LOMBARD

Lombard Bank Malta p.l.c.

2013

ANNUAL REPORT

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Lombard Bank Malta p.l.c.
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Contents

Chairman's Statement to the Members

Notwithstanding the challenging operating environment prevailing during 2013, Lombard Bank Malta p.l.c. (the 'Bank') turned in a satisfactory performance. Domestic market conditions were characterised by increased competition for customer deposits in a generally low-interest rate setting and by subdued credit growth, such that interest margins remained under pressure throughout. This was compounded by the impact of a regulatory regime that has become more stringent with regard to the grading of loans, provisioning and dividend distribution.

The Bank responded to these challenges with measures designed to sustain its underlying profitability while maintaining robust fundamentals. On the assets side, interest income was supported by new lending activity, which nevertheless continued to be based on a selective strategy oriented towards quality; and by judicious treasury management such that the Bank's investment portfolio was diversified to give greater weight to higher-yielding securities yet without departing from the policy of not holding any bonds issued by non-Maltese sovereign or corporate entities. Further growth in transaction banking within our International Business Banking Unit also contributed to the diversification of revenue sources. With regard to liability management, the Bank's efforts were mainly reflected in a reduction in interest paid, achieved without any impact on the retail deposit base, which continued to expand during the year in a sign of customer confidence and remained by far the largest single funding source.

As a result of these measures we are pleased to report that the Bank registered a 10% growth, to €10.5 million, in profit before tax and impairment. Net profit after tax of €4.1 million, compared with €5.6 million in 2012, is the result of an impairment charge of €4.1 million, reflecting the Bank's prudent application of provisioning criteria.

On a Group level, principally the Bank and MaltaPost p.l.c., the consolidated profit after tax declined to €4.5 million, which is in the main attributable to the drop in the Bank's profits explained above.

Preserving the Bank's financial strength in the best interests of all stakeholders remained the primary concern of the Board of Directors during the year under review. The capital base was further strengthened, with a capital adequacy ratio of 19%, compared to a regulatory minimum of 8%, while shareholders' funds increased to €77.8 million. This strong capital position continued to be accompanied by a high level of liquidity, reflected in two important indicators: the liquidity ratio, which at 87.4% was well above the required level of 30%; and the advances-to-deposits ratio, which stood at 63.7%. In spite of this high degree of liquidity and the consequent pressure on interest income due to record low market rates, an increase in net interest income was nevertheless recorded.

Looking ahead, the Bank's performance will continue to be conditioned by ongoing developments in the economic environment and in the regulatory regime. The world economy is progressively improving, but the latest sentiment indicators suggest a subdued growth rate in 2014 of both output and trade. In the euro area, the economy is expected to recover gradually, partly on the back of stronger export demand. Unemployment levels in Europe, however, remain high and will continue to act as a drag on the pace of the recovery. Furthermore, credit growth and underlying price pressures remain weak, suggesting that euro interest rates will stay at present or lower levels for an extended period of time.

This modest improvement in the economies of our major trading partners is not expected to translate into significant new domestic export activity. The Central Bank of Malta's latest projections in fact suggest that the acceleration in growth forecast for this year will be driven entirely by private consumption and investment, particularly in the energy sector. Hopefully this will give rise to new opportunities for the Bank to continue performing its important intermediation role in support of the economy, while remaining committed to the practice of sound banking principles and the maintenance of strong balance sheet fundamentals.

Chairman's Statement to the Members

The pursuit of this objective may be somewhat constrained by a demanding regulatory regime. In this regard, the new EU standards to be implemented later this year could have unintended consequences in Malta. The understandable need of the single European supervisor to develop a tool with which to assess on a comparable basis across the EU the level of non-performing exposures has resulted in a one-size-fits-all approach, especially as regards the grading of loans and the resultant impact on provisioning. It could be argued, however, that systemic resilience is not incompatible with functional diversity. High regulatory standards can still be achieved in the presence of differentiated lending rules and guidelines designed to accommodate national characteristics, such as those of the Maltese property market, trade credit terms and related lending practices.

As things stand, the chosen remedy is a prescription for a malaise that Malta does not have. Unlike those in several EU countries, the Maltese banking system has not been weakened by a deterioration in asset quality, whether in loan books or in investment portfolios. Indeed, it is universally acknowledged to have remained both robust and resilient, characterised by banks that are well capitalised, highly liquid and profitable. The Board of Directors is satisfied that Lombard Bank's business model, in which customer relationships are long-standing and credit facilities amply collateralised, is sound and has stood the test of time. This is borne out by the fact that over the past thirty years, the Bank has written off loans totalling no more than €1 million.

Furthermore, the interpretation given by the domestic regulator to the European Commission's recommendation to Malta regarding the need for higher provisioning levels is now also set to affect the profit distribution policy of credit institutions. In fact, a further allocation of €1.0 million from profits has had to be made to a new Reserve for General Banking Risks in compliance with the revised Banking Rule BR/09 issued by the Malta Financial Services Authority ('MFSA') on 31 December 2013. Under this rule the allocation is calculated as a percentage of facilities termed as non-performing loans, and is required to be funded from planned dividends over three years. In these circumstances the Board of Directors is only able to recommend a gross dividend of 4 cent per share for 2013. The Board is further recommending the issue of one bonus share for every twenty shares held on 27 May 2014, through a capitalisation of reserves amounting to €0.5 million.

In order to be better able to meet these challenges, we will continue to explore new avenues for growth compatible with our commitment to good corporate governance and judicious risk management. At the Bank these efforts will in particular seek to maximise the potential of existing relationships in transaction banking, while not eschewing profitable lending and investment opportunities. With regard to our investment in MaltaPost p.l.c., we will continue to support a strategy designed to counter the impact on the company's profitability of declining traffic volumes in the traditional postal market. This includes plans, already being implemented, to leverage the company's assets to ensure that its branch network and other resources can provide a diversified product mix, starting with financial services, document management and hybrid mail.

Going forward, Lombard Bank Malta p.l.c. shall build on its proven record as an independent domestic commercial bank whose policy and business strategy are fully geared to the needs of its customer base and to the characteristics of the Maltese market. We are able to make this claim thanks to the professional competence and integrity of our staff, and on behalf of the Board I would like to thank them and the management team, ably led by the Chief Executive Officer, Joseph Said, for their hard work and dedication to the Bank's mission. I would also like to thank you, the Bank's shareholders, for your continued support as well as all our customers for their loyalty.

Michael C. Bonello
Chairman

Chief Executive Officer's Review of Operations

The results for the financial year ended 31 December 2013 of the Lombard Bank Group combine the financial performance of Lombard Bank Malta p.l.c. and Redbox Limited (the company holding the Bank's shares in MaltaPost p.l.c.).

Economic sentiment during 2013 remained subdued reflecting in the main the difficult financial climate prevalent in most of Europe. Locally, the banking sector was faced with further regulation, most of which was set at a European level in response to problems experienced in other jurisdictions. This notwithstanding the Group continued to deliver satisfactory levels of profitability while upholding its prudent strategy of maintaining robust capital and liquidity ratios and implementing a conservative management of risk while in full compliance with the various regulatory frameworks.

Following the tightening of capital requirements for credit institutions, competition for deposits became more intense. The core domestic commercial banks were faced with competition, not least from those institutions that limit their activity in Malta to taking deposits. On the other hand, the demand for credit with sound commercial objectives remained limited throughout most of 2013.

Income streams from most of the Bank's activities remained strong and though profit before taxation decreased by 25.4%, this was principally due to increased provisioning in respect of certain credit facilities. Throughout the year the Bank's assets remained prudently invested and shareholder funds were well protected. The Bank ended the year with strong balance sheet ratios, which will enhance the trust and confidence that the Bank enjoys in the local community.

Profit after tax at MaltaPost was lower by just 5.2%, which is considered to be a satisfactory performance when taking into consideration that one-off gains registered in the previous year were not repeated. Growth in turnover at MaltaPost was partly set off by decreases in revenue from cross-border mail as a result of an unfavourable change in the Universal Postal Union ('UPU') fee structure. Even after implementation of some tariff increases approved by the Malta Communications Authority, Malta's postal rates remain among the lowest in the European Union. MaltaPost remains an important investment and makes a significant contribution to the Group.

Review of Financial Performance

Operating income for the Group increased by 4.0% to €38.6 million as net interest income rose by 9.2%. Interest income from credit operations was up by 1.7% to €22.1 million, while the interest expense was reduced by circa 9.3%.

Revenue from postal sales increased due to higher parcel volumes, balanced by the continued contraction of the traditional letter market and unfavourable changes to foreign counterparty tariffs. Employee compensation and benefits at €15.4 million increased by 4.5%, reflecting costs associated with maintaining a well-trained and motivated staff complement. Other operating costs were well contained and showed a decrease of 1.9% to €10.4 million. Intergroup efficiencies compensated for increased costs of regulatory compliance as well as new investment in technology. The cost efficiency ratio for the Group was 70.7% (2012: 72.0%), while for the Bank this stood at 42.3% (2012: 43.9%).

In 2013 specific allowances increased by €3.1 million mainly due to the exposure that the Bank held to certain credit facilities that were considered to require a longer term so as to reach a positive conclusion. Notwithstanding this increase in provisions, Management believes that these facilities stand to be repaid in full. Collective allowances were increased by €1 million to take into account the possibility that some market sectors may be experiencing short-term pressure on cash flows thereby causing delays in loan repayments.

The year's impairment allowances of €4.2 million were therefore the primary reason for the decrease in net profit.

Chief Executive Officer's Review of Operations

Gross loans and advances to customers at €327.5 million were at the same level of the previous year. Over 60% of the lending portfolio was concentrated on property project finance (Construction & real estate activities). Conservative margins are maintained on the estimated market value of security offered. The Bank remained selective with regard to the type of property development financed, while ensuring that promoters held suitable credentials. Close and personalised relationships with customers ensure that our input on structuring and business re-engineering remains valid and useful. Our traditional and tested approach to banking has, however, become difficult to practice in view of new banking regulation with regard to making allowances for cashflow delays often encountered by customers in the normal course of their business. Overall, a high percentage of facilities are tangibly and adequately secured.

Customer accounts at €493.9 million increased by €31.8 million or 6.9% over 2012. Long-term deposits remained central to the Bank's strategy of maintaining lasting relationships.

Net asset value ('NAV') per share decreased to €2.00 (2012: €2.15). Group earnings per share ('EPS') decreased by 4.1 cent during 2013 to 10.3 cent. Return on assets ('ROA') was also down from 1.1% to 0.7%. The Bank's post tax return on equity ('ROE') at 5.3% was down from 7.3%.

Liquidity and Own Funds

The revised Banking Rule BR/09 became effective on 31 December 2013. This rule was intended to address the Country Specific Recommendations of the European Commission with respect to Malta, which required improvement in local banks' coverage ratios and increases in provisioning. Banking Rule BR/09 requires the Bank to transfer part of the 2013 profits to a Reserve for General Banking Risks. This appropriation from planned dividends was calculated as a percentage of credit facilities termed 'non-performing loans'. Under the three year transitional rules, the Bank has set aside €1.0 million in 2013 (40% of the currently required reserve). The balance of €1.6 million will be set aside in two equal instalments over the following two years. As a consequence, it is anticipated there will be lower levels of distributions made to shareholders.

Equity attributable to shareholders of the Group increased by €1.7 million to €79.3 million. Own funds were up from €74.4 million to €76.3 million thereby allowing further room for new business opportunities. Capital adequacy ratio stood at 19.0% (2012: 18.5%) compared to a minimum requirement of 8%. Core Tier 1 capital ratio was 17.4%, providing a strong base to meet the new capital requirements under the Basel framework ('CRD IV').

The advances-to-deposits ratio continued to be within the prudent limits set by the Bank and at the end of 2013 stood at 63.7%. Eligible liquid assets, in terms of Banking Rule BR/05 stood at 87.4% of short-term liabilities and thus well over the statutory minimum of 30%.

Treasury and Finance

Following the surprise interest rate cut by the ECB in November, the Governing Council kept interest rates unchanged in December. While ECB President Draghi acknowledged that there had been some brief discussion about negative interest rates, he also said no specific instrument had been identified, implying that concrete proposals for a negative interest rate on banks' deposits at the ECB had not yet been fully worked out. However, with money supply growth at just 2.1% year-on-year, and bank lending declining, balance sheet expansion both by the ECB and by commercial banks in the Eurozone is needed to sustain growth. Instead the ECB's balance sheet has been shrinking since January, and the Asset Quality Review ('AQR') planned for 2014 under the single supervisory mechanism, plus the stress tests to be implemented after the AQR are likely to make banks even more risk averse during 2014, further contracting their balance sheets.

Chief Executive Officer's Review of Operations

When determining the placement of funds our main objective remained capital protection thus engaging mostly in short-term interbank deals in the money markets with reputable counterparties. The Bank also used short-term Government of Malta Treasury paper and balances with the Central Bank of Malta ('CBM') to employ its short-term liquidity excess. The level of Treasury Bills held by the Bank increased by more than 39.7% from €67.1 million in 2012, to €93.8 million in 2013. Balances held at year-end with the CBM stood at €37.3 million, decreasing by €25.3 million from 2012. Given the limited investment opportunities in the local market the Bank increased its holdings in local sovereign debt securities from €20.2 million in 2012 to €30.9 million in 2013. The Bank is not exposed to any non-Maltese sovereign or corporate securities.

Risk Management

The Bank carried on with the ongoing process of assessing its capital adequacy relative to its risk profile and operating environment as well as the monitoring of its liquidity buffers. This assessment was performed in line with the MFSA Banking Rules mainly Banking Rule BR/04: Capital Requirements of Credit Institutions authorised under the Banking Act, 1994 and Banking Rule BR/08: Capital Adequacy of Credit Institutions Authorised under the Banking Act 1994 and Banking Rule BR/12: The Supervisory Review Process of Credit Institutions authorised under the Banking Act, 1994.

The Internal Capital Adequacy Assessment Process ('ICAAP') report confirmed that the requirements under 'Pillar II' of the Capital Requirements Directive ('CRD') were complied with. The Bank's ICAAP was based on a 'Pillar I Plus' approach whereby the 'Pillar I' capital requirements for credit and operational risks were supplemented by the capital allocation for other material risks not fully addressed within 'Pillar I'.

Risk management techniques were applied to ensure that an adequate amount of capital was allocated against identified risks. The Bank's conservative approach together with its strong financial position ensured that it had sufficient capital and liquidity buffers to meet unexpected stressed conditions. We carried out the process of identification, quantification and monitoring of risks inherent in operations, using methodology tailored to suit the requirements of the Bank's operational needs as well as its size, nature and complexity. This included the review of any significant credit exposures and the underlying classifications. Stress testing exercises were also undertaken in anticipation of any adverse scenarios so as to put in place contingencies to minimise the impact of such events. Detailed preparation with regard to the Capital Requirements Regulation ('CRR') and the CRD, collectively known as CRD IV package, ensured that the Bank would be in a position to comply with the implementation of the revised framework, which will start to be phased-in during 2014.

Human Resources

Group staff complement as at the end of December 2013 stood at 784 (2012: 774).

The Group remained committed to realistic and practical solutions intended as building blocks for the continued development of strategic human resource management with established priorities and the setting of goals. Professional in-house training sessions were organised during the year, supplemented when necessary with external specialised presentations and seminars for staff at all levels.

The Group continued to devote attention to selection and recruitment of both experienced professionals as well as those with the potential and skills that match our mission and values.

Projects

Preparations for full compliance with the new process associated with the Foreign Account Tax Compliance Act

('FATCA') as well as with the Single European Payments Area ('SEPA') were undertaken.

Our internet banking and other software systems were reviewed and upgraded so as to keep up with advanced technological systems and processes. Resilience of our computer systems was also improved to meet higher risk mitigation requirements.

A number of offices were upgraded and modernised.

Community Involvement

For the seventh year the Bank, in collaboration with the Directorate for Educational Services and the Malta Cancer Foundation, continued its support of the anti-smoking campaign in all schools. The Bank continues to support Volserv in its useful work mainly carried out at Mater Dei hospital.

Financial support was also extended to projects and initiatives of a philanthropic nature.

Outlook

Lombard Bank has proven that it can perform the business of traditional banking by financing reasonable and realistic projects prudently and in a conservative manner. By spending time understanding our clients' business and in determining their requirements we are always mindful in ensuring that we hold adequate and sufficient collateral.

MaltaPost has considerable potential. We continue to direct the strategy through its Board and by transfer of knowledge, especially in retail, financial services and internal procedures and processes. With some selective appointments, MaltaPost's growth and profitability could move into a higher gear.

As a Bank, we face the future with a mixture of confidence and caution: confident that we have the wherewithal to continue providing a profitable service; cautious because of the need to manage consequences brought about by an increasingly demanding regulatory regime.

That having been said, however the Group will continue to build on its strong fundamentals and will remain focused on the aspirations of its staff and the expectations of its depositors, customers and shareholders while always practising a cautious approach to business.

Joseph Said
Chief Executive Officer

Directors' Report

The Group

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

Principal Activities

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

Redbox Limited, a company wholly owned by the Bank, was registered in 2006. During the year under review, Redbox Limited continued to serve as the special purpose vehicle holding, as at 31 December 2013, the Bank's 69.2% shareholding in MaltaPost p.l.c., with the remaining 30.8% of the ordinary share capital of MaltaPost p.l.c. being held by the general public. MaltaPost p.l.c. was listed on the MSE 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

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

Results for 2013

Profit after taxation of €4.5 million and €4.1 million for the Group and the Bank respectively, were registered for the twelve months ended 31 December 2013.

A gross dividend of 4 cent per nominal 25 cent share (net 2.6 cent) for the twelve months ended 31 December 2013 is being proposed for approval by the shareholders. A resolution to this effect will be proposed to the Annual General Meeting.

In compliance with the revised Banking Rule BR/09: 'Measures addressing credit risks arising from the assessment of the quality of asset portfolios of credit institutions authorised under the Banking Act, 1994', issued by the MFSA, an amount of €1.0 million from profits has been allocated to a newly set up Reserve for General Banking Risks.

Board of Directors, Officers and Senior Management

The composition of the Board of Directors, Officers and Senior Management is shown in the section on 'Company Information' and further information is given in the 'Statement of Compliance with the Code of 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; and
- ensuring that the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business as a going concern.

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

The financial statements of the Bank for the year ended 31 December 2013 are included in this Annual Report 2013 which is being published in printed form and made available on the Bank's website. The directors are responsible for the maintenance and integrity of the Annual Report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the Bank's website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

Statement of the Directors Pursuant to Listing Rule 5.68

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

- the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2013, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU; and
- the Annual Report includes a fair review of the development and performance of the business and the position of the Bank, together with a description of the principal risks and uncertainties faced.

Standard Licence Conditions

In accordance with SLC 7.35 of the Investment Services Rules for Investment Service Providers regulated by the MFSA, 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.

Information Provided in Accordance with Listing Rule 5.70.1

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

Going Concern

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

Listing Rules – Disclosures

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

As at the Annual General Meeting held on the 25 April 2013, the Authorised Share Capital of the Bank was €20,000,000 made up of 80,000,000 Ordinary Shares of a nominal value of 25 cent each. Following the approval of the Bank's shareholders at the above-mentioned 2013 Annual General Meeting, the amount of €902,326 from the Bank's Retained Earnings Account was capitalised for the purpose of a bonus share issue of 3,609,302 fully paid Ordinary Shares of a nominal value of 25 cent per share. Following this allotment, the Issued and Fully Paid-Up Share Capital of the Bank increased to €9,925,499 divided into 39,701,994 Ordinary Shares of a nominal value of 25 cent each, all of one class.

Equity attributable to shareholders as at 31 December 2013 stood at €79.3 million.

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

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

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

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

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

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

	Shares in Lombard Bank Malta p.l.c.	
	at 31 December 2013	at 13 March 2014
Cyprus 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 2013	at 13 March 2014
Safaco Limited	37,815	37,815
First Gemini p.l.c.	2,101,139	2,101,139

	Shares in MaltaPost p.l.c.	
	at 31 December 2013	at 13 March 2014
Safaco Limited	39,925	41,418
First Gemini p.l.c.	32,427	33, 639

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 Code of 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 14 March 2014 and signed on its behalf by:

Michael C. Bonello
Chairman

Joseph Said
Chief Executive Officer

Statement of Compliance
with the Code of Principles of Good Corporate Governance

A. Introduction

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

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

After having carried out a review of the extent to which the Bank has been compliant with the Principles throughout the financial year ended 31 December 2013, the Board of Directors, in terms of Listing Rule 5.94, presents its report as follows:

B. Compliance with the Code

Principle 1: The Board

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

In order to assist it in the execution of its duties and responsibilities, the Board of Directors has set up a number of Board committees and these include the Audit Committee, the Asset-Liability Committee and the Credit Committee, all of which are regulated by their own Terms of Reference as approved by the Board. Details regarding the composition of these committees are set out below.

Principle 2: Chairman and Chief Executive Officer

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

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

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

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

PRINCIPLE 3: COMPOSITION OF THE BOARD

The following directors served on the Board during the period under review:
Michael C. Bonello (1)
Christian Lemmerich (2)
Sophoklis Argyrou
Graham A. Fairclough
Kimon Palamidis
Joseph Said
Christos J. Stylianides
Michael Zammit

(1) Appointed 25 April 2013
(2) Retired 25 April 2013

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

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

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

The composition and election of the Board of Directors is determined by the Bank's Articles of Association wherein it is established that it is the shareholders who must appoint directors to serve on the Board. In addition, however, the MFSA undertakes due diligence exercises in order to ensure that the fit and proper criteria are observed, pursuant to the Banking Act (Chapter 371 of the Laws of Malta) and the Investment Services Act (Chapter 370 of the Laws of Malta).

PRINCIPLE 4: THE RESPONSIBILITIES OF THE BOARD

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

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

Furthermore, the Board of Directors:

- defines in clear and concise terms the Bank's strategy, policies, management performance criteria and business policies and effectively monitors the application and implementation of such by management;
- establishes a clear internal and external reporting system so that the Board has continuous access to accurate, relevant and timely information;
- has established an Audit Committee in terms of Listing Rules 5.117 to 5.134;
- continuously assesses and monitors the Bank's present and future operations, opportunities, threats and risks;
- evaluates the management's implementation of corporate strategy and financial objectives;
- ensures that the Bank has appropriate policies and procedures in place to assure that the Bank and its employees maintain the highest standards of corporate conduct, including compliance with applicable laws, regulations, business and ethical standards;
- ensures that the financial statements of the Bank and the annual audit thereof are completed within the stipulated time periods; and
- requires management to constantly monitor performance and report fully and accurately to the Board.

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

Principle 5: Board Meetings

The Board convened seven (7) times during the period under review with attendance as follows:

Michael C. Bonello (appointed 25 April 2013)	5 (out of 5)
Christian Lemmerich (retired 25 April 2013)	2 (out of 2)
Sophoklis Argyrou	1
Graham A. Fairclough	7
Kimon Palamidis	7
Joseph Said	7
Christos J. Stylianides	0
Michael Zammit	7

The dates when the Board meetings are scheduled to be held are determined at the beginning of the year thus better facilitating attendance at the meetings. Board members, at times, participate in meetings either by electronic means or by appointing an alternate director.

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 balances items of a long-term strategic nature, as well as performance related issues together with credit applications which fall within the discretionary limits of the Board. During meetings, directors are encouraged to present their views pertinent to the subject matter and are given every opportunity to contribute to the relevant issues on the agenda. 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

The Board of Directors appoints the Chief Executive Officer.

Each newly appointed member of the Board is briefed by the Chief Executive Officer on all aspects of the Bank's business, while the Company Secretary provides each newly appointed director with a dossier containing reference to the more important relevant Legislation, Rules 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. The Company Secretary is responsible for advising the Board, through the Chairman, on all governance matters. The Secretary is responsible for ensuring that Board procedures are complied with as well as that effective information flows within the Board, its committees and with senior management. The Secretary also facilitates induction and assists with professional development, as required.

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

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

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

Principle 7: Evaluation of the Board's Performance

An assessment exercise was carried out through a 'self examination' questionnaire in which Board members participated. This evaluation exercise was analysed and did not reveal the need for any material changes in the Bank's governance structures and organisation.

Principle 8: Committees

The Board has appointed the following committees:

Audit Committee

The primary purpose of the Audit Committee, in accordance with the MFSA Listing Rules, is to protect the interests of the Bank`s shareholders and to assist the directors in conducting their role effectively so that the Bank's decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times.

The Audit Committee assists the Board in fulfilling its supervisory and monitoring responsibility by reviewing the financial statements and disclosures, the systems of internal control established by management as well as the external and internal audit processes. The Bank's independent Internal Audit department reviews the adequacy and proper operation of internal controls in individual areas of operation and reports its findings directly to the Audit Committee. The Terms of Reference of the Audit Committee are modelled on the Principles.

The Audit Committee is currently composed of the following three non-executive independent Board members: Michael C. Bonello (Chairman), Graham A. Fairclough and Michael Zammit. In order to ensure continuity, Kimon Palamidis was appointed as the fourth person from among the Board's non-executive members who will serve on the Audit Committee should any one of the above appointed members be unavailable, as the case may be, and this in accordance with the Audit Committee's Terms of Reference.

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

The Bank's internal auditor is asked to attend meetings of the Audit Committee and the external auditors are also invited to attend. Members of senior management are invited to attend meetings as is deemed necessary by the Committee.

The main roles and responsibilities of the Audit Committee include:

- the monitoring of the financial reporting process;

- the monitoring of the effectiveness of the Bank's internal control, internal audit and risk management systems;
- the monitoring of the audit of the annual consolidated financial statements;
- the maintenance of communication on matters referred to above between the Board, management, the independent external auditors and the internal auditors;
- the making of recommendations to the Board in relation to the appointment of the external auditor and the approval of the remuneration and terms of engagement of the external auditor following appointment by the shareholders in General Meeting;
- the monitoring and reviewing of the external auditor's independence, and in particular the provision of additional services to the Bank;
- the development and implementation of a policy on the engagement of the external auditor to supply non-audit services; and
- the scrutiny, monitoring and approval of related party transactions.

When the Audit Committee`s monitoring and review activities reveal cause for concern/scope for improvement, it must make recommendations to the Board of Directors on action needed to address the issue or make improvements.

Asset-Liability Committee ('ALCO')

Membership of this committee is made up of a number of chief officers and senior managers, including from the Finance and Treasury departments. The Chief Executive Officer chairs ALCO whose main objective is to manage risks within approved limits at the same time as maximising the Bank's returns by efficient and judicious management of the Bank's assets and liabilities.

Credit Committee

The Credit Committee is responsible for considering and approving credit applications 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

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

A separate 'Remuneration Report' features on page 21 of this Annual Report in compliance with the Principles.

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

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

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

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

It is therefore the Bank's policy:

- to publish information that can have a significant effect on the Bank's share price through the MSE and immediately after on the website;
- to make other published information available to the public on the Bank's website;

- to strive for open, transparent communications;
- to ensure continuity and high quality in the information disclosed; and
- to be accessible to all stakeholders.

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

Principle 11: Conflicts of Interest

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

Strict policies are in place 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 in conformity 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 certain companies that have a shareholding in the Group, as disclosed in the Directors' Report.

Principle 12: Corporate Social Responsibility

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

C. Non-Compliance with the Code

Principle 4: (Code Provision 4.2.7)

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

The appointment of directors to serve on the Board is a matter which is entirely reserved to the shareholders of the Bank in terms of its Memorandum and Articles of Association (except where the need arises to fill a casual vacancy). Therefore, the Board does not 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 Provisions 7.1, 7.2, 7.3)

In carrying out a performance evaluation of its role the Board did not appoint an *ad hoc* committee, but it involved directors in this task so as to obtain an in-depth assessment of its performance.

The above evaluation did not include the Board committees nor an evaluation of the Chairman.

Principle 8A: (Remuneration Committee)

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

Principle 8B (Nomination Committee)

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

In this connection every member of the Bank holding in the aggregate at least fifteen per cent (15%) of the Ordinary Issued Share Capital of the Bank shall be entitled to appoint one (1) director for each and every fifteen per cent (15%) of the Ordinary Issued Capital owned by that member. Any fractional shareholding in excess of fifteen per cent (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: (Code Provision 9.3)

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

D. Internal Control (Listing Rule 5.97.4)

The Board is ultimately responsible for the Bank's internal controls as well as their effectiveness, while authority to operate the Bank is delegated to the Chief Executive Officer. The Bank's system of internal controls is designed to manage all the risks in the most appropriate manner. Such controls, however, cannot completely eliminate the possibility of material error or fraud. The Board, therefore, assumes responsibility for executing the four basic roles of Corporate Governance, i.e. accountability, monitoring, strategy formulation and policy development.

In summary, the Board is therefore responsible for:

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

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

- identifying and ensuring that significant risks are managed satisfactorily.

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

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

- Chief Executive Officer; and
- Chief Officers and other Senior Managers.

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

E. General Meetings (Listing Rule 5.97.6)

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

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

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

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

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

Approved by the Board of Directors on 14 March 2014 and signed on its behalf by:

Michael C. Bonello
Chairman

Joseph Said
Chief Executive Officer

Remuneration Report

As stated in the 'Statement of Compliance with the Code of Principles of Good Corporate Governance', in terms of the Malta Financial Services Authority ('MFSA') 'Code of Principles of Good Corporate Governance', the functions of a Remuneration Committee are performed by the Board of Directors, on the basis that the remuneration of the Bank's directors is not performance-related and does not include share options, pension benefits, profit-sharing arrangements or any emolument related to the performance of the Bank. Amongst the obligations established in the Listing Rules, the Board, where applicable, carries out the main duties established in the Supporting Principles enshrined in Principle 8A of the 'Code of Principles of Good Corporate Governance'. The Board of Directors approved this Remuneration Report at the Board Meeting held on 14 March 2014.

Remuneration Policy

Directors

No material changes in the remuneration policy for the Bank's directors during the financial year under review warrant reporting. In terms of the Bank's Memorandum and Articles of Association, the shareholders of the Bank determine the maximum annual aggregate remuneration of the directors. The maximum amount is established by resolution at each Annual General Meeting of the Bank. The aggregate amount fixed for this purpose during the last Annual General Meeting was seventy thousand euro (€70,000).

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

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

The payment of fees to directors for the holding of their office during 2013 amounts to €44,435. This amount is within the limit of €70,000 approved by the Annual General Meeting of 25 April 2013.

Christian Lemmerich retired from his position as Director and Chairman of the Bank at the last Annual General Meeting of 25 April 2013. Michael C. Bonello was nominated and appointed as a director at the same Annual General Meeting and appointed as Chairman of the Bank at a Board of Directors Meeting held on the same date.

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

	€
Christian Lemmerich (Chairman till 25.04.2013)	6,604
Michael C. Bonello (Chairman w.e.f. 25.04.2013)	13,373
Graham A. Fairclough	6,988
Joseph Said	6,988
Michael Zammit	6,988
Kimon Palamidis	3,494
Total	**44,435**

Senior Management

No material changes in the remuneration policy for the Bank's Senior Management during the financial year under review warrant reporting. The Board of Directors considers that the packages offered to senior management ensure that the Bank attracts and retains management staff with the right qualities and skills and capable of fulfilling their duties and obligations appropriately. Furthermore, it remains the Bank's policy to engage its senior management staff on the basis of indefinite contracts of employment, and this after a period of probation. The terms and conditions of employment of senior management are established in the relative employment contracts. Accordingly, the applicable notice periods, after probation, are those provided for in the relevant legislation.

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

Senior management staff are eligible for annual salary increases, which increases are not directly performance-related. Annual bonuses paid are based on an assessment of individual 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
€509,296	€261,500	None	Non-Cash Benefits referred to above

Other

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

The Bank, to date, does not plan to effect any changes in its Remuneration Policy in the upcoming financial year.

Company Information

Number of shareholders at 31 December 2013 analysed by range:

Range	Shareholders	Shares
1 – 500	160	28,566
501 – 1000	111	82,889
1001 – 5000	529	1,356,148
5001 and over	746	38,234,391
Total	**1,546**	**39,701,994**

Number of shareholders at 13 March 2014 analysed by range:

Range	Shareholders	Shares
1 – 500	160	28,696
501 – 1000	115	85,101
1001 – 5000	520	1,329,932
5001 and over	753	38,258,265
Total	**1,548**	**39,701,994**

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

Company Information

Board of Directors

Michael C. Bonello (Chairman)
Graham A. Fairclough
Kimon Palamidis
Joseph Said
Sophoklis Argyrou
Christos J. Stylianides
Michael Zammit

Company Secretary

Helena Said

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 & Corporate Advisory 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
Raymond Formosa	Branch Operations
Mark Gauci	Credit
Edward Pirotta	Premises
Helena Said	Credit Support Services
Geoffrey Tedesco Triccas	Information Technology
Carmel Vassallo	Data Processing Management

Area Managers

Kevin Galea Souchet	Area Manager - Sliema
Mark Lauri	Area Manager - Balzan

Company Information

Registered Office

Lombard House
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

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

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

Ninu Cremona Street, Victoria VCT 2561
Tel: 25581 600

Credit Department

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

Wealth Management

67 Republic Street, Valletta VLT 1117
Tel: 25581 117

Legal Office

59 Republic Street, Valletta VLT 1117
Tel: 25581 116

LOMBARD

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 2013

We have audited the consolidated and stand-alone parent company financial statements of Lombard Bank Malta p.l.c. (together the 'financial statements') on pages 29 to 129 which comprise the consolidated and parent company statements of financial position as at 31 December 2013, 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 Banking Act, 1994 and the 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.

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

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 2013, 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 Banking Act, 1994 and the Companies Act, 1995.

Report on Other Legal and Regulatory Requirements

Opinion on other matters prescribed by the 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 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.

Report on the Statement of Compliance with the Code of 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 13 to 20 has been properly prepared in accordance with the requirements of the Listing Rules issued by the Malta Listing Authority.

PricewaterhouseCoopers

78 Mill Street
Qormi QRM 3101
Malta

Fabio Axisa
Partner

14 March 2014

LOMBARD

FINANCIAL STATEMENTS

For the Year Ended 31 December 2013

2013

Statements of Financial Position

As at 31 December 2013

	Notes	Group		Bank	
		2013	2012	**2013**	2012
		€ 000	€ 000	**€ 000**	€ 000
Assets					
Balances with Central Bank of Malta, treasury bills and cash	5	**134,596**	133,641	**134,283**	133,200
Cheques in course of collection		**739**	1,063	**739**	1,063
Investments	6	**43,554**	32,669	**40,491**	29,871
Loans and advances to banks	7	**73,193**	46,911	**68,116**	39,379
Loans and advances to customers	8	**314,773**	319,864	**315,405**	320,221
Investment in subsidiaries	9	**-**	-	**10,237**	9,352
Intangible assets	10	**1,466**	1,548	**214**	227
Property, plant and equipment	11	**23,229**	22,915	**13,304**	13,172
Investment property	12	**745**	745	**745**	745
Assets classified as held for sale	8	**417**	584	**417**	584
Current tax assets		**1,907**	1,454	**1,397**	654
Deferred tax assets	13	**4,016**	2,998	**3,622**	2,610
Inventories	14	**862**	810	**260**	175
Trade and other receivables	15	**6,085**	5,474	**2,045**	1,941
Accrued income and other assets	16	**4,259**	4,568	**3,061**	3,120
Total assets		**609,841**	575,244	**594,336**	556,314

Statements of Financial Position *(continued)*

As at 31 December 2013

	Notes	Group 2013 € 000	Group 2012 € 000	Bank 2013 € 000	Bank 2012 € 000
Equity and Liabilities					
Equity					
Share capital	17	**9,925**	9,023	**9,925**	9,023
Share premium	18	**17,746**	17,746	**17,746**	17,746
Revaluation and other reserves	18	**6,231**	4,463	**6,087**	4,342
Retained earnings		**45,372**	46,307	**44,025**	44,735
Equity attributable to equity holders of the Bank		**79,274**	77,539	**77,783**	75,846
Non-controlling interests		**5,127**	5,027	**-**	-
Total equity		**84,401**	82,566	**77,783**	75,846
Liabilities					
Amounts owed to banks	19	**2,563**	3,256	**2,563**	3,256
Amounts owed to customers	20	**493,901**	462,116	**498,724**	463,276
Provisions for liabilities and other charges	21	**2,284**	2,264	**642**	666
Other liabilities	22	**16,995**	14,800	**9,654**	8,307
Accruals and deferred income	23	**9,697**	10,242	**4,970**	4,963
Total liabilities		**525,440**	492,678	**516,553**	480,468
Total equity and liabilities		**609,841**	575,244	**594,336**	556,314
Memorandum items					
Contingent liabilities	24	**4,780**	4,916	**4,780**	4,916
Commitments	24	**64,214**	81,232	**64,214**	81,232

The notes on pages 39 to 129 are an integral part of these financial statements.

These financial statements on pages 29 to 129 were approved and authorised for issue by the Board of Directors on 14 March 2014 and signed on its behalf by:

Michael C. Bonello
Chairman

Joseph Said
Chief Executive Officer

Income Statements

For the Year Ended 31 December 2013

		Group		Bank	
	Notes	**2013**	2012	**2013**	2012
		€ 000	€ 000	**€ 000**	€ 000
Interest receivable and similar income					
- on loans and advances, balances with Central					
Bank of Malta and treasury bills	25	**22,912**	23,195	**22,852**	23,183
- on debt and other fixed income instruments	25	**1,261**	648	**1,103**	485
Interest expense	25	**(9,106)**	(10,040)	**(9,118)**	(9,908)
Net interest income		**15,067**	13,803	**14,837**	13,760
Fee and commission income	26	**2,421**	2,468	**1,473**	1,471
Fee and commission expense	26	**(95)**	(87)	**(95)**	(87)
Net fee and commission income		**2,326**	2,381	**1,378**	1,384
Postal sales and other revenues	27	**20,603**	20,038	**9**	20
Dividend income	28	**185**	159	**1,488**	1,466
Net trading income	29	**281**	536	**291**	220
Net gains on disposal of non-trading financial instruments		**-**	23	**-**	1
Other operating income		**109**	144	**178**	144
Operating income		**38,571**	37,084	**18,181**	16,995
Employee compensation and benefits	30	**(15,431)**	(14,765)	**(4,632)**	(4,445)
Other operating costs	32	**(10,402)**	(10,602)	**(2,595)**	(2,600)
Depreciation and amortisation	10, 11	**(1,420)**	(1,335)	**(464)**	(417)
Provisions for liabilities and other charges	21	**(105)**	40	**-**	-
Net impairment losses	31	**(4,181)**	(985)	**(4,103)**	(971)
Profit before taxation		**7,032**	9,437	**6,387**	8,562
Income tax expense	33	**(2,550)**	(3,289)	**(2,276)**	(3,012)
Profit for the year		**4,482**	6,148	**4,111**	5,550
Attributable to:					
Equity holders of the Bank		**4,094**	5,719	**4,111**	5,550
Non-controlling interests		**388**	429	**-**	-
Profit for the year		**4,482**	6,148	**4,111**	5,550
Earnings per share	34	**10c3**	14c4		

The notes on pages 39 to 129 are an integral part of these financial statements.

LOMBARD

Statements of Comprehensive Income

For the Year Ended 31 December 2013

Group

	Note	**2013 € 000**	2012 € 000
Profit for the year		**4,482**	6,148
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Fair valuation of available-for-sale financial assets:			
Net changes in fair value arising during the year, before tax		**1,033**	(399)
Reclassification adjustments - net amounts reclassified to profit or loss, before tax		**(9)**	(9)
Income tax relating to components of other comprehensive income	33	**(345)**	142
Other comprehensive income for the year, net of income tax		**679**	(266)
Total comprehensive income for the year, net of income tax		**5,161**	5,882
Attributable to:			
Equity holders of the Bank		**4,761**	5,454
Non-controlling interests		**400**	428
Total comprehensive income for the year, net of income tax		**5,161**	5,882

Bank

	Note	**2013 € 000**	2012 € 000
Profit for the year		**4,111**	5,550
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Fair valuation of available-for-sale financial assets:			
Net changes in fair value arising during the year, before tax		**996**	(404)
Reclassification adjustments - net amounts reclassified to profit or loss, before tax		**(10)**	(1)
Income tax relating to components of other comprehensive income	33	**(345)**	142
Other comprehensive income for the year, net of income tax		**641**	(263)
Total comprehensive income for the year, net of income tax		**4,752**	5,287

The notes on pages 39 to 129 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2013

Group

	Note	Share capital € 000	Share premium € 000	Revaluation and 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 2012		9,023	17,746	4,563	43,553	74,885	4,774	79,659
Comprehensive income								
Profit for the year		-	-	-	5,719	5,719	429	6,148
Other comprehensive income								
Fair valuation of available-for-sale financial assets:								
Net changes in fair value arising during the year		-	-	(259)	-	(259)	(1)	(260)
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	(6)	-	(6)	-	(6)
Transfers and other movements		-	-	165	(165)	-	-	-
Total other comprehensive income for the year		-	-	(100)	(165)	(265)	(1)	(266)
Total comprehensive income for the year		-	-	(100)	5,554	5,454	428	5,882
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Dividends to equity holders	35	-	-	-	(2,698)	(2,698)	(417)	(3,115)
Changes in ownership interests in subsidiaries that do not result in a loss of control								
Change in non-controlling interests in subsidiary		-	-	-	(102)	(102)	242	140
Total transactions with owners		-	-	-	(2,800)	(2,800)	(175)	(2,975)
At 31 December 2012		9,023	17,746	4,463	46,307	77,539	5,027	82,566

The notes on pages 39 to 129 are an integral part of these financial statements.

Statements of Changes in Equity
For the Year Ended 31 December 2013

Group

		Attributable to equity holders of the Bank						
	Notes	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000	Non-controlling interests € 000	Total equity € 000
At 1 January 2013		**9,023**	**17,746**	**4,463**	**46,307**	**77,539**	**5,027**	**82,566**
Comprehensive income								
Profit for the year		-	-	-	**4,094**	**4,094**	**388**	**4,482**
Other comprehensive income								
Fair valuation of available-for-sale financial assets:								
Net changes in fair value arising during the year		-	-	**673**	-	**673**	**12**	**685**
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	**(6)**	-	**(6)**	-	**(6)**
Transfers and other movements		-	-	**1,104**	**(1,104)**	-	-	-
Total other comprehensive income for the year		-	-	**1,771**	**(1,104)**	**667**	**12**	**679**
Total comprehensive income for the year		-	-	**1,771**	**2,990**	**4,761**	**400**	**5,161**
Transactions with owners, recorded directly in equity								
Contributions by and distributions to owners								
Bonus shares issued	17	**902**	-	-	**(902)**	-	-	-
Dividends to equity holders	35	-	-	-	**(2,815)**	**(2,815)**	**(422)**	**(3,237)**
Changes in ownership interests in subsidiaries that do not result in a loss of control								
Change in non-controlling interests in subsidiary		-	-	**(3)**	**(208)**	**(211)**	**122**	**(89)**
Total transactions with owners		**902**	-	**(3)**	**(3,925)**	**(3,026)**	**(300)**	**(3,326)**
At 31 December 2013		**9,925**	**17,746**	**6,231**	**45,372**	**79,274**	**5,127**	**84,401**

The notes on pages 39 to 129 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2013

Bank

	Note	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000
At 1 January 2012		9,023	17,746	4,440	42,048	73,257
Comprehensive income						
Profit for the year		-	-	-	5,550	5,550
Other comprehensive income						
Fair valuation of available-for-sale financial assets:						
Net changes in fair value arising during the year		-	-	(262)	-	(262)
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	(1)	-	(1)
Transfers and other movements		-	-	165	(165)	-
Total other comprehensive income for the year		-	-	(98)	(165)	(263)
Total comprehensive income for the year		-	-	(98)	5,385	5,287
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Dividends to equity holders	35	-	-	-	(2,698)	(2,698)
Total transactions with owners		-	-	-	(2,698)	(2,698)
At 31 December 2012		9,023	17,746	4,342	44,735	75,846

The notes on pages 39 to 129 are an integral part of these financial statements.

Statements of Changes in Equity

For the Year Ended 31 December 2013

Bank

	Notes	Share capital € 000	Share premium € 000	Revaluation and other reserves € 000	Retained earnings € 000	Total € 000
At 1 January 2013		**9,023**	**17,746**	**4,342**	**44,735**	**75,846**
Comprehensive income						
Profit for the year		-	-	-	**4,111**	**4,111**
Other comprehensive income						
Fair valuation of available-for-sale financial assets:						
Net changes in fair value arising during the year		-	-	**646**	-	**646**
Reclassification adjustments - net amounts reclassified to profit or loss		-	-	**(5)**	-	**(5)**
Transfers and other movements		-	-	**1,104**	**(1,104)**	-
Total other comprehensive income for the year		-	-	**1,745**	**(1,104)**	**641**
Total comprehensive income for the year		-	-	**1,745**	**3,007**	**4,752**
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Bonus shares issued	17	**902**	-	-	**(902)**	-
Dividends to equity holders	35	-	-	-	**(2,815)**	**(2,815)**
Total transactions with owners		**902**	-	-	**(3,717)**	**(2,815)**
At 31 December 2013		**9,925**	**17,746**	**6,087**	**44,025**	**77,783**

The notes on pages 39 to 129 are an integral part of these financial statements.

Statements of Cash Flows

For the Year Ended 31 December 2013

	Notes	Group		Bank	
		2013	2012	**2013**	2012
		€ 000	€ 000	**€ 000**	€ 000
Cash flows from operating activities					
Interest and commission receipts		**23,977**	23,694	**24,073**	23,697
Receipts from customers relating to postal sales and other revenue		**22,030**	28,004	**9**	20
Interest and commission payments		**(9,275)**	(10,486)	**(9,289)**	(10,354)
Payments to employees and suppliers		**(26,284)**	(23,832)	**(7,159)**	(7,051)
Cash flows from operating profit before changes in operating assets and liabilities		**10,448**	17,380	**7,634**	6,312
Decrease/(increase) in operating assets:					
Treasury bills		**(6,201)**	20,698	**(6,201)**	20,698
Deposits with Central Bank of Malta		**315**	3,014	**315**	3,014
Loans and advances to banks and customers		**4,013**	(13,438)	**738**	(10,398)
Other receivables		**374**	(1,864)	**302**	(1,864)
(Decrease)/increase in operating liabilities:					
Amounts owed to banks and to customers		**31,658**	(4,512)	**35,322**	(791)
Other payables		**1,275**	4,147	**1,347**	4,147
Net cash from operations		**41,882**	25,425	**39,457**	21,118
Income tax paid		**(4,367)**	(4,266)	**(3,958)**	(3,276)
Net cash flows from operating activities		**37,515**	21,159	**35,499**	17,842
Cash flows from investing activities					
Dividends received		**186**	159	**186**	159
Interest received from investments		**2,314**	2,123	**2,085**	1,933
Purchase of investments		**(11,323)**	(17,952)	**(10,683)**	(17,952)
Proceeds on maturity/disposal of investments		**1,227**	1,040	**816**	69
Purchase of property, plant and equipment		**(1,684)**	(2,653)	**(586)**	(1,068)
Acquisition of non-controlling interests		**(270)**	-	**-**	-
Net cash flows (used in)/from investing activities		**(9,550)**	(17,283)	**(8,182)**	(16,859)
Cash flows from financing activities					
Dividends paid to equity holders of the Bank	35	**(2,815)**	(2,698)	**(2,815)**	(2,698)
Dividends paid to non-controlling interests		**(236)**	(275)	**-**	-
Net cash flows used in financing activities		**(3,051)**	(2,973)	**(2,815)**	(2,698)
Net increase/(decrease) in cash and cash equivalents		**24,914**	903	**24,502**	(1,715)
Cash and cash equivalents at beginning of year		**123,432**	122,529	**118,453**	120,168
Cash and cash equivalents at end of year	36	**148,346**	123,432	**142,955**	118,453

The notes on pages 39 to 129 are an integral part of these financial statements.

LOMBARD

Notes to the Financial Statements

For the Year Ended 31 December 2013

1 **Summary of significant accounting policies**

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

1.1 *Basis of preparation*

The consolidated financial statements include the financial statements of Lombard Bank Malta p.l.c. (the 'Bank') and its subsidiary undertakings (together referred to as the 'Group' and individually as 'Group entities'). The Bank's financial statements have been prepared in accordance with the requirements of International Financial Reporting Standards ('IFRS's) as adopted by the EU and with the requirements of the Banking Act, 1994 (Chapter 371 of the Laws of Malta) and the Companies Act, 1995 (Chapter 386 of the Laws of Malta). These consolidated financial statements are prepared under the historical cost convention, as modified by the fair valuation of available-for-sale financial assets, financial assets and financial liabilities at fair value through profit or loss (including all derivative financial instruments), 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 Group's accounting policies (see note 3.1 – Critical accounting estimates, and judgments in applying the Group's accounting policies).

1.2 *Standards, interpretations and amendments to published standards effective in 2013*

In 2013, the Group adopted new standards, amendments and interpretations to existing standards that are mandatory for the Group's accounting period beginning on 1 January 2013. The adoption of these revisions to the requirements of IFRSs as adopted by the EU did not result in significant changes to the Group's accounting policies impacting the Group's financial performance and position.

The Group adopted IAS 19 (revised 2011) 'Employee benefits', which amended the accounting for post-employment employee benefits. The Group was required to apply the revised standard retrospectively in accordance with the transition provisions of the standard. Under the revised standard, actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. The impact on the Group of the adoption of IAS 19 (revised 2011) is deemed to be insignificant.

The Bank also adopted the amendment to IAS 1, 'Financial statement presentation' regarding other comprehensive income. The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially re-classifiable to profit or loss subsequently (reclassification adjustments).

The Bank adopted IFRS 13, 'Fair value measurement', which aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs. The standard requires extensive disclosures about fair value measurements and this has a significant impact on the disclosures in the Group's financial statements with respect to fair valuation of non-financial assets.

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

The Bank early adopted amendments to IAS 36, 'Impairment of assets', on the recoverable amount disclosures for non-financial assets. This amendment removes certain disclosures on the recoverable amount of CGUs which had been included in IAS 36 through the issue of IFRS 13. The amendment is not mandatory for the Bank until 1 January 2014, however the Bank has decided to early adopt the amendment as of 1 January 2013.

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

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 the Group's accounting periods beginning after 1 January 2013. The Group has not early adopted these revisions to the requirements of IFRSs as adopted by the EU, except as disclosed above, and the Bank's Directors 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 Group's financial statements in the period of initial application

IFRS 9, 'Financial instruments', addresses the classification and measurement of financial assets and financial liabilities. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The Group is yet to assess IFRS 9's full impact. The Group will also consider the impact of the remaining phases of IFRS 9 when completed.

1.4 *Consolidation*

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

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

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair 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 aggregate is less than the fair value of the identifiable net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss.

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

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

1.5 *Segment reporting*

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

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

1.6 *Foreign currency translation*

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

1.6.1 Functional and presentation currency

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

1.6.2 Transactions and balances

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

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

1.7 *Financial assets*

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

1.7.1 Initial recognition and derecognition

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

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

1.7.2 Financial assets at fair value through profit or loss

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

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

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

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

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

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

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

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

1.7.3 Loans and receivables

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

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

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

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

1.7.4 Held-to-maturity financial assets

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

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

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

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

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

1.7.5 Available-for-sale financial assets

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

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

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

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

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

1.8 *Impairment of financial assets*

1.8.1 Assets carried at amortised cost

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1.8.1.1 Forborne loans

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

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

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

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

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

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

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

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

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

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

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

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

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

1.8.2 Assets classified as available-for-sale

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

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

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

1.9 *Offsetting financial instruments*

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

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

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.

1.10.3 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, which expired in 2013, had a definite useful life and was measured at cost less accumulated amortisation and accumulated impairment losses. Amortisation was 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 was fifteen years.

On 1 November 2012 the Malta Communications Authority issued its decision to grant a new licence to MaltaPost p.l.c. for an indefinite period. This new licence was granted to MaltaPost p.l.c. with effect from 1 May 2013.

1.11 *Property, plant and equipment*

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

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

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

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

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

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

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

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

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.

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

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.

1.13 *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 costs to sell or the value in use can be determined reliably. Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

1.14 *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.

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

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

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

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

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

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.

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

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.

1.23.1 Provision for pension obligations

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

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

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

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 drawdown of a loan, the related loan commitment fees are recognised on a straight-line basis over the commitment period. Fee and commission expense, relating mainly to transaction and service fees, are expensed as the services are received.

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

1.27 *Dividend income*

Dividends are recognised in 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 **Summary of significant accounting policies** *(continued)*

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.

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

2 **Financial risk management**

2.1 *Introduction*

2.1.1 Preamble

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

The Group considers risk management a core competency that helps produce consistently high returns for its various stakeholders. The Group aims to manage all major types of risk by applying methods that meet best practice. The Group considers it important to have a clear distribution of responsibilities within the 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.

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

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.

2.1.2 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, 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 BR/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:

- claims on a customer including actual and potential claims which would arise from the drawing down in full of undrawn advised facilities, which the Bank has committed itself to provide;
- contingent liabilities arising in the normal course of business, and those contingent liabilities which would arise from the drawing down in full of undrawn advised facilities which the Bank has committed itself to provide; and
- other on and off-balance sheet financial assets and commitments.

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

The main categories of risk are:

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

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

- *Liquidity risk*: Liquidity risk may be divided into two sub-categories:
  - Market (product) liquidity risk: risk of losses arising from difficulty in accessing a product or market at the required time, price and amount.
  - 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, systems or external occurrences that in turn affect the income and capital funds of financial institutions. The Bank has adopted an operational risk management framework and procedures, which provide for the identification, assessment, management, monitoring and reporting of the Bank's operational risks.

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

2 **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 facility.

In order to minimise the credit risk undertaken, counterparty credit limits are defined with respect to investment activities, which limits consider a counterparty's creditworthiness, the value of collateral and guarantees pledged, which can reduce the overall credit risk exposure, as well as the type and the duration of the credit asset. In order to examine a counterparty's creditworthiness, the following are considered: country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates. The Group has set limits of authority and has segregation of duties so as to maintain impartiality and independence during the approval process and control new and existing assets or credit facilities.

The Group manages, limits and controls concentrations of credit risk wherever they are identified – in particular, to individual counterparties and groups, and to industries and countries. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, 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, trade and other receivables, and loans and advances to banks and customers. The maximum exposure to credit risk of these financial assets equals their carrying amount.
- Guarantee obligations incurred on behalf of third parties. The maximum exposure to credit risk is the full amount that the Group would have to pay as disclosed in note 24 if the guarantees are called upon.
- Loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities as disclosed in note 24.

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

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Credit risk exposures relating to on-balance sheet assets				
Loans and receivables				
Balances with Central Bank of Malta	**37,325**	62,635	**37,325**	62,635
Cheques in course of collection	**739**	1,063	**739**	1,063
Loans and advances to banks	**73,193**	46,911	**68,116**	39,379
Loans and advances to customers	**314,773**	319,864	**315,405**	320,221
Trade and other receivables	**6,085**	5,474	**2,045**	1,941
Accrued income and other assets	**4,259**	4,568	**3,061**	3,120
Available-for-sale financial assets				
Debt securities	**37,701**	27,369	**34,638**	24,571
Malta Government treasury bills	**93,764**	67,095	**93,764**	67,095
	567,839	534,979	**555,093**	520,025
Credit risk exposures relating to off-balance sheet instruments				
Contingent liabilities	**4,780**	4,916	**4,780**	4,916
Commitments	**64,214**	81,232	**64,214**	81,232

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

The exposures set out in this note are based on carrying amounts as reported in the statement of financial position. The table represents a worse case scenario of credit risk exposure to the Group and Bank at 31 December 2013 and 2012.

2.3.4 Investment debt securities by industry sector

Investment debt securities are analysed by industry sector as follows:

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Government	**32,344**	21,218	**30,945**	20,240
Corporate				
Financial services	**1,145**	1,943	**615**	1,415
Real estate and construction	**551**	778	**327**	321
Tourism	**1,015**	1,190	**726**	733
Wholesale and retail trade	**2,129**	1,919	**1,508**	1,541
Others	**517**	321	**517**	321
	37,701	27,369	**34,638**	24,571

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

2.3.5 Loans and advances to customers by industry sector

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

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Transportation, storage and communication	**6,899**	7,813	**7,531**	8,170
Financial services	**5,590**	2,289	**5,590**	2,289
Agriculture and fishing	**3,206**	3,069	**3,206**	3,069
Manufacturing	**11,750**	15,421	**11,750**	15,421
Construction	**123,564**	128,001	**123,564**	128,001
Hotels and restaurants, excluding related construction activities	**10,484**	9,713	**10,484**	9,713
Wholesale and retail trade	**34,862**	37,771	**34,862**	37,771
Community, recreational and personal service activities	**7,586**	4,751	**7,586**	4,751
Administration and support services activities	**748**	730	**748**	730
Education	**6,964**	8,621	**6,964**	8,621
Health and social work	**175**	146	**175**	146
Mining and quarrying	**1,031**	1,334	**1,031**	1,334
Electricity, gas and water supply	**771**	1,008	**771**	1,008
Real estate, renting and business activities	**83,515**	76,031	**83,515**	76,031
Households and individuals	**30,306**	31,879	**30,306**	31,879
Gross advances to customers	**327,451**	328,577	**328,083**	328,934

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

As at 31 December 2013, no loans and advances to customers were deemed to be prohibited large exposures, prior to any eligible exemptions, in accordance with the requirements of 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 in the context of Banking Rule BR/02, these exposures are monitored and reported more frequently and rigorously.

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

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

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

Within its daily operations the Bank transacts with banks and other financial institutions. The Bank primarily places short-term funds with pre-approved banks subject to limits in place and subject to the respective institution's credit rating being within controlled parameters. By conducting these transactions the Bank is running the risk of losing funds due to the possible delays in the repayment to the Bank of the existing and future obligations of the counterparty banks. Actual exposures are monitored against the limits on a daily basis and in a real-time manner. The credit status of the pre-authorised banks is monitored on an ongoing basis. At 31 December 2013, 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 €36,856,000 (2012: €20,540,000) at the end of the reporting period.

The majority of the loans and advances to banks comprise exposures to credit and financial institutions that are credit rated A and above.

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

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

Group	**A- to AA-**	**Lower than A-**	**Unrated**	**Total**
	€ 000	**€ 000**	**€ 000**	**€ 000**
At 31 December 2013				
Loans and receivables				
Balances with Central Bank of Malta	**37,325**	**-**	**-**	**37,325**
Loans and advances to banks	**73,069**	**124**	**-**	**73,193**
Available-for-sale financial assets				
Debt securities	**32,344**	**851**	**4,506**	**37,701**
Malta Government treasury bills	**93,764**	**-**	**-**	**93,764**
	236,502	**975**	**4,506**	**241,983**

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

Group	A- to AA-	Lower than A-	Unrated	Total
	€ 000	**€ 000**	**€ 000**	**€ 000**
At 31 December 2012				
Loans and receivables				
Balances with Central Bank of Malta	62,635	-	-	62,635
Loans and advances to banks	41,501	5,410	-	46,911
Available-for-sale financial assets				
Debt securities	21,218	1,651	4,500	27,369
Malta Government treasury bills	67,095	-	-	67,095
	192,449	7,061	4,500	204,010

Bank	A- to AA-	Lower than A-	Unrated	Total
	€ 000	**€ 000**	**€ 000**	**€ 000**
At 31 December 2013				
Loans and receivables				
Balances with Central Bank of Malta	**37,325**	**-**	**-**	**37,325**
Loans and advances to banks	**68,033**	**83**	**-**	**68,116**
Available-for-sale financial assets				
Debt securities	**30,946**	**615**	**3,077**	**34,638**
Malta Government treasury bills	**93,764**	**-**	**-**	**93,764**
	230,068	**698**	**3,077**	**233,843**

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

Bank	A- to AA-	Lower than A-	Unrated	Total
	€ 000	**€ 000**	**€ 000**	**€ 000**
At 31 December 2012				
Loans and receivables				
Balances with Central Bank of Malta	62,635	-	-	62,635
Loans and advances to banks	34,046	5,333	-	39,379
Available-for-sale financial assets				
Debt securities	20,240	1,414	2,917	24,571
Malta Government treasury bills	67,095	-	-	67,095
	184,016	6,747	2,917	193,680

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

2.3.7 Information on credit quality of loans and advances to customers

The Bank reviews and grades advances to customers using the following internal risk grades:

- Performing
  - Regular
  - Watch
  - Substandard
- Non-performing
  - Doubtful

Regular

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

Watch

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

Substandard

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

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

Doubtful

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

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 household sectors and relate to advances which are past due by more than ninety days and/or graded as 'Doubtful'. Provisions for impairment in respect of balances with corporate customers relate to entities which are in adverse trading and operational circumstances. It was assessed that a significant portion of these advances is expected to be recovered. Provisions for impairment as at the end of the reporting period and movements in such provisions arising during the year are disclosed in notes 8 and 31 to the financial statements. Reversals of provisions for impairment arise in those situations where customers recover from unfavourable circumstances and accordingly start meeting repayment obligations including accrued interest.

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

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

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

	2013	2012
	€ 000	€ 000
Construction	**24,179**	16,219
Manufacturing	**2,006**	2,210
Personal	**3,909**	2,167
Tourism	**3,008**	2,520
Trade	**2,835**	752
Professional	**212**	150
Other	**320**	1,319
	36,469	25,337

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

Bank	**Gross loans & advances**	Gross loans & advances
	2013	2012
	€ 000	€ 000
Performing		
Neither past due nor impaired		
Regular	**107,659**	106,537
Watch	**33,030**	16,588
Substandard	**13,308**	2,904
	153,997	126,029
Past due by less than 90 days but not impaired		
Regular	**9,361**	60,851
Watch	**19,374**	4,178
Substandard	**740**	1,064
	29,475	66,093
Non-performing		
Impaired, gross of specific impairment allowances	**36,469**	25,337
Forborne (excluding impaired exposures)	**64,401**	58,935
Non-forborne past due by 90 days or more but not impaired	**43,741**	52,540
	144,611	136,812
	328,083	328,934
Specific impairment allowances applied to impaired exposures reflected above	**9,548**	6,544
Collective impairment allowances	**3,130**	2,169

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

2.3.8 Forbearance measures and forborne loans

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

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

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

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

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

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

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

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

There were no material changes to the Bank's policies and procedures regarding forbearance or forborne loans in 2013.

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

2.3.9 Required disclosures in relation to loans and advances to customers

Bank	**Non-forborne exposures**	**Forborne exposures**	**Total**
	€ 000	**€ 000**	**€ 000**
At 31 December 2013			
Neither past due nor impaired	**153,997**	**12,666**	**166,663**
Past due by less than 90 days but not impaired	**29,475**	**4,817**	**34,292**
Past due by 90 days or more but not impaired	**43,741**	**46,918**	**90,659**
Impaired, net of specific impairment allowances	**19,194**	**7,727**	**26,921**
Loans and advances, net of specific impairment allowances	**246,407**	**72,128**	**318,535**
Specific impairment allowances	**8,189**	**1,359**	**9,548**
Collective impairment allowances	**1,828**	**1,302**	**3,130**

Interest income recognised during the financial year ended 31 December 2013 in respect of forborne exposures amounted to €4,765,000.

Bank	**Non-forborne exposures**	**Forborne exposures**	**Total**
	€ 000	**€ 000**	**€ 000**
At 31 December 2012			
Neither past due nor impaired	126,029	2,417	128,446
Past due by less than 90 days but not impaired	66,093	4,172	70,265
Past due by 90 days or more but not impaired	52,540	52,346	104,886
Impaired, net of specific impairment allowances	17,469	1,324	18,793
Loans and advances, net of specific impairment allowances	262,131	60,259	322,390
Specific impairment allowances	6,353	191	6,544
Collective impairment allowances	1,672	497	2,169

Interest income recognised during the financial year ended 31 December 2012 in respect of forborne exposures amounted to €4,494,000.

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

Past due but not impaired loans

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

Bank	**Non-forborne exposures 2013 € 000**	**Forborne exposures 2013 € 000**	Non-forborne exposures 2012 € 000	Forborne exposures 2012 € 000
Past due up to 30 days	**18,189**	**3,477**	51,010	601
Past due between 31 and 60 days	**7,842**	**749**	12,816	2,031
Past due between 61 and 90 days	**3,444**	**591**	2,267	1,540
Past due over 90 days	**43,741**	**46,918**	52,540	52,346
	73,216	**51,735**	118,633	56,518

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

	Loans & advances € 000
At 1 January 2013	60,450
Loans to which forbearance measures have been extended during 2013	30,293
Repayments	(17,256)
At 31 December 2013	**73,487**

No loans to which forbearance measures have been applied during the current financial year have been derecognised. During the current financial year, Specific impairment allowances on forborne loans have increased from €191,000 at 1 January 2013 to €1,359,000 at 31 December 2013. The movement reflects solely increases in allowances in respect of specific exposures.

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

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

Bank	**Neither past due nor impaired € 000**	**Past due but not impaired € 000**	**Impaired € 000**	**Total € 000**
At 31 December 2013				
Financial services	**28**	**340**	**-**	**368**
Real estate and construction	**9,235**	**41,872**	**5,438**	**56,545**
Tourism	**597**	**2,326**	**312**	**3,235**
Wholesale and retail trade	**1,330**	**1,907**	**1,348**	**4,585**
Manufacturing	**12**	**1,240**	**1,725**	**2,977**
Households	**697**	**2,592**	**198**	**3,487**
Other	**767**	**1,458**	**65**	**2,290**
	12,666	**51,735**	**9,086**	**73,487**

	Neither past due nor impaired € 000	**Past due but not impaired € 000**	**Impaired € 000**	**Total € 000**
At 31 December 2012				
Real estate and construction	430	50,749	-	51,179
Tourism	416	2,350	-	2,766
Wholesale and retail trade	791	1,732	-	2,523
Manufacturing	-	-	1,403	1,403
Households	-	1,297	112	1,409
Other	780	390	-	1,170
	2,417	56,518	1,515	60,450

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

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

2.3.10 Collateral

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

The extendible value of the collateral is the net value of a pledged asset for lending purposes, after applying a precautionary margin to its market value. The following is an analysis of the fair value of the extendible collateral and other credit enhancements held by the Bank against exposures of loans and advances to customers. The amounts disclosed in the table represent the lower of the fair value of the extendible collateral and the carrying amount of the respective secured loans.

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

Bank

	Fair value of extendible collateral			
	Non-forborne exposures 2013 € 000	**Forborne exposures 2013 € 000**	Non-forborne exposures 2012 € 000	Forborne exposures 2012 € 000
Neither past due nor impaired				
Immovable property	**115,472**	**11,415**	83,541	2,351
Cash or quasi cash	**7,553**	**351**	5,806	-
Other security	**4,299**	**4**	8,150	-
	127,324	**11,770**	97,497	2,351
Past due by less than 90 days but not impaired				
Immovable property	**17,919**	**4,722**	50,376	3,197
Cash or quasi cash	**338**	**-**	1,062	369
Other security	**4,822**	**-**	3,302	62
	23,079	**4,722**	54,740	3,628
Past due by 90 days or more but not impaired				
Immovable property	**37,819**	**41,096**	45,989	45,019
Cash or quasi cash	**377**	**708**	637	2,649
Other security	**84**	**69**	215	251
	38,280	**41,873**	46,841	47,919
Impaired				
Immovable property	**16,710**	**6,973**	14,298	1,300
Cash or quasi cash	**161**	**-**	219	-
Other security	**17**	**-**	9	-
	16,888	**6,973**	14,526	1,300
Fair value of extendible collateral held as security and other credit enhancements	**205,571**	**65,338**	213,604	55,198

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

2.3.11 Trade and other receivables

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

Standard credit terms are in place for individual clients, however, wherever possible, new corporate customers are analysed individually for creditworthiness before the subsidiary's standard payment and service delivery terms and conditions are offered. The entity's review includes external creditworthiness databases when available. The subsidiary establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. This allowance represents specific provisions against individual exposures. The movement in provisions for impairment in respect of trade receivables is disclosed in note 15. Other overdue trade receivables amounted to €559,000 (2012: €675,000), principally overdue by nine months, but were not impaired.

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

2.3.12 Contingencies and commitments

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

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

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 three elements:

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

2.4.1 Interest rate risk

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

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice within different time periods or on different terms. The Bank accepts deposits from customers at both fixed and floating rates and for varying terms. This poses a risk to the Bank, which risk is managed by monitoring on a continuous basis the level of mismatch of interest rate repricing taking cognisance of the terms of the Bank's principal assets, loans and advances to customers, that are repriceable at the Bank's discretion. The Bank also invests in highly liquid quality assets and other short-term instruments for the purposes of mitigating exposures to fluctuations in interest rates. The Bank is accordingly in a position to manage the interest rate terms of its financial assets and simultaneously to effect changes to interest terms of liabilities reflecting the Bank's strategy together with market developments. The Group seeks to manage its net interest spread, considering the cost of capital, by investing funds in a portfolio of assets with a longer term than the liabilities funding them (therefore 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 following tables summarise the Group's exposures to interest rate risks. These analyse the Group's financial instruments, which were interest-bearing at their carrying amounts, categorised by the earlier of contractual repricing or maturity dates.

Group

At 31 December 2013	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	134,596	0.47	68,134	35,866	-	-	30,596
Debt and other fixed income instruments classified as available-for-sale investments	37,701	4.94	2,274	2,631	9,392	23,404	-
Loans and advances to banks	73,193	0.18	62,203	-	-	-	10,990
Loans and advances to customers	314,773	6.56	313,091	-	-	-	1,682
Total financial assets	560,263		445,702	38,497	9,392	23,404	43,268
Financial liabilities							
Amounts owed to banks	2,563	1.24	2,384	-	-	-	179
Amounts owed to customers	493,901	2.12	240,227	108,497	102,266	27,538	15,373
Total financial liabilities	496,464		242,611	108,497	102,266	27,538	15,552
Interest repricing gap			203,091	(70,000)	(92,874)	(4,134)	27,716
Cumulative gap			203,091	133,091	40,217	36,083	

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

Group

At 31 December 2012	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	133,641	0.68	115,883	13,847	-	-	3,911
Debt and other fixed income instruments classified as available-for-sale investments	27,369	5.63	727	786	8,197	17,659	-
Loans and advances to banks	46,911	0.54	35,273	-	-	-	11,638
Loans and advances to customers	319,864	6.58	318,219	-	-	-	1,645
Total financial assets	527,785		470,102	14,633	8,197	17,659	17,194
Financial liabilities							
Amounts owed to banks	3,256	1.22	3,175	-	-	-	81
Amounts owed to customers	462,116	2.04	233,326	78,329	103,200	25,883	21,378
Total financial liabilities	465,372		236,501	78,329	103,200	25,883	21,459
Interest repricing gap			233,601	(63,696)	(95,003)	(8,224)	(4,265)
Cumulative gap			233,601	169,905	74,902	66,678	

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

Bank

At 31 December 2013	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	**134,283**	**0.47**	**68,134**	**35,866**	**-**	**-**	**30,283**
Debt and other fixed income instruments classified as available-for-sale investments	**34,638**	**4.90**	**2,154**	**1,730**	**8,652**	**22,102**	**-**
Loans and advances to banks	**68,116**	**0.19**	**56,785**	**-**	**-**	**-**	**11,331**
Loans and advances to customers	**315,405**	**6.55**	**313,091**	**-**	**-**	**-**	**2,314**
Total financial assets	**552,442**		**440,164**	**37,596**	**8,652**	**22,102**	**43,928**
Financial liabilities							
Amounts owed to banks	**2,563**	**1.24**	**2,384**	**-**	**-**	**-**	**179**
Amounts owed to customers	**498,724**	**2.11**	**243,358**	**109,497**	**102,266**	**27,538**	**16,065**
Total financial liabilities	**501,287**		**245,742**	**109,497**	**102,266**	**27,538**	**16,244**
Interest repricing gap			**194,422**	**(71,901)**	**(93,614)**	**(5,436)**	**27,684**
Cumulative gap			**194,422**	**122,521**	**28,907**	**23,471**	

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

Bank

At 31 December 2012	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	133,200	0.68	115,883	13,847	-	-	3,470
Debt and other fixed income instruments classified as available-for-sale investments	24,571	5.62	369	611	6,603	16,988	-
Loans and advances to banks	39,379	0.40	29,225	-	-	-	10,154
Loans and advances to customers	320,221	6.58	318,576	-	-	-	1,645
Total financial assets	517,371		464,053	14,458	6,603	16,988	15,269
Financial liabilities							
Amounts owed to banks	3,256	1.22	3,175	-	-	-	81
Amounts owed to customers	463,276	2.04	233,817	78,329	103,200	25,883	22,047
Total financial liabilities	466,532		236,992	78,329	103,200	25,883	22,128
Interest repricing gap			227,061	(63,871)	(96,597)	(8,895)	(6,859)
Cumulative gap			227,061	163,190	66,593	57,698	

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

2.4.2 Interest rate profile

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

Group	**Fixed rate**		**Variable rate**	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Interest-earning assets				
Balances with Central Bank of Malta and treasury bills	**7,252**	58,247	**96,748**	71,483
Debt and other fixed income instruments classified as available-for-sale investments	**35,699**	27,369	**2,002**	-
Loans and advances to banks	**56,753**	32,200	**5,450**	3,073
Loans and advances to customers	**-**	-	**313,091**	318,219
	99,704	117,816	**417,291**	392,775
Interest-bearing liabilities				
Amounts owed to banks	**2,384**	3,175	**-**	-
Amounts owed to customers	**332,489**	307,748	**146,039**	132,990
	334,873	310,923	**146,039**	132,990

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

Bank	**Fixed rate**		**Variable rate**	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Interest-earning assets				
Balances with Central Bank of Malta and treasury bills	**7,252**	58,247	**96,748**	71,483
Debt and other fixed income instruments classified as available-for-sale investments	**32,636**	24,571	**2,002**	-
Loans and advances to banks	**56,753**	29,200	**32**	25
Loans and advances to customers	**-**	-	**313,091**	318,576
	96,641	112,018	**411,873**	390,084
Interest-bearing liabilities				
Amounts owed to banks	**2,384**	3,175	**-**	-
Amounts owed to customers	**334,489**	307,748	**148,170**	133,481
	336,873	310,923	**148,170**	133,481

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

2.4.3 Fair value sensitivity analysis for fixed rate instruments

The Group's instruments exposing the Bank to fair value interest rate risk consist of available-for-sale quoted debt securities (also refer to note 6) since these are fair valued with fair value changes recognised in other comprehensive income. Considering the nature and carrying amount of the investments, 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	**2013**	2012
	€ 000	€ 000
(+) 100bp	**2,713**	2,598
(-) 100bp	**(2,713)**	(2,598)

Bank	**2013**	2012
	€ 000	€ 000
(+) 100bp	**2,637**	2,566
(-) 100bp	**(2,637)**	(2,566)

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 did not have any derivative financial instruments as at 31 December 2013 and 2012.

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

Group

	Total	EUR	GBP	USD	Other
At 31 December 2013	**€ 000**	**€ 000**	**€ 000**	**€ 000**	**€ 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	**134,596**	**127,031**	**85**	**7,447**	**33**
Investments classified as available-for-sale	**43,554**	**43,527**	**-**	**27**	**-**
Loans and advances to banks	**73,193**	**27,035**	**31,781**	**13,186**	**1,191**
Loans and advances to customers	**314,773**	**304,840**	**1,881**	**5,302**	**2,750**
Other assets	**11,083**	**9,892**	**229**	**790**	**172**
Total financial assets	**577,199**	**512,325**	**33,976**	**26,752**	**4,146**
Financial liabilities					
Amounts owed to banks	**2,563**	**179**	**-**	**-**	**2,384**
Amounts owed to customers	**493,901**	**438,069**	**29,017**	**25,274**	**1,541**
Other liabilities	**26,785**	**20,514**	**4,961**	**1,082**	**228**
Total financial liabilities	**523,249**	**458,762**	**33,978**	**26,356**	**4,153**
Net currency exposure in financial assets/liabilities		**53,563**	**(2)**	**396**	**(7)**
Commitments and contingent liabilities	**68,994**	**68,824**	**19**	**151**	**-**

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

Group

At 31 December 2012	Total € 000	EUR € 000	GBP € 000	USD € 000	Other € 000
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	133,641	120,435	12,874	284	48
Investments classified as available-for-sale	32,669	32,032	-	637	-
Loans and advances to banks	46,911	10,404	18,764	16,274	1,469
Loans and advances to customers	319,864	308,764	1,955	6,087	3,058
Other assets	11,105	9,608	292	981	224
Total financial assets	544,190	481,243	33,885	24,263	4,799
Financial liabilities					
Amounts owed to banks	3,256	181	-	-	3,075
Amounts owed to customers	462,116	406,736	31,324	22,602	1,454
Other liabilities	24,626	19,403	2,841	1,930	452
Total financial liabilities	489,998	426,320	34,165	24,532	4,981
Net currency exposure in financial assets/liabilities		54,923	(280)	(269)	(182)
Commitments and contingent liabilities	86,148	85,820	42	286	-

Under the scenario that all currencies move adversely against the euro by 20% the effect would be a decrease of €65,000 (2012: €122,000) 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 €65,000 (2012: €122,000) in the carrying amount of financial instruments and the favourable impact would be recognised in profit or loss.

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

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

Bank

At 31 December 2013	**Total € 000**	**EUR € 000**	**GBP € 000**	**USD € 000**	**Other € 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	**134,283**	**126,718**	**85**	**7,447**	**33**
Investments classified as available-for-sale	**40,491**	**40,464**	**-**	**27**	**-**
Loans and advances to banks	**68,116**	**22,033**	**31,762**	**13,129**	**1,192**
Loans and advances to customers	**315,405**	**305,472**	**1,881**	**5,302**	**2,750**
Other assets	**5,845**	**5,801**	**20**	**24**	**-**
Total financial assets	**564,140**	**500,488**	**33,748**	**25,929**	**3,975**
Financial liabilities					
Amounts owed to banks	**2,563**	**179**	**-**	**-**	**2,384**
Amounts owed to customers	**498,724**	**442,888**	**29,017**	**25,277**	**1,542**
Other liabilities	**14,624**	**9,732**	**4,697**	**172**	**23**
Total financial liabilities	**515,911**	**452,799**	**33,714**	**25,449**	**3,949**
Net currency exposure in financial assets/liabilities		**47,689**	**34**	**480**	**26**
Commitments and contingent liabilities	**68,994**	**68,824**	**19**	**151**	**-**

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

Bank

At 31 December 2012	**Total € 000**	**EUR € 000**	**GBP € 000**	**USD € 000**	**Other € 000**
Financial assets					
Balances with Central Bank of Malta, treasury bills and cash	133,200	119,994	12,874	284	48
Investments classified as available-for-sale	29,871	29,234	-	637	-
Loans and advances to banks	39,379	2,914	18,750	16,246	1,469
Loans and advances to customers	320,221	309,121	1,955	6,087	3,058
Other assets	6,125	6,084	24	11	6
Total financial assets	528,796	467,347	33,603	23,265	4,581
Financial liabilities					
Amounts owed to banks	3,256	181	-	-	3,075
Amounts owed to customers	463,276	407,862	31,324	22,636	1,454
Other liabilities	13,270	10,858	2,296	80	36
Total financial liabilities	479,802	418,901	33,620	22,716	4,565
Net currency exposure in financial assets/liabilities		48,446	(17)	549	16
Commitments and contingent liabilities	86,148	85,820	42	286	-

Under the scenario that all currencies move adversely against the euro by 20% the effect would be a decrease of €90,000 (2012: €91,000) 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 €90,000 (2012: €91,000) in the carrying amount of financial instruments and the favourable impact would be recognised in profit or loss.

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

2.4.6 Equity price risk

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

2.5 *Liquidity risk*

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

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

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

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

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

The Bank's advances-to-deposit ratio of 63% 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 2013 is 87%, 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 previously referred to.

As at 31 December 2013, the Bank had outstanding guarantees on behalf of third parties amounting to €4,780,000 (2012: €4,916,000), 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

	Less than 3 months	Between 3 months and 1 year	Between 1 year and 5 years	More than 5 years	No maturity date	Total
At 31 December 2013	**€ 000**	**€ 000**	**€ 000**	**€ 000**	**€ 000**	**€ 000**
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	**95,224**	**35,866**	**-**	**-**	**3,506**	**134,596**
Available-for-sale investments	**271**	**2,631**	**10,393**	**24,406**	**5,853**	**43,554**
Loans and advances to banks	**73,193**	**-**	**-**	**-**	**-**	**73,193**
Loans and advances to customers	**164,652**	**32,302**	**87,541**	**30,278**	**-**	**314,773**
Other assets	**7,517**	**418**	**-**	**-**	**3,148**	**11,083**
Total financial assets	**340,857**	**71,217**	**97,934**	**54,684**	**12,507**	**577,199**
Financial liabilities						
Amounts owed to banks	**2,563**	**-**	**-**	**-**	**-**	**2,563**
Amounts owed to customers	**255,601**	**108,497**	**102,266**	**27,537**	**-**	**493,901**
Other liabilities	**18,217**	**1,240**	**1,875**	**2**	**5,451**	**26,785**
Total financial liabilities	**276,381**	**109,737**	**104,141**	**27,539**	**5,451**	**523,249**
Maturity gap	**64,476**	**(38,520)**	**(6,207)**	**27,145**		
Cumulative gap	**64,476**	**25,956**	**19,749**	**46,894**		
At 31 December 2012						
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	115,883	13,847	-	-	3,911	133,641
Available-for-sale investments	727	786	8,197	17,659	5,300	32,669
Loans and advances to banks	46,911	-	-	-	-	46,911
Loans and advances to customers	144,313	55,819	88,722	31,010	-	319,864
Other assets	6,887	703	-	-	3,515	11,105
Total financial assets	314,721	71,155	96,919	48,669	12,726	544,190
Financial liabilities						
Amounts owed to banks	3,256	-	-	-	-	3,256
Amounts owed to customers	254,704	78,329	103,200	25,883	-	462,116
Other liabilities	14,873	512	2,325	995	5,921	24,626
Total financial liabilities	272,833	78,841	105,525	26,878	5,921	489,998
Maturity gap	41,888	(7,686)	(8,606)	21,791		
Cumulative gap	41,888	34,202	25,596	47,387		

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

Bank

At 31 December 2013	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	**95,224**	**35,866**	**-**	**-**	**3,193**	**134,283**
Available-for-sale investments	**152**	**1,730**	**9,653**	**23,103**	**5,853**	**40,491**
Loans and advances to banks	**68,116**	**-**	**-**	**-**	**-**	**68,116**
Loans and advances to customers	**165,284**	**32,302**	**87,541**	**30,278**	**-**	**315,405**
Other assets	**3,492**	**425**	**-**	**-**	**1,928**	**5,845**
Total financial assets	**332,268**	**70,323**	**97,194**	**53,381**	**10,974**	**564,140**
Financial liabilities						
Amounts owed to banks	**2,563**	**-**	**-**	**-**	**-**	**2,563**
Amounts owed to customers	**259,424**	**109,497**	**102,266**	**27,537**	**-**	**498,724**
Other liabilities	**10,290**	**1,247**	**1,875**	**1**	**1,211**	**14,624**
Total financial liabilities	**272,277**	**110,744**	**104,141**	**27,538**	**1,211**	**515,911**
Maturity gap	**59,991**	**(40,421)**	**(6,947)**	**25,843**		
Cumulative gap	**59,991**	**19,570**	**12,623**	**38,466**		
At 31 December 2012						
Financial assets						
Balances with Central Bank of Malta, treasury bills and cash	115,883	13,847	-	-	3,470	133,200
Available-for-sale investments	369	611	6,603	16,988	5,300	29,871
Loans and advances to banks	39,379	-	-	-	-	39,379
Loans and advances to customers	144,670	55,819	88,722	31,010	-	320,221
Other assets	3,251	704	-	-	2,170	6,125
Total financial assets	303,552	70,981	95,325	47,998	10,940	528,796
Financial liabilities						
Amounts owed to banks	3,256	-	-	-	-	3,256
Amounts owed to customers	255,864	78,329	103,200	25,883	-	463,276
Other liabilities	8,382	512	2,325	994	1,057	13,270
Total financial liabilities	267,502	78,841	105,525	26,877	1,057	479,802
Maturity gap	36,050	(7,860)	(10,200)	21,121		
Cumulative gap	36,050	28,190	17,990	39,111		

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 2013	**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	**2,565**	**-**	**-**	**-**	**2,565**
Amounts owed to customers	**257,844**	**114,640**	**113,623**	**28,854**	**514,961**
Total financial liabilities	**260,409**	**114,640**	**113,623**	**28,854**	**517,526**
At 31 December 2012					
Financial liabilities					
Amounts owed to banks	3,265	-	-	-	3,265
Amounts owed to customers	256,559	80,301	115,840	33,379	486,079
Total financial liabilities	259,824	80,301	115,840	33,379	489,344

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 2013	**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	**2,565**	**-**	**-**	**-**	**2,565**
Amounts owed to customers	**261,680**	**115,657**	**113,623**	**28,854**	**519,814**
Total financial liabilities	**264,245**	**115,657**	**113,623**	**28,854**	**522,379**
At 31 December 2012					
Financial liabilities					
Amounts owed to banks	3,265	-	-	-	3,265
Amounts owed to customers	257,719	80,301	115,840	33,379	487,239
Total financial liabilities	260,984	80,301	115,840	33,379	490,504

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

2.6 *Operational risk*

Operational risk is the risk of losses due to:

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

Operational risk is thus often associated with specific and one-off events, such as failure to observe business or working procedures, defects or breakdowns of the technical infrastructure, criminal acts, fire and storm damage or litigation.

Operational risks are, thus, non-financial risks. Operational risk management relies on a framework of policies 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 European Union Directive on Capital Requirements ('CRD') rules. The capital requirement for operational risk under this method was calculated at €2,690,000 (2012: €2,738,000).

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 regularly by the Bank's management, employing techniques based on the guidelines developed by the Basel Committee and the European Union Directives, as implemented by the MFSA for supervisory purposes. The Bank's capital management is based on the regulatory requirements established by local laws and regulations which are modelled on the requisites of the CRD rules. The CRD consists of three pillars: Pillar I contains a set of rules for a mathematical calculation of the capital requirement; Pillar II describes the supervisory review process and contains requirements for the internal calculation of the capital requirement 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 applicable until 31 December 2013:

	2013	2012
	€ 000	€ 000
Total original own funds	**70,130**	69,625
Additional own funds		
Property revaluation reserve	**2,045**	2,045
Investment revaluation reserve	**974**	566
Collective impairment allowances	**3,130**	2,169
Total own funds	**76,279**	74,405

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

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

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

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

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 2013 and 2012 financial years, the Bank complied with all of the externally imposed capital requirements to which it is subject.

Bank

At 31 December 2013	Carrying amount € 000	Weighted amount € 000	Capital requirement € 000
On-balance sheet assets			
Balances with Central Bank of Malta and cash	40,519	-	-
Malta Government treasury bills	93,764	-	-
Cheques in course of collection	739	148	12
Equity shares	5,853	5,853	468
Debt securities	34,638	3,385	271
Loans and advances to banks	68,116	13,648	1,092
Loans and advances to customers	315,405	309,230	24,738
Investment in subsidiaries	10,237	10,237	819
Intangible assets	214	214	17
Property, plant and equipment	13,304	13,304	1,064
Current tax assets	1,397	-	-
Accrued income	3,061	3,061	245
Other assets	7,089	7,089	567
	594,336	366,169	29,293
Off-balance sheet instruments			
Contingent liabilities and commitments	68,994	2,337	187
Credit risk		368,506	29,480
Foreign exchange risk		63	5
Operational risk		33,622	2,690
		402,191	32,175

Own funds	
Original own funds	70,130
Additional own funds	6,149
Gross own funds	76,279
Deductions	-
Total own funds	76,279
Capital Adequacy Ratio	19.0%

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

Bank

At 31 December 2012	Carrying amount € 000	Weighted amount € 000	Capital requirement € 000
On-balance sheet assets			
Balances with Central Bank of Malta and cash	66,105	-	-
Malta Government treasury bills	67,095	-	-
Cheques in course of collection	1,063	213	17
Equity shares	5,300	5,300	424
Debt securities	24,571	4,026	322
Loans and advances to banks	39,379	9,479	758
Loans and advances to customers	320,221	315,675	25,254
Investment in subsidiaries	9,352	9,352	748
Intangible assets	227	227	18
Property, plant and equipment	13,172	13,172	1,054
Current tax assets	654	-	-
Accrued income	3,120	3,120	250
Other assets	6,055	6,055	484
	556,314	366,619	29,329
Off-balance sheet instruments			
Contingent liabilities and commitments	86,148	2,490	199
Credit risk		369,109	29,528
Foreign exchange risk		50	4
Operational risk		34,228	2,738
		403,387	32,270

Own funds	
Original own funds	69,625
Additional own funds	4,780
Gross own funds	74,405
Deductions	-
Total own funds	74,405
Capital Adequacy Ratio	18.5%

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

2.8 *Fair values of financial assets and liabilities*

2.8.1 Financial instruments measured at fair value

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

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

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

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

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

As at 31 December 2013 and 2012, the principal financial instruments that are measured at fair value, consisted of the available-for-sale investments, that were valued using Level 1 inputs. No transfers of financial instruments between different levels of the fair value hierarchy have occurred during the financial years ended 31 December 2013 and 2012.

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

2.8.2 Financial instruments not measured at fair value

Loans and advances to banks and customers

These categories of assets are presented net of impairment allowances to reflect the estimated recoverable amounts. As at 31 December 2013, the Group's aggregate carrying amount in this respect was €387,966,000 (2012: €366,775,000). The loans and advances to customers, which are principally subject to floating interest rates, are measured at the amount of €314,773,000 (2012: €319,864,000). 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 €73,193,000 (2012: €46,911,000). Rates on advances reflect current market rates, and the directors consider the carrying amounts to be a reasonable estimate of their fair value principally in view of the relatively short periods to repricing or maturity from the end of the reporting periods. The current market interest rates utilised for fair value estimation, which reflect essentially the respective instruments' contractual interest rates, are deemed observable and accordingly these fair value estimates have been categorised as Level 2.

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 €496,464,000 as at 31 December 2013 (2012: €465,372,000). 3.1% (2012: 4.6%) of this liability is non-interest bearing, 39.5% (2012: 38.9%) of the liability has a contractual repricing term of three months or less, 25.1% (2012: 24.7%) reprices between three months and one year, 18.4% (2012: 19.4%) reprices between one year and five years whilst 13.9% (2012: 12.4%) is repriceable after more than five years. Accordingly, in view of their profile, the fair value of these financial liabilities is not deemed to be significantly different from their carrying amounts. This applies to variable rate deposits in view of the short periods to repricing, but also applies to liabilities subject to fixed interest rates, based on discounting future contractual cash flows at current market interest rates, taking into account the short periods to maturity. The current market interest rates utilised for discounting purposes, which were almost equivalent to the respective instruments' contractual interest rates, are deemed observable and accordingly these fair value estimates have been categorised as Level 2.

Other financial instruments

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

3 Accounting estimates and judgements

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

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

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

3.2 *Impairment losses on loans and advances*

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

3.3 *Assessment of estimates and judgements*

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

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

4 **Segmental information**

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

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

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

Information about reportable segments:

	Banking services		**Postal services**		**Total**	
	2013	2012	**2013**	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000	**€ 000**	€ 000
Interest receivable	**23,942**	23,664	**231**	179	**24,173**	23,843
Interest expense	**(9,106)**	(9,904)	**-**	(136)	**(9,106)**	(10,040)
Postal sales and other revenue	**9**	20	**20,594**	20,018	**20,603**	20,038
Net fee and commission income	**1,377**	1,384	**949**	997	**2,326**	2,381
Other	**585**	645	**(10)**	217	**575**	862
Segment operating income	**16,807**	15,809	**21,764**	21,275	**38,571**	37,084
Depreciation and amortisation	**(464)**	(418)	**(956)**	(917)	**(1,420)**	(1,335)
Impairment allowances	**(4,103)**	(971)	**(78)**	(14)	**(4,181)**	(985)
Employee compensation and benefits	**(4,591)**	(4,411)	**(10,840)**	(10,354)	**(15,431)**	(14,765)
Other costs	**(2,567)**	(2,634)	**(7,940)**	(7,928)	**(10,507)**	(10,562)
Profit before taxation	**5,082**	7,375	**1,950**	2,062	**7,032**	9,437
Income tax expense	**(1,858)**	(2,554)	**(692)**	(735)	**(2,550)**	(3,289)
Profit for the year	**3,224**	4,821	**1,258**	1,327	**4,482**	6,148
Segment total assets	**579,415**	546,271	**30,426**	28,973	**609,841**	575,244
Capital expenditure during the year	**586**	1,070	**1,068**	1,837	**1,654**	2,907
Segment total liabilities	**511,647**	479,280	**13,793**	13,398	**525,440**	492,678

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 11.8% (2012: 12.7%) of its revenue for 2013 internationally.

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

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

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Balances with Central Bank of Malta	**37,325**	62,635	**37,325**	62,635
Malta Government treasury bills	**93,764**	67,095	**93,764**	67,095
Cash in hand	**3,507**	3,911	**3,194**	3,470
	134,596	133,641	**134,283**	133,200

The balances with the Central Bank of Malta include a reserve deposit amounting to €2,983,000 (2012: €3,298,000) 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 €2,995,000 (2012: €3,262,000).

At 31 December 2013, the Bank had pledged a deposit with the Central Bank of Malta amounting to €1,090,000 (2012: €1,090,000) in favour of the Depositor Compensation Scheme to comply with local regulatory requirements.

At 31 December 2013, the Bank did not have any Malta Government treasury bills pledged in favour of the Central Bank of Malta. At 31 December 2012, Malta Government treasury bills amounting to €7,921,000 were pledged as security for a facility that was not utilised during the reporting period.

6 **Investments**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Debt and other fixed income instruments				
- available-for-sale	**37,701**	27,369	**34,638**	24,571
Equity instruments				
- available-for-sale	**5,853**	5,300	**5,853**	5,300
	43,554	32,669	**40,491**	29,871

6 **Investments** *(continued)*

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

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Issued by public bodies:				
- local government	**32,344**	21,218	**30,945**	20,240
Issued by public issuers:				
- local banks	**1,145**	1,943	**615**	1,414
- local corporates	**4,212**	4,208	**3,078**	2,917
	37,701	27,369	**34,638**	24,571

At 31 December 2013, the Bank held Malta Government Stocks classified as available-for-sale investments amounting to €1,720,000 (2012: €1,719,000) that were pledged in favour of the Depositor Compensation Scheme to comply with local regulatory requirements.

At 31 December 2013, the Bank had pledged Malta Government Stocks with Central Bank of Malta amounting to €9,505,000 held in terms of Directive No.8 (Chapter 204 of the Central Bank of Malta Act) as security for a facility that was not utilised during the reporting period. At 31 December 2012, the Bank did not have any Malta Government Stocks pledged in favour of the Central Bank of Malta.

The Bank's holdings of equity instruments classified as available-for-sale investments as at 31 December 2013 includes a carrying amount of €2,997,000 in relation to investments in shares of MIDI p.l.c.. The original cost of these investments amounted to €4,717,000. At 31 December 2013 the Bank carried a negative investment revaluation reserve amounting to €1,720,000, gross of deferred tax impacts, in respect of these investments in view of the decline in the equity's quoted market price. The Bank's management has carried out an impairment review in relation to these investments to determine whether there is objective evidence that impairment exists. Based on the information available, the Bank's directors are of the view that at 31 December 2013 no impairment indicators existed as the decline in the fair value of the investments in MIDI p.l.c.'s equity below cost was not deemed by the directors to be significant or prolonged by reference to the requirements of IFRSs as adopted by the EU.

As at 31 December 2012, equity instruments classified as available-for-sale investments included equities listed on the Malta Stock Exchange amounting to €2,018,000, which were the subject of a call option arrangement whereby a third party had the option to purchase back these shares subject to the terms and conditions, including pre-determined exercise prices, specified in the agreement. The option expired, without being exercised, on 31 July 2013.

Equity instruments classified as available-for-sale investments include equities listed on the Malta Stock Exchange, except for investments with a carrying amount of €90,000 (2012: €90,000) which are measured at cost in view of the absence of a reliable fair valuation of these investments.

6 **Investments** *(continued)*

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

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
At 1 January	**32,669**	16,328	**29,871**	12,565
Exchange differences	**(1)**	(12)	**(1)**	(12)
Amortisation	**(234)**	(169)	**(232)**	(160)
Acquisitions	**11,323**	17,952	**10,683**	17,952
Redemptions/disposals	**(1,236)**	(1,031)	**(825)**	(70)
Fair value movement	**1,033**	(399)	**995**	(404)
At 31 December	**43,554**	32,669	**40,491**	29,871

7 **Loans and advances to banks**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Repayable on call and at short notice	**61,367**	43,911	**56,290**	39,379
Term loans and advances	**11,826**	3,000	**11,826**	-
	73,193	46,911	**68,116**	39,379

8 **Loans and advances to customers**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Repayable on call and at short notice	**94,441**	98,495	**95,073**	98,495
Term loans and advances	**233,010**	230,082	**233,010**	230,439
Gross loans and advances to customers	**327,451**	328,577	**328,083**	328,934
Impairment allowances	**(12,678)**	(8,713)	**(12,678)**	(8,713)
Net loans and advances to customers	**314,773**	319,864	**315,405**	320,221
Impairment allowances				
Specific impairment allowances	**9,548**	6,544	**9,548**	6,544
Collective impairment allowances	**3,130**	2,169	**3,130**	2,169
	12,678	8,713	**12,678**	8,713

The aggregate gross amount of impaired loans and advances to customers amounted to €36,469,000 (2012: €25,337,000). The balance of individually assessed allowances at the end of the reporting period includes €741,000 (2012: €766,000), reflected in the table above, in respect of interest in suspense.

Assets acquired in settlement of debt amounting to €417,000 (2012: €584,000) are presented as assets classified as held for sale.

As at 31 December 2013, loans and advances to customers amounting to €1,645,195 (2012: €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 2015. The asset is still being presented within loans and advances on the basis that the customer has retained substantially all risks and rewards of these unquoted equities and accordingly at the end of the reporting period, management are not in a position to determine whether this option will be exercised.

9 **Investment in subsidiaries**

Name of company	**Country of incorporation**	**Nature of business**	**Equity interest**		**Carrying amount**	
			2013	2012	**2013**	2012
			%	%	**€ 000**	€ 000
Redbox Limited	Malta	Holding Company	**100**	100	**10,237**	9,352

9 **Investment in subsidiaries** *(continued)*

At 31 December 2013, Redbox Limited held 69.2% (2012: 67.7%) of the equity share capital of MaltaPost p.l.c. The remaining 30.8% (2012: 32.3%) 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 2013, since the financial statements prepared as of this date constitute the most recent audited financial statements of MaltaPost p.l.c..

10 **Intangible assets**

	Group				Bank
	Goodwill € 000	**Computer software € 000**	**Postal licence € 000**	**Total € 000**	**Computer software € 000**
At 1 January 2012					
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
Year ended 31 December 2012					
At 1 January 2012	857	544	117	1,518	244
Acquisitions	-	357	-	357	73
Amortisation for the year	-	(248)	(79)	(327)	(90)
At 31 December 2012	857	653	38	1,548	227
At 31 December 2012					
Cost	857	3,131	1,159	5,147	1,846
Accumulated amortisation	-	(2,478)	(1,121)	(3,599)	(1,619)
Net book amount	857	653	38	1,548	227
Year ended 31 December 2013					
At 1 January 2013	**857**	**653**	**38**	**1,548**	**227**
Acquisitions	**-**	**295**	**-**	**295**	**93**
Amortisation for the year	**-**	**(339)**	**(38)**	**(377)**	**(106)**
Expiration of licence	**-**	**-**	**(1,159)**	**(1,159)**	**-**
Amortisation released on expiration of licence	**-**	**-**	**1,159**	**1,159**	**-**
At 31 December 2013	**857**	**609**	**-**	**1,466**	**214**
At 31 December 2013					
Cost	**857**	**3,426**	**-**	**4,283**	**1,939**
Accumulated amortisation	**-**	**(2,817)**	**-**	**(2,817)**	**(1,725)**
Net book amount	**857**	**609**	**-**	**1,466**	**214**

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

The intangible asset represented the amount paid for the right to operate the postal services in Malta. This right had a useful life of fifteen years and was amortised over this definite period.

The European Postal Directive as amended by Directive 2008/06/EC, adopted on 20 February 2008, identified 31 December 2012 as the final step in the gradual opening of Malta's postal markets to competition – referred to as full market opening of the postal sector. On 1 November 2012 the Malta Communications Authority issued its decision to grant a new licence to MaltaPost p.l.c. for an indefinite period. This new licence was granted to MaltaPost p.l.c. with effect from 1 May 2013.

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

The recognised goodwill represents payments made by the Group in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised. As at 31 December 2013 and 2012 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 €1.15 as at 31 December 2013 (2012: 85 cent). On this basis, the recoverable amount of the cash-generating unit is higher than its carrying amount.

11 **Property, plant and equipment**

Group	**Land and buildings € 000**	**Computer equipment € 000**	**Other € 000**	**Total € 000**
At 1 January 2012				
Cost or valuation	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
Year ended 31 December 2012				
At 1 January 2012	19,378	647	1,348	21,373
Acquisitions	1,842	178	530	2,550
Disposals	-	(12)	-	(12)
Charge for the year	(452)	(243)	(313)	(1,008)
Depreciation released on disposals	-	12	-	12
At 31 December 2012	20,768	582	1,565	22,915
At 31 December 2012				
Cost or valuation	24,701	3,134	6,450	34,285
Accumulated depreciation	(3,933)	(2,552)	(4,885)	(11,370)
Net book amount	20,768	582	1,565	22,915
Year ended 31 December 2013				
At 1 January 2013	**20,768**	**582**	**1,565**	**22,915**
Acquisitions	**921**	**208**	**230**	**1,359**
Disposals	**-**	**(23)**	**(400)**	**(423)**
Charge for the year	**(461)**	**(273)**	**(309)**	**(1,043)**
Depreciation released on disposals	**-**	**23**	**398**	**421**
Other movements	**(1)**	**1**	**-**	**-**
At 31 December 2013	**21,227**	**518**	**1,484**	**23,229**
At 31 December 2013				
Cost or valuation	**25,621**	**3,308**	**6,280**	**35,209**
Accumulated depreciation	**(4,394)**	**(2,790)**	**(4,796)**	**(11,980)**
Net book amount	**21,227**	**518**	**1,484**	**23,229**

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

Bank	**Land and buildings € 000**	**Computer equipment € 000**	**Other € 000**	**Total € 000**
At 1 January 2012				
Cost or valuation	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
Year ended 31 December 2012				
At 1 January 2012	11,746	342	416	12,504
Acquisitions	803	67	125	995
Disposals	-	(12)	-	(12)
Charge for the year	(95)	(115)	(117)	(327)
Depreciation released on disposals	-	12	-	12
At 31 December 2012	12,454	294	424	13,172
At 31 December 2012				
Cost or valuation	13,116	1,706	2,588	17,410
Accumulated depreciation	(662)	(1,412)	(2,164)	(4,238)
Net book amount	12,454	294	424	13,172
Year ended 31 December 2013				
At 1 January 2013	**12,454**	**294**	**424**	**13,172**
Acquisitions	**285**	**70**	**136**	**491**
Disposals	**-**	**(23)**	**(400)**	**(423)**
Charge for the year	**(112)**	**(124)**	**(122)**	**(358)**
Depreciation released on disposals	**-**	**24**	**398**	**422**
At 31 December 2013	**12,627**	**241**	**436**	**13,304**
At 31 December 2013				
Cost or valuation	**13,401**	**1,741**	**2,322**	**17,464**
Accumulated depreciation	**(774)**	**(1,500)**	**(1,886)**	**(4,160)**
Net book amount	**12,627**	**241**	**436**	**13,304**

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

11.1 *Fair valuation of land and buildings*

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. The revaluation surplus net of applicable deferred income taxes is shown in 'other reserves' in shareholders' equity (note 18). As at 31 December 2013 and 2012, the directors have reviewed the carrying amounts of the Bank's properties and no adjustments were deemed necessary to the carrying amounts of the Bank's properties.

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

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

The Bank's land and buildings comprise various offices and operational premises, including the Bank's head office. All the recurring property fair value measurements at 31 December 2013 use significant unobservable inputs and are accordingly categorised within Level 3 of the fair valuation hierarchy.

The Bank's policy is to recognise transfers into and out of fair value hierarchy levels as of the beginning of the reporting period. There were no transfers between different levels of the fair value hierarchy during the year ended 31 December 2013.

A reconciliation from the opening balance to the closing balance of land and buildings for recurring fair value measurements categorised within Level 3 of the value hierarchy, is reflected in the table above. The only movement reflects additions and depreciation charge for the year ended 31 December 2013.

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

The subsidiary's land and buildings have not been revalued since acquisition. The directors have assessed the fair values of these properties at 31 December 2013 and 2012, which fair values were deemed to fairly approximate the carrying amounts.

11.2 *Valuation processes*

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

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

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

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

When management considers that the valuation report is appropriate, the valuation report is recommended to the audit committee. The audit committee considers the valuation report as part of its overall responsibilities.

11.3 *Valuation techniques*

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

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

		Range of significant unobservable inputs		
Property description	**Valuation technique**	**Rental value €/sqm**	**Growth rate %**	**Discount rate %**
Bank's land and buildings reflected in table above	Discounted cash flows	200 - 400	2	5

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

11.5 *Historical cost of land and buildings*

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

	Group		**Bank**	
	2013 € 000	2012 € 000	**2013 € 000**	2012 € 000
Cost	**23,137**	22,217	**10,920**	10,635
Accumulated depreciation	**(4,763)**	(4,287)	**(1,146)**	(1,019)
Net book amount	**18,374**	17,930	**9,774**	9,616

12 **Investment property**

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

	Group		Bank	
	2013	2012	**2013**	2012
	€ 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 of the Laws of Malta). Accordingly the fair value measurement has been categorised within Level 3 of the fair value hierarchy.

13 **Deferred tax assets**

Deferred tax assets and liabilities are attributable to the following:

Group

	Assets 2013 € 000	**Liabilities 2013 € 000**	**Net 2013 € 000**	Assets 2012 € 000	Liabilities 2012 € 000	Net 2012 € 000
Differences between depreciation and capital allowances	**356**	**(79)**	**277**	378	(59)	319
Provisions for liabilities and charges	**258**	**-**	**258**	266	-	266
Loan impairment allowances	**4,497**	**-**	**4,497**	3,082	-	3,082
Revaluation of property	**-**	**(823)**	**(823)**	-	(823)	(823)
Fair value movements on investments	**-**	**(137)**	**(137)**	208	-	208
Other temporary differences	**-**	**(56)**	**(56)**	-	(54)	(54)
	5,111	**(1,095)**	**4,016**	3,934	(936)	2,998

Bank

	Assets 2013 € 000	**Liabilities 2013 € 000**	**Net 2013 € 000**	Assets 2012 € 000	Liabilities 2012 € 000	Net 2012 € 000
Differences between depreciation and capital allowances	**-**	**(79)**	**(79)**	-	(58)	(58)
Provisions for liabilities and charges	**225**	**-**	**225**	233	-	233
Loan impairment allowances	**4,436**	**-**	**4,436**	3,050	-	3,050
Revaluation of property	**-**	**(823)**	**(823)**	-	(823)	(823)
Fair value movements on investments	**-**	**(137)**	**(137)**	208	-	208
	4,661	**(1,039)**	**3,622**	3,491	(881)	2,610

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

Movement in temporary differences relate to:

Group

	At 1 January 2012 € 000	Recognised in profit or loss € 000	Recognised in other comprehensive income € 000	**At 31 December 2012 € 000**	**Recognised in profit or loss € 000**	**Recognised in other comprehensive income € 000**	**At 31 December 2013 € 000**
Differences between depreciation and capital allowances	340	(21)	-	**319**	**(42)**	**-**	**277**
Provisions for liabilities and charges	267	(1)	-	**266**	**(8)**	**-**	**258**
Loan impairment allowances	2,780	302	-	**3,082**	**1,415**	**-**	**4,497**
Revaluation of property	(823)	-	-	**(823)**	**-**	**-**	**(823)**
Fair value movements on investments	66	-	142	**208**	**-**	**(345)**	**(137)**
Other temporary differences	(58)	4	-	**(54)**	**(2)**	**-**	**(56)**
	2,572	284	142	**2,998**	**1,363**	**(345)**	**4,016**

Bank

	At 1 January 2012 € 000	Recognised in profit or loss € 000	Recognised in other comprehensive income € 000	**At 31 December 2012 € 000**	**Recognised in profit or loss € 000**	**Recognised in other comprehensive income € 000**	**At 31 December 2013 € 000**
Differences between depreciation and capital allowances	(51)	(7)	-	**(58)**	**(21)**	**-**	**(79)**
Provisions for liabilities and charges	237	(4)	-	**233**	**(8)**	**-**	**225**
Loan impairment allowances	2,752	298	-	**3,050**	**1,386**	**-**	**4,436**
Revaluation of property	(823)	-	-	**(823)**	**-**	**-**	**(823)**
Fair value movements on investments	66	-	142	**208**	**-**	**(345)**	**(137)**
	2,181	287	142	**2,610**	**1,357**	**(345)**	**3,622**

The recognised deferred tax assets and liabilities are expected to be recovered or settled principally after more than twelve months from the end of the reporting period. The deferred tax liabilities reflected in other comprehensive income relate to the revaluation of property, plant and equipment and the fair valuation of available-for-sale investments.

14 Inventories

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Postal supplies and materials	**149**	123	**-**	-
Merchandise	**453**	512	**-**	-
Other stock items	**260**	175	**260**	175
	862	810	**260**	175

15 Trade and other receivables

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Trade receivables - net of impairment allowances	**4,112**	3,575	**-**	-
Others	**1,973**	1,899	**2,045**	1,941
	6,085	5,474	**2,045**	1,941

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

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
At 1 January	**93**	79	**-**	-
Impairment loss recognised	**78**	14	**-**	-
At 31 December	**171**	93	**-**	-

16 Accrued income and other assets

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Accrued income	**2,872**	2,952	**2,816**	2,891
Other assets	**1,387**	1,616	**245**	229
	4,259	4,568	**3,061**	3,120

17 Share capital

Bank

	2013		2012	
	No. of shares 000s	**€ 000**	No. of shares 000s	€ 000
Authorised				
Ordinary shares of 25 cent each	**80,000**	**20,000**	80,000	20,000
Issued				
Ordinary shares of 25 cent each	**39,702**	**9,925**	36,093	9,023

By virtue of a resolution dated 25 April 2013, the directors of the Bank approved the allotment of 3,609,269 ordinary shares of 25 cent each as a bonus issue of one (1) share for every ten (10) shares held by shareholders on the Company's Register of Shareholders as at close of business on 27 May 2013, the last trading date being 22 May 2013. This bonus issue was allotted to shareholders on 28 May 2013, and thereby increased the issued and fully paid share capital to 39,701,961 shares of 25 cent each, resulting in a paid up share capital of €9,925,490.

18 Reserves

These reserves are non-distributable.

18.1 *Share premium*

There was no increase in the share premium account during the reporting period as the Bank did not issue any shares during the year.

18.2 *Revaluation and other reserves*

The Group and the Bank had the following reserves as at end of the reporting period:

	Group		**Bank**	
	2013 € 000	2012 € 000	**2013 € 000**	2012 € 000
Property revaluation reserve	**2,045**	2,043	**2,045**	2,043
Investment revaluation reserve	**363**	(301)	**219**	(422)
General Banking Risks reserve	**1,048**	-	**1,048**	-
Other reserve	**2,775**	2,721	**2,775**	2,721
	6,231	4,463	**6,087**	4,342

18 **Reserves** *(continued)*

The property revaluation reserve relates to the fair valuation of the land and buildings component of property, plant and equipment, and the balance represents the cumulative net increase in fair value of such property, net of related deferred tax.

The investment revaluation reserve represents the cumulative net change in fair values of available-for-sale financial assets held by the Group and by the Bank, net of related deferred tax impacts.

The General Banking Risks reserve is attributable to the new requirement emanating from the revised Banking Rule BR/09: Measures Addressing Credit Risks Arising from the Assessment of the Quality of Asset Portfolios of Credit Institutions Authorised under the Banking Act, 1994, which requires banks to allocate funds to this reserve for cover against potential risks linked to the Bank's non-performing loans and advances. This allocation is to occur over a three year period, with a 40% allocation during the financial year ended 31 December 2013, and a 30% allocation both in the financial years ending 31 December 2014 and 31 December 2015.

The other reserve represents amounts set aside by the Bank from its retained earnings in relation to the Depositor Compensation Scheme reflecting the carrying amount of assets pledged in favour of the Scheme to comply with local regulatory requirements.

19 **Amounts owed to banks**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Term deposits with agreed maturity dates or periods of notice	**2,384**	3,175	**2,384**	3,175
Repayable on demand	**179**	81	**179**	81
	2,563	3,256	**2,563**	3,256

20 **Amounts owed to customers**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Term deposits with agreed maturity dates	**332,489**	307,763	**334,489**	307,763
Repayable on demand	**161,412**	154,353	**164,235**	155,513
	493,901	462,116	**498,724**	463,276

21 **Provisions for liabilities and other charges**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Obligation to Government	**1,547**	1,503	**-**	-
Legal	**737**	761	**642**	666
	2,284	2,264	**642**	666

These provisions are predominantly non-current in nature.

Group	**2013**			2012		
	Obligation to Government	**Legal**	**Total**	Obligation to Government	Legal	Total
	€ 000	**€ 000**	**€ 000**	€ 000	€ 000	€ 000
At 1 January	**1,503**	**761**	**2,264**	1,663	763	2,426
Exchange differences recognised in profit or loss	**-**	**(24)**	**(24)**	-	(10)	(10)
Charge/(credit) for the year	**103**	**-**	**103**	(48)	8	(40)
Crystallised obligations	**(59)**	**-**	**(59)**	(112)	-	(112)
At 31 December	**1,547**	**737**	**2,284**	1,503	761	2,264

The obligation to Government arises in terms of Article 8A of the Pensions Ordinance (Chapter 93 of the Laws of Malta), covering former Government employees who opted to become full-time employees of MaltaPost p.l.c., and who continued to be entitled to pension benefits which go beyond the National Insurance Scheme. The pension benefits scheme is a final salary defined benefit plan and is unfunded.

Obligation to Government recognised in the statement of financial position is arrived at as follows:

	2013	2012
	€ 000	€ 000
Present value of unfunded obligations	**2,722**	2,619
Crystallised obligations	**(476)**	(417)
Fair value of obligations to be reimbursed by Government	**(699)**	(699)
	1,547	1,503

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

The movement for the year is made up of:

	2013 **€ 000**	2012 € 000
Charge/(credit) to the income statement	**103**	(48)
Crystallised obligations	**(59)**	(112)
	44	(160)

The amount recognised in the income statement is as follows:

	2013 **€ 000**	2012 € 000
Interest cost	**64**	42
Other movements	**39**	(90)
Total amount charged/(credited) to the income statement	**103**	(48)

In computing the Obligation to Government, the Group used a discount rate of 4.09%. The sensitivity of the Obligation to changes in the discount rate utilised is not deemed sufficiently material for disclosure purposes.

Bank

	2013 **Legal** **€ 000**	2012 Legal € 000
At 1 January	**666**	676
Exchange differences recognised in profit or loss	**(24)**	(10)
At 31 December	**642**	666

In addition, the Bank is also a defendant in legal actions by other customers as a result of which the directors are of the opinion that no liability will be incurred.

22 **Other liabilities**

	Group		**Bank**	
	2013 **€ 000**	2012 € 000	**2013** **€ 000**	2012 € 000
Trade payables	**3,236**	1,954	**-**	-
Bills payable	**1,854**	1,949	**1,854**	1,949
Cash collateral	**72**	72	**72**	72
Other payables	**11,833**	10,825	**7,728**	6,286
	16,995	14,800	**9,654**	8,307

23 **Accruals and deferred income**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Accrued interest	**4,286**	4,370	**4,296**	4,370
Other	**5,411**	5,872	**674**	593
	9,697	10,242	**4,970**	4,963

24 **Commitments and contingent liabilities**

Group/Bank

	2013	2012
	€ 000	€ 000
Contingent liabilities		
Guarantee obligations incurred on behalf of third parties	**4,780**	4,916
Commitments		
Documentary credits	**1,328**	1,332
Credit facilities and other commitments to lend	**62,886**	79,900
	64,214	81,232

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 property and motor vehicle operating leases, subject to ordinary arrangements, are as follows:

	2013	2012
	€ 000	€ 000
Current		
Within 1 year	**172**	104
Non-current		
Between 1 and 2 years	**148**	52
Between 2 and 5 years	**386**	-
After 5 years	**55**	-
	761	156

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

25 **Net interest income**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Interest income				
On loans and advances to banks	**157**	151	**97**	139
On loans and advances to customers	**22,061**	21,692	**22,061**	21,692
On balances with Central Bank of Malta	**44**	75	**44**	75
On Malta Government treasury bills	**650**	1,277	**650**	1,277
	22,912	23,195	**22,852**	23,183
On debt and other fixed income instruments	**1,495**	817	**1,335**	645
Net amortisation of premiums and discounts	**(234)**	(169)	**(232)**	(160)
	1,261	648	**1,103**	485
Total interest income	**24,173**	23,843	**23,955**	23,668
Interest expense				
On amounts owed to banks	**(8)**	(189)	**(8)**	(54)
On amounts owed to customers	**(9,098)**	(9,851)	**(9,110)**	(9,854)
Total interest expense	**(9,106)**	(10,040)	**(9,118)**	(9,908)
Net interest income	**15,067**	13,803	**14,837**	13,760

26 **Net fee and commission income**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Fee and commission income				
Retail banking customer fees	**1,299**	1,368	**1,299**	1,368
Brokerage	**10**	24	**10**	24
Other	**1,112**	1,076	**164**	79
Total fee and commission income	**2,421**	2,468	**1,473**	1,471
Fee and commission expense				
Inter bank transaction fees	**(94)**	(83)	**(94)**	(83)
Other	**(1)**	(4)	**(1)**	(4)
Total fee and commission expense	**(95)**	(87)	**(95)**	(87)
Net fee and commission income	**2,326**	2,381	**1,378**	1,384

27 **Postal sales and other revenues**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Stamps, parcel post and postal stationery including income from foreign inbound mail	**20,196**	19,383	**-**	-
Collectibles and philatelic sales	**407**	569	**9**	20
Other	**-**	86	**-**	-
	20,603	20,038	**9**	20

28 **Dividend income**

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Subsidiary company	**-**	-	**1,303**	1,307
Available-for-sale equity shares	**185**	159	**185**	159
	185	159	**1,488**	1,466

29 Net trading income

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Gains on foreign exchange activities	**281**	536	**291**	220

30 Employee compensation and benefits

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Staff costs				
Wages, salaries and allowances	**14,337**	13,717	**4,366**	4,183
Social security costs	**1,094**	1,048	**266**	262
	15,431	14,765	**4,632**	4,445

	Group		Bank	
	2013	2012	**2013**	2012
Average number of employees				
Managerial	**70**	62	**44**	38
Others	**680**	686	**107**	115
	750	748	**151**	153

31 Net impairment losses

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Write-downs				
Loans and advances to customers				
- specific allowances	**(3,239)**	(1,070)	**(3,239)**	(1,070)
- collective allowances	**(961)**	(248)	**(961)**	(248)
- bad debts written off	**(113)**	(79)	**(113)**	(79)
Trade receivables – specific allowances	**(78)**	(14)	**-**	-
	(4,391)	(1,411)	**(4,313)**	(1,397)
Reversals of write-downs				
Loans and advances to customers				
- specific allowances	**210**	426	**210**	426
	210	426	**210**	426
Net impairment losses	**(4,181)**	(985)	**(4,103)**	(971)

32 **Profit before taxation**

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

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
After charging				
Directors' emoluments				
- fees	**77**	77	**63**	63
- other emoluments	**291**	307	**291**	307
After crediting				
Rental income from investment property	**37**	37	**37**	37
Net income from investment services	**105**	103	**105**	103

Other operating costs are analysed as follows:

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Foreign outbound mail	**2,997**	3,303	**-**	-
Utilities and insurance	**588**	748	**307**	441
IT support and telecommunication costs	**360**	387	**225**	222
Repairs and maintenance	**1,027**	1,026	**266**	289
Operating lease rental charges	**1,125**	938	**442**	280
Other administrative expenses	**4,305**	4,200	**1,355**	1,368
Total other operating costs	**10,402**	10,602	**2,595**	2,600

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				
2013	**46**	**-**	**4**	**2**
2012	43	-	4	-
Auditors of subsidiary companies				
2013	**18**	**11**	**2**	**14**
2012	18	11	4	14

LOMBARD

33 Income tax expense

Recognised in profit or loss:

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Current taxation				
Current tax expense	**3,911**	3,593	**3,628**	3,320
Adjustment to prior years' current tax expense	**2**	(20)	**5**	(21)
	3,913	3,573	**3,633**	3,299
Deferred taxation				
Deferred tax income (note 13)	**(1,363)**	(284)	**(1,357)**	(287)
	2,550	3,289	**2,276**	3,012

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

	Group		Bank	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Profit before income tax	**7,032**	9,437	**6,387**	8,562
Tax on profit at 35%	**2,461**	3,303	**2,235**	2,997
Tax effect of:				
Non-taxable income	**(39)**	-	**(39)**	-
Expenses non-deductible for tax purposes	**11**	11	**10**	5
Income taxed at different tax rates	**(1)**	(47)	**-**	(2)
Depreciation expense not deductible by way of capital allowances	**91**	84	**40**	33
Adjustment to prior years' current tax expense	**2**	(20)	**5**	(21)
Other differences	**25**	(42)	**25**	-
	2,550	3,289	**2,276**	3,012

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

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

Group		**2013**			2012	
	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	**1,015**	**(342)**	**673**	(399)	139	(260)
- Reclassification adjustments to profit or loss	**9**	**(3)**	**6**	(9)	3	(6)
	1,024	**(345)**	**679**	(408)	142	(266)
Bank						
Fair valuation of available-for-sale financial assets:						
- Net changes in fair value	**990**	**(349)**	**641**	(404)	142	(262)
- Reclassification adjustments to profit or loss	**-**	**-**	**-**	(1)	-	(1)
	990	**(349)**	**641**	(405)	142	(263)

34 Earnings per share

Earnings per share is based on the net profit for the year divided by the weighted average number of ordinary shares in issue during the year.

	Group	
	2013	2012
Net profit attributable to equity holders of the Bank (€ 000)	**4,094**	5,719
Weighted average number of ordinary shares in issue	**39,701,961**	39,701,961
Earnings per share (€ cent)	**10c3**	14c4

The comparative information has been restated to reflect the bonus share issue effected during the current financial year and the impact on the number of shares in issue, referred to in note 17, retrospectively.

The Bank has no instruments or arrangements which give rise to dilutive potential ordinary shares, and accordingly diluted earnings per share is equivalent to basic earnings per share.

35 Dividends

	2013	2012
Dividends declared and paid by the Bank (€ 000)	**2,815**	2,698
€ cent per share – gross	**12c0**	11c5

Subsequent to the end of the reporting period, a gross dividend of 4 cent per share (net dividend of 2.6 cent for a total amount of €1,032,000), with a nominal amount of 25 cent per share, for the twelve months ended 31 December 2013 is being proposed for approval by the shareholders. A resolution to that effect will be proposed to the shareholders at the Annual General Meeting.

36 **Cash and cash equivalents**

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

	Group		**Bank**	
	2013	2012	**2013**	2012
	€ 000	€ 000	**€ 000**	€ 000
Malta Government treasury bills (note 5)	**40,957**	20,488	**40,957**	20,488
Loans and advances to banks (notes 5 and 7)	**106,445**	102,163	**101,367**	97,625
Cash (note 5)	**3,507**	3,911	**3,194**	3,470
Amounts owed to banks (note 19)	**(2,563)**	(3,130)	**(2,563)**	(3,130)
Cash and cash equivalents	**148,346**	123,432	**142,955**	118,453

37 **Related parties**

37.1 *Identity of related parties*

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

37.2 *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
	2013	**2013**	2012	2012
Year ended 31 December	**€ 000**	**€ 000**	€ 000	€ 000
At 1 January	**1,431**	**60**	583	919
Additions	**86**	**-**	1,027	-
Repayments	**(165)**	**-**	(179)	-
Drawn commitments	**-**	**(60)**	-	(859)
At 31 December	**1,352**	**-**	1,431	60

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

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

37.3 *Compensation to key management personnel*

Details of directors' fees and emoluments are stated in note 32.

37.4 *Transactions with other related parties*

37.4.1 Subsidiaries

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

	2013	2012
	€ 000	€ 000
Income statement		
Other income	**82**	47
Interest payable	**14**	3
Administrative expenses	**83**	57
Statement of financial position		
Loans and advances to customers	**632**	357
Amounts owed to customers	**4,824**	1,160
Other liabilities	**-**	76

During the year, Redbox Limited received gross dividends from MaltaPost p.l.c. amounting to €1,304,000 (2012: €1,307,000), which dividends were ultimately received by the Bank (note 28).

37.4.2 Major shareholder

The Bank entered into no material transactions with its major shareholder during the financial year.

38 **Investor Compensation Scheme**

In accordance with the requirements of the Investor Compensation Scheme Regulations, 2003 issued under the Investment Services Act, 1994 (Chapter 370 of the Laws of Malta) licence holders are required to transfer a variable contribution to an Investor Compensation Scheme Reserve and place the equivalent amount with a bank, pledged in favour of the Scheme. Alternatively licence holders can elect to pay the amount of variable contribution directly to the Scheme. Lombard Bank Malta p.l.c. has elected to pay the amount of the variable contribution directly to the Scheme.

39 **Statutory information**

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

LOMBARD

ADDITIONAL REGULATORY DISCLOSURES

For the Year Ended 31 December 2013

2013

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 by the Bank in accordance with the Pillar III quantitative and qualitative disclosure requirements as governed by Banking Rule BR/07: Publication of Annual report and Audited Financial Statements of Credit Institutions authorised under the Banking Act, 1994, issued by the Malta Financial Services Authority. These disclosures 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 – Disclosure 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 stakeholders 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.

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

Risk management within the Bank is mainly carried out on a unified basis, using an integrated and global framework. This framework is based on local and international guidelines, such as the Basel 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 , the Capital Requirements Directive of the EU and the Malta Financial Services Authority ('MFSA') rules. The Bank has adopted the Standardised Approach and the Basic Method with respect to the calculation of capital requirements and management of credit and foreign exchange risk respectively, as well as the Basic Indicator Approach with respect to operational risk.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

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 ALCO monitors the Bank's financial performance, considers investment policy and overseas counterparty limits. Membership of this Committee is made up of a number of Chief Officers and Senior Managers including managers from Finance and Treasury departments. The Chief Executive Officer is Chairman of ALCO and retains primary responsibility for asset and liability management.

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

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.

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.

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

In terms of MFSA Banking Rule BR/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 instruments. Consistent with this, an exposure would include the amount at risk arising from the Bank's:

- claims on a customer including actual and potential claims which would arise from the drawing down in full of undrawn advised facilities, which the Bank has committed itself to provide;
- contingent liabilities arising in the normal course of business, and those contingent liabilities which would arise from the drawing down in full of undrawn advised facilities which the Bank has committed itself to provide; and
- other on and off-balance sheet financial assets and commitments.

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

The main categories of risk are:

- *Credit risk*: Credit risk stems from the possible non-prompt repayment or non-payment of existing and contingent obligations by the Bank's counterparties, resulting in the loss of equity and profit. 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, the following are considered: country risk, quantitative and qualitative characteristics, as well as the industry sector in which the counterparty operates. The Bank has set limits of authority and has segregated duties so as to maintain impartiality and independence during the approval process and control for new and existing credit facilities.

The Bank's maximum exposure 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 principally balances with Central Bank of Malta, Malta Government treasury bills, cheques in course of collection, available-for-sale financial assets as well as loans and advances to banks and customers. The maximum exposure of these financial assets to credit risk equals their carrying amount.

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

- Guarantee obligations incurred on behalf of third parties. The maximum exposure to credit risk is the full amount that the Bank would have to pay if the guarantees are called upon.
- Loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities. The maximum exposure to credit risk is the full amount of the committed facilities.

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:

	2013
	€ 000
Credit risk exposures relating to on-balance sheet assets	
Balances with Central Bank of Malta	37,325
Cheques in course of collection	739
Loans and advances to banks	68,116
Loans and advances to customers	315,405
Available-for-sale financial assets	134,255
Other assets	14,450
	570,290
Credit risk exposures relating to off-balance sheet instruments	
Contingent liabilities	4,780
Commitments	64,214
	68,994

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 worst case scenario of credit risk exposure to the Bank at 31 December 2013.

The company's cash was placed with quality financial institutions.

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

2.3 *Concentration risk*

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.

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.

As at 31 December 2013, 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.

The following tables analyse the concentration of credit risk by geographical region, industry sector and residual maturity at the end of the reporting period.

2.3.1 Credit risk exposures analysed by geographical region

The Bank monitors concentration of credit risk by geographical region. The following table summarises the country of risk of the on-balance sheet assets and off-balance sheet instruments.

At 31 December 2013	**Carrying amount € 000**	**Malta € 000**	**Eurozone € 000**	**Other European countries € 000**	**Other € 000**
On-balance sheet assets					
Central Government or central banks	163,429	163,429	-	-	-
Institutions	68,761	31,906	19,708	11,682	5,465
Public Sector Entities	7,877	7,877	-	-	-
Corporates	43,445	42,417	621	407	-
Retail	17,419	16,232	11	-	1,176
Secured by real estate property	147,550	145,121	718	1,711	-
Past due items	112,399	111,810	-	58	531
Other items	9,410	9,396	-	-	14
	570,290	**528,188**	**21,058**	**13,858**	**7,186**
Off-balance sheet instruments					
Public Sector Entities	393	393	-	-	-
Corporates	24,600	24,491	-	109	-
Retail	22,686	21,935	674	51	26
Secured by real estate property	21,315	21,315	-	-	-
	68,994	**68,134**	**674**	**160**	**26**

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

2.3.2 Credit risk exposures analysed by industry sector

The following are industry concentrations that relate to the on-balance sheet assets and off-balance sheet instruments:

At 31 December 2013	**Carrying amount € 000**	**Manufacturing € 000**	**Tourism € 000**	**Trade € 000**	**Property and construction € 000**	**Personal, professional and home loans € 000**	**Financial institutions € 000**	**Other sectors € 000**
On-balance sheet assets								
Central Government or central banks	163,429	-	-	-	-	-	163,429	-
Institutions	68,761	-	-	-	-	-	68,761	-
Public Sector Entities	7,877	-	-	-	-	-	-	7,877
Corporates	43,445	408	2,368	7,374	7,940	5	3,929	21,421
Retail	17,419	803	1,423	1,642	2,616	6,439	1,108	3,388
Secured by real estate property	147,550	5,058	1,868	19,091	97,949	14,760	82	8,742
Past due items	112,399	5,124	4,799	7,114	82,492	7,137	395	5,338
Other items	9,410	72	187	437	5,523	126	2,892	173
	570,290	**11,465**	**10,645**	**35,658**	**196,520**	**28,467**	**240,596**	**46,939**
Off-balance sheet instruments								
Public Sector Entities	393	-	-	-	-	-	-	393
Corporates	24,600	435	-	6,257	15,797	55	151	1,905
Retail	22,686	1,793	613	3,332	8,495	5,227	53	3,173
Secured by real estate property	21,315	-	2,569	233	8,162	1,252	-	9,099
	68,994	**2,228**	**3,182**	**9,822**	**32,454**	**6,534**	**204**	**14,570**

The majority of the Bank's loans and advances to customers comprised exposures to corporate.

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

2.3.3 Credit risk exposures analysed by residual maturity

The residual maturity breakdown of all exposures was as follows:

At 31 December 2013	Carrying amount € 000	Less than 1 year € 000	Over 1 but less than 5 years € 000	Over 5 years € 000
On-balance sheet assets				
Central Government or central banks	163,429	132,484	8,676	22,269
Institutions	68,761	68,146	-	615
Public Sector Entities	7,877	430	7,447	-
Corporates	43,445	33,112	7,739	2,594
Retail	17,419	10,164	5,711	1,544
Secured by real estate property	147,550	74,504	49,699	23,347
Past due items	112,399	91,469	17,919	3,011
Other items	9,410	9,410	-	-
	570,290	**419,719**	**97,191**	**53,380**
Off-balance sheet instruments				
Public Sector Entities	393	393	-	-
Corporates	24,600	24,600	-	-
Retail	22,686	22,686	-	-
Secured by real estate property	21,315	21,315	-	-
	68,994	**68,994**	**-**	**-**

2.4 *Asset quality*

The credit quality of debt securities and treasury bills as determined by credit ratings applicable to issuers based on Fitch's ratings was as follows:

At 31 December 2013	Treasury bills € 000	Debt securities € 000	Total € 000
A- to AA-	93,764	30,946	124,710
Lower than A-	-	615	615
Unrated	-	3,077	3,077
	93,764	**34,638**	**128,402**

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

The Bank reviews and grades advances to customers using the following internal risk grades:

- Regular
- Watch
- Substandard
- Doubtful

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

	2013
	€ 000
Gross loans and advances to customers	
Regular	117,020
Watch	52,404
Substandard	14,048
Doubtful	144,611
	328,083

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

2.5 *Impaired loans and advances to customers*

Impaired loans and advances are advances for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loans and advances agreement(s).

The Bank reviews all material credit exposures on a case by case and collective basis in order to consider the likelihood that the Bank may be exposed to losses on loans and advances and with a view to taking early recovery action.

The individually impaired loans and advances mainly relate to a number of independent customers which are accordingly not meeting repayment obligations.

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

2.6 *Past due but not impaired loans*

Past due but not impaired loans comprise loans and advances where contractual interest or principal payments are past due, but the Bank believes that impairment is not appropriate on the basis of the level of security available and/or the stage of collection of amounts owed to the Bank. Related credit losses, which may arise, are partly covered by collective impairment allowances.

	2013 **€ 000**
Gross loans and advances to customers	
Impaired	36,469
Past due but not impaired	124,951
Neither past due nor impaired	166,663
	328,083

This table analyses the impaired and the past due but not impaired gross loans and advances to customers by industry sector.

At 31 December 2013	**Impaired** **€ 000**	**Past due but not impaired** **€ 000**
Construction	24,179	81,165
Manufacturing	2,006	6,606
Personal	3,909	6,443
Tourism	3,008	2,759
Trade	2,835	15,163
Professional	212	643
Other	320	12,172
	36,469	**124,951**

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

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

2.7 *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 extendible value of the collateral is the net value of a pledged asset for lending purposes, after applying a precautionary margin to its market value. The following is an analysis of the fair value of the extendible collateral and other credit enhancements held by the Bank against exposures of loans and advances to customers. The amounts disclosed in the table represent the lower of the fair value of the extendible collateral and the carrying amount of the respective secured loans.

	Fair value of extendible collateral against		
	Individually impaired	**Past due but not impaired**	**Neither past due nor impaired**
At 31 December 2013	**€ 000**	**€ 000**	**€ 000**
Immovable property	23,683	101,556	126,887
Cash or quasi cash	161	1,423	7,904
Prime bank guarantees	-	-	101
Other security	17	4,975	4,202
	23,861	**107,954**	**139,094**

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

2.8 *Allowances for impairment*

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses on its loans and advances portfolio. The main components of this allowance are specific impairment allowances that relate to individually significant exposures, and a collective impairment allowance established for groups of loans and advances in respect of losses that have not been identified and subjected to individual assessment for impairment.

	Specific impairment allowances	**Collective impairment allowances**	**Total**
	€ 000	**€ 000**	**€ 000**
At 1 January 2013	6,544	2,169	8,713
Additions	3,239	961	4,200
Reversals	(210)	-	(210)
Other movements	(25)	-	(25)
At 31 December 2013	**9,548**	**3,130**	**12,678**

2.9 *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.

2.10 *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.

2.11 *Country risk*

The Bank runs the risk of loss of funds due to the possible political, economic and other events in a particular country where funds have been placed or invested with several counterparties. Countries are assessed according to their size, economic data and prospects and their credit ratings from international rating agencies. Existing country credit risk exposures are monitored and reviewed periodically. The Bank's exposures are predominantly in Malta. Other country risks are mainly to bank balances and money market placements with a total carrying amount of €36,856,000.

3 Market risk

The Bank 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 Bank consists of three elements:

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

3.1 *Interest rate risk*

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or re-price at different times or at different amounts. The Bank accepts deposits from customers at both fixed and floating rates and for varying maturity periods. This risk is managed through the matching of the interest resetting 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.

3.2 *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 Bank had no open foreign currency forward contracts at the end of the reporting period.

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

The following table summarises the Bank's currency position taking into account the Bank's total assets and liabilities as well as off-balance sheet instruments:

At 31 December 2013	Total € 000	EUR € 000	GBP € 000	USD € 000	Other € 000
Assets					
Balances with Central Bank of Malta, treasury bills and cash	134,283	126,718	85	7,447	33
Investments classified as available-for-sale	40,491	40,464	-	27	-
Loans and advances to banks	68,116	22,033	31,762	13,129	1,192
Loans and advances to customers	315,405	305,472	1,881	5,302	2,750
Other assets	36,041	35,997	20	24	-
Total assets	**594,336**	**530,684**	**33,748**	**25,929**	**3,975**
Liabilities					
Amounts owed to banks	2,563	179	-	-	2,384
Amounts owed to customers	498,724	442,888	29,017	25,277	1,542
Other liabilities	15,266	9,845	4,697	702	22
Total liabilities	516,553	452,912	33,714	25,979	3,948
Total equity	77,783	77,783	-	-	-
Total liabilities and equity	**594,336**	**530,695**	**33,714**	**25,979**	**3,948**
Net currency exposure		(11)	34	(50)	27
Commitments and contingent liabilities	**68,994**	**68,824**	**19**	**151**	**-**

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

3.3 *Equity price risk*

The exposure of the Bank to this risk is not significant given the low equity holding by the Bank, which is not deemed material in the context of the Bank's statement of financial position. Such holdings are limited to local well known corporate issuers. Frequent management reviews are carried out to ensure high quality of the portfolio.

4 **Liquidity risk**

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

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

Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value. The Bank is exposed to daily calls on its available cash resources from overnight deposits, current and call deposits, maturing term deposits, loan draw-downs and guarantees.

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

The Bank manages this risk by ensuring that its assets and liabilities are matched in terms of maturities as much as is practicable. However, the Bank 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 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 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.

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

As at 31 December 2013, the Bank had outstanding guarantees on behalf of third parties amounting to €4,780,000 (2012: €4,916,000), which are cancellable upon the request of the third parties. The Bank's liquidity exposures arising from these commitments and contingencies are expected to expire principally within a period of twelve months from the end of the reporting period.

5 Operational risk

Operational risk is the 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. Operational risk is also addressed through proper insurance cover. Additionally, the Bank is also providing capital charge for Operational risk using the Basic Indicator Approach under the Capital Requirements Directive ('CRD') rules.

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.

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

6 Capital risk management *(continued)*

6.1 *Own funds*

Own funds represents the Bank's available capital and reserves for the purposes of capital adequacy. Capital adequacy is a measure of the financial strength of a bank, usually expressed as a ratio of its capital to its assets. The Bank adopts processes to ensure that the minimum regulatory requirements are met at all times, through the assessment of its capital resources and requirements given current financial projections. During the year ended 31 December 2013, 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, as follows:

	2013
	€ 000
Original own funds – Tier 1	
Share capital (note a)	9,925
Share premium (note b)	17,746
Retained earnings (note c)	42,990
Reserves for general banking risks (note f)	1,048
Less: Intangible assets	(214)
Less: Unrealised net losses on available-for-sale investments	(1,365)
Total original own funds	**70,130**
Additional own funds – Tier 2	
Property revaluation reserve (note d)	2,045
Investment revaluation reserve (note e)	974
Collective impairment allowances	3,130
Total own funds	**76,279**

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

(a) Share capital

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

	2013	
	No. of shares	
	000s	**€ 000**
Authorised		
Ordinary shares of 25 cent each	**80,000**	**20,000**
Issued		
Ordinary shares of 25 cent each	**39,702**	**9,925**

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.

(f) Reserve for general banking risks

The Bank is required to allocate funds to this reserve in accordance with the revised Banking Rule BR/09: Measures Addressing Credit Risks Arising from the Assessment of the Quality of Asset Portfolios of Credit Institutions authorised under the Banking Act, 1994.

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, the Basic Method for foreign exchange risk and the Basic Indicator Approach for operational risk in order to calculate the Pillar I minimum capital requirements. For credit risk, under the Standardised Approach, risk weights are determined according to the asset class, credit risk mitigation and credit ratings provided by Fitch or by using the applicable regulatory risk weights for unrated exposures. Capital charge for foreign exchange risk using the Basic Method is calculated at 8% of the higher of the sum of all the net short positions and the sum of all the net long positions in each foreign currency. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income of the preceding three years.

The capital ratio is calculated using the definition of regulatory capital and risk-weighted assets. In terms of the current MFSA Banking Rule BR/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 instruments, 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)*

The Bank's capital requirements and capital adequacy ratio computation is as follows:

At 31 December 2013	Carrying amount € 000	Average amount € 000	Weighted amount € 000	Capital Requirement amount € 000
On-balance sheet assets by exposure classes				
Government or central banks	163,429	134,535	-	-
Institutions	68,762	51,953	13,985	1,119
Public Sector Entities	7,877	7,961	7,895	632
Corporates	43,445	50,204	43,540	3,483
Retail	17,419	15,768	13,102	1,048
Secured by real estate property	147,550	161,926	137,499	11,000
Past due items	112,399	104,992	120,549	9,644
Other items	33,455	32,820	29,599	2,367
	33,455	32,820	29,599	2,367
	594,336	**560,159**	**366,169**	**29,293**
Off-balance sheet instruments by exposure classes				
Public Sector Entities	393	1,782	-	-
Corporates	24,600	18,834	1,287	103
Retail	22,686	20,271	1,050	84
Secured by real estate property	21,315	32,788	-	-
Credit risk			368,506	29,480
Foreign exchange risk			63	5
Operational risk			33,622	2,690
			402,191	**32,175**
Own funds				
Original own funds				70,130
Additional own funds				6,149
Total own funds				**76,279**
Capital Adequacy Ratio				**19.0%**

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 BR/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 document. Apart from the responsibility of the conceptual design, the Board discussed, approved, endorsed and delivered the yearly ICAAP submission.

The ICAAP is an ongoing process which starts with defining risk strategy followed by identifying, quantifying and aggregating risks, determining risk-bearing ability, allocating capital, establishing limits and lead to ongoing risk monitoring. The individual elements of the process 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 involves a quantitative assessment of individual types of risk and an assessment of the existing methods and systems for monitoring and managing risk (qualitative assessment). The risk assessment concept is 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, market and operational requirements are supplemented by the capital allocation for other material risks not fully addressed within Pillar I. The risks considered for ICAAP include concentration, liquidity, reputational and strategic risks, interest rate risk in the banking book, and risks arising from the macroeconomic environment.

The Bank's ICAAP contains three year projections as well as the capital plan, and the Board monitors that there are adequate capital resources to support the corporate goals contained within the 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 has evaluated the estimated impact of the Basel III on capital adequacy and the Bank's liquidity framework. 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. No change to the current Bank's liquidity framework is predicted during the Basel III implementation process to hold the regulatory liquidity requirements.

Five Year Summary
Statements of Financial Position
As at 31 December

Group

	2013	2012	2011	2010	2009
	€ 000	€ 000	€ 000	€ 000	€ 000
Assets					
Balances with Central Bank of Malta, treasury bills and cash	**134,596**	133,641	164,175	109,314	116,357
Cheques in course of collection	**739**	1,063	456	750	811
Investments	**43,554**	32,669	16,328	46,332	45,025
Loans and advances to banks	**73,193**	46,911	35,570	44,975	22,383
Loans and advances to customers	**314,773**	319,864	310,354	333,731	327,802
Intangible assets	**1,466**	1,548	1,518	1,295	1,238
Property, plant and equipment	**23,229**	22,915	21,373	14,740	13,878
Investment property	**745**	745	745	745	745
Assets classified as held for sale	**417**	584	111	109	109
Current tax assets	**1,907**	1,454	760	2,683	1,171
Deferred tax assets	**4,016**	2,998	2,572	1,585	1,993
Inventories	**862**	810	784	714	671
Trade and other receivables	**6,085**	5,474	8,361	7,503	6,545
Accrued income and other assets	**4,259**	4,568	4,847	3,324	4,113
Total assets	**609,841**	575,244	567,954	567,800	542,841
Equity and liabilities					
Equity					
Share capital	**9,925**	9,023	9,023	9,023	8,903
Share premium	**17,746**	17,746	17,746	17,746	16,409
Property revaluation reserve	**2,045**	2,043	2,043	2,043	2,288
Investment revaluation reserve	**363**	(301)	(36)	566	290
General banking risks reserve	**1,048**	-	-	-	-
Other reserves	**2,775**	2,721	2,556	2,397	-
Retained earnings	**45,372**	46,307	43,553	39,932	36,395
Equity attributable to equity holders of the Bank	**79,274**	77,539	74,885	71,707	64,285
Non-controlling interests	**5,127**	5,027	4,774	4,336	3,917
Total equity	**84,401**	82,566	79,659	76,043	68,202
Liabilities					
Derivative financial instruments	**-**	-	9	-	-
Amounts owed to banks	**2,563**	3,256	6,942	149	3,675
Amounts owed to customers	**493,901**	462,116	462,322	472,697	446,209
Current tax liabilities	**-**	-	-	-	-
Provisions for liabilities and other charges	**2,284**	2,264	2,426	2,652	2,520
Other liabilities	**16,995**	14,800	6,245	7,907	12,586
Accruals and deferred income	**9,697**	10,242	10,351	8,352	9,649
Total liabilities	**525,440**	492,678	488,295	491,757	474,639
Total equity and liabilities	**609,841**	575,244	567,954	567,800	542,841
Memorandum items					
Contingent liabilities	**4,780**	4,916	6,314	7,067	10,484
Commitments	**64,214**	81,232	79,470	82,246	98,611

Five Year Summary
Income Statements
For the Year Ended 31 December

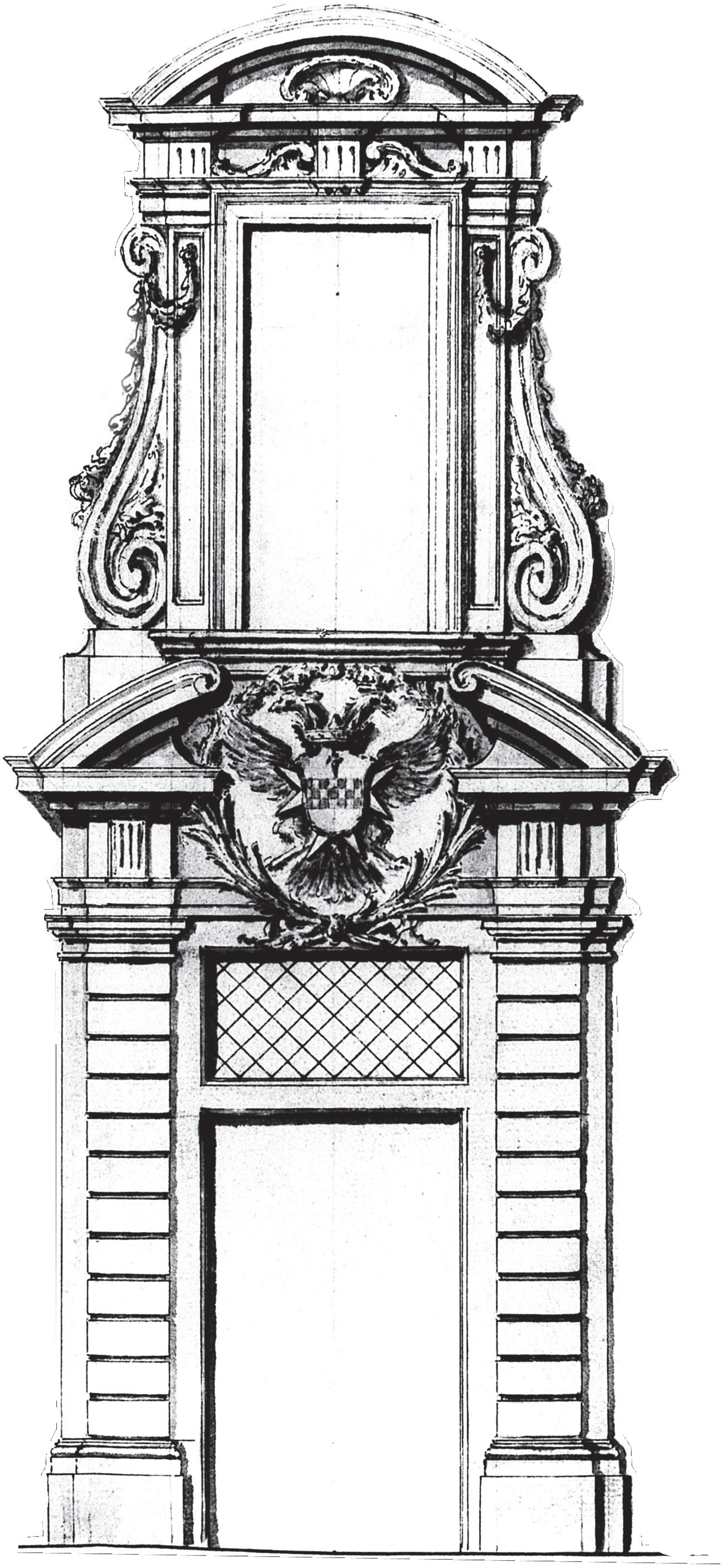
Group

	2013	2012	2011	2010	2009
	€ 000	€ 000	€ 000	€ 000	€ 000
Interest receivable and similar income	**24,173**	23,843	24,917	26,353	28,150
Interest expense	**(9,106)**	(10,040)	(10,734)	(10,287)	(13,560)
Net interest income	**15,067**	13,803	14,183	16,066	14,590
Other operating income	**23,490**	23,201	22,903	22,840	21,971
Other operating charges	**(27,344)**	(26,582)	(23,530)	(24,779)	(23,759)
Net impairment (losses)/reversals	**(4,181)**	(985)	(2,231)	(186)	125
Profit before taxation	**7,032**	9,437	11,325	13,941	12,927
Income tax expense	**(2,550)**	(3,289)	(4,098)	(4,901)	(4,863)
Profit for the year	**4,482**	6,148	7,227	9,040	8,064
Attributable to:					
Equity holders of the Bank	**4,094**	5,719	6,593	8,332	7,377
Non-controlling interests	**388**	429	634	708	687
Profit for the year	**4,482**	6,148	7,227	9,040	8,064

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

Group

	2013	2012	2011	2010	2009
	€ 000	€ 000	€ 000	€ 000	€ 000
Net cash flows from/(used in) operating activities	**37,515**	21,159	4,345	23,431	(4,024)
Cash flows from investing activities					
Dividends received	**185**	159	136	157	122
Interest received from investments	**2,315**	2,123	2,975	3,074	4,867
Proceeds on maturity/disposal of investments	**1,227**	1,040	31,025	5,954	8,632
Purchase of investments	**(11,323)**	(17,952)	-	(3,642)	(1,779)
Purchase of property, plant and equipment	**(1,684)**	(2,653)	(8,495)	(1,681)	(1,892)
Acquisition of non-controlling interests	**(270)**	-	(72)	(133)	(156)
Net cash flows (used in)/from investing activities	**(9,550)**	(17,283)	25,569	3,729	9,794
Cash flows from financing activities					
Dividends paid to equity holders of the Bank	**(2,815)**	(2,698)	(2,698)	(858)	(865)
Dividends paid to non-controlling interests	**(236)**	(275)	(202)	(213)	(249)
Net cash flows used in financing activities	**(3,051)**	(2,973)	(2,900)	(1,071)	(1,114)



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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