assets with a net interest amount that is calculated by applying the discount rate to the net defined benefit liability (asset). The Group is yet to assess the full impact of the amendments.

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 10.

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

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired is recorded as goodwill. If this 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 **Summary of significant accounting policies** *(continued)*

1.5 *Segment reporting*

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

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

1.6 *Foreign currency translation*

The financial statements are presented in Euro (€), which is the 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 **Summary of significant accounting policies** *(continued)*

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.

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.

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

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

In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the loan and receivable and recognised in profit or loss as "Net impairment 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 comprised of government and 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.

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

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

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

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 identifiable net assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in "intangible assets".

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

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

1.10.2 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 four years.

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

1.10.3 Postal licence

The postal licence represents the amount paid for the right to operate postal services in Malta. Separately acquired licences 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 licence. The estimated useful life of the postal licence 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 operations. Group policies and procedures are in place for the reporting and addressing of fraudulent activities.

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

2 **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 with respect to on and off-balance sheet financial instruments can be classified in the following categories:

- Financial assets recognised on-balance sheet comprising principally balances with Central Bank of Malta, Malta Government treasury bills, derivative financial instruments, 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 25 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 25.

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**	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Credit risk exposures relating to on-balance sheet assets:				
Loans and receivables:				
Balances with Central Bank of Malta	**41,902**	38,680	**41,902**	38,680
Cheques in course of collection	**456**	750	**456**	750
Loans and advances to banks	**35,570**	44,975	**33,983**	43,477
Loans and advances to customers	**310,354**	333,731	**310,752**	334,012
Trade and other receivables	**8,361**	7,503	**906**	385
Accrued income and other assets	**4,847**	3,324	**3,100**	3,247
Held-for-trading financial assets:				
Derivative financial instruments-				
Forward foreign exchange contracts	**-**	-	**179**	-
Available-for-sale financial assets:				
Debt securities	**10,251**	8,079	**6,488**	2,848
Malta Government treasury bills	**118,638**	-	**118,638**	-
Held-to-maturity financial assets:				
Debt securities	**-**	30,891	**-**	30,891
Malta Government treasury bills	**-**	67,193	**-**	67,193
	530,379	535,126	**516,404**	521,483
Credit risk exposures relating to off-balance sheet instruments:				
Contingent liabilities	**6,314**	7,067	**6,314**	7,067
Commitments	**79,470**	82,246	**79,470**	82,246

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

The exposures set out in 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 2011 and 2010.

Derivative counterparties of the Bank are principally limited to its subsidiary MaltaPost p.l.c. that is controlled by the Bank.

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 2011			
A- to AA-	**118,638**	**3,922**	**122,560**
Lower than A-	**-**	**1,147**	**1,147**
Unrated	**-**	**5,182**	**5,182**
	118,638	**10,251**	**128,889**
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

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

Bank

	Treasury bills € 000	Debt securities € 000	Total € 000
At 31 December 2011			
A- to AA-	**118,638**	**2,666**	**121,304**
Lower than A-	**-**	**914**	**914**
Unrated	**-**	**2,908**	**2,908**
	118,638	**6,488**	**125,126**
At 31 December 2010			
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

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.

Investment debt securities are analysed by sector as follows:

Group	**2011 € 000**	2010 € 000
Government	**3,922**	32,451
Corporate:		
Financial services	**2,085**	2,083
Real estate and construction	**778**	784
Tourism	**1,239**	1,436
Wholesale and retail trade	**1,913**	1,905
Others	**314**	311
	10,251	38,970

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

Bank	**2011**	2010
	€ 000	€ 000
Government	**2,666**	29,924
Corporate:		
Financial services	**914**	904
Real estate and construction	**317**	321
Tourism	**783**	800
Wholesale and retail trade	**1,494**	1,479
Others	**314**	311
	6,488	33,739

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 relate to loans and advances to customers, gross of impairment allowances:

	Group		**Bank**	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Transportation, storage and communication	**7,960**	8,886	**8,358**	9,167
Financial services	**1,800**	1,770	**1,800**	1,770
Agriculture and fishing	**3,206**	2,373	**3,206**	2,373
Manufacturing	**7,029**	17,270	**7,029**	17,270
Construction	**127,442**	140,061	**127,442**	140,061
Hotels and restaurants, excluding related construction activities	**9,056**	7,824	**9,056**	7,824
Wholesale and retail trade	**37,205**	41,826	**37,205**	41,826
Community, recreational and personal service activities	**7,951**	10,818	**7,951**	10,818
Education	**7,766**	3,179	**7,766**	3,179
Health and social work	**166**	149	**166**	149
Mining and quarrying	**913**	709	**913**	709
Real estate, renting and business activities	**75,026**	72,283	**75,026**	72,283
Households and individuals	**32,698**	32,116	**32,698**	32,116
Gross amount granted to customers	**318,218**	339,264	**318,616**	339,545

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

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

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

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Gross loans and advances:				
Regular	**168,308**	173,555	**168,706**	173,836
Watch	**54,361**	39,510	**54,361**	39,510
Substandard	**8,537**	25,119	**8,537**	25,119
Doubtful	**87,012**	101,080	**87,012**	101,080
	318,218	339,264	**318,616**	339,545

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 2011, 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 **Financial risk management** *(continued)*

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Gross loans and advances:				
Impaired	**24,050**	14,301	**24,050**	14,301
Past due but not impaired	**140,969**	171,490	**140,969**	171,490
Neither past due nor impaired	**153,199**	153,473	**153,597**	153,754
	318,218	339,264	**318,616**	339,545

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.

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 writes back any related allowances for impairment losses) when it determines that these are uncollectible. This decision is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

The individually impaired loans and advances mainly relate to a number of independent customers which are in unexpectedly difficult economic situations and which are accordingly not meeting repayment obligations. These exposures mainly arose in the construction and 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 notes 9 and 32 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

	2011	2010
	€ 000	€ 000
Past due up to 30 days	**50,972**	76,612
Past due between 31 and 60 days	**27,586**	19,870
Past due between 61 and 90 days	**6,799**	22,543
Past due over 90 days	**55,612**	52,465
	140,969	171,490

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.

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

	2011 € 000	2010 € 000
Against individually impaired		
Immovable property	**13,684**	13,374
Cash or quasi cash	**155**	27
Other security	**545**	-
	14,384	13,401

	2011 € 000	2010 € 000
Against past due but not impaired		
Immovable property	**106,526**	137,241
Cash or quasi cash	**2,006**	2,529
Prime bank guarantees	**386**	3,604
Other security	**366**	76
	109,284	143,450

	2011 € 000	2010 € 000
Against neither past due nor impaired		
Immovable property	**107,949**	104,607
Cash or quasi cash	**7,764**	6,134
Prime bank guarantees	**1,098**	517
Other security	**2,234**	1,878
	119,045	113,136
Total fair value of collateral held as security and other credit enhancements	**242,713**	269,987

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 2011 amounted to €39,728,000 (2010: €18,534,000).

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 2011, loans and advances to banks consisted primarily of term placements maturing within one month.

The Bank runs the risk of loss of funds due to the possible political, economic and other events in a particular country where funds have been placed or invested with several counterparties domiciled in the same country or region. Countries are assessed according to their size, economic data and prospects together with credit ratings issued by international rating agencies. Existing country credit risk exposures, based on groupings of individual counterparties, are monitored and reviewed periodically. The Bank's assets are predominantly in Malta. The Group's exposures to other countries are mainly limited to bank balances and money market placements with a total carrying amount of €20,158,000 (2010: €24,008,000) 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 16. Other overdue trade receivables amounted to €3,670,000 (2010: €1,040,000) 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 to a negative maturity gap position) but with shorter repricing periods or terms. The Bank manages the shorter term nature of the liabilities funding the assets for the purposes of ensuring a steady base of deposits with differing terms over the medium to longer term.

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 2011	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	164,175	1.15	112,559	47,981	-	-	3,635
Debt and other fixed income instruments classified as:							
- available-for-sale investments	10,251	5.88	195	767	5,268	4,021	-
Loans and advances to banks	35,570	0.51	31,539	-	-	-	4,031
Loans and advances to customers	310,354	6.78	308,709	-	-	-	1,645
Total financial assets	520,350		453,002	48,748	5,268	4,021	9,311
Financial liabilities							
Amounts owed to banks	6,942	3.13	2,347	431	-	4,000	164
Amounts owed to customers	462,322	2.26	218,747	98,600	97,719	32,898	14,358
Total financial liabilities	469,264		221,094	99,031	97,719	36,898	14,522
Interest repricing gap			231,908	(50,283)	(92,451)	(32,877)	(5,211)
Cumulative gap			231,908	181,625	89,174	56,297	

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

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	

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

Bank

At 31 December 2011	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	163,445	1.15	112,560	47,980	-	-	2,905
Debt and other fixed income instruments classified as:							
- available-for-sale investments	6,488	6.12	20	414	3,677	2,377	-
Loans and advances to banks	33,983	0.53	30,712	-	-	-	3,271
Loans and advances to customers	310,752	6.78	309,107	-	-	-	1,645
Total financial assets	514,668		452,399	48,394	3,677	2,377	7,821
Financial liabilities							
Amounts owed to banks	2,985	1.31	2,347	431	-	-	207
Amounts owed to customers	463,761	2.25	220,186	98,600	97,719	32,898	14,358
Total financial liabilities	466,746		222,533	99,031	97,719	32,898	14,565
Interest repricing gap			229,866	(50,637)	(94,042)	(30,521)	(6,744)
Cumulative gap			229,866	179,229	85,187	54,666	

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

Bank

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	2,848	6.19	-	-	1,777	1,071	-
- held-to-maturity investments	30,891	6.53	3,531	-	24,863	2,497	-
Loans and advances to banks	43,477	0.40	39,286	-	-	-	4,191
Loans and advances to customers	334,012	6.85	332,367	-	-	-	1,645
Total financial assets	520,002		451,739	29,318	26,640	3,568	8,737
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
Total financial liabilities	475,234		225,391	108,251	87,801	38,833	14,958
Interest repricing gap			226,348	(78,933)	(61,161)	(35,265)	(6,221)
Cumulative gap			226,348	147,415	86,254	50,989	

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:

Group	Fixed rate		Variable rate	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Interest earning assets				
Balances with Central Bank of Malta and treasury bills	**34,500**	30,282	**126,040**	75,591
Debt and other fixed income instruments classified as:				
- available-for-sale investments	**10,251**	8,079	**-**	-
- held-to-maturity investments	**-**	30,891	**-**	-
Loans and advances to banks	**28,382**	39,287	**3,157**	2,555
Loans and advances to customers	**-**	1,562	**308,709**	330,523
	73,133	110,101	**437,906**	408,669
Interest bearing liabilities				
Amounts owed to banks	**2,778**	-	**4,000**	-
Amounts owed to customers	**342,048**	353,639	**105,916**	104,644
	344,826	353,639	**109,916**	104,644

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

Bank	Fixed rate		Variable rate	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Interest earning assets				
Balances with Central Bank of Malta and treasury bills	**34,500**	30,282	**126,040**	75,591
Debt and other fixed income instruments classified as:				
- available-for-sale investments	**6,488**	2,848	**-**	-
- held-to-maturity investments	**-**	30,891	**-**	-
Loans and advances to banks	**28,382**	39,287	**2,330**	-
Loans and advances to customers	**-**	1,562	**309,107**	330,804
	69,370	104,870	**437,477**	406,395
Interest bearing liabilities				
Amounts owed to banks	**2,778**	-	**-**	-
Amounts owed to customers	**342,048**	354,714	**107,355**	105,561
	344,826	354,714	**107,355**	105,561

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

2.4.3 Fair value sensitivity analysis for fixed rate instruments

The Group's instruments exposing the Bank to fair value interest rate risk consist of available-for-sale quoted debt securities (also refer to note 7) 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.

2.4.4 Cash flow sensitivity analysis for variable rate instruments

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

Group	**(+) 100bp € 000**	**(-) 100bp € 000**
At 31 December 2011	**3,280**	**(3,280)**
At 31 December 2010	3,040	(3,040)

Bank	**(+) 100bp € 000**	**(-) 100bp € 000**
At 31 December 2011	**3,301**	**(3,301)**
At 31 December 2010	3,008	(3,008)

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.

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

The Bank enters into forward foreign exchange contracts with customers in the normal course of its business. Generally, it is the Bank's policy to cover the exposure arising from forward contracts.

As a result, the Group is not exposed to any significant exchange risk in respect of outstanding derivative financial instruments at the end of the reporting periods. The Bank also retains a deposit margin covering a portion of the notional amount of the respective contract from the customer thereby reducing the extent of credit risk should the derivative client default. The Bank's outstanding forward foreign currency contracts at the end of the reporting period had a notional amount of €2,745,000 (2010: €316,000). Derivative counterparties are principally limited to the subsidiary of the Bank, MaltaPost p.l.c. that is controlled by the Bank.

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. The off-balance sheet gap represents the difference between the notional amounts of foreign currency derivative financial instruments, which could be used to reduce the Group's exposure to currency movements and for related purposes, and their fair values.

Group

	Total	EUR	GBP	USD	Other
At 31 December 2011	**€ 000**	**€ 000**	**€ 000**	**€ 000**	**€ 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	164,175	163,727	89	335	24
Investments classified as:					
- available-for-sale	16,328	15,682	-	646	-
Loans and advances to banks	35,570	8,859	15,298	10,371	1,042
Loans and advances to customers	310,354	300,351	2	7,670	2,331
Other assets	13,664	10,434	639	2,092	499
Total financial assets	540,091	499,053	16,028	21,114	3,896
Financial liabilities					
Derivative financial instruments	9	-	-	9	-
Amounts owed to banks	6,942	4,163	-	-	2,779
Amounts owed to customers	462,322	426,024	15,792	19,593	913
Other liabilities	16,596	15,645	278	555	118
Total financial liabilities	485,869	445,832	16,070	20,157	3,810
Net on-balance sheet position		53,221	(42)	957	86
Off-balance sheet net notional position		271	-	(262)	-
Net currency exposure in financial assets/liabilities		53,492	(42)	695	86
Commitments	79,470	78,767	2	3	698

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

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	30,891	30,891	-	-	-
- available-for-sale	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 in financial assets/liabilities		54,351	232	1,827	414
Commitments	82,246	81,702	7	537	-

Under the scenario that all currencies move adversely against the euro by 20% the effect would be a decrease of €123,000 (2010: €412,000) 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%, the effect would be a gain of €123,000 (2010: €412,000) in the carrying amount of financial instruments and the favourable impact would be recognised in profit or loss.

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

The following table summarises the Bank'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. The off-balance sheet gap represents the difference between the notional amount of foreign currency derivative financial instruments, which could be used to reduce the Bank's exposure to currency movements and for related purposes, and their fair values.

Bank

At 31 December 2011	**Total € 000**	**EUR € 000**	**GBP € 000**	**USD € 000**	**Other € 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	163,445	162,997	89	335	24
Derivative financial instruments	179	-	16	127	36
Investments classified as:					
- available-for-sale	12,565	11,919	-	646	-
Loans and advances to banks	33,983	7,288	15,289	10,364	1,042
Loans and advances to customers	310,752	300,749	2	7,670	2,331
Other assets	4,462	4,458	-	4	-
Total financial assets	525,386	487,411	15,396	19,146	3,433
Financial liabilities					
Derivative financial instruments	9	-	-	9	-
Amounts owed to banks	2,985	206	-	-	2,779
Amounts owed to customers	463,761	427,463	15,792	19,593	913
Other liabilities	8,879	8,489	102	245	43
Total financial liabilities	475,634	436,158	15,894	19,847	3,735
Net on-balance sheet position		51,253	(498)	(701)	(302)
Off-balance sheet net notional position		(2,203)	435	1,254	344
Net currency exposure in financial assets/liabilities		49,050	(63)	553	42
Commitments	79,470	78,767	2	3	698

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

Bank

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	108,774	101,101	65	7,568	40
Investments classified as:					
- 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	4,381	4,367	-	14	-
Total financial assets	531,745	476,641	13,589	35,338	6,177
Financial liabilities					
Amounts owed to banks	149	149	-	-	-
Amounts owed to customers	475,085	421,172	13,413	34,411	6,089
Other liabilities	9,540	9,222	177	103	38
Total financial liabilities	484,774	430,543	13,590	34,514	6,127
Net on-balance sheet position		46,098	(1)	824	50
Off-balance sheet net notional position		316	-	(316)	-
Net currency exposure in financial assets/liabilities		46,414	(1)	508	50
Commitments	82,246	81,702	7	537	-

Under the scenario that all currencies move adversely against the euro by 20% the effect would be a decrease of €89,000 (2010: €93,000) 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%, the effect would be a gain of €89,000 (2010: €93,000) 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 7) 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 ought to manage its net interest spread by investing funds in a portfolio of assets with a longer term than the liabilities funding them (therefore giving rise to a negative maturity gap position). To mitigate exposures arising in this respect, the Bank holds significant liquid assets in the form of Malta Government treasury bills, money market placements and other short term instruments for managing liquidity risk to support payment obligations and contingent funding in a stressed market environment.

The Bank's loan to deposit ratio of 67% 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 2011 is 83%, 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 2011, the Group and Bank had outstanding guarantees on behalf of third parties amounting to €6,314,000 (2010: €7,067,000), 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 2011	**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	**112,560**	**47,980**	**-**	**-**	**3,635**	**164,175**
Available-for-sale investments	**195**	**767**	**5,268**	**4,021**	**6,077**	**16,328**
Loans and advances to banks	**35,570**	**-**	**-**	**-**	**-**	**35,570**
Loans and advances to customers	**145,929**	**34,406**	**104,113**	**25,906**	**-**	**310,354**
Other assets	**10,124**	**748**	**-**	**-**	**2,792**	**13,664**
Total financial assets	**304,378**	**83,901**	**109,381**	**29,927**	**12,504**	**540,091**
Financial liabilities						
Derivative financial instruments	**9**	**-**	**-**	**-**	**-**	**9**
Amounts owed to banks	**2,511**	**431**	**-**	**4,000**	**-**	**6,942**
Amounts owed to customers	**233,104**	**98,601**	**97,719**	**32,898**	**-**	**462,322**
Other liabilities	**4,654**	**2,883**	**1,379**	**465**	**7,215**	**16,596**
Total financial liabilities	**240,278**	**101,915**	**99,098**	**37,363**	**7,215**	**485,869**
Maturity gap	**64,100**	**(18,014)**	**10,283**	**(7,436)**	**-**	**-**
Cumulative gap	**64,100**	**46,086**	**56,369**	**48,933**	**-**	**-**
At 31 December 2010						
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	168,096	45,206	93,591	26,838	-	333,731
Other assets	10,305	746	-	-	526	11,577
Total financial assets	303,819	75,271	121,822	33,688	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	58,397	(34,173)	33,079	(5,562)	-	-
Cumulative gap	58,397	24,224	57,303	51,741	-	-

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

Bank

At 31 December 2011	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	112,560	47,980	-	-	2,905	163,445
Derivative financial instruments	-	-	179	-	-	179
Available-for-sale investments	20	414	3,677	2,377	6,077	12,565
Loans and advances to banks	33,983	-	-	-	-	33,983
Loans and advances to customers	146,327	34,406	104,113	25,906	-	310,752
Other assets	2,670	684	-	-	1,108	4,462
Total financial assets	295,560	83,484	107,969	28,283	10,090	525,386
Financial liabilities						
Derivative financial instruments	9	-	-	-	-	9
Amounts owed to banks	2,554	431	-	-	-	2,985
Amounts owed to customers	234,543	98,601	97,719	32,898	-	463,761
Other liabilities	2,792	2,883	1,379	465	1,360	8,879
Total financial liabilities	239,898	101,915	99,098	33,363	1,360	475,634
Maturity gap	55,662	(18,431)	8,871	(5,080)	-	-
Cumulative gap	55,662	37,231	46,102	41,022	-	-
At 31 December 2010						
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	43,477	-	-	-	-	43,477
Loans and advances to customers	168,096	45,488	93,591	26,837	-	334,012
Other assets	3,185	668	-	-	528	4,381
Total financial assets	294,843	75,475	120,230	30,406	10,791	531,745
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	1,333	9,540
Total financial liabilities	246,005	109,444	88,743	39,249	1,333	484,774
Maturity gap	48,838	(33,969)	31,487	(8,843)	-	-
Cumulative gap	48,838	14,869	46,356	37,513	-	-

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

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

Group

At 31 December 2011	**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	**2,517**	**439**	**-**	**4,176**	**7,132**
Amounts owed to customers	**233,595**	**101,533**	**111,442**	**42,140**	**488,710**
Total financial liabilities	**236,112**	**101,972**	**111,442**	**46,316**	**495,842**
At 31 December 2010					
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

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

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

Bank

At 31 December 2011	**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	**2,560**	**438**	**-**	**-**	**2,998**
Amounts owed to customers	**235,038**	**101,532**	**111,442**	**42,140**	**490,152**
Total financial liabilities	**237,598**	**101,970**	**111,442**	**42,140**	**493,150**
At 31 December 2010					
Financial liabilities					
Amounts owed to banks	149	-	-	-	149
Amounts owed to customers	241,823	110,304	97,771	51,658	501,556
Total financial liabilities	241,972	110,304	97,771	51,658	501,705

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

The following tables analyse all the principal derivative financial instruments, consisting of forward foreign exchange contracts, into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash flows.

	Group	Bank		
	Less than 3 months € 000	**Less than 3 months € 000**	**Between 1 year and 5 years € 000**	**Total € 000**
At 31 December 2011				
Inflows	**271**	**271**	**2,653**	**2,924**
Outflows	**(280)**	**(280)**	**(2,474)**	**(2,754)**
	(9)	**(9)**	**179**	**170**
At 31 December 2010				
Inflows	316	316	-	316
Outflows	(315)	(315)	-	(315)
	1	1	-	1

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

2.6 *Operational risk*

Operational risk is the risk of losses owing to:
- deficient or erroneous internal procedures
- human or system errors
- external events, including legal events
- internal and external fraud
- employment practices and workplace safety
- clients, products and business practices
- damage to physical assets
- business disruption and system failures
- 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.

A financial measurement of this risk is arrived at by the Group for the purpose of allocating risk capital using the Basic Indicator Approach under the Directive on Capital Requirements ("CRD") rules. The capital requirement for operational risk under this method was calculated at €2,775,000 (2010: €2,591,000).

2.7 *Capital risk management*

The Group's objectives when managing capital, which is a broader concept than the "equity" on the consolidated statement of financial position, are:
- to comply with the capital requirements set by the 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.

Capital adequacy and the use of regulatory capital are monitored daily 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 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.

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

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

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

	2011	2010
	€ 000	€ 000
Total original own funds	**67,760**	65,552
Additional own funds:		
Property revaluation reserve	**1,833**	1,833
Investment revaluation reserve	**369**	424
Collective impairment allowances	**1,921**	1,442
Total own funds	**71,883**	69,251

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%) 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 2011 and 2010 financial years, the Bank complied with all of the externally imposed capital requirements to which it is subject.

Bank

At 31 December 2011	Carrying amount € 000	Weighted amount € 000	Capital requirement € 000
On-balance sheet assets			
Balances with Central Bank of Malta and cash	44,807	-	-
Malta Government treasury bills	118,638	-	-
Cheques in course of collection	456	90	6
Equity shares	6,077	5,583	447
Debt securities	6,488	3,772	302
Loans and advances to banks	33,983	8,319	665
Loans and advances to customers	310,752	271,524	21,722
Investment in subsidiaries	8,502	8,502	680
Intangible assets	244	244	20
Property, plant and equipment	12,504	12,504	1,000
Current tax assets	220	-	-
Accrued income	2,894	2,894	232
Other assets	4,395	4,395	352
	549,960	317,827	25,426
Off-balance sheet items			
Forward foreign exchange contracts	2,745	223	18
Contingent liabilities and commitments	85,784	9,863	789
Credit risk		327,913	26,233
Foreign exchange risk		513	41
Operational risk		34,688	2,775
Total		363,114	29,049

Own funds	
Original own funds	67,760
Additional own funds	4,123
Gross own funds	71,883
Deductions	-
Total own funds	71,883
Capital Adequacy Ratio	19.8%

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

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)*

2.8 *Fair values of financial assets and liabilities*

2.8.1 Financial instruments not measured at fair value

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

During the current financial year, all investments previously categorised as held-to-maturity were reclassified into available-for-sale investments. As at 31 December 2010, held-to-maturity investments, composed entirely of listed securities, were carried at amortised cost and were measured at the amount of €30,891,000. The investments' fair value, based on quoted market prices at 31 December 2010 amounted to €33,667,000.

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 2011, the Group's aggregate carrying amount in this respect was €345,924,000 (2010: €378,706,000). The loans and advances to customers, which are principally subject to floating interest rates, are measured at the amount of €310,354,000 (2010: €333,731,000). 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 €35,570,000 (2010: €44,975,000). 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 €469,264,000 as at 31 December 2011 (2010: €472,846,000). 3.1% (2010: 2.8%) of this liability is non-interest bearing, 28.7% (2010: 36.0%) of the liability has a contractual repricing term of three months or less, 33.5% (2010: 30.7%) reprices between three months and one year, 21.5% (2010: 19.8%) reprices between one year and five years whilst 13.2% (2010: 10.7%) 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)*

2.8.2 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 7) 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 when the impact of the time value of money is significant. The valuation techniques used are supported by observable market prices or rates since their variables include only data from observable markets. Fair values for forward foreign exchange contracts are based on forward exchange market rates.

As at 31 December 2011 and 2010, the main financial instruments that are measured at fair value, consisted of the available-for-sale investments, that were valued using Level 1 inputs and the derivative financial instruments, that were fair valued using Level 2 inputs.

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, 9 and 32).

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**	
	2011	2010	**2011**	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000	**€ 000**	€ 000
Interest receivable	**24,701**	26,066	**216**	287	**24,917**	26,353
Interest expense	**(10,734)**	(10,287)	**-**	-	**(10,734)**	(10,287)
Postal sales and other revenue	**(50)**	302	**20,444**	19,506	**20,394**	19,808
Net fee and commission income	**1,037**	1,334	**955**	895	**1,992**	2,229
Other	**2,540**	532	**(58)**	150	**2,482**	682
Segment operating income	**17,494**	17,947	**21,557**	20,838	**39,051**	38,785
Depreciation and amortisation	**(398)**	(278)	**(915)**	(917)	**(1,313)**	(1,195)
Impairment allowances	**(2,231)**	(215)	**-**	29	**(2,231)**	(186)
Employee compensation and benefits	**(4,392)**	(4,180)	**(10,083)**	(10,142)	**(14,475)**	(14,322)
Other costs	**(2,196)**	(2,533)	**(7,511)**	(6,608)	**(9,707)**	(9,141)
Profit before taxation	**8,277**	10,741	**3,048**	3,200	**11,325**	13,941
Income tax expense	**(2,979)**	(3,813)	**(1,119)**	(1,088)	**(4,098)**	(4,901)
Profit for the year	**5,298**	6,928	**1,929**	2,112	**7,227**	9,040
Segment total assets	**540,478**	546,778	**27,476**	21,022	**567,954**	567,800
Capital expenditure during the year	**844**	921	**7,325**	1,263	**8,169**	2,184
Segment total liabilities	**475,348**	483,663	**12,947**	8,094	**488,295**	491,757

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 12.5% (2010: 12.1%) of its revenue for 2011 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	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Balances with Central Bank of Malta	**41,902**	38,680	**41,902**	38,680
Malta Government treasury bills	**118,638**	67,193	**118,638**	67,193
Cash in hand	**3,635**	3,441	**2,905**	2,901
	164,175	109,314	**163,445**	108,774

The balances with the Central Bank of Malta include a reserve deposit amounting to €6,473,000 (2010: €7,438,000) 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 €6,452,000 (2010: €7,407,000).

At 31 December 2011, the Bank has pledged a deposit with the Central Bank of Malta amounting to €929,000 (2010: €959,000) in favour of the Depositor Compensation Scheme to comply with local regulatory requirements.

At 31 December 2011 the Bank's investments in Malta Government treasury bills are categorised as available-for-sale financial assets. At 31 December 2010 the Bank's investments in Malta Government treasury bills were classified as held-to-maturity investments. This reclassification is attributable to changes in the Bank's intentions (refer to note 7).

At 31 December 2011, the Bank has pledged Malta Government treasury bills with an amortised cost and fair value of €8,500,000 in favour of the Central Bank of Malta as security for a facility that was not utilised at the end of the reporting period.

6 **Derivative financial instruments**

The fair values of derivative financial instruments held at the end of the reporting period, which are categorised as held-for-trading, are set out in the following table:

Group	**Total 2011**	**Fair Value Liabilities**
	€ 000	**€ 000**
Notional amount of forward foreign exhange contracts with remaining maturity of less than 3 months	**271**	**9**

6 **Derivative financial instruments** *(continued)*

Bank	**Remaining maturity of less than 3 months € 000**	**Remaining maturity of more than 1 year € 000**	**Total 2011 € 000**	**Fair Value Assets € 000**	**Fair Value Liabilities € 000**
Notional amount of forward foreign exchange contracts	**271**	**2,474**	**2,745**	**179**	**9**

The Bank entered into derivative contracts, primarily with its subsidiary, MaltaPost p.l.c.. The derivative contracts outstanding at 31 December 2011 mainly relate to the forward purchase of JPY 31,158,000, GBP 292,000 and USD 1,717,000 against euro within two years at the weighted average contracted rates of 113.68, 0.8805 and 1.4325 respectively and the forward purchase of JPY 11,283,000, GBP 105,000 and USD 612,000 against euro maturing within three years at the weighted average contracted rates of 106.5, 0.8865 and 1.375 respectively.

7 **Investments**

	Group		**Bank**	
	2011 € 000	2010 € 000	**2011 € 000**	2010 € 000
Debt and other fixed income instruments				
- available-for-sale	**10,251**	8,079	**6,488**	2,848
- held-to-maturity	**-**	30,891	**-**	30,891
Equity instruments available-for-sale	**6,077**	7,362	**6,077**	7,362
	16,328	46,332	**12,565**	41,101

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

	Group		**Bank**	
	2011 € 000	2010 € 000	**2011 € 000**	2010 € 000
Issued by public bodies:				
- local government	**3,922**	2,528	**2,666**	-
Issued by public issuers:				
- local banks	**2,085**	2,083	**914**	904
- local corporates	**4,244**	3,468	**2,908**	1,944
	10,251	8,079	**6,488**	2,848

7 **Investments** *(continued)*

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

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Issued by public bodies:				
- local government	-	30,076	-	30,076
Issued by public issuers:				
- local corporate	-	815	-	815
	-	30,891	-	30,891

During the current financial year, the Bank reclassified its held-to-maturity financial assets portfolio into available-for-sale investments as a result of changes in the Bank's intentions.

As at 31 December 2010, the Bank's held-to-maturity financial assets comprised Malta Government Treasury Bills with a carrying amount of €67,193,000 (note 5) and investment debt securities, primarily Malta Government Stocks, with a carrying amount of €30,891,000. During 2011, the Bank reclassified Treasury Bills with an amortised cost and fair value of €105,000,000, together with debt securities, mainly Malta Government Stocks, having an amortised cost of €13,185,000 and fair value of €14,148,000. The resultant adjustment to equity, net of deferred tax, upon reclassification amounted to €626,000.

At 31 December 2011, the Bank held Malta Government Stocks classified as available-for-sale investments with a carrying amount of €1,421,000 (2010: €1,438,000) that were pledged in favour of the Depositor Compensation Scheme to comply with local regulatory requirements.

At 31 December 2010 the Bank had pledged Malta Government Stocks classified as held-to-maturity investments with an amortised cost of €13,115,000 in favour of the Central Bank of Malta as a security for a facility that was not utilised at 31 December 2010.

Borrowings by MaltaPost p.l.c. of €4,000,000 (included in note 20) are secured by general and special hypothecs over all the subsidiary's present and future assets and by pledges over its available-for-sale investments.

Equity instruments classified as available-for-sale investments comprise equities listed on the Malta Stock Exchange, except for investments with a carrying amount of €90,000 (2010: €133,000) which are measured at cost in view of the absence of a reliable fair valuation of these investments.

Equity instruments classified as available-for-sale investments include equities listed on the Malta Stock Exchange amounting to €2,789,010 (2010: €3,303,000), 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.

7 **Investments** *(continued)*

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 2011	**15,441**	**30,891**	**46,332**	**10,210**	**30,891**	**41,101**
Exchange differences	**21**	**-**	**21**	**21**	**-**	**21**
Amortisation	**(34)**	**(29)**	**(63)**	**-**	**(29)**	**(29)**
Reclassification	**13,185**	**(13,185)**	**-**	**13,185**	**(13,185)**	**-**
Redemptions/disposals	**(11,393)**	**(17,677)**	**(29,070)**	**(10,083)**	**(17,677)**	**(27,760)**
Fair value movement	**(892)**	**-**	**(892)**	**(768)**	**-**	**(768)**
At 31 December 2011	**16,328**	**-**	**16,328**	**12,565**	**-**	**12,565**
At 1 January 2010	10,392	34,633	45,025	4,724	34,633	39,357
Exchange differences	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

8 **Loans and advances to banks**

	Group		Bank	
	2011 € 000	2010 € 000	**2011 € 000**	2010 € 000
Repayable on call and at short notice	**35,570**	43,238	**33,983**	41,740
Term loans and advances	**-**	1,737	**-**	1,737
	35,570	44,975	**33,983**	43,477

9 Loans and advances to customers

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Repayable on call and at short notice	**90,522**	95,215	**90,564**	95,215
Term loans and advances	**227,696**	244,049	**228,052**	244,330
Gross loans and advances to customers	**318,218**	339,264	**318,616**	339,545
Impairment allowances	**(7,864)**	(5,533)	**(7,864)**	(5,533)
Net loans and advances to customers	**310,354**	333,731	**310,752**	334,012
Impairment allowances				
Specific impairment allowances	**5,943**	4,091	**5,943**	4,091
Collective impairment allowances	**1,921**	1,442	**1,921**	1,442
	7,864	5,533	**7,864**	5,533

The aggregate gross amount of impaired loans and advances to customers amounted to €24,050,000 (2010: €14,301,000). The balance of individually assessed allowances at the end of the reporting period includes €808,000 (2010: €671,000), reflected in the table above, in respect of interest in suspense.

Assets acquired in settlement of debt amounting to €111,000 (2010: €109,000) are presented as assets classified as held for sale.

As at 31 December 2011, loans and advances to customers amounting to €1,645,195 (2010: €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.

10 **Investment in subsidiaries**

Name of company	Country of incorporation	Nature of business	Equity interest		Carrying amount	
			2011	2010	**2011**	2010
			%	%	**€ 000**	€ 000
Redbox Limited	Malta	Holding Company	**100**	100	**8,502**	7,690
Lombard Asset Managers Limited	Malta	Management of Collective Investment Schemes	**100**	100	**-**	344
					8,502	8,034

At 31 December 2011, Redbox Limited held 67.1% (2010: 66.5%) of the equity share capital of MaltaPost p.l.c.. The remaining 32.9% (2010: 33.5%) is held by the general public. The increase in the carrying amount of the investment in Redbox Limited is attributable to additional investments by the Bank.

The end of the reporting period of the audited financial statements of MaltaPost p.l.c. that have been utilised in the preparation of these consolidated financial statements is 30 September 2011, since the financial statements prepared as of this date constitute the most recent audited financial statements of MaltaPost p.l.c..

Lombard Asset Managers Limited was the investment manager of Lombard Enterprise Fund, which was a sub-fund of Lombard Funds SICAV p.l.c.. 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. Accordingly the investment in Lombard Asset Managers Limited was written down.

11 **Intangible assets**

	Group				Bank
	Goodwill € 000	Computer software € 000	Postal licence € 000	Total € 000	Computer software € 000
At 1 January 2010					
Cost	857	2,083	1,159	4,099	1,456
Accumulated amortisation	-	(1,973)	(888)	(2,861)	(1,453)
Net book amount	857	110	271	1,238	3
Year ended 31 December 2010					
At 1 January 2010	857	110	271	1,238	3
Additions	-	183	-	183	4
Amortisation for the year	-	(49)	(77)	(126)	(4)
At 31 December 2010	857	244	194	1,295	3
At 31 December 2010					
Cost	857	2,266	1,159	4,282	1,460
Accumulated amortisation	-	(2,022)	(965)	(2,987)	(1,457)
Net book amount	857	244	194	1,295	3
Year ended 31 December 2011					
At 1 January 2011	**857**	**244**	**194**	**1,295**	**3**
Additions	**-**	**267**	**-**	**267**	**72**
Reclassification (note 12)	**-**	**241**	**-**	**241**	**241**
Amortisation for the year	**-**	**(208)**	**(77)**	**(285)**	**(72)**
At 31 December 2011	**857**	**544**	**117**	**1,518**	**244**
At 31 December 2011					
Cost	**857**	**2,774**	**1,159**	**4,790**	**1,773**
Accumulated amortisation	**-**	**(2,230)**	**(1,042)**	**(3,272)**	**(1,529)**
Net book amount	**857**	**544**	**117**	**1,518**	**244**

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.

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

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

The recognised goodwill represents payments made by the Group in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised. As at 31 December 2011 and 2010 the recognised goodwill amounted to €857,000 and related to the acquisition of MaltaPost p.l.c..

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

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

This calculation takes into account the market capitalisation of MaltaPost p.l.c. based on the quoted price of its equity on the Malta Stock Exchange at a price per share of €1 as at 31 December 2011 (2010: €1). On this basis, the recoverable amount of the cash-generating unit is higher than its carrying amount.

12 **Property, plant and equipment**

Group	**Land and buildings € 000**	**Computer equipment € 000**	**Other € 000**	**Total € 000**
At 1 January 2010				
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
Acquisitions	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
Year ended 31 December 2011				
At 1 January 2011	**13,060**	**727**	**953**	**14,740**
Acquisitions	**6,814**	**397**	**691**	**7,902**
Reclassification (note 11)	**-**	**(241)**	**-**	**(241)**
Disposals	**-**	**(9)**	**(1)**	**(10)**
Charge for the year	**(496)**	**(236)**	**(296)**	**(1,028)**
Released on disposals	**-**	**9**	**1**	**10**
At 31 December 2011	**19,378**	**647**	**1,348**	**21,373**
At 31 December 2011				
Cost	**22,859**	**2,956**	**5,920**	**31,735**
Accumulated depreciation	**(3,481)**	**(2,309)**	**(4,572)**	**(10,362)**
Net book amount	**19,378**	**647**	**1,348**	**21,373**

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

Bank	**Land and buildings € 000**	**Computer equipment € 000**	**Other € 000**	**Total € 000**
At 1 January 2010				
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
Acquisitions	486	303	129	918
Revaluation of land and buildings:				
- effect on cost or valuation	(138)	-	-	(138)
- effect on accumulated depreciation	138	-	-	138
Charge for the year	(79)	(73)	(121)	(273)
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
Year ended 31 December 2011				
At 1 January 2011	**11,213**	**596**	**490**	**12,299**
Acquisitions	**632**	**97**	**43**	**772**
Reclassification (note 11)	**-**	**(241)**	**-**	**(241)**
Disposals	**-**	**(9)**	**(1)**	**(10)**
Charge for the year	**(99)**	**(110)**	**(117)**	**(326)**
Released on disposals	**-**	**9**	**1**	**10**
At 31 December 2011	**11,746**	**342**	**416**	**12,504**
At 31 December 2011				
Cost	**12,313**	**1,639**	**2,461**	**16,413**
Accumulated depreciation	**(567)**	**(1,297)**	**(2,045)**	**(3,909)**
Net book amount	**11,746**	**342**	**416**	**12,504**

12 **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 2011 and 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	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Cost	**20,375**	13,562	**9,832**	9,200
Accumulated depreciation	**(3,833)**	(3,322)	**(921)**	(810)
Net book amount	**16,542**	10,240	**8,911**	8,390

13 **Investment property**

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

	Group		Bank	
	2011	2010	**2011**	2010
	€ 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 5% by reference to Article 1501 (2) of the Civil Code (Chapter 16, Laws of Malta).

14 **Deferred tax assets**

Deferred tax assets and liabilities are attributable to the following:

Group

	Assets 2011 € 000	**Liabilities 2011 € 000**	**Net 2011 € 000**	Assets 2010 € 000	Liabilities 2010 € 000	Net 2010 € 000
Difference between depreciation and capital allowances	**391**	**(51)**	**340**	310	-	310
Provisions for liabilities and charges	**267**	**-**	**267**	339	-	339
Loan impairment allowances	**2,780**	**-**	**2,780**	1,964	-	1,964
Revaluation of property	**-**	**(823)**	**(823)**	-	(823)	(823)
Fair value movements on investments	**66**	**-**	**66**	-	(205)	(205)
Other temporary differences	**-**	**(58)**	**(58)**	-	-	-
	3,504	**(932)**	**2,572**	2,613	(1,028)	1,585

Bank

	Assets 2011 € 000	**Liabilities 2011 € 000**	**Net 2011 € 000**	Assets 2010 € 000	Liabilities 2010 € 000	Net 2010 € 000
Difference between depreciation and capital allowances	**-**	**(51)**	**(51)**	-	(47)	(47)
Provisions for liabilities and charges	**237**	**-**	**237**	223	-	223
Loan impairment allowances	**2,752**	**-**	**2,752**	1,936	-	1,936
Revaluation of property	**-**	**(823)**	**(823)**	-	(823)	(823)
Fair value movements on investments	**66**	**-**	**66**	-	(205)	(205)
	3,055	**(874)**	**2,181**	2,159	(1,075)	1,084

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

	2011 € 000	2010 € 000
Tax losses carried forward	**-**	179

14 **Deferred tax assets** *(continued)*

Movement in temporary differences relating to:

Group

	At 1 January 2010 € 000	Recognised in profit or loss € 000	Recognised in other comprehensive income € 000	**At 31 December 2010 € 000**	**Recognised in profit or loss € 000**	**Recognised in other comprehensive income € 000**	**At 31 December 2011 € 000**
Difference between depreciation and capital allowances	285	25	-	**310**	**30**	**-**	**340**
Provisions for liabilities and charges	322	17	-	**339**	**(72)**	**-**	**267**
Loan impairment allowances	2,152	(188)	-	**1,964**	**816**	**-**	**2,780**
Revaluation of property	(578)	-	(245)	**(823)**	**-**	**-**	**(823)**
Fair value movements on investments	(188)	-	(17)	**(205)**	**-**	**271**	**66**
Other temporary differences	-	-	-	**-**	**(58)**	**-**	**(58)**
	1,993	(146)	(262)	**1,585**	**716**	**271**	**2,572**

Bank

	At 1 January 2010 € 000	Recognised in profit or loss € 000	Recognised in other comprehensive income € 000	**At 31 December 2010 € 000**	**Recognised in profit or loss € 000**	**Recognised in other comprehensive income € 000**	**At 31 December 2011 € 000**
Difference between depreciation and capital allowances	5	(52)	-	**(47)**	**(4)**	**-**	**(51)**
Provisions for liabilities and charges	202	21	-	**223**	**14**	**-**	**237**
Loan impairment allowances	2,110	(174)	-	**1,936**	**816**	**-**	**2,752**
Revaluation of property	(578)	-	(245)	**(823)**	**-**	**-**	**(823)**
Fair value movements on investments	(188)	-	(17)	**(205)**	**-**	**271**	**66**
	1,551	(205)	(262)	**1,084**	**826**	**271**	**2,181**

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.

15 Inventories

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Postal supplies and materials	**141**	123	**-**	-
Merchandise	**397**	448	**-**	-
Other stock items	**246**	143	**246**	143
	784	714	**246**	143

16 Trade and other receivables

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Trade receivables - net of impairment allowances	**7,455**	7,121	**-**	-
Others	**906**	382	**906**	385
	8,361	7,503	**906**	385

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

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
At 1 January	**79**	118	**-**	-
Reversal of provisions	**-**	(39)	**-**	-
At 31 December	**79**	79	**-**	-

17 Accrued income and other assets

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Accrued income	**2,962**	3,180	**2,897**	3,103
Other assets	**1,885**	144	**203**	144
	4,847	3,324	**3,100**	3,247

18 **Share capital**

Bank

	2011		2010	
	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**	36,093	9,023

	Ordinary shares	
	2011	2010
	000s	000s
On issue at 1 January	**36,093**	35,614
Rights issue	**-**	479
On issue at 31 December	**36,093**	36,093

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.

19 **Reserves**

These reserves are non-distributable.

19.1 *Share premium*

The increase in the share premium account during the preceding 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.

19.2 *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.

19.3 *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.

19.4 *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.

20 **Amounts owed to banks**

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Term deposits with agreed maturity dates or periods of notice	**6,779**	-	**2,779**	-
Repayable on demand	**163**	149	**206**	149
	6,942	149	**2,985**	149

21 **Amounts owed to customers**

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Term deposits with agreed maturity dates	**342,047**	353,639	**342,047**	354,714
Repayable on demand	**120,275**	119,058	**121,714**	120,371
	462,322	472,697	**463,761**	475,085

22 **Provisions for liabilities and other charges**

Provisions	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Obligation to Government	**1,663**	1,683	**-**	-
Legal	**763**	969	**676**	636
	2,426	2,652	**676**	636

These provisions are predominantly non-current in nature.

Group	**2011**			2010		
	Obligation to Government	**Legal**	**Total**	Obligation to Government	Legal	Total
	€ 000	**€ 000**	**€ 000**	€ 000	€ 000	€ 000
At 1 January	**1,683**	**969**	**2,652**	1,600	920	2,520
Exchange differences recognised in profit or loss	**-**	**17**	**17**	-	37	37
Charge/(credit) for the year	**20**	**(223)**	**(203)**	127	12	139
Crystallised obligations	**(40)**	**-**	**(40)**	(44)	-	(44)
At 31 December	**1,663**	**763**	**2,426**	1,683	969	2,652

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:

	2011	2010
	€ 000	€ 000
Present value of unfunded obligations	**2,667**	2,647
Crystallised obligations	**(305)**	(265)
Fair value of obligations to be reimbursed by Government	**(699)**	(699)
	1,663	1,683

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

The movement for the year is made up of:

	2011 **€ 000**	2010 € 000
Charge to the income statement	**20**	127
Crystallised obligations	**(40)**	(44)
	(20)	83

The amount recognised in the income statement is as follows:

	2011 **€ 000**	2010 € 000
Interest cost	**69**	80
Net actuarial (gains)/losses recognised during the year	**(49)**	47
Total amount charged to the income statement	**20**	127

In computing the Obligation to Government, the Group used a discount rate of 4.56% (2010: 4.46%), whereas the future salary increases were based on inflation rates and past salary increases.

Bank

	2011 **Legal** **€ 000**	2010 Legal € 000
Year ended 31 December		
At 1 January	**636**	577
Exchange differences recognised in profit or loss	**17**	37
Charge for the year	**23**	22
At 31 December	**676**	636

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.

23 **Other liabilities**

	Group		**Bank**	
	2011 **€ 000**	2010 € 000	**2011** **€ 000**	2010 € 000
Trade payables	**1,862**	1,841	**-**	-
Bills payable	**955**	2,594	**955**	2,594
Cash collateral	**72**	2	**72**	2
Other payables	**3,356**	3,470	**3,122**	3,083
	6,245	7,907	**4,149**	5,679

24 Accruals and deferred income

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Accrued interest	**4,728**	3,826	**4,728**	3,861
Other	**5,623**	4,526	**574**	671
	10,351	8,352	**5,302**	4,532

25 Commitments and contingent liabilities

Group/Bank

	2011	2010
	€ 000	€ 000
Contingent liabilities		
Guarantee obligations incurred on behalf of third parties	**6,314**	7,067
Commitments		
Documentary credits	**1,133**	1,718
Credit facilities and other commitments to lend	**78,337**	80,528
	79,470	82,246

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:

	2011	2010
	€ 000	€ 000
Within 1 year	**158**	262
Between 2 and 5 years	**147**	322
	305	584

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.

26 **Net interest income**

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Interest income				
On loans and advances to banks	**298**	136	**286**	128
On loans and advances to customers	**21,591**	22,894	**21,591**	22,894
On balances with Central Bank of Malta	**171**	112	**171**	112
On Malta Government treasury bills	**1,404**	704	**1,404**	704
	23,464	23,846	**23,452**	23,838
On debt and other fixed income instruments	**1,516**	2,583	**1,281**	2,332
Net amortisation of premiums and discounts	**(63)**	(76)	**(29)**	(65)
	1,453	2,507	**1,252**	2,267
Total interest income	**24,917**	26,353	**24,704**	26,105
Interest expense				
On amounts owed to banks	**(7)**	(10)	**(7)**	(10)
On amounts owed to customers	**(10,727)**	(10,277)	**(10,732)**	(10,316)
Total interest expense	**(10,734)**	(10,287)	**(10,739)**	(10,326)
Net interest income	**14,183**	16,066	**13,965**	15,779

27 Net fee and commission income

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Fee and commission income				
Retail banking customer fees	**1,067**	673	**1,067**	673
Brokerage	**24**	197	**24**	197
Other	**977**	1,422	**22**	520
Total fee and commission income	**2,068**	2,292	**1,113**	1,390
Fee and commission expense				
Inter bank transaction fees	**(67)**	(47)	**(67)**	(47)
Other	**(9)**	(16)	**(7)**	(16)
Total fee and commission expense	**(76)**	(63)	**(74)**	(63)
Net fee and commission income	**1,992**	2,229	**1,039**	1,327

28 Postal sales and other revenues

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Stamps, parcel post and postal stationery including income from foreign inbound mail	**19,942**	18,755	**-**	-
Collectibles and philatelic sales	**339**	930	**8**	342
Other	**113**	123	**-**	-
	20,394	19,808	**8**	342

29 Dividend income

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Subsidiary company	**-**	-	**1,107**	1,169
Available-for-sale equity shares	**136**	157	**136**	157
	136	157	**1,243**	1,326

30 **Net trading income**

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Gains on foreign exchange activities	**305**	583	**556**	364

31 **Employee compensation and benefits**

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Staff costs				
- wages, salaries and allowances	**13,435**	13,312	**4,203**	3,935
- social security costs	**1,040**	1,010	**254**	245
	14,475	14,322	**4,457**	4,180

	Group		Bank	
	2011	2010	**2011**	2010
Average number of employees				
Managerial	**64**	69	**40**	39
Others	**694**	678	**116**	118
	758	747	**156**	157

32 **Net impairment losses**

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Write-downs				
Loans and advances to customers				
- specific allowances	**(2,049)**	(636)	**(2,049)**	(636)
- collective allowances	**(479)**	-	**(479)**	-
- bad debts written off	**(37)**	-	**(37)**	-
	(2,565)	(636)	**(2,565)**	(636)
Reversals of write-downs				
Loans and advances to customers				
- specific allowances	**334**	4	**334**	4
- collective allowances	**-**	417	**-**	417
Trade receivables - specific allowances	**-**	29	**-**	-
	334	450	**334**	421
Net impairment losses	**(2,231)**	(186)	**(2,231)**	(215)

33 **Profit before taxation**

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

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
After charging				
Directors' emoluments				
- fees	**72**	74	**61**	63
- other emoluments	**313**	303	**313**	303
After crediting				
Rental income from investment property	**37**	37	**37**	37
Net income from investment services	**45**	269	**45**	269

Other operating costs are analysed as follows:

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Foreign outbound mail	**3,193**	2,703	**-**	-
Utilities and insurance	**555**	586	**268**	304
IT support and telecommunication costs	**840**	855	**225**	293
Repairs and maintenance	**944**	836	**231**	213
Operating lease rental charges	**907**	911	**289**	222
Other administrative expenses	**3,225**	3,111	**1,216**	1,486
Total other operating costs	**9,664**	9,002	**2,229**	2,518

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				
2011	**40**	**-**	**4**	**-**
2010	40	-	-	5
Auditors of subsidiary companies				
2011	**18**	**11**	**4**	**9**
2010	24	11	10	4

34 **Income tax expense**

Recognised in profit or loss:

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Current taxation				
Current tax expense	**4,814**	4,792	**4,098**	4,017
Adjustment to prior years' current tax expense	**-**	(37)	**-**	-
	4,814	4,755	**4,098**	4,017
Deferred taxation				
Deferred tax (income)/expense (note 14)	**(716)**	146	**(826)**	205
	4,098	4,901	**3,272**	4,222

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

	Group		Bank	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Profit before income tax	**11,325**	13,941	**9,281**	11,938
Tax on profit at 35%	**3,964**	4,879	**3,248**	4,178
Tax effect of:				
Expenses non-deductible for tax purposes	**49**	79	**84**	11
Income taxed at different tax rates	**(49)**	(63)	**(92)**	-
Depreciation expense not deductible by way of capital allowances	**32**	33	**32**	33
Adjustment to prior years' current tax expense	**-**	(37)	**-**	-
Impact of change in tax status of a foreign shareholder	**61**	-	**-**	-
Other differences	**41**	10	**-**	-
	4,098	4,901	**3,272**	4,222

34 **Income tax expense** *(continued)*

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

Group	**2011**			2010		
	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	**1,060**	**(374)**	**686**	423	(68)	355
- Reclassification adjustments to profit or loss	**(1,981)**	**693**	**(1,288)**	(2)	-	(2)
Revaluation of property	**-**	**-**	**-**	-	(245)	(245)
Other adjustments	**-**	**(35)**	**(35)**	-	-	-
	(921)	**284**	**(637)**	421	(313)	108

Bank						
Fair valuation of available-for-sale financial assets:						
- Net changes in fair value	**1,183**	**(414)**	**769**	271	(69)	202
- Reclassification adjustments to profit or loss	**(1,981)**	**693**	**(1,288)**	(2)	-	(2)
Revaluation of property	**-**	**-**	**-**	-	(245)	(245)
Other adjustments	**-**	**5**	**5**	-	-	-
	(798)	**284**	**(514)**	269	(314)	(45)

35 **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	
	2011	2010
Net profit attributable to equity holders of the Bank (€ 000)	**6,593**	8,332
Weighted average number of ordinary shares in issue	**36,092,692**	35,935,176
Earnings per share (€)	**18c3**	23c2

The Bank's issued share capital did not change during the reporting period ended 31 December 2011. The increase in the weighted average number of ordinary shares in issue reflected in the table above is attributable to the rights issue approved by the shareholders during the Annual General Meeting held on 22 April 2010.

36 **Dividends**

	2011	2010
Dividends declared and paid by the Bank (€ 000)	**2,698**	2,315
€ per share – gross	**0.115**	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 per share, for the twelve months ended 31 December 2011 is being proposed for approval by the shareholders. A resolution to that effect will be proposed to the shareholders at the Annual General Meeting.

37 **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	
	2011	2010	**2011**	2010
	€ 000	€ 000	**€ 000**	€ 000
Malta Government treasury bills (note 5)	**51,334**	16,965	**51,334**	16,965
Loans and advances to banks (notes 5 and 8)	**70,070**	75,258	**68,483**	73,760
Cash (note 5)	**3,635**	3,441	**2,905**	2,901
Amounts owed to banks (note 20)	**(2,510)**	(149)	**(2,554)**	(149)
Cash and cash equivalents	**122,529**	95,515	**120,168**	93,477

38 **Related parties**

38.1 *Identity of related parties*

The Bank has a related party relationship with its subsidiaries, its major shareholder Marfin Popular Bank Public Co Limited, the Bank's directors ("key management personnel") and other related parties, primarily entities controlled by key management personnel.

38.2 *Transaction arrangements and agreements involving key management personnel*

Information on transactions, arrangements and agreements entered into by the Bank with key management personnel, being the directors, and entities controlled by such individuals as highlighted below:

	Loans and advances	**Commitments**	Loans and advances	Commitments
	2011	**2011**	2010	2010
Year ended 31 December	**€ 000**	**€ 000**	€ 000	€ 000
At 1 January	**1,360**	**532**	1,232	697
Additions	**295**	**450**	434	-
Repayments	**(1,072)**	**-**	(306)	-
Drawn commitments	**-**	**(63)**	-	(165)
At 31 December	**583**	**919**	1,360	532

The above banking facilities are part of long-term commercial relationships and were made in the ordinary course of business on substantially the same terms, including rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

38 **Related parties** *(continued)*

38.3 *Compensation to key management personnel*

Details of directors' fees and emoluments are stated in note 33.

38.4 *Transactions with other related parties*

38.4.1 Subsidiaries

Information relating to transactions undertaken by the Bank with its subsidiary companies during the year:

	2011	2010
	€ 000	€ 000
Income statement		
Other income	**64**	9
Interest payable	**6**	39
Administrative expenses	**59**	40
Statement of financial position		
Loans and advances to customers	**398**	281
Amounts owed to customers	**1,438**	2,389
Other liabilities	**-**	3

During the current financial year, the Bank entered into forward foreign exchange contracts with MaltaPost p.l.c. for an aggregate notional amount disclosed in note 6 to the financial statements. These contracts were entered into at market rates prevailing on transaction date such that MaltaPost p.l.c. hedges its principal foreign exchange exposures.

Moreover, during the year, Redbox Limited received gross dividends from MaltaPost p.l.c. amounting to €1,107,000 (2010: €1,169,000), which dividends were ultimately received by the Bank (Note 29).

38.4.2 Major shareholder

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

	2011	2010
	€ 000	€ 000
Income statement		
Interest receivable and similar income	**-**	11
Statement of financial position		
Accruals and deferred income	**-**	41

39 **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.

40 **Statutory information**

Lombard Bank Malta p.l.c. is a limited liability company domiciled and incorporated in Malta.

LOMBARD

ADDITIONAL REGULATORY DISCLOSURES

For the Year Ended 31 December 2011

2011

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 III quantitative and qualitative disclosure requirements as governed by Banking Rule BR 07, "Publication of Annual report and Audited Financial Statements of Credit Institutions authorised under the Banking Act 1994" issued by the Malta Financial Services Authority. These disclosures 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 oversees 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 changes that affect the country in which the loan is booked. Settlement risk refers to the risk of losses through failure of the counter-party to settle outstanding dues on the settlement date owing to bankruptcy or other causes.

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

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

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

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

- *Operational risk*: Risk of 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.

2.2 *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 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, derivative financial instruments, 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.

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

- 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.

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 in accordance with the regulatory information submitted to the MFSA, are as follows:

	2011
	€ 000
Credit risk exposures relating to on-balance sheet assets	
Balances with Central Bank of Malta	41,902
Cheques in course of collection	456
Loans and advances to banks	33,983
Loans and advances to customers	310,752
Available-for-sale financial assets	131,203
Other assets	11,619
	529,915
Credit risk exposures relating to off-balance sheet instruments	
Forward foreign exchange contracts	2,745
Contingent liabilities	6,314
Commitments	79,470
	88,529

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 2011.

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.

Derivative counterparties of the Bank are principally limited to its subsidiary MaltaPost p.l.c. that is controlled by the Bank.

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 Bank'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.

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

As at 31 December 2011, 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.

An analysis of concentrations of credit risk at the end of the reporting period is as follows.

2.2.1 Credit risk exposures analysed by location

The Bank monitors concentrations of credit risk by location. The following table summarises the country of risk of the on-balance and off-balance sheet items.

At 31 December 2011	**Carrying amount**	**Malta**	**Eurozone**	**Other European countries**	**Other**
	€ 000	**€ 000**	**€ 000**	**€ 000**	**€ 000**
On-balance sheet assets					
Central Government or central banks	163,426	163,426	-	-	-
Institutions	36,048	15,877	13,829	5,799	543
Corporates	62,632	61,090	-	-	1,542
Retail	22,777	22,476	34	5	262
Secured by real estate property	161,938	161,938	-	-	-
Past due items	79,741	79,281	-	-	460
Other items	3,353	3,353	-	-	-
	529,915	507,441	13,863	5,804	2,807
Off-balance sheet instruments					
Corporates	3,802	3,802	-	-	-
Retail	520	520	-	-	-
Secured by real estate property	5,869	5,869	-	-	-
Other items	78,338	78,338	-	-	-
	88,529	88,529	-	-	-

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

2.2.2 Credit risk 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 relate to loans and advances to customers, gross of impairment allowances:

	2011 **€ 000**
Agriculture and fishing	3,206
Community, recreational and personal service activities	7,951
Construction	127,442
Education	7,766
Financial services	1,800
Health and social work	166
Hotels and restaurants excluding related construction activities	9,056
Households and individuals	32,698
Manufacturing	7,029
Mining and quarrying	913
Real estate, renting and business activities	75,026
Transport, storage and communication	8,358
Wholesale and retail trade	37,205
Gross amount granted to customers	318,616

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:

	2011 **€ 000**
Corporate:	
Financial services	914
Real estate and construction	317
Tourism	783
Wholesale and retail trade	1,494
Others	314
Government	2,666
	6,488

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

2.2.3 Credit risk exposures analysed by residual maturity

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

At 31 December 2011	**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	163,426	160,760	1,298	1,368
Institutions	36,048	35,327	621	100
Corporates	62,632	13,669	44,195	4,768
Retail	22,777	13,247	7,631	1,899
Secured by real estate property	161,938	94,183	54,255	13,500
Past due items	79,741	79,741	-	-
Other items	3,353	3,353	-	-
	529,915	400,280	108,000	21,635
Off-balance sheet instruments				
Corporates	3,802	1,328	2,474	-
Retail	520	520	-	-
Secured by real estate property	5,869	5,869	-	-
Other items	78,338	78,338	-	-
	88,529	86,055	2,474	-

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 2011	**Treasury bills**	**Debt securities**	**Total**
	€ 000	**€ 000**	**€ 000**
A- to AA-	118,638	2,666	121,304
Lower than A-	-	914	914
Unrated	-	2,908	2,908
	118,638	6,488	125,126

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

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

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

	2011
	€ 000
Gross loans and advances	
Regular	168,706
Watch	54,361
Substandard	8,537
Doubtful	87,012
	318,616

	2011
	€ 000
Gross loans and advances	
Impaired	24,050
Past due but not impaired	140,969
Neither past due nor impaired	153,597
	318,616

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 review 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)*

2.3.1 Impaired loans and advances

The Bank reviews and grades advances using the criteria laid down in the Banking Rule 09: Credit and Country Risk Provisioning by Credit Institutions Licensed under the Banking Act, 1994. The individually impaired loans and advances mainly relate to a number of independent customers 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 2011	**Impaired**	**Past due but not impaired**
	€ 000	**€ 000**
Gross loans and advances by industry		
Construction	14,294	85,503
Manufacturing	1,871	3,382
Personal	2,458	14,426
Tourism	2,288	2,657
Trade	654	5,139
Professional	102	1,528
Other	2,383	28,334
	24,050	140,969

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.

	2011
	€ 000
Past due up to 30 days	50,972
Past due between 31 and 60 days	27,586
Past due between 61 and 90 days	6,799
Past due over 90 days	55,612
	140,969

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

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.

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 2011

	Collateral against		
	Individually impaired	**Past due but not impaired**	**Neither past due nor impaired**
	€ 000	**€ 000**	**€ 000**
Immovable property	13,684	106,526	107,949
Cash or quasi cash	155	2,006	7,764
Prime bank guarantees	-	386	1,098
Other security	545	366	2,234
	14,384	109,284	119,045

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 2011 amounted to €39,728,000.

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

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.

At 31 December 2011

	Specific impairment allowances	**Collective impairment allowances**	**Total**
	€ 000	**€ 000**	**€ 000**
At 1 January	4,091	1,442	5,533
Additions	2,049	479	2,528
Reversals	(334)	-	(334)
Other movements	137	-	137
At 31 December	5,943	1,921	7,864

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 to the respective institutions 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 €20,158,000.

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 re-price at different times or at different amounts. The Bank accepts deposits from customers at both fixed and floating rates and for varying maturity periods. This risk is managed through the matching of the interest resetting dates on assets and liabilities as much as it is practicable. However, the Bank seeks to manage its net interest spread over 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.

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 **Market risk** *(continued)*

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 2011

	Fixed Rate	**Variable Rate**
	€ 000	**€ 000**
Interest earning assets		
Balances with Central Bank of Malta and treasury bills	34,500	126,040
Debt and other fixed income instruments classified as:		
- available-for-sale investments	6,488	-
Loans and advances to banks	28,382	2,330
Loans and advances to customers	-	309,107
	69,370	437,477
Interest bearing liabilities		
Amounts owed to banks	2,778	-
Amounts owed to customers	342,048	107,355
	344,826	107,355

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 2011

	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	163,445	1.15	112,560	47,980	-	-	2,905
Debt and other fixed income instruments classified as:							
- available-for-sale investments	6,488	6.12	20	414	3,677	2,377	-
Loans and advances to banks	33,983	0.53	30,712	-	-	-	3,271
Loans and advances to customers	310,752	6.78	309,107	-	-	-	1,645
	514,668		452,399	48,394	3,677	2,377	7,821
Financial liabilities							
Amounts owed to banks	2,985	1.31	2,347	431	-	-	207
Amounts owed to customers	463,761	2.25	220,186	98,600	97,719	32,898	14,358
	466,746		222,533	99,031	97,719	32,898	14,565
Interest repricing gap			229,866	(50,637)	(94,042)	(30,521)	(6,744)
Cumulative gap			229,866	179,229	85,187	54,666	

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 analyses 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 2011	3,301	(3,301)

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 open foreign currency forward contracts at the end of the reporting period had a notional amount of €2,745,000.

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

The following table summarises the Bank's currency position taking into account all the Bank's assets and liabilities in accordance with the regulatory information submitted to the MFSA:

At 31 December 2011

	Total	**EUR**	**GBP**	**USD**	**Other**
	€ 000	**€ 000**	**€ 000**	**€ 000**	**€ 000**
Assets					
Balances with Central Bank of Malta, treasury bills and cash	163,445	162,997	89	335	24
Derivative financial instruments	179	-	16	127	36
Investments classified as:					
- available-for-sale	12,565	11,919	-	646	-
Loans and advances to banks	33,983	7,288	15,289	10,364	1,042
Loans and advances to customers	310,752	300,749	2	7,670	2,331
Other assets	29,215	29,208	-	7	-
Total assets	550,139	512,161	15,396	19,149	3,433
Liabilities					
Derivative financial instruments	9	-	-	9	-
Amounts owed to banks	2,985	206	-	-	2,779
Amounts owed to customers	463,761	427,463	15,792	19,593	913
Other liabilities	10,127	9,168	101	816	42
Total liabilities	476,882	436,837	15,893	20,418	3,734
Total equity	73,257	73,257	-	-	-
Total liabilities and equity	550,139	510,094	15,893	20,418	3,734
Net on balance sheet currency position		2,067	(497)	(1,269)	(301)
Net notional position of derivative financial instruments		(2,203)	435	1,254	344
Net currency exposure		(136)	(62)	(15)	43
Contingent liabilities and commitments	85,784	84,758	12	316	698

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

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.

3.4 *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.

	2011
	%
Investments:	
- issued by local government	21
- issued by corporate	79
	100
Debt and other fixed income instruments:	
- issued by local government	41
- issued by corporate	59
	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.

4 **Liquidity risk** *(continued)*

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 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.

As at 31 December 2011, the Bank had outstanding guarantees on behalf of third parties amounting to €6,314,000, which are cancellable upon the request of third parties.

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 2011

	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	112,560	47,980	-	-	2,905	163,445
Derivative financial instruments	-	-	179	-	-	179
Available-for-sale investments	20	414	3,677	2,377	6,077	12,565
Loans and advances to banks	33,983	-	-	-	-	33,983
Loans and advances to customers	146,327	34,406	104,113	25,906	-	310,752
Other assets	2,670	684	-	-	1,109	4,463
	295,560	83,484	107,969	28,283	10,091	525,387
Financial liabilities						
Derivative financial instruments	9	-	-	-	-	9
Amounts owed to banks	2,554	431	-	-	-	2,985
Amounts owed to customers	234,543	98,601	97,719	32,898	-	463,761
Other liabilities	2,792	2,883	1,379	465	1,360	8,879
	239,898	101,915	99,098	33,363	1,360	475,634
Maturity gap	55,662	(18,431)	8,871	(5,080)	-	-
Cumulative gap	55,662	37,231	46,102	41,022	-	-

4 **Liquidity risk** *(continued)*

As at 31 December 2011, the Bank had outstanding guarantees on behalf of the third parties amounting to €6,314,000 (2010: €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 2011

	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	2,560	438	-	-	2,998
Amounts owed to customers	235,038	101,532	111,442	42,140	490,152
	237,598	101,970	111,442	42,140	493,150

The following tables analyse all the Bank's principal derivative financial instruments 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 2011

	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
Inflows	271	-	2,653	-	2,924
Outflows	(280)	-	(2,474)	-	(2,754)
	(9)	-	179	-	170

5 Operational risk

Operational risk is the risk of losses owing to:
- deficient or erroneous internal procedures
- human or system errors
- external events, including legal events
- internal and external fraud
- employment practices and workplace safety
- clients, products and business practices
- damage to physical assets
- business disruption and system failures
- 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.

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 €2,775,000.

6 Capital risk 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 risk management *(continued)*

6.1 *Own funds*

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.

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 2011, 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 BR 03: Own Funds of Credit Institutions Authorised under the Banking Act, 1994 being Original own funds and Additional own funds.

	2011 **€ 000**
Original own funds – Tier 1	
Share capital (note a)	9,023
Share premium (note b)	17,746
Retained earnings (note c)	42,048
Less: Intangible assets	(246)
Less: Unrealised net losses on available-for-sale investments	(811)
Total original own funds	67,760
Additional own funds – Tier 2	
Property revaluation reserve (note d)	1,833
Investment revaluation reserve (note e)	369
Collective impairment allowances	1,921
Total own funds	71,883

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

(a) Share capital

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

	2011	
	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 retained earnings represent earnings not paid out as dividends.

(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 risk 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 I 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% 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%. 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%) and adding the resulting figures to the sum of risk-weighted assets for credit risk.

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

Below is the Bank's capital requirements and capital adequacy ratio computation, in accordance with the regulatory information submitted by the Bank to the MFSA:

At 31 December 2011

	Exposure value	Average amount	Weighted amount	Capital Requirement amount
	€ 000	€ 000	€ 000	€ 000
On-balance sheet assets by exposure classes				
Government or central banks	163,426	162,547	-	-
Institutions	36,048	41,247	9,690	775
Corporates	62,632	59,601	62,645	5,012
Retail	22,777	20,533	17,082	1,367
Secured by real estate property	161,938	158,334	138,463	11,077
Past due items	79,741	73,811	69,681	5,574
Other items	23,398	22,151	20,266	1,621
	549,960	538,224	317,827	25,426
Off-balance sheet instruments by exposure classes				
Corporates	3,802	4,424	1,281	103
Retail	520	513	390	31
Secured by real estate property	5,869	6,327	5,281	422
Other items	78,338	83,394	3,134	251
Credit risk			327,913	26,233
Foreign exchange risk			513	41
Operational risk			34,688	2,775
Total			363,114	29,049
Own funds				
Original own funds				67,760
Additional own funds				4,123
Gross own funds				71,883
Deductions				-
Total own funds				71,883
Capital Adequacy Ratio				19.8%

6 **Capital risk 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 Crediting 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.

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

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.

6.3 *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
At 31 December

Group

	2011	2010	2009	2008	2007
	€ 000	€ 000	€ 000	€ 000	€ 000
Assets					
Balances with Central Bank of Malta, treasury bills and cash	**164,175**	109,314	116,357	68,576	75,181
Cheques in course of collection	**456**	750	811	2,748	2,229
Investments	**16,328**	46,332	45,025	51,627	54,894
Loans and advances to banks	**35,570**	44,975	22,383	49,214	88,975
Loans and advances to customers	**310,354**	333,731	327,802	325,025	260,284
Intangible assets	**1,518**	1,295	1,238	1,302	1,400
Property, plant and equipment	**21,373**	14,740	13,878	13,009	10,352
Investment property	**745**	745	745	745	745
Assets classified as held for sale	**111**	109	109	-	-
Current tax assets	**760**	2,683	1,171	234	-
Deferred tax assets	**2,572**	1,585	1,993	1,973	2,055
Inventories	**784**	714	671	821	804
Trade and other receivables	**8,361**	7,503	6,545	4,438	3,937
Accrued income and other assets	**4,847**	3,324	4,113	5,022	3,606
Total assets	**567,954**	567,800	542,841	524,734	504,462
Equity and liabilities					
Equity					
Share capital	**9,023**	9,023	8,903	8,762	5,024
Share premium	**17,746**	17,746	16,409	15,137	13,590
Property revaluation reserve	**2,043**	2,043	2,288	2,288	2,288
Investment revaluation reserve	**(36)**	566	290	23	587
Other reserves	**2,556**	2,397	-	-	-
Retained earnings	**43,553**	39,932	36,395	31,518	29,550
Equity attributable to equity holders of the Bank	**74,885**	71,707	64,285	57,728	51,039
Non-controlling interests	**4,774**	4,336	3,917	3,401	3,460
Total equity	**79,659**	76,043	68,202	61,129	54,499
Liabilities					
Derivative financial instruments	**9**	-	-	-	-
Amounts owed to banks	**6,942**	149	3,675	130	736
Amounts owed to customers	**462,322**	472,697	446,209	439,860	418,206
Current tax liabilities	**-**	-	-	-	1,640
Provision for liabilities and other charges	**2,426**	2,652	2,520	2,413	2,262
Other liabilities	**6,245**	7,907	12,586	12,416	20,431
Accruals and deferred income	**10,351**	8,352	9,649	8,786	6,688
Total liabilities	**488,295**	491,757	474,639	463,605	449,963
Total equity and liabilities	**567,954**	567,800	542,841	524,734	504,462
Memorandum items					
Contingent liabilities	**6,314**	7,067	10,484	6,624	6,508
Commitments	**79,470**	82,246	98,611	79,948	60,592

Five Year Summary
Income Statements
For the Year Ended 31 December

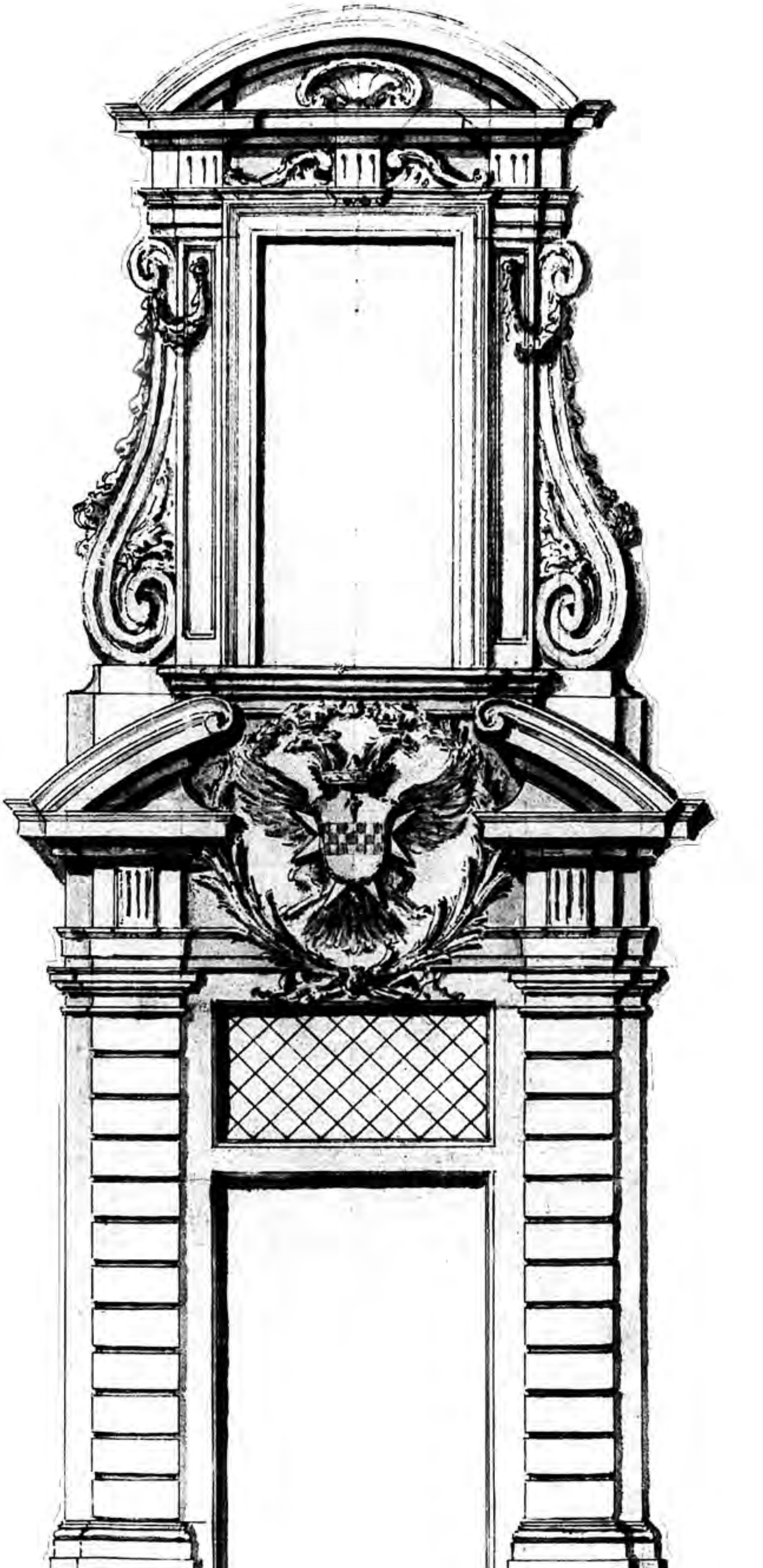
Group

	2011	2010	2009	2008	2007
	€ 000	€ 000	€ 000	€ 000	€ 000
Interest receivable and similar income	**24,917**	26,353	28,150	29,061	29,404
Interest expense	**(10,734)**	(10,287)	(13,560)	(14,493)	(13,871)
Net interest income	**14,183**	16,066	14,590	14,568	15,533
Other operating income	**22,903**	22,840	21,971	22,359	3,699
Other operating charges	**(23,530)**	(24,779)	(23,759)	(24,174)	(7,099)
Net impairment (losses)/gains	**(2,231)**	(186)	125	1,387	(1,863)
Shares of profit of equity accounted investee (net of tax)	**-**	-	-	-	366
Profit before taxation	**11,325**	13,941	12,927	14,140	10,636
Income tax expense	**(4,098)**	(4,901)	(4,863)	(5,057)	(3,552)
Profit for the year	**7,227**	9,040	8,064	9,083	7,084
Attributable to:					
Equity holders of the Bank	**6,593**	8,332	7,377	8,402	7,065
Non-controlling interests	**634**	708	687	681	19
	7,227	9,040	8,064	9,083	7,084

Five Year Summary
Statements of Cash Flows
For the Year Ended 31 December

Group

	2011	2010	2009	2008	2007
	€ 000	€ 000	€ 000	€ 000	€ 000
Net cash from/(used in) operating activities	**4,345**	23,431	(4,024)	(73,009)	(46,667)
Cash flows from investing activities					
Dividends received	**136**	157	122	65	93
Interest received from investments	**2,975**	3,074	4,867	4,683	4,461
Proceeds on maturity/disposal of investments	**31,025**	5,954	8,632	4,238	4,635
Purchase of investments	**-**	(3,642)	(1,779)	(1,673)	(1,479)
Purchase of property, plant and equipment	**(8,495)**	(1,681)	(1,892)	(3,554)	(943)
Acquisition of interest in subsidiary (net of cash acquired)	**-**	-	-	-	2,632
Acquisition of non-controlling interests	**(72)**	(133)	(156)	(916)	-
Net cash flows from investing activities	**25,569**	3,729	9,794	2,843	9,399
Cash flows from financing activities					
Dividends paid to equity holders of the Bank	**(2,698)**	(858)	(865)	(564)	(464)
Dividends paid to non-controlling interests	**(202)**	(213)	(249)	(559)	-
Cash used in financing activities	**(2,900)**	(1,071)	(1,114)	(1,123)	(464)



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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