BNF BANK

Annual Report

18

Company Registration No. C 41030

BNF BANK P.L.C. (previously known as Banif Bank (Malta) p.l.c.)

Contents

General information

Directors

THE DIRECTORS WHO SERVED THROUGHOUT THE YEAR WERE AS FOLLOWS:

Michael Frendo	Non-Executive Chairman
Sheikh Mohamed Faisal Q.F. Al-Thani	Non-Executive Board Member (Deputy Chairman)
Michael Anthony Collis	Executive Board Member
Kenneth Mizzi	Non-Executive Board Member
Mark Portelli	Non-Executive Board Member
Maurice Mizzi	Non-Executive Board Member
Mohamed Ahmed Shafiek Mohamed Ahmed	Non-Executive Board Member
Mario P Galea	Non-Executive Board Member
Charles Borg	Non-Executive Board Member
Juanita Bencini	Non-Executive Board Member
Sheikh Turki Faisal Q.F. Al-Thani	Non-Executive Board Member

Company secretary
Roderick Zammit Pace

Registered office
Level 2, 203, Rue D'Argens, Gzira, GZR 1368, Malta

Auditors
PricewaterhouseCoopers, 78, Mill Street, Qormi, QRM 3101, Malta

Core values

We are a team of inspired people who believe that opportunities start with a conversation.

The values that guide our daily behaviour are at the basis of everything we do: Ambition, Responsibility and Empathy.

Ambition

Ambition to us represents a strong desire to do and achieve. We embrace change and face challenges head-on, while continually looking for solutions.

Responsibility

We take personal **responsibility** for growth and development, keeping in mind the community in which we operate. We want to share our knowledge and experience with our customers, who know they can count and depend on us, and who trust our word.

Empathy

We are **empathic** because we have the ability to understand and share the feelings of others. We understand our customers' needs to deliver quality service.

Board of directors

MICHAEL FRENDO, NON-EXECUTIVE CHAIRMAN

Chairman of the Board since May 2013. A former Speaker of the House of Representatives, Parliament of Malta (2010-2013) and a former Minister for Foreign Affairs (2004-2008), Dr Michael Frendo also held various other Ministerial portfolios including Information and Communication Technologies, Transport and Civil Aviation, and Culture, Broadcasting and Consumer Protection. Dr Frendo is a lawyer with a postgraduate specialisation in European Union law who has also worked in the private sector in both Malta and the United Kingdom. Dr Michael Frendo is a signatory of the Treaty of Lisbon and was a member of the European Convention on the Future of Europe. He is a Senior Lecturer in the Faculty of Laws at the University of Malta. Dr Frendo is Vice-President of the Venice Commission– an international independent legal think-tank that acts as an advisory body on constitutional matters. He has published widely including a number of books and articles on European, diplomatic and legal issues.

MOHAMED AHMED SHAFIEK MOHAMED AHMED, NON-EXECUTIVE DIRECTOR

Mr Shafiek joined the Al Faisal Group in 2002 and has held a variety of senior positions including Group Head of Internal Audit. He has also been a Board Member of Al Faisal Holding. Mr Shafiek is currently Managing Director of Al Faisal International for Investment and of Al Sawari Holding.

He holds a Bachelor's Degree of Commerce in addition to a Bachelor's Degree of Law from Ain Shams University, Egypt, as well as a Certification in Risk Management Assurance (CRMA) from The Institute of Internal Auditors. Mr Shafiek is a Certified Internal Auditor (CIA) from the USA and a Chartered Accountant from Egypt.

SHEIKH MOHAMED FAISAL Q.F. AL THANI, DEPUTY CHAIRMAN

Sheikh Mohamed Bin Faisal Al Thani has been Vice Chairman of the Board of Al Faisal Holding since 2010 and also sits on the Board of Directors of Al Khaliji Bank. He is a member of the Board of Trustees at the American University of Sharjah (UAE) and of the Arab Academy for Banking and Financial Sciences (Egypt), as well as being Honorary President of the Italian Chamber of Commerce in Qatar.

He holds a Bachelor's Degree in Business Administration from Carnegie Mellon University, Qatar.

MICHAEL ANTHONY COLLIS, CHIEF EXECUTIVE OFFICER AND MANAGING DIRECTOR

Mr Collis has extensive banking experience having worked in the banking industry in the UK and the Middle East in excess of thirty years. During this time, he served on a number of bank boards and held senior positions in a number of banks with responsibility for a wide variety of activities including retail and wholesale banking, corporate finance and private banking. He has served as CEO and Executive Director of Ahli United Bank (UK) Limited, a UK licensed bank regulated by the FSA. He also served as Senior Deputy Group CEO of Ahli United Bank B.S.C. (Bahrain). Prior to that, he served as Executive Director and head of European corporate finance at Nikko Bank, a UK licensed bank regulated by the FSA. He originally started his banking career with Lloyds Bank plc and subsequently joined Mizuho Bank where he held various senior positions and headed the bank's UK corporate banking and corporate finance activities for over ten years.

Prior to this latest appointment, Mr Collis served as Chief Executive Officer of Al Faisal International for Investment QPSC (Qatar), the ultimate majority shareholder of the Bank, a position which he has since relinquished. He had occupied this position since 2015 during which time he was also responsible for AFII's proprietary trading and strategic financial investments, including the acquisition of Banif Bank (Malta) plc in 2016.

SHEIKH TURKI FAISAL, Q.F. AL THANI, NON-EXECUTIVE DIRECTOR

Sheikh Turki Bin Faisal Al Thani is the Chairman of Al Sawari Holding Company and is also a member of the Board of Al Faisal Holding since 2014. He is also the Founder and the CEO of Catalyst Company. He holds a Bachelor's degree in Economics from Georgetown University Qatar.

MAURICE MIZZI, NON-EXECUTIVE DIRECTOR

Director on the Board since April 2008. He read law at the University of Malta where he obtained a Diploma of Legal Procurator. He joined the family business in 1957 and was appointed on the Board of a number of Mizzi Organisation companies. He is currently Managing Director of Continental Cars Limited, Mizzi Limited and Titan International Limited. He has held a number of chairmanships for the government including Mediterranean Film Studios (1984-1990) and the Malta Development Corporation (1997-1998). He has been Honorary Consul of Iceland since 1978. He also served as a Director on the Board of Plaza Centres plc, Allcom Limited, Technical and Management Services Limited, Datatrak Holdings plc, Datatrak Systems Limited, Datastream Limited, and Maltacom plc. He is currently also inter alia Director of Mizzi Associated Enterprises and President of Mizzi Organisation and of the Maltese Chinese Chamber of Commerce.

MARIO P. GALEA, NON-EXECUTIVE DIRECTOR

Mr Galea has been a member of the audit committee since 2013. A fellow of the Association of Chartered Certified Accountants and the Malta Institute of Accountants. Mr Galea sits on the Accountancy Board, which is the accountancy profession regulator in Malta. He founded and served as Managing Partner and Chairman of Ernst & Young in Malta specialising mainly in auditing, until his retirement in 2012. Served on the Council of the Malta Institute of Accountants as Officer and President. Served on the Council of the Federation des Experts Comptables Europeens (FEE). More recently serving as an independent Non-Executive director on the boards of a number of companies listed on the Malta Stock Exchange. Served as Chairman of the Malta Resources Authority. Serves as a member or Chairman on a number of audit committees in both regulated and non-regulated sectors. He is engaged also in assisting the boards of a number of family businesses with governance, organisational and financial matters. Sits on a number of finance committees and currently serves as Chairman of the Ethics Committee and member of the Anti-Money Laundering committee of the Malta Institute of Accountants.

KENNETH MIZZI, NON-EXECUTIVE DIRECTOR

Director on the Board since April 2008. A qualified Chartered Accountant, after working with Touche Ross in London he returned to Malta to join the family business in 1971. He has served as Director on the Board of the Malta Development Corporation (1978-1980) and a number of other parastatal companies. He also served as Director on the Board of Mid-Med Bank Limited and of HSBC Fund Management (Malta) Limited. He is also Managing Director of SAK Limited, franchisee of The Body Shop in Malta, Managing Director of Muscat's Motors Limited and United Acceptances Finance Limited and a Director of a number of other Mizzi Organisation companies.

CHARLES BORG, NON-EXECUTIVE DIRECTOR

Mr Borg, a fellow of the Chartered Institute of Bankers (UK), holds a Banking and Finance Honours Degree and a Master Degree in Financial Services from the University of Malta. He enjoyed a 34-year career at Bank of Valletta plc until December 2015. During this time he occupied various senior management positions, including that of Chief Executive Officer from 2012 to 2015. Prior to that, Mr Borg also served as Chief Officer, Financial Markets and Investments at BOV, with responsibility for all retail and wholesale funding of the BOV Group, as well as the management of BOV's treasury portfolio. Mr Borg also served as a Director of Valletta Fund Management Ltd, of which he was also General Manager, Valletta Fund Services Limited and BOV Investments Limited. In addition, Mr Borg also served as a Director on other listed companies on the Malta Stock Exchange, including Mapfre Middlesea Insurance PLC. He also chaired the Audit Board of the European Investment Fund, a subsidiary of the European Investment Bank. He served as a Director on the World's Savings Bank in Brussels and was also the President of the Institute of Financial Services and the President of the Malta Bankers Association. Mr Borg is currently the CEO and an Executive Director of PG plc which has recently been listed on the Malta Stock Exchange and holds a number of other non-executive directorship positions in Malta. Apart from serving as a Non-Executive Director of BNF Bank plc, Mr Borg will also be chairing the Bank's Credit Approvals Committee.

MARK PORTELLI, NON-EXECUTIVE DIRECTOR

Director on the Board since April 2008. A graduate in Economics from the University of Manchester. He has served as Executive Chairman of Malta Freeport Corporation between 2002 and 2013 and as Chairman of the Grand Harbour Regeneration Corporation and Transport Malta between 2007 and 2013. He is currently employed as Chief Executive Officer of MIDI plc and he serves as a non-executive director of a number of companies.

JUANITA BENCINI, NON-EXECUTIVE DIRECTOR

Juanita Bencini is an ex-KPMG partner where for 17 years she headed Risk Consulting Advisory within the Malta practice and for seven years was also Head of Risk Consulting within the KPMG international region of which the Malta practice forms part. Today, she works as a consultant to the financial services industry and is a professional director on boards of regulated entities. Her areas of expertise include risk management, financial services regulation, corporate governance and AML. She has also served as President of the Institute of Financial Services Practitioners and today is still a Council Member. She acts as Chair of the AML Committee of both the Institute of Financial Services Practitioners and the Malta Institute of Accountants.

Director's report

Director's report

The Directors present their annual report together with the audited financial statements of the Bank for the year ended 31 December 2018.

The Directors who served during the year are listed under the General Information section.

PRINCIPAL ACTIVITIES

BNF Bank p.l.c. (the "Bank", "BNF Bank") was incorporated and licenced to operate as a credit institution in terms of the Banking Act, Cap. 371 of the Laws of Malta since 27 March 2007, with an authorised and issued share capital of €50 million and €32.5 million respectively. On 4 October 2016, following the non-objection of the European Central Bank by virtue of a decision dated 12 August 2016 made pursuant to Articles 4(1)(c) and 15(3) of Council Regulation EU no. 1024/2013, Article 87 of Regulation (EU) no. 468/2014 of the European Central Bank (EC/2014/17) and Article 13(1) and Article 13A of the Banking Act (Cap. 371 of the laws of Malta), 25,500,000 ordinary shares in the Bank (representing 78.46% of the issued share capital of the Bank) owned by Oitante S.A. was purchased by Al Faisal International for Investment Malta Limited, a subsidiary of Al Faisal for Investment Q.P.S.C. headquartered in Qatar. On 3 July 2018 Al Faisal International for Investment Malta Limited changed its name to JUD Investment Group Limited. Subsequent to the share purchase and by virtue of a board resolution, it was resolved to offset €7,956,000 of the accumulated losses in the Statement of Financial Position of the Company as at 31 October 2016, through a reduction in the nominal value of each Ordinary Share in the issued share capital of the Company from a nominal value of €1 each Ordinary Share to €0.7552 each Ordinary Share, amounting to a reduction in the total issued share capital of the Company from €32,500,000 (divided into 32,500,000 Ordinary Shares of a nominal value of €1 each) to €24,544,000 (divided into 32,500,000 Ordinary Shares of €0.7552 each). Pursuant to the reduction of the issued share capital of the Company, the authorised share capital was altered from €70,000,000 divided into 70,000,000 Ordinary Shares of a nominal value of €1 each to €70,000,000 divided into 92,690,678 Ordinary Shares of a nominal value of €0.7552 each.

By virtue of a resolution dated 20 January 2017, the Bank increased its issued share capital by €15,000,000 (divided into 19,862,289 shares of a nominal value of €0.7552 each) from €24,544,000 (divided into 32,500,000 ordinary shares of a nominal value of €0.7552 each) to €39,544,000 (divided into 52,362,289 shares of a nominal value of €0.7552 each). By virtue of a resolution dated 18 January 2018, the Bank increased its issued share capital by €20,000,000 divided into 26,483,050 ordinary shares of a nominal value of €0.7552 each from €39,544,000 (divided into 52,362,289 ordinary shares of a nominal value of €0.7552 each) to €59,544,000 (divided into 78,845,340 shares of a nominal value of €0.7552 each). Through another resolution dated 7 December 2018, the Bank increased further its share capital by €7,500,000 divided into 9,931,144 ordinary shares of a nominal value of €0.7552 each from €59,544,000 (divided into 78,845,340 ordinary shares of a nominal value of €0.7552 each) to €67,044,000 (divided into 88,776,483 shares of a nominal value of €0.7552 each). Share capital injections take place as part of the Bank's capital plan, typically in anticipation of a growing asset base.

The Bank provides a full range of commercial banking services through a network of twelve branches and three corporate and business banking units. In 2018, BNF Bank concluded its eleventh year of business activity in Malta. The Bank has maintained its position in the local market as a reliable financial services provider, assisted by favourable local economic conditions.

A REVIEW OF 2018

2018 Financial Objectives

BNF Bank's main objective for 2018 was one of conservative, robust, and profitable growth, primarily within the Maltese market.

The Bank started the year by ensuring that it was set up for growth, the priorities being governance and financial position. As highlighted in the 'Corporate and Internal Governance' section to this report, in 2017 the governance structure was enhanced to reflect the Bank's existing business model and forward-looking strategy.

From the perspective of financial position, in January 2018 the Bank increased its tier 1 capital by €20 million through a rights issue, strengthening further its regulatory capital position. The capital increase was fully subscribed to by the parent company, JUD Investment Group Limited (previously known as Al Faisal International for Investment Malta Limited), and the capital injection resulted in an increase in their shareholding from 86.6% to 91.8%. The Bank also commenced the year with a robust funding structure. On 1 January 2018 the Liquidity Coverage Ratio stood at 337.27% and the Advances to Deposits ratio at 78.6%.

2018 Financial Achievements

The Bank's financial statements highlight the following financial achievements in 2018:

- Growth in total assets and loans and advances to customers, both exceeding 35%;
- Liquidity position improved, and sources of funding enhanced;
- Profitability generated from the Bank's core business, exceeding internal targets;
- Non-performing exposure recovery of over 10%; and
- Capital position maintained through capital injections.

BNF's management team is satisfied that the financial objectives for 2018 were achieved.

Asset growth: The Bank's plan to grow in 2018 was aided by a strong Maltese economy, with GDP growth of over 6% and healthy unemployment and inflation indicators. Nevertheless, salary and price pressures, coupled with increasing compliance and regulatory initiatives led to an increase in operating costs of over 11% compared to 2017. This trend is expected to continue into 2019, and the management is therefore focused on controlling costs. In 2018, the Bank's cost to income ratio stood at 73% (2017: 86%). The Bank acknowledges that further focus ought to be placed to achieve its target cost efficiency ratio, however the solid improvement in 2018 is considered a step in the right direction.

Another key area of focus for BNF's management team is the economic outlook of Malta, and the risks and opportunities which Malta faces as a country. Such are always at the forefront of strategic discussions and they play a key role in decision making.

Liquidity and funding: Deposits from customers being the Bank's key source of funding, grew by 32% to €677m. The Bank's advances-to-deposit ratio at 31 December 2018 was of 76.9% (2017: 74.4%). Additionally as described further below, in 2018 the Bank obtained regulatory approval to passport deposit products to the German retail market, which is being done through an online platform.

Profitability: The Bank's profitability surpassed internal targets in 2018, although interest income was impacted by the benign interest rate environment across the Eurozone. Given that the interest rate environment is expected to continue into 2019, BNF's management will continue to strive to optimise efficiency in (i) structure and allocation of capital and funding, and (ii) cost of funds.

BNF Bank believes that a customer-centric approach was crucial in meeting objectives set for 2018 and will continue to be going forward. BNF's customers are the key to its success in the short, medium, and long-term.

BNF services retail and corporate customers, the vast majority of whom are based in Malta. In carrying out its services, the Bank endeavours to ensure that customers can get the best possible deal in terms of pricing and product structure, and as far as quality service is concerned. To achieve these objectives, BNF's management do all within their means to retain continuous lines of communication with customers. Such enables one to keep abreast with customer requirements and anticipate any changes accordingly.

Non-Performing Exposure

During 2018 the Bank recovered €3.4m of its stock of non-performing loans (NPL) exposure, decreasing total NPL exposure from €31.5 million in 2017 to €28.1 million in 2018.

Capital Position

The Bank's capital position at 31 December 2018 was as follows:

2018	€000
CET1 capital	65,662
Additional Tier 1 capital	7,500
Tier 1 capital	73,162
Total risk weighted assets	426,672

Capital ratios	%
CET1 ratio	15.39%
Tier 1 ratio	17.15%
Capital Adequacy Ratio	17.15%

Institution specific buffer requirement	1.915
• of which: capital conservation buffer requirement	1.875
• of which: institution specific countercyclical capital buffer	0.04

Corporate and Internal Governance

The most vital of our customers' requirements is trust.

To ensure long-term success, the Bank must ensure that it continues to enjoy the trust of its customers, and the key to operate in a controlled and trustworthy manner is through a robust governance structure.

In 2017 BNF Bank embarked on a journey to ensure it is in line with best practice standards of governance. This journey continued throughout 2018 and will continue in future in line with the Bank's strategic development.

The Statement of Compliance with the Principles of Good Corporate Governance in this Annual Report details the Bank's structure and some of the key changes are summarised in this section.

In 2017 the Bank appointed a Chief Risk Officer, Chief Operating Officer, and new Chief Executive Officer. Additionally, in 2018 a new Chief Financial Officer was appointed.

In February 2018, the Board welcomed Ms Juanita Bencini as an Independent Non-Executive Director. Following a distinguished career at KPMG with a focus on banking supervision, Mrs Bencini brings to the Board a wealth of experience. She is the Chairperson of the Risk Committee and a Member of the Audit Committee.

At the same time, the Board welcomed His Excellency Sheikh Turki Bin Faisal al Thani as a Member representing the majority shareholder. Sheikh Turki is an IT expert who has and will make a significant contribution to the Bank's development of IT and digital strategy.

Risk management is a core pillar of the Bank's governance structure. The Financial Risk Management note in the Financial Statements (Note 3), illustrates the process of how the Bank identifies and manages its risks. The main categories of risk described in this note are credit risk, market risk, liquidity risk and operational risk. The same note includes extensive detail of the processes undertaken by the bank to manage these risks.

The Statement of Compliance with the Principle of Good Corporate Governance also describes the non-financial key performance indicators relevant to the bank, including information relating to environmental and employee matters.

Finally, the Bank acknowledges its strongly motivated workforce, which has and will continue to be instrumental to maintaining standards of internal governance. The Bank's people have enabled it to consistently deliver the quality service that customers have come to expect. BNF Bank continues to enjoy high levels of customer confidence, and its reputation is built on transparency, engagement in the community and the delivery of excellent quality of service.

Technology transformation and process efficiency

BNF is fully committed to ensuring that customers' technological requirements are satisfied, and to that end a project has been launched to identify and transform the Bank's technology. The first phase of the project was to identify and shortlist, with external assistance, vendors best positioned to act as the Bank's technology partners. 2019 will see the Bank through a vendor selection process, compilation of a detailed implementation plan, and initiation of the first phase of implementation.

Another equally important requirement is that of ensuring that customers' needs are addressed efficiently and without compromising on internal control. To achieve this objective, during 2018 BNF Bank initiated an exercise to reorganise internal departmental structures and rethink internal processes.

BNF's technology transformation and process efficiency exercise will enable a platform for a more structured, controlled, and profitable growth.

The Market Environment

Malta continued to experience strong and diversified economic growth in 2018, with GDP growth of over 6% and healthy unemployment and inflation measures. In December 2018 the Central Bank of Malta projected continued growth with upward revisions to domestic demand, due to increased private consumption and investment. Malta's debt to GDP ratio is expected to continue to decrease over the next 3 years, and unemployment and inflation are projected to remain at favourable levels.

In the Eurozone political uncertainty continued to negatively impact economic conditions, and a slowdown in GDP growth in the second half of 2018 has led to downward revisions of Eurozone forecasts. There is yet a degree of uncertainty as to when the ECB will increase interest rates. The European economy is also affected by global economic growth being under threat, due to geopolitical events such as trade disputes between both major and emerging economies.

A more detailed look at financial performance and position

In 2018, the Bank registered a profit after tax of €2.3 million (2017: €1.2 million). The improvement in performance is attributed primarily to growth in the Bank's core assets, being the retail and corporate lending books.

Net interest income on lending to customers and banks amounted to €15.5 million (2017: €10.9 million).

Net fee and commission income amounted to €2.7 million (2017: €2.3 million). Fee and commission income was mainly generated from credit processing and related legal services, as well as fees for payments, cards and other banking services.

Trading income amounted to €0.7 million (2017: €0.6 million) which consisted mainly of gains on financial assets and foreign exchange income.

Total assets increased to €767 million at the end of 2018 (2017: €568 million). The growth in total assets is attributed mainly to gross loans and advances to customers, which increased by €141 million, reaching €532 million by end of 2018. Deposits from customers on the other hand increased by €163 million, reaching €677 million by end of 2018. The deposit transformation ratio as at end of 2018 therefore stood at 78.6% (2017: 76.1%), comfortably within the Bank's appetite of 85%.

Total operating income for 2018 amounted to €19.1 million, 30% more than the €14.7 million generated in 2017. Operating expenses excluding impairment also increased, albeit at a lower rate of 11%. In 2018 the Bank incurred operating expenses excluding impairment of €13.9 million, (2017: €12.5 million). The largest operating expense for the Bank remained employee and director compensation in 2018, which amounted to €7.4 million (2017: €6.9 million).

Impairment provisioning and non-performing loans

IFRS 9 came into force on 1 January 2018. IFRS 9 sets out a number of requirements, including that of calculating expected credit losses to ensure adequate impairment provisioning levels. In order to estimate expected credit losses, the Bank uses its own historical loss data to segment its portfolio and model statistically sound probability of default and loss given default parameters per segment.

Upon adoption of IFRS 9 an initial remeasurement loss of €1.3m was recognised. The opening remeasurement loss related to expected credit loss allowances, the majority of which pertained to loans and advances to customers. Opening remeasurement losses are broken down in the table below:

	IAS 39 carrying amount	Remeas-urements	IFRS 9 carrying amount
	31 December 2017	(Expected credit loss allowances)	1 January 2018
Amortised cost	**€000**	**€000**	**€000**
Balances with Central Bank of Malta and cash	22,734	(25)	22,709
Loans and advances to banks	69,911	(29)	69,882
Loans and advances to customers	382,314	(1,213)	381,101
Total financial assets measured at amortised cost	**474,959**	**(1,267)**	**473,692**

During 2018, total impairment provisioning increased by €1.5m to a total of €12.1m. The largest contributor to impairment provisioning recognised through profit or loss in 2018 was stage one provisioning, due to growth in the loans and advances to customers portfolio.

Non-performing loans (NPL) also absorb a large portion of the Bank's impairment provisioning. At the end of 2018, the Bank had a ratio of NPL to total loans and advances to customers of 4.1%, a substantial improvement over the 6.5% ratio as at 31 December 2017. The improved ratio came about primarily because the Bank reported net recoveries of €3.4 million of non-performing loans, bringing total NPL exposure down from €31.5 million at 31 December 2017 to €28.1 million at 31 December 2018. Growth in the size of the performing loans and advances to customers book also contributed towards an improved ratio.

Of the €28.1 million of NPL exposure, the Bank held security carrying a total value of €69.7 million. Nevertheless 31% (€8.8 million) of NPL were covered by IFRS 9 stage 3 impairment provisioning.

Tax

The Bank registered a profit before tax of €3.6 million (2017: €1.6 million). This attracted a tax charge of €1.3 million (2017: €0.4 million). The deferred tax asset increased by €1.1 million and amounted to €5.0 million by end of December 2018 (2017: €3.9 million). Part of this increase (€0.5 million) is attributable to the increase in impairment provisions taken upon adoption of IFRS 9, whereas a further €0.6 million resulted from increases in impairment provisions during the year. Furthermore, in 2018 the Bank used all outstanding tax losses brought forward from 2017.

Regulatory capital and liquidity

The Bank's Capital Adequacy Ratio stood at 17.15% (2017: 14.12%) as at 31 December 2018, whilst Common Equity Tier 1 Capital ratio stood at 15.39% (2017: 12.16%). The Bank recognises that regulatory capital is a limiting factor insofar as growth in exposure is concerned, and therefore constantly monitors the regulatory capital and its allocation.

Throughout the year the Bank carries out regular capital planning exercises to identify and anticipate any potential shortcomings vis-à-vis its risk appetite and regulatory requirements.

The Bank's Liquidity Coverage Ratio (LCR) stood at 337.27% at 31 December 2018 (2017: 126%).

The improvement in capital adequacy and LCR were mainly as a result of an exercise to raise capital and liquidity in December 2018, in anticipation of growth in 2019.

BUILDING OUR NEW FUTURE

The Bank's primary objective for 2019 continues to be of conservative, robust, and profitable growth. Management also plans that 2019 will be a year where the Bank builds on existing foundations to continue developing and diversifying its business model.

Further injections of capital and liquidity will ensure that the Bank is positioned to grow once again in 2019. December 2018 marked a further increase in tier 1 capital of €10 million, and yet another increase of €10 million is planned for March 2019. Furthermore, in November 2018 BNF Bank entered into a partnership with Deposit Solutions, a globally recognised Fintech company, for the use of its open banking platform for deposits. The platform allows the Bank to expand and diversify its retail funding sources across various channels, and on a European scale, without having to set up and operate its own deposit infrastructure.

Growth in 2019 will once again stem primarily from Maltese retail and corporate customers, as the Bank continues to develop product propositions to suit customer needs. The Bank will also continue to develop its people, providing training to ensure staff have the skills and knowledge necessary to enable them to deliver outstanding customer service whilst observing the highest standards.

In 2019 and 2020 the Bank will invest heavily to ensure it is set up to develop strategically. In 2019 the Bank will work to diversify its product offerings and build the structure needed to internationalise its business. In this respect, in the first quarter of 2019 the Bank obtained authorisation under EU passporting rules to operate a branch in the UK. Two further strategic enablers, and the main areas of investment in 2019 and 2020 will be (i) human capital, where the Bank will seek to recruit in specific roles of strategic importance, and (ii) a technology transformation project which was initiated in 2018 and is expected to require significant investment for a further two years.

Although investments made in 2019 and 2020 will have a bearing on profitability in the same years, BNF's management are confident that the medium and long-term gains will far outweigh the costs in the short-term.

As always, BNF remains committed to offering its customers the best possible standard of service, and peace of mind that their finances are in good hands. For that reason, good governance is and will remain a top priority.

DISCLOSURE IN TERMS OF THE SIXTH SCHEDULE TO THE COMPANIES ACT, CAP. 386 OF THE LAWS OF MALTA.

During the year ended 31 December 2018, no shares in the Bank were:

- Purchased by it or acquired by it by forfeiture or surrender or otherwise;
- Acquired by another person in circumstances where the acquisition was by the Bank's nominee, or by another with the Bank's financial assistance, the Bank itself having a beneficial interest; and
- Made subject to pledge or other privileges, to a hypothec or to any other charge in favour of the Bank.

PREPARATION OF FINANCIAL STATEMENTS AND DIRECTORS' RESPONSIBILITIES

The Companies Act, Cap. 386 of the Laws of Malta (the "Act") requires the Directors of BNF Bank p.l.c to prepare financial statements for each financial year which give a true and fair view of the financial position of the Bank as at the end of the financial year and of the profit or loss of the Bank for that year in accordance with the requirements of International Financial Reporting Standards, as adopted by the European Union.

In preparing such financial statements, the Directors are required to:

- Adopt the going concern basis unless it is inappropriate to presume that the Bank will continue in business;
- Select suitable accounting policies and apply them consistently from one accounting year to another;
- Make judgements and estimates that are reasonable and prudent; and
- Account for income and charges relating to the accounting year on the accruals basis.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy, at any time, the financial position of the Bank and to enable them to ensure that the financial statements have been properly prepared in accordance with the provisions of the Companies Act, Cap. 386 of the Laws of Malta and the Banking Act, Cap. 371 of the Laws of Malta.

The Directors are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors, through management oversight, are responsible to ensure that the Bank establishes and maintains internal control to provide reasonable assurance with regards to the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

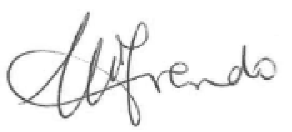
Management is responsible, with oversight from the Directors, to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the Bank's business. This responsibility includes establishing and maintaining controls pertaining to the Bank's objective of preparing financial statements as required by the Act and managing risks that may give rise to material misstatements in those financial statements. In determining which controls to implement, to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud.

AUDITORS

PricewaterhouseCoopers have indicated their willingness to continue in office and a resolution for their re-appointment will be proposed at the Annual General Meeting.

Approved by the Board of Directors and signed on its behalf on 15 April 2019 by:

Michael Anthony Collis
Chief Executive Officer



Michael Frendo
Chairman

Statement of Compliance with the Principles of Good Corporate Governance

Statement of Compliance with the Principles of Good Corporate Governance

BNF Bank p.l.c. (the 'Bank') believes that good corporate governance should be the basis of every decision and action taken by the Bank.

Despite the fact that The Code of Principles of Good Corporate Governance (the 'Code') contained in Appendix 5.1 to Chapter 5 of the Listing Rules, as issued by the Malta Financial Services Authority is not mandatory upon the Bank given that the Bank is not listed on the Malta Stock Exchange, the Bank has endorsed the Code and is committed to implement high standards of corporate governance.

This statement is divided into three sections with the first section indicating the extent to which the Bank has adopted the Code, and the second section providing reasons why the Bank is non-compliant with the same Code. The third section provides details of the Bank's internal control system.

Section 1 - Compliance with the code

PRINCIPLE 1 – THE BOARD

The affairs of the Bank are directed by the Board of Directors (the 'Board').

The Bank's Directors includes a mix of individuals who have distinguished themselves in diverse business sectors. All Directors hold or have previously held key management positions in various local and international organisations.

The Board has appointed an Executive Committee to be responsible for the day-to-day management of the Bank. In addition, the Board delegates certain responsibilities to the Audit Committee, the Risk Committee, the Compensation and Nomination Committee and the Credit Approval Committee. Further detail in relation to the mentioned Committees can be found under Principle 4 below.

PRINCIPLE 2 – CHAIRMAN AND CHIEF EXECUTIVE

The roles of the Chief Executive Officer and the Chairman of the Board are separate and distinct and are held by different individuals.

The Chairman leads and sets the agenda of each of the Board of Directors' meetings. In addition, the Chairman is responsible for ensuring that all the Directors of the Board engage in effective discussions and ultimately take informed decisions. The Chairman also ensures that there is effective communication between the Directors of the Bank, the Directors and management, as well as with the shareholders.

The Chairman meets the independence criteria set out in the Code.

On the other hand, the Chief Executive Officer, who is also a member of the Board of Directors, heads the Executive Committee. He has been entrusted with the execution of the Bank's strategy agreed by the Board and also acts as the link between the Board of Directors, whereby the strategy is set, and the Executive Committee, which is delegated with implementing such strategy.

PRINCIPLE 3 – COMPOSTION OF THE BOARD

The Board is composed of an Independent Non-Executive Chairman (INEC), one Executive Director (ED), six Non-Executive Directors (NED) and two Independent Non-Executive Directors (INED).

The shareholders appoint or remove Directors on the Board using a transparent approach after each Annual General Meeting, after taking into consideration diversity of knowledge, judgement and experience. Prior to being appointed, each Director undergoes the due diligence process by the Malta Financial Services Authority in order to establish that such Director is a fit and proper person pursuant to the Banking Act.

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

Dr Michael Frendo – chairman	INED
Sheikh Mohamed Faisal Q.F. Al-Thani – Deputy Chairman	NED
Mr Michael Anthony Collis – Chief Executive Officer and Managing Director	ED
Ms Juanita Bencini	INED
Mr Charles Borg	NED
Mr Mario P Galea	INED
Mr Kenneth Mizzi	NED
Chev. Maurice Mizzi	NED
Mr Mark Portelli	NED
Mr Mohamed Ahmed Shafiek Mohamed Ahmed	NED
Sheikh Turki Faisal Q.F Al-Thani	NED

The remuneration paid to the Directors is as established by the Bank's shareholders and discussed at the Compensation and Nomination Committee.

PRINCIPLE 4 – THE RESPONSIBILITIES OF THE BOARD

The Board of Directors determines the strategic goals and formulates the policies of the Bank. It also sets the Bank's values and standards. The Board understands that high ethical standards should be applied in its decision-making process. Decisions and strategies formulated by the Board seek to encompass the interests of all stakeholders including the Bank's shareholders and employees.

The Board also regularly reviews the Bank's performance against approved budgets and sets targets. In addition, the Board considers and determines credit proposals falling within the same Board's credit sanctioning limits, as well as any credit decisions where the Directors have a direct or indirect interest. In such instances, the Directors shall inform the Board, the nature of their interest and shall not participate and vote in respect of that decision.

Board Committees

As detailed below, the Board of Directors have delegated certain responsibilities to various committees, with specific responsibilities, as follows:

The Audit Committee

The Audit Committee is responsible for monitoring the financial reporting process in order to ensure the integrity of the Bank's financial statements and related announcements. Furthermore, the Audit Committee reviews and, where appropriate, reports to the Board on the significant financial reporting issues, estimates and judgments made in connection with the preparation of the Bank's financial statements, interim management statements, and any announcements relating to the Bank's financial performance. The Committee advises the Board on whether, taken as a whole, the annual report and accounts of the Bank are fair, balanced and understandable and provide the information necessary for shareholders to assess the Bank's performance, business model and strategy.

The Committee provides assurance to the Board that the Executive Management's control assurance processes are implemented and are complete and effective.

The Committee also reviews and monitors the management function of the Bank and ensures that the management function takes necessary corrective actions in a timely manner to address control weaknesses, non-compliance with laws, regulations and policies, and other problems identified by the auditors.

The Internal Audit function of the Bank reports specifically and exclusively to the Committee. The Committee frames the policy on internal audit, and subsequently monitors and reviews the effectiveness, independence and objectivity of the Bank's Internal Audit function.

Furthermore, the Audit Committee oversees the Bank's relationship with the external auditors and assesses the effectiveness of the external audit process. It makes recommendations to the Board of Directors regarding the appointment of the Bank's external auditors, their remuneration and terms of engagement.

The Audit Committee also oversees the function of the Bank's Whistleblowing Reporting Officer and the effectiveness of the Bank's whistleblowing procedures.

The Committee is made up of three Non-Executive Directors appointed by the Board, the majority of which are independent. The Committee as a whole has competence relevant to the sector/s which the Bank operates in, and all members of the Committee have significant recent and relevant experience in financial reporting, auditing and/or accounting.

Members

- Mr Mario P Galea - Chairman
- Ms Juanita Bencini
- Mr Mohamed Ahmed Shafiek Mohamed Ahmed

The Chief Executive Officer, the Chief Financial Officer, the Chief Risk Officer, the Whistleblowing Reporting Officer and representatives of the Bank's External Auditors attend the Audit Committee meetings by invitation. The Head of Internal Audit Unit also attends the meetings of the Audit Committee.

The Risk Committee

The Risk Committee monitors and reviews the Bank's risks as identified and quantified by the Bank. The Committee's oversight responsibilities cover financial, market, credit, operational and reputational risk, as well as oversight of the management's implementation of the Bank's strategies in relation to the mentioned risks.

The Committee considers and recommends to the Board, the Bank's overall risk appetite for all relevant risks and reviews the Bank's risk profile of such risks, taking into account the current and prospective macroeconomic, macro-prudential and financial environment. Risk strategies are discussed on both an aggregate basis, as well as by type of risk. The Committee also advises the Board on the Bank's risk appetite and tolerance limits when determining strategy.

The Committee reviews and considers reports from the Risk Management and Compliance functions, in particular with reference to the risk profile of the Bank, current state of risk culture, utilisation against the established risk appetite, and limits, limit breaches and mitigation plans. It also receives notification of any breaches of the Bank's overall risk appetite or risk limits for financial, market, credit, operational risk (including AML, legal and IT risks) and reputational risks, and the proposed course of action.

The Risk Committee reviews and advises the Board on the liquidity adequacy assessment and internal capital adequacy assessment process.

It also reviews and endorses statements in relation to financial and operational risk made in the annual report. The Committee considers, advises and where necessary, updates and approves, on the recommendation of the Audit Committee to the Board, relating to any financial or operational risk policy statements required by law or regulation.

With effect from 7 December 2018, the Committee is made up of three Non-Executive Directors. The Bank deems that the Committee as a whole has the necessary competence and expertise to perform their functions within the Committee.

Members

- Ms Juanita Bencini - Chairperson
- Mr Michael Anthony Collis until 7 December 2018
- Mr Mario P Galea with effect from 7 December 2018
- Mr Mark Portelli

The Chief Executive Officer, the Chief Financial Officer, the Chief Risk Officer, the Head of Risk Control an Oversight Unit and the Head of Legal and Compliance Unit attend meetings of the Risk Committee by invitation.

In addition, during the year numerous informal meetings were held between the Chairperson of this Committee and members of the senior management especially the Chief Executive Officer, the Chief Risk Officer, the Head of Risk Control and Oversight Unit, the Compliance Officer and the Bank's MLRO.

The Compensation and Nomination Committee

Information on the functions of this Committee is considered under Principle 8.

The Credit Approval Committee

This Committee is responsible for assessing credit facilities and taking credit decisions within certain monetary and risk bands. Additionally, it makes recommendations to the Board of Directors on credit facilities which exceed its upper discretionary threshold.

The Committee is made up of three Directors appointed by the Board with experience in credit.

Members

- Mr Charles Borg - Chairman
- Mr Michael Anthony Collis
- Mr Mark Portelli

The Head of Credit Analysis Unit and senior representatives of the Bank's Commercial Department attend the Committee meetings by invitation.

Management Committees

The Executive Committee

The Executive Committee meets on a weekly basis to oversee the overall management of the Bank. The Executive Committee is composed of four members, the Chief Executive Officer, the Chief Operations Officer, the Chief Risk Officer and the Chief Financial Officer, with the latter joining the Executive Committee during April 2018.

Formulation of risk strategies and risk profiles, including policies conducive to the achievement of organisational goals are the responsibility of the Executive Committee, however implementation is delegated to the Departmental Heads through a formally documented organisational structure with clear and transparent demarcation of functional responsibilities. The Executive Committee is also responsible for assessing credit facilities and taking credit decisions as prescribed in the Bank's credit policy.

Various senior members of the Bank's management attend the meetings of the Executive Committee by invitation.

The Executive Committee also established the following committees within the Bank:

The Assets and Liabilities Committee

The Assets and Liabilities Committee (ALCO) meets on a monthly basis to analyse financial information and to assess the impact that the various types of risks arising from changes in interest rates, exchange rates and the market, have on the profitability of the Bank and the various other components of the financial statements. This Committee also drives the commercial activity of the Bank and reviews liquidity risk, and capital adequacy risk. It also sets the framework for the design of policies to address and manage all these types of risks with a view to ensure that adequate mitigating actions are taken to reduce the negative impacts of adverse movements on the operations of the Bank and on the financial statements.

The ALCO is made up of the Members of the Executive Committee, the Head of the Treasury Department, the Head of the Business Development Department and the Head of the Commercial Department. The Heads of the Risk Control and Oversight Unit, the Regulatory Unit and the Financial and Management Accounting Units are also invited to attend the meetings of the ALCO.

The Budget and Planning Committee

During the year under review, the Bank dissolved this committee and its functions were taken over by the Executive Committee.

The Credit Committees

These Committees are responsible for assessing credit facilities and taking credit decisions within certain monetary and risk bands. Additionally, they make recommendations to the Executive Committee on credit facilities which exceed its upper discretionary threshold.

The Committees are coordinated at three different levels, each assigned a sanction limit under which they operate. The Committees meet on a weekly basis and comprise officials from the Commercial Department and the Credit Analysis Unit. Each Committee is chaired by the official coming from the Credit Analysis Unit.

The Products Oversight Committee

During 2018, the Bank reviewed this Committee and its functions. In this regard, the Bank redesignated this Committee to Products Oversight Committee with its main purpose being that of discussing and implementing projects in relation to new products, new services, channels and/or changes to existing products.

The Committee is made up of senior members from a number of Units, mainly the Products Strategy Unit, the Corporate Business Unit, the Legal and Compliance Unit, the Risk Control and Oversight Unit, the Credit Operations Unit, the Credit Analysis Unit, the Financial Regulatory Unit, the Financial Management Unit, the Treasury Unit, the Information Technology Unit and the Business Analysis Unit. The Product Strategy Unit is responsible for the chairing and steering of this Committee.

The Global Risk Committee

The Bank dissolved this committee with effect from 21 February 2018. Its functions were taken over by the Executive Committee.

PRINCIPLE 5 – BOARD MEETINGS

The Board meets as often as necessary, at least quarterly, in order to discharge its duties effectively. The Chairman sets and circulates the agenda to all Directors. The Chairman, in collaboration with the Company Secretary, also ensures that all supporting material is circulated to all Directors well in advance, so that they have ample time to consider the information prior to the next scheduled meeting. The Chairman also ensures that the Directors participate actively in all Board meetings.

During 2018 the Board of Directors met 6 times. Directors' attendance at Board Meetings during 2018 was as follows:

MEMBERS	ATTENDED
Dr Michael Frendo – Chairman	5 out of 6
Sheikh Mohamed Faisal Q.F. Al-Thani – Deputy Chairman	1 out of 6
Mr Michael Anthony Collis	6 out of 6
Ms Juanita Bencini	6 out of 6
Mr Charles Borg	5 out of 6
Mr Mario P Galea	6 out of 6
Mr Kenneth Mizzi	6 out of 6
Chev. Maurice Mizzi	5 out of 6
Mr Mark Portelli	6 out of 6
Mr Mohamed Ahmed Shafiek Mohamed Ahmed	6 out of 6
Sheikh Turki Faisal Q.F. Al-Thani	2 out of 6

PRINCIPLE 6 – INFORMATION AND PROFESSIONAL DEVELOPMENT

The Board of Directors appoints the Chief Executive Officer and participates in the selection of the members of senior management. The Directors have access to the advice and services of the Company Secretary who is responsible for ensuring that the Board procedures and all applicable rules and regulations are followed. Furthermore, the Company Secretary ensures that the minutes faithfully record attendance, matters discussed, and decisions taken. Such minutes are circulated to all Directors in advance of meetings.

The Board and the Executive Committee ensure that the Bank applies schemes in order to recruit, retain, motivate and promote senior management. The Bank also encourages its staff to progress in their career streams.

The Board adheres to the Induction and Training Policy which regulates the training and professional development which should be undertaken by the Directors of the Bank.

PRINCIPLE 7 – EVALUATION OF THE BOARD'S PERFORMANCE

During the period under review, the Compensation and Nomination Committee undertook an evaluation of the suitability of the Board of Directors. The Board of Directors undertook a self-assessment in line with the Joint EBA and ESMA Guidelines (EBA/CP/2016/17). The individual and collective scores of the Board of Directors were analysed by the Compensation and Nomination Committee, and discussed at Board level. The suitability evaluation reflected the following:

- The Board of Directors is strong, diverse and well-balanced, having the necessary skills, knowledge and varying levels of professional experience to carry out its mandate;
- The members of the Board Committees have the necessary competence and expertise to perform their delegated roles and report back fully and clearly to the Board of Directors; and
- Particular areas for training of the Board members were identified, and subsequently delivered to the Board of Directors.

PRINCIPLE 8 – COMPENSATION AND NOMINATION COMMITTEE

The Compensation and Nomination Committee is responsible for reviewing the remuneration policy of the Bank and for making any recommendations as the Committee deems appropriate in light of the general strategic interests of the Bank and regulations.

The Committee was redesignated as Compensation and Nomination Committee with effect from 21 February 2018.

In discharging this overarching purpose, the Committee's principal responsibilities are to:

a. Set the over-arching principles and parameters of remuneration policy across the Bank;

b. Consider and approve the remuneration arrangements of the senior executives of the Bank and those executives whose total remuneration exceeds a figure which may be agreed with the Board from time to time;

c. Monitor and review the remuneration paid to the Chairman and other members of the Board of Directors and to make recommendations to Shareholders through the forum of a General Meeting for approval as appropriate;

d. Approve annual pay increases and bonuses as recommended by the Executive Management of the Bank;

e. Exercise oversight for remuneration issues; and

f. Exercise the functions of a Board Nomination Committee.

During 2018, the Compensation Committee met 5 times. The Committee was made up of three Non-Executive Directors. Their attendance at Committee meetings during 2018 was as follows:

MEMBERS	ATTENDED
Mr Mohamed Ahmed Shafiek Mohamed Ahmed – Chairman	5 out of 5
Mr Mario P Galea	5 out of 5
Mr Kenneth Mizzi	5 out of 5

Dr Michael Frendo replaced Mr Mario P Galea on this Committee with effect from 1 January 2019.

Further information on the Bank's Remuneration Policy can be found in Section 3 of the Statement of Compliance with the Principles of Good Corporate Governance.

PRINCIPLE 9 & 10 – RELATIONS WITH SHAREHOLDERS, THE MARKET AND INSTITUTIONAL SHARHOLDERS

The Bank provides regular and timely information to its shareholders in order for such shareholders to make informed decisions. Despite the fact that the Bank is not listed on any regulated market, the Bank communicates its long-term strategic decisions to third parties through press releases, interviews and the Bank's Annual Report. It is believed that such communication enhances trust and confidence in the Bank and its management.

The Board ensures that the interests of the Bank's shareholders are protected at all times. In addition, the Chairman ensures that the views of all shareholders are communicated to the Board.

PRINCIPLE 11 – CONFLICTS OF INTEREST

The Directors are strongly aware of their responsibility to act in the best interest of the Bank and of their obligation to avoid conflicts of interest. Given that certain conflicts of interest arise naturally, the Bank has established a policy whereby any director experiencing such conflict of interest is to make a declaration to the Board of Directors. In such instances, the relative director neither participates in the discussion nor votes on the matter. The minutes of the Board duly reflect the manner in which such situations were handled.

PRINCIPLE 12 – CORPORATE SOCIAL RESPONSIBILITY

BNF's brand values are shared by the Members of the Board and Executive Management, and instilled within the Bank's culture. BNF's brand values include:

- Ethical business practices: BNF is in the business of corporate and retail banking, and therefore has a role which is engrained within society. BNF endeavours to operate ethically in all that it does;
- Investing in its people: The Bank invests heavily in training and career development and believes in providing equal opportunities and desirable working conditions;
- Communication: BNF fosters a culture of open communication and inclusion;
- Maintaining a role in the development and progress of the local community: The Bank undertakes initiatives to contribute towards sections of society that are lacking in education, opportunity and inclusion. This value is observed through the Bank's product offerings and through the Bank's CSR Policy, which apportions a fund toward supporting various CSR projects;
- Minimising its carbon footprint: The Bank regularly reviews its purchasing policies and physical infrastructures to determine opportunities to minimise any environmental impact.

SECTION 2 – NON-COMPLIANCE WITH THE CODE

PRINCIPLE 4 (CODE PROVISION 4.2.7)

Code provision 4.2.7 recommends "the development of a succession policy for the future composition of the Board of Directors and particularly the executive component thereof, for which the Chairman should hold key responsibility".

The Bank's succession policy is set out in the Board Suitability Policy which establishes that the Compensation and Nomination Committee is to, when carrying out the annual Board suitability assessment, consider the results of such an assessment and make appropriate recommendations to the Board, on an annual basis, for the succession of the Board over the longer term to maintain the appropriate balance of knowledge, skills, diversity and experience on the Board. Any gaps in knowledge, skills, diversity and experience on the Board shall be identified by the Compensation and Nomination Committee. The Compensation and Nomination Committee shall put forward recommendations to the Board on how any identified gaps are to be addressed.

The Board Suitability Policy also sets out that the Compensation and Nomination Committee is to keep under review the leadership needs of the Bank, and on an annual basis, consider the adequacy of proposals for the succession over the longer term, to key positions within the Bank.

SECTION 3 – REMUNERATION POLICY

BNF Bank p.l.c. has a Remuneration Policy in place, which is approved by the Board of Directors and is subject to annual review. The Bank's Remuneration Policy is drawn up in line with The Supervisory Review Process of Credit Institutions Authorised under the Banking Act, Banking Rule 12.

The Policy is intended to create guidelines for the Bank when offering remuneration and benefits to all the employees of the Bank and at the same time to ensure transparency in remuneration matters. It primarily aims at helping the Bank attract, retain and motivate high calibre employees within the context of the market in which it operates, keeping in mind the interest of the Bank, the shareholders and all other stakeholders. The Bank also carries a set of rules and procedures for the appraisal of performance, which are updated from time to time in line with operational requirements/realities.

BNF Bank p.l.c. remunerates employees through a system of:

- Fixed Pay for full-time and part-time salaried employees, within a published pay structure and dependant on employee's skills, experience and level of responsibility;
- Fees are payable to Non-Executive directors in line with the time and effort committed to the institution and industry practice;
- Benefits in kind are offered to the employees in the form of reduced fees, preferential interest rates and other benefits in line with industry practice; and
- Annual Bonuses as further detailed below.

The Bank's performance related reward system does not guarantee the levels of variable performance pay-outs to employees. On a yearly basis, the Bank's Board of Directors approve a fund for bonuses and salary increases, which reflects the efforts and the results achieved by the Bank on its short and longer-term goals. This is then distributed among employees in accordance with the Performance Appraisal Policy and Procedures and the Bank's Remuneration Policy.

The strategy of the Bank is to offer low levels of variable compensation in comparison to the employee's fixed pay. This is intended to ensure that risks taken are within acceptable parameters and that employees follow the Bank's values and vision. Individual targets are set out in a way that encourage employees to achieve individual and group targets whilst improving personal skills and competencies.

In view of the low proportion of performance related reward to fixed pay, it has hitherto not been the practice to apply deferred payment of such reward. Malus and clawback have not, to date, therefore been considered applicable.

Non-Executive Directors

Non-Executive Directors are not full-time employees of the Bank and do not receive a regular salary, allowances, pension rights or other benefits. The compensation for Non-Executive Directors is based solely on a fee for their services together with reimbursement of any expenses made in the course of the Bank's business.

The compensation paid by the Bank to Non-Executive Directors compensation for the year 2018 was €202,966.

Executive Committee

The Bank's Executive Committee was made up of one Executive Director and two Chief Officers up to April 2018, and one Executive Director and three Chief Officers thereafter. Remuneration payable to the Executive Committee for the year was € 604,331.

Material Risk Takers (MRTs) Remuneration

Remuneration paid to MRTs is detailed in the table below and is aggregated by distinction between senior and non-senior management. The identification of MRTs is based on the framework for prudential supervision established by Directive 2013/36/EU.

	SENIOR MANAGEMENT	MRTS
Remuneration	€807,297	€1,031,482

All variable remuneration was paid in cash and no shares, share linked instruments or similar instruments were used.

The members of the Bank's Executive Committee, and Heads of Department enjoy cash and non-cash benefits which in a number of cases includes the service of a company vehicle. All Bank employees benefit from life cover, health insurance and personal accident cover.

No sign-on or severance payments were made to MRTs during 2018.

None of the members of senior management or MRTs received remuneration in excess of €1 million.

SECTION 4 – INTERNAL CONTROL

The Board of Directors is ultimately responsible for internal control within the Bank. The Board is also responsible for ensuring that the basic roles of corporate responsibility, namely accountability, strategy formulation and policy development are implemented throughout the Bank. The Board of Directors delegates to the Executive Committee the authority to operate the Bank within the limits set by the Executive Committee's Terms of Reference.

On a regular basis, the Bank issues policies and procedures to control and/or mitigate material operational risks. Policies are subject to a periodic review of the Board of Directors, so as to adjust processes in accordance with the Bank's current risk profile. Procedures, are subsequently circulated and adhered to by staff at all times. In addition, such Policies and Procedures are kept permanently on the Bank's intranet so that staff has access to such documents at all times. Any deviance from policy parameters must be sanctioned outside such policy by the applicable sanctioning level.

The Institution prides itself on practising high ethical and professional standards and a very serious view of any deviance is taken. A robust internal control mechanism, premised on separate second line of defence composed of the Compliance and Risk functions is followed. The central plank of the Organisation's risk activity remains the full independence of the risk function and its segregation into risk management and risk control/oversight activities. Such compartmentalisation is firmly established thereby reinforcing the robust risk governance infrastructure:

- Risk control and oversight activities are performed by Risk Control and Oversight Unit, which is entrusted with implementing the risk-related policies, risk metrics and other risk mitigation procedures. Risk Control and Oversight Unit identifies, quantifies and reports to top management the degree to which the Bank is exposed to different risks. These include solvency, credit (on a portfolio basis), concentration, market, liquidity, interest-rate, operational, reputational and all other "residual" risks.
- On the other hand, the Bank's Credit Analysis Unit performs a risk management role at the micro level. That is to say, as a fully distinct internal entity (independent from the Risk Control and Oversight Unit), Credit Analysis Unit officials are involved in the credit sanctioning and renewal process. They analyse credit requests and make recommendations which seek to implement the risk policies, procedures and metrics formulated by the Bank. Credit Committee sittings at different authorization levels only approve granting and/or renewal of credit by consensus; each Credit Committee must include one official emanating from Credit Analysis Unit. The Credit Analysis Unit official is enabled to withhold consensus by giving risk-based considerations effectively sending the credit decision to a higher sanctioning level than would otherwise be the case.

In addition, the Bank believes in and practises an internal control mechanism founded on the four eyes principle, functional segregation and audit procedures. The Legal & Compliance Unit advises and keeps senior management informed on the implication of compliance with laws and regulations that have a bearing on the Bank's operations. The Unit also identifies, documents and assesses the compliance risks associated with the Bank's operational activities, including the development of new products and business practices.

The Internal Audit Unit, as the third line of defence, on the other hand, monitors the conformity of the Bank's operations with the set policies and standards and reviews key business processes and controls. The work of the Internal Audit Unit focuses on areas of greatest risk as determined by a risk management approach.

The responsibility for the development of financial forecasts of the Bank in line with the strategic plans devised by the Board is delegated to the Executive Committee. These financial forecasts provide the basis for continuous monitoring and control at various levels within the Bank. The relevant functions are then responsible to report on financial performance against plans to the Board on a monthly basis, identifying reasons for variances and, if necessary, corrective actions that need to be taken to ensure that objectives and targets set by the Board are achieved.

SECTION 5 – CORPORATE PHILANTHROPY AND COMMUNITY RELATIONS

BNF Bank is an important institution in Malta's economic landscape and has, over the years, made a significant footprint in the financial services industry. And while the Bank offers a valuable service via financial solutions that meet individual, family and corporate needs, of course for a profit, nevertheless BNF also holds a moral obligation towards the social progress of the community.

"We take decisions and actions that go beyond the Bank's direct commercial interests. We embrace ethical considerations that not only meet the expectations of our team, our clients and the public, but in reality they also meet our own personal wish, as members of the Executive Committee, to make a difference to people's lives, those caught in a vicious circle of educational and social poverty. As business practitioners we have an obligation to also take affirmative action in the interest of the environment we all live in, in its widest definition. It is only then that our business role can foster a strong bond with our employees, our customers and the community."

Adrian Coppini, Chief Operations Officer

PHILANTHROPY

The President's Solidarity Fun Run

2018 marked ten years of support to The President's Solidarity Fun Run. The initiative started out as an idea for a charity marathon expecting a couple of thousand participants. The success of the event not only surpassed all expectations but took on a life and brand of its own, drawing in a staggering 16,000 participants and millions of contributions that go towards the President's list of beneficiaries, and focusing on ultra-expensive cancer therapy for families who otherwise are not able to afford the treatment. In 2018, a total amount of €270,000 was raised during the Fun Run and the funds were passed on to the Malta Community Chest Fund Foundation (MCCFF) during l-Istrina.

More funds for therapeutic services to persons facing diverse physical and mental difficulties are allocated by the Bank by supporting the Malta Hospice Movement, the Malta Service Dogs Foundation, and the Ronald McDonald House Charities.

Malta Hospice Movement

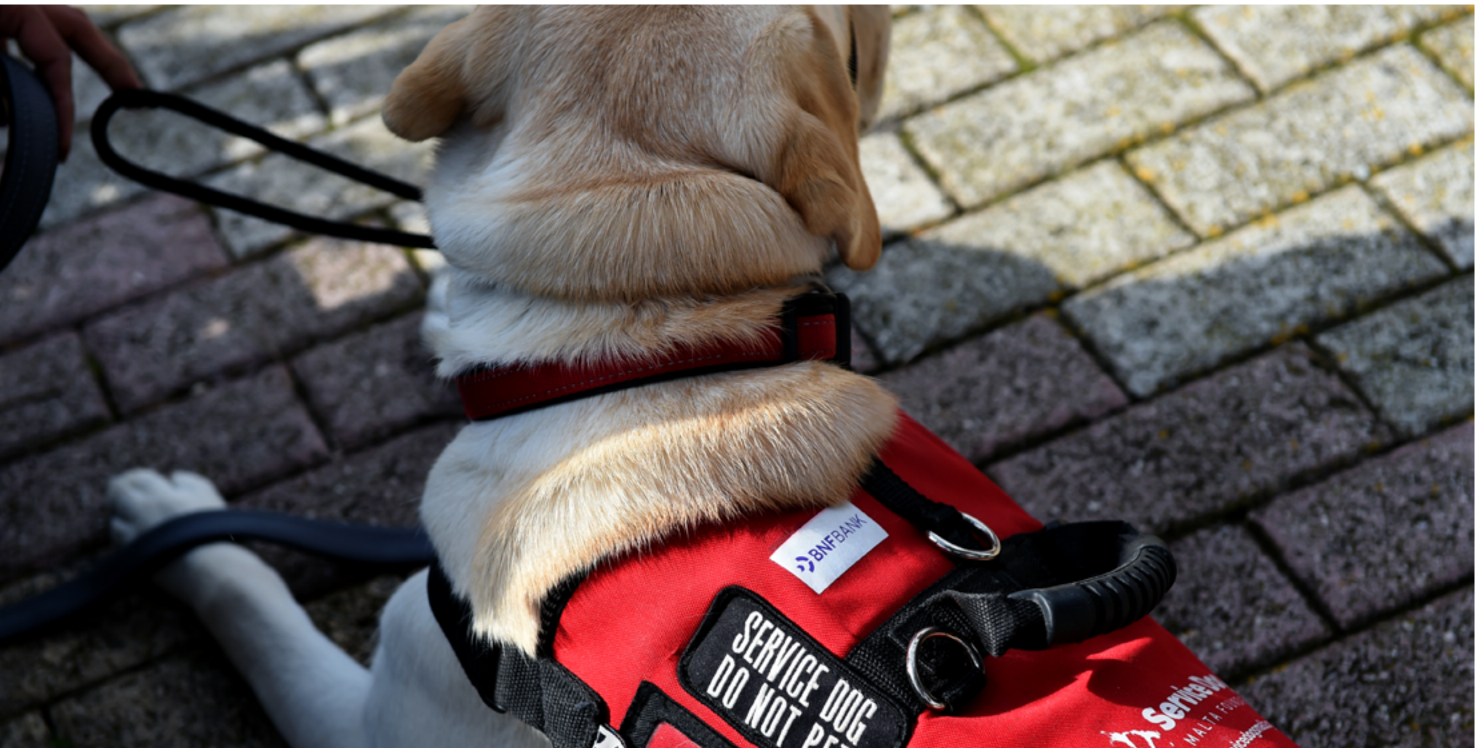
The Malta Hospice Movement is an NGO that needs no introduction since cancer affects an impressive one in four people at a point in time – no doubt one of the reasons for the NGO being consistently chosen by Bank staff as a beneficiary for their salary donation scheme. The hospice supports over a thousand patients and families.

Service Dogs Malta Foundation

Now in its third year of sponsorship, BNF Bank supports the Service Dogs Malta Foundation with funds that go specifically towards the development of puppies into therapy and service dogs. The Foundation's aim is to allocate a fully-certified and fully-matched dog to a person living with a condition or a disability and where the dog is expected to transform a person's life by giving the psychological comfort through constant accompaniment, and aid them conduct their daily tasks both inside the home and in their out-door life. The costs of raising a puppy to become a certified service dog are many and include trainer expenses, vaccination and vet fees and insurance cover. BNF staff were also elated to welcome the puppies in the Bank's branches - visits devised as part of the puppies' ambience training.

Ronald McDonald House Charities

The Bank also extended its support to RMCH (Malta) in its endeavour to set up its first learning centre in Qawra intended to reach children in the region challenged by social and familial situations like poverty, disability and learning difficulties. It will be offering free specialised support services together with educational and therapeutic programmes to help those children who have fallen behind on the development of core skills and competences necessary for a good quality of life in adulthood. It will also be running an early intervention programme for children on the autism spectrum.



Blue Light Foundation

The Bank was quick to support the new local organisation Simon Schembri Blue Light Foundation in its objective to create a fund for those members of emergency services like paramedics, police, correctional facility officers, the armed forces and members of the civil protection who suffer physical injury while on duty. In a year where so many accidents made the headlines, the organisation has been timely to react to the need to provide a safety net for those who put their lives at risk for the protection of others.

EDUCATION

Europa Donna (Malta) and Pink October

Generating awareness on issues important to society is never enough, and the Bank makes it a point not to miss out on the opportunity to educate on the importance of disease prevention. Every October, BNF engages in a month of action using its own communications channels and retail network to remind both its team and the public of the dangers of breast disease. The Bank teamed up with Europa Donna (Malta) to involve employees in a number of activities, including wearing pink ribbon pins and attending an informative lecture on breast cancer survival with perspectives from health care professions and patients. The Bank offered free mammography exams to those team members who will directly benefit from getting tested, hoping this will urge them to check their health on a regular basis. Team members also enjoyed organic green tea in pocket-flyers, as a reminder to eat and drink well, and stay healthy.

Men's Health Awareness Month

Through Movember, the Bank aimed to raise awareness of men's health issues to help men live healthier, happier and longer lives and also offered free Prostate-Specific Antigen (PSA) screening to all male employees over 40 years of age.

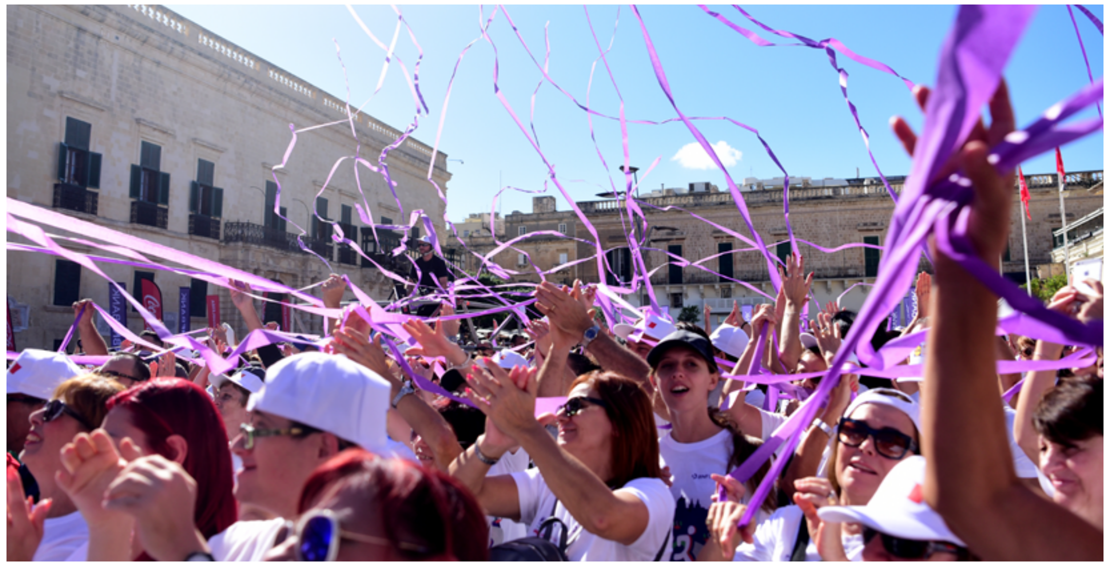
Rakkonti literacy project

The National Literacy Agency within the Ministry for Education is active in creating and maintaining a number of literacy projects aimed at primary and secondary schools' children. One such initiative is the BNF sponsored Rakkonti that has been going now for a few years. The project has recreated a number of traditional Maltese tales told recounted through animations, music and puppet shows, with text and illustrations by Trevor Zahra and music by Manolito Galea. The project gives students the opportunity to learn by using a variety of media. Since its inception the project has reached 1,641 children in 53 different state schools.

CULTURE AND HERITAGE

The Majlis – Cultures in Dialogue

Through BNF's majority shareholder, the Bank has had the very unique opportunity to collaborate on an interesting cross-cultural project. The Bank sponsored the first stop in the international tour of the exhibition The Majlis – Cultures in Dialogue, organised by The Sheikh Faisal Bin Qassim Al



Thani Museum of Doha, Qatar, at the Grand Master's Palace in Valletta. The exhibition is part of a wider project that seeks to connect people, beliefs and cultures through dialogue.

Visitors were encouraged to sit in the re-created majlis, listen to stories and exchange ideas with each other and with scholars on what they see, discover and experience in the exhibition displays. A majlis is a space in Gulf homes – a setting for hospitality and dialogue, where families welcome visitors bearing stories and exotic gifts from their homelands, where children learn from their elders, and where communities gather to make decisions, great and small. The public had the chance to see rare and precious antiques and artefacts from all over the globe representing world faiths and cultures, and BNF Bank was truly a proud sponsor of this multicultural opportunity in Malta.

Fondazzjoni Wirt Artna

Conscious and appreciative of the valuable work undertaken by the Fondazzjoni Wirt Artna (FWA), BNF Bank supports the organisation's indefatigable work as a corporate sponsor. What the FWA is perennially doing is researching, documenting and preserving Malta's rich history by maintaining a number of museums and improving existing sites so that the Islands' intricate and chequered past can be understood and appreciated by locals and foreign visitors to our country. The passion of the people behind the FWA is contagious and the Bank wanted to also share this with its team, via a family membership for staff to all FWA sites.

ENVIRONMENT

Every March without fail, the Bank observes Earth Hour by switching off all ancillary lighting across its branch network. Earth Hour is a worldwide initiative organised by WWF to encourage individuals, communities, households and businesses to turn off the lights for a symbolic one hour, as a sign of commitment to a greener and healthier world.

The Bank also organises a yearly car-free day, during which BNF employees ditch the car and take alternative means to get to work and back home. Many walk, take public transport, car pool, cycle, or run. The activity is held during EU Mobility Week intended to highlight the issues of pollution, emissions and air quality.

THE TEAM AT BNF BANK

With a 200-strong team of employees as the driving force of BNF's commercial business and organisational culture, it goes without saying that the Bank unilaterally holds the team in high respect. What would corporate social responsibility be without affirmative action that targets a crucial stakeholder at the core of the Bank's essence?

Every year, the Bank strives to improve terms of employment and work ambience. Staff now enjoys a number of conditions over and above general contracts. These include health insurance, a number of free medical tests, staff discounts at commercial and retail outlets, regular professional training and personal development in soft skills, performance appraisals and rewards, a suggestion platform with prizes for best implementable ideas, social and motivational events, and recognition of outstanding accomplishments.

In 2018 BNF endeavoured to expose managers to mental health issues at the workplace, recognising that psychological first aid skills are necessary at the office, more than ever before. The Bank endorsed Richmond Foundation's Standard Mental Health First Aid at the Workplace training where those in supervisory roles learnt how to assist a co-worker who might be developing a mental health problem or experiencing a mental health crisis. This new initiative was taken with two objectives – to contribute towards the general mental health wellbeing for the workforce, in order to eventually be well equipped to deal with any particular cases when they arise.

Long service awards are presented to those employees with ten years' service. The honour reflects the Bank's appreciation for years of unfailing dedication and personal achievements. The Bank also awards the Employee of the Year, to an employee who is usually nominated by peers and strongly recommended by the Executive Committee. The employee is usually an all-rounder, somebody who embraces the Bank's values of ambition, responsibility and empathy, and delivers results keeping in focus factors like concern for colleagues, positivity and motivation. The Bank also acknowledges the performance of its retail and commercial teams, with best performers acknowledged and rewarded.

Through the Bank's Sports and Social Committee, the team is offered participation in ample social events that bring staff together outside of the office set up. The events vary from socialising over food to cultural events, activities with a charity aim, family oriented initiatives, sports and more. The male and female football team also represent the Bank in the local and international Banca Cup.

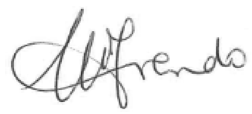
The strides the Bank has made in building a strong team are the result of a belief in open communication between management and employees at all levels. It is on the strength of honest and transparent discussion and the willingness to take into consideration different views and perceptions, that the Bank can boast a culture of professionalism and personal respect.

GOING CONCERN

Having taken into consideration the Bank's performance and its future strategic goals, the Directors declare that the Bank is able to continue operating as a going concern for the foreseeable future.

APPROVED BY THE BOARD OF DIRECTORS AND SIGNED ON ITS BEHALF ON 15 APRIL 2019 BY:

Michael Anthony Collis
Chief Executive Officer



Michael Frendo
Chairman

Independent auditor's report

pwc

Independent auditor's report

To the Shareholders of BNF Bank p.l.c.

Report on the audit of the financial statements

Our opinion

In our opinion:

- BNF Bank p.l.c.'s financial statements give a true and fair view of the financial position of the Bank as at 31 December 2018, and of the Bank's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU; and
- The financial statements have been prepared in accordance with the requirements of the Banking Act (Cap.371) and the Maltese Companies Act (Cap. 386).

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

What we have audited

BNF Bank p.l.c.'s financial statements, set out on pages 48 to 199, comprise:

- the statement of financial position as at 31 December 2018;
- the income statement and statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

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

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

pwc

Independent auditor's report - continued

To the Shareholders of BNF Bank p.l.c.

Independence

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

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

The non-audit services that we have provided to the Bank, in the period from 1 January 2018 to 31 December 2018, are disclosed in Note 29 to the financial statements.

Our audit approach

Overview

Overall materiality: €159,000, which represents 5% of adjusted profit before tax after remeasurement

Credit loss allowances in respect of loans and advances to customers of the bank

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

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which the company operates.

Independent auditor's report - continued

To the Shareholders of BNF Bank p.l.c.

Materiality

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

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

Overall materiality	€159,000
How we determined it	5% of adjusted profit before tax after remeasurement
Rationale for the materiality benchmark applied	We chose profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Bank is most commonly measured by users, and is a generally accepted benchmark. We chose 5% which is within the range of acceptable quantitative materiality thresholds in auditing standards

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above €16,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

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

Key audit matter	How our audit addressed the Key audit matter
Credit loss allowances in respect of loans and advances to customers of the bank Credit loss allowances in respect of loans and advances to customers represent management's best estimate of expected credit losses ('ECLs') within the loan portfolios at the balance sheet date. On 1 January 2018, the Bank transitioned to IFRS 9, a new and complex accounting standard which introduced the measurement of impairment allowances based on an expected loss model rather than an incurred loss model previously applied under IAS 39.	As IFRS 9 was adopted at the start of the year, we performed audit procedures on the opening balances to gain assurance on the transition from IAS 39. This included evaluating the accounting interpretations to apply the requirements of IFRS 9 and testing the adjustments and disclosures made on transition. Discussions with the Audit Committee included: • the policies and methodologies used by the bank in respect of computing ECLs on loans and advances;

Independent auditor's report - continued

To the Shareholders of BNF Bank p.l.c.

Key audit matter	How our audit addressed the Key audit matter
A considerable level of judgement is required in the development of the models designed to measure ECLs on loans measured at amortised cost in accordance with the requirements of IFRS 9. Credit loss allowances relating to all loans and advances in the Bank's Corporate and Retail portfolios are determined at an instrument level. In general the bank calculates ECL by multiplying three main components: probability of default (PD), loss given default (LGD) and exposure at default (EAD): i. Probability of default ("PD"): the likelihood of a borrower defaulting on its financial obligation either over the next 12 months or over the remaining lifetime of the obligation. ii. Loss given default ("LGD"): the expected losses taking into account, among other attributes, the mitigating effect of collateral value (if any) at the time it is expected to be realised and the time value of money. iii. Exposure at default ("EAD"): the expected exposure in the event of a default (including any expected drawdowns of committed facilities). For both non-defaulted (Stage 1 and 2) and defaulted (Stage 3) exposures, the Bank uses internally developed statistical models. For non-defaulted (Stages 1 and 2) exposures, PDs are estimated using historical model development data based on the Bank's own experience as available at the reporting date. For exposures secured by immovable properties, LGDs are driven by the loan-to-value ratio of the individual facilities and takes into account other assumptions, including market value haircut (which includes costs to sell), time to sell and the impact of discounting the collateral from the date of realisation back to the date of default. The maximum period considered when measuring ECL is the maximum contractual period over which the bank is exposed to credit risk.	• inputs, assumptions and adjustments to ECL, in particular changes to risk factors and other inputs within the bank's models; • individually significant loan impairments. For ECL models the appropriateness of the modelling policy and methodology used was independently assessed by reference to the requirements of IFRS 9. The more judgemental interpretations of IFRS 9 made by management continued to be discussed during the year, in particular the application of forward looking economic scenarios, including the severity and magnitude of modelled downside scenarios. We understood and critically assessed the models used for ECL estimation for both Corporate and Retail portfolios. Since modelling assumptions and parameters are based on historic data, we assessed whether historic experience was representative of current circumstances and of the recent losses incurred within the portfolios. The appropriateness of management's judgements was also independently considered in respect of calculation methodologies, calibration of PDs and LGDs, segmentation and selection of macroeconomic variables. Substantive procedures which were performed in respect of the ECL models included: • Performing an overall assessment of the ECL provision levels by stage to determine if they were reasonable considering the Bank's portfolios, risk profile, credit risk management practices and the macroeconomic environment. • Testing of a sample of exposures to independently review the borrower's financial performance and ability to meet loan repayments and assess the appropriateness of the credit rating assigned by management.

Independent auditor's report - continued

To the Shareholders of BNF Bank p.l.c.

Key audit matter	How our audit addressed the Key audit matter
Internal credit risk management practices are used to determine when a default has occurred, considering quantitative and qualitative factors where appropriate. Judgement is required to determine when a default has occurred and then to estimate the expected future cash flows related to defaulted (Stage 3) exposures which are dependent on parameters or assumptions such as the valuation of collateral (including forced sale discounts and assumed realisation period) or forecasted operating cash flows. Under the new expected credit loss model, the bank is required to formulate and incorporate multiple forward-looking economic conditions, reflecting management's view of potential future economic variables and environments, into the ECL estimates. A number of macro-economic scenarios based on the selected macro-economic variables are considered to capture non-linearity across credit portfolios. The complexity attributable to this factor requires management to develop multiple macro-economic scenarios involving the use of significant judgements. In order to meet the requirements of the new standard, significant changes have been made to models, processes and controls with effect from 1 January 2018. There is also a significant increase in the number of data inputs required for the impairment calculation. The ECL models are based on a general-purpose application which requires extensive manual handling of data. This increases risk around the accuracy and completeness of data used to create assumptions and to operate the ECL models. In some cases, data is unavailable and reasonable alternatives have been applied to allow calculations to be performed. As this is the first year of adoption of IFRS 9, there is limited experience available to back-test the ECL income statement charge with actual results. The credit environment has remained relatively benign for an extended period of time,	• Challenging the criteria used to allocate an asset to stage 1, 2 or 3 in accordance with IFRS 9 and testing assets in stage 1, 2 and 3 to verify that they were allocated to the appropriate stage (comprising the determination of significant increase in credit risk and the identification of defaulted exposures). • Testing the completeness and accuracy of the critical data utilised within the models for the year-end ECL calculation. • Risk based testing of models, including testing of the assumptions, inputs and formulas used in ECL models on a sample basis. This included assessing the appropriateness of model design, methodology and formulas used, specifically challenging the appropriateness of the methodology to derive PD calculations. • Reviewing basis for property collateral valuations utilised to determine LGDs applied by the Bank within ECL calculations, using our valuation experts; challenging the application of certain parameters considered in the LGD estimations such as the time to realise the collateral and costs associated with such process. • Recalculating PDs, LGDs and EADs on a sample basis. • Reviewing the multiple macro-economic variables and scenarios using our experts to assess their reasonableness. We assessed the base case and alternative economic scenarios, including challenging probability weights. We assessed whether forecasted macroeconomic variables were appropriate and we challenged the correlation and impact of the macroeconomic factors with respect to the ECLs. Based on the evidence obtained, we found the model assumptions, data used within the models and the model calculations to be reasonable.

Independent auditor's report - continued

To the Shareholders of BNF Bank p.l.c.

Key audit matter	How our audit addressed the Key audit matter
in part due to low interest rates and relative strength of the local economy. However, whilst the current levels of delinquencies and defaults remains low, the risk of impairment remains significant. Since the estimation of ECLs is subjective in nature and inherently judgemental, the bank's application of the IFRS 9 impairment requirements is deemed to be an area of focus. Relevant references in the Annual Report and Financial Statements: – Accounting policy: Note 2; – Credit risk management: Note 3; – Note on Credit impairment losses: Note 30; – Note on Loans and advances to customers: Note 9; and – Critical accounting judgements and estimates: Note 4.2.1.	For defaulted exposures, the methodology and policy used to calculate ECLs was independently assessed. • We understood and evaluated the processes for identifying default events within loan portfolios, as well as the impairment assessment processes. • In respect of defaulted exposures the design and operating effectiveness of key controls management has established were tested over the determination of which loans and advances are credit-impaired. We determined that we could rely on these controls for the purposes of our audit. Substantive procedures were performed in respect of identification of defaults as follows: • Assessed critically the criteria used for determining whether a default event had occurred by testing a sample of loans with characteristics that might imply a default event had occurred to challenge whether default events had actually occurred. • Selected a sample of performing loans, which had not been identified by management as potentially defaulted, to form our own judgement as to whether that was appropriate and to further challenge whether all relevant events had been identified by management. Substantive procedures were performed on defaulted exposures as follows: • Reviewed the credit files of a selected sample of loans to understand the latest developments and the basis of measuring the ECL provisions, and considered whether key judgements were appropriate.

Independent auditor's report - continued

To the Shareholders of BNF Bank p.l.c.

Key audit matter	How our audit addressed the Key audit matter
	• Challenged the severity of the different scenarios applied within the ECL calculation for the exposures in the sample, together with their respective probability weights by forming an independent view on the recoverability of the selected loans under the different scenarios. • Tested key inputs and assumptions within the ECL calculation for the sample, including the expected future cash flows and valuation of collateral held, and reperformed the calculations within the discounted cash flow model used to derive expected cash flows under the different scenarios. • Tested the estimation of the future expected cash flows from customers from realisation of collateral held for the sample of defaulted loans, including assessment of the work performed by external experts used by the bank to value the collateral and challenged management to demonstrate that the valuations were up to date. We also used our experts to assess the appropriateness of valuations and estimates utilised. In the case of some impairment provisions, we formed a different view from that of management, but in our view the differences were within a reasonable range of outcomes.

Independent auditor's report - continued

To the Shareholders of BNF Bank p.l.c.

Other information

The directors are responsible for the other information. The other information comprises the General information, the Directors' Report, the Statement of Compliance with the Principles of Good Corporate Governance, the Additional Regulatory Disclosures, the Five Year Summary and the Supplemental Financial Information (but does not include the financial statements and our auditor's report theron).

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

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

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

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

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

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

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

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

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

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

Independent auditor's report - continued

To the Shareholders of BNF Bank p.l.c.

Auditor's responsibilities for the audit of the financial statements

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

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

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

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

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

Independent auditor's report - continued

To the Shareholders of BNF Bank p.l.c.

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

Report on other legal and regulatory requirements

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

In our opinion:

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

Other matters on which we are required to report by exception

We also have responsibilities under the Maltese Companies Act (Cap. 386) to report to you if, in our opinion:

- returns adequate for our audit have not been received from branches not visited by us; and
- certain disclosures of Directors' remuneration specified by law are not made in the financial statements, giving the required particulars in our report.

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

Appointment

We were first appointed as auditors of the Bank on 25 July 2014. Our appointment has been renewed annually by shareholder resolution representing a total period of uninterrupted engagement appointment of 5 years.

PricewaterhouseCoopers
78, Mill Street
Qormi
Malta

Fabio Axisa, Partner

15 April 2019

Statement of Financial Position

STATEMENT OF FINANCIAL POSITION
As at 31 December 2018

	Notes	2018	2017
		€000	€000
Assets			
Balances with Central Bank of Malta and cash	6	99,853	26,777
Cheques in course of collection		677	2,259
Financial investments	7	68,263	67,663
Loans and advances to banks	8	57,516	69,911
Loans and advances to customers	9	520,745	382,314
Property and equipment	10	5,995	6,908
Intangible assets	11	1,044	1,124
Derivative assets	12	122	-
Deferred tax assets	13	5,046	3,923
Prepayments and accrued income	14	2,583	2,335
Other assets	15	5,628	4,351
Total Assets		**767,472**	**567,565**
Equity			
Share capital	16	67,044	39,544
Perpetual capital notes	17	7,500	5,000
Revaluation reserve	18	(533)	(248)
Reserve for General Banking Risks	18	992	992
Retained earnings	18	1,460	591
Total Equity		**76,463**	**45,879**

STATEMENT OF FINANCIAL POSITION
As at 31 December 2018

	Notes	2018	2017
		€000	€000
Liabilities			
Amounts owed to banks	19	90	290
Amounts owed to customers	20	677,272	513,851
Current tax liabilities		1,538	-
Other liabilities	21	8,688	4,349
Accruals and deferred income	22	3,421	3,196
Total Liabilities		**691,009**	**521,686**
Total Equity and Liabilities		**767,472**	**567,565**
Memorandum items			
Contingent liabilities	23	11,199	8,820
Commitments	23	158,607	112,755

The accounting policies and explanatory notes on pages 60 to 199 form an integral part of the financial statements. The financial statements on pages 48 to 199 were approved and authorised for issue by the Board of Directors and signed on its behalf on 15 April 2019 by:

Michael Anthony Collis
Chief Executive Officer

Michael Frendo
Chairman

INCOME STATEMENT
For the year ended 31 December 2018

	NOTES	2018	2017
		€000	€000
Interest receivable and similar income			
• on loans and advances, balances with Central Bank of Malta and other instruments	24	19,077	15,318
• on debt and other fixed income instruments	24	100	264
Interest payable and similar expense	25	(3,644)	(4,680)
Net interest income		15,533	10,902
Fees and commission income	26	3,629	2,985
Fees and commission expense	26	(912)	(652)
Net fees and commission income		2,717	2,333
Net trading income	27	744	561
Gain on disposal of investments measured at FVOCI		60	862
Other Income		24	-
Net operating income		19,078	14,658
Employee compensation and benefits	28	(7,364)	(6,864)
Other administrative expenses	29	(5,788)	(4,749)
Depreciation of property and equipment	10	(447)	(569)
Amortisation of intangible assets	11	(348)	(350)
Credit impairment losses	30	(1,572)	(517)

INCOME STATEMENT
For the year ended 31 December 2017

	NOTES	2018	2017
		€000	€000
Profit before tax		3,559	1,609
Income tax expense	31	(1,289)	(411)
Profit for the year		2,270	1,198
Earnings per share	32	2c9	2c3

The accounting policies and explanatory notes on pages 60 to 199 form an integral part of the financial statements.

STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2018

	2018	2017
	€000	€000
Profit for the year	2,270	1,198
Other comprehensive income Items that may be subsequently reclassified to profit or loss		
Investments measured at FVOCI (2017: available-for-sale):		
• Net loss in fair value, before tax	(538)	(390)
• Net gain on financial assets reclassified to profit or loss on disposal, before tax	(46)	(534)
• Net gain attributable to change in credit risk, before tax	(92)	-
Income taxes	236	324
Other comprehensive income for the year, net of tax	(440)	(600)
Total comprehensive income for the year, net of tax	1,830	598

The accounting policies and explanatory notes on pages 60 to 199 form an integral part of the financial statements.

STATEMENT OF CHANGES IN EQUITY For the year ended 31 December 2018	NOTES	SHARE CAPITAL	PERPETUAL CAPITAL NOTES	REVALUATION RESERVE	RESERVE FOR GENERAL BANKING RISKS	RETAINED EARNINGS	TOTAL
		€000	€000	€000	€000	€000	€000
At 1 January 2017		**24,544**	**5,000**	**352**	**992**	**(100)**	**30,788**
Comprehensive income							
Profit for the year		-	-	-	-	1,198	1,198
Other comprehensive income							
Fair valuation of available-for-sale sale financial assets:							
• net changes in fair value arising during the year	7	-	-	(253)	-	-	(253)
• reclassifications - net amounts classified to profit or loss	7	-	-	(347)	-	-	(347)
Total other comprehensive income for the year		-	-	(600)	-	-	(600)
Total comprehensive income		**-**	**-**	**(600)**	**-**	**1,198**	**598**
Transactions with owners							
Issue of share capital	16	15,000	-	-	-	-	15,000
Interest on perpetual capital notes		-	-	-	-	(507)	(507)
Total transactions with owners		**15,000**	**-**	**-**	**-**	**(507)**	**14,493**
At 31 December 2017		**39,544**	**5,000**	**(248)**	**992**	**591**	**45,879**
Changes on initial application of IFRS9	2.2	-	-	155	-	(894)	(739)

(continued on the next page)

At 1 January 2018 – restated balance		**39,544**	**5,000**	**(93)**	**992**	**(303)**	**45,140**
Comprehensive income							
Profit for the year		**-**	**-**	**-**	**-**	**2,270**	**2,270**
Other comprehensive income							
Fair valuation of financial assets measured at FVOCI:							
• net changes in fair value arising during the year	7	-	-	(350)	-	-	(350)
• reclassifications - net amounts classified to profit or loss		-	-	(30)	-	-	(30)
• net gain attributable to change in credit risk	7	-	-	(60)	-	-	(60)
Total other comprehensive income for the year		-	-	(440)	-	-	(440)
Total comprehensive income		-	-	**(440)**	**-**	**2,270**	**1,830**
Transactions with owners							
Issue of share capital	16	27,500	-	-	-	-	**27,500**
Issue of perpetual additional Tier 1 Capital Notes	17	-	2,500	-	-	-	**2,500**
Interest on perpetual capital notes		-	-	-	-	(507)	**(507)**
Total transactions with owners		**27,500**	**2,500**	**-**	**-**	**(507)**	**29,493**
At 31 December 2018		**67,044**	**7,500**	**(533)**	**992**	**1,460**	**76,463**

The accounting policies and explanatory notes on pages 60 to 199 form an integral part of the financial statements.

STATEMENT OF CASH FLOWS
For the year ended 31 December 2018

	Notes	2018	2017
		€000	€000
Cash flows from operating activities			
Interest, fees and commission received		22,374	18,402
Interest, fees and commission paid		(5,365)	(4,946)
Net return from investment and trading activities		652	561
Payments to employees and suppliers		(12,245)	(12,314)
Net interest on financial assets		2,108	619
Cash flows from operating profit before changes in operating assets and liabilities		**7,524**	**2,322**
Increase/(decrease) in operating assets:			
• Balances with Central Bank of Malta		(1,260)	(439)
• Loans and advances to customers		(140,974)	(41,032)
• Other assets		1,187	(434)
Increase/(decrease) in operating liabilities:			
• Amounts owed to customers		163,421	30,887
• Other liabilities		3,869	(872)
Net cash flows generated from/(used in) operating activities before tax		**33,767**	(9,568)
Income tax paid		(111)	-
Net cash flows generated from/(used in) operating activities		**33,656**	**(9,568)**

STATEMENT OF CASH FLOWS
For the year ended 31 December 2018

	Notes	2018	2017
		€000	€000
Cash flows from investing activities			
• Purchase of property, equipment and intangible assets		(481)	(388)
• Purchase of investments measured at FVOCI	7	(20,130)	(84,592)
• Proceeds from disposal and redemption of investments measured at FVOCI		17,141	32,860
Net cash flows used in investing activities		**(3,470)**	(52,120)
Cash flows from financing activities			
• Issue of perpetual additional Tier 1 Capital Notes	17	2,500	-
• Issue of share capital	16	27,500	15,000
• Interest on perpetual additional Tier 1 Capital Notes		(507)	(507)
Net cash flows generated from financing activities		29,493	14,493
Net increase/(decrease) in cash and cash equivalents		**59,679**	(47,195)
Cash and cash equivalents at beginning of year		92,931	140,126
Cash and cash equivalents at end of year	33	**152,610**	92,931

The accounting policies and explanatory notes on pages 60 to 199 form an integral part of the financial statements.

Notes to Financial Statements

Notes to Financial Statements

For the year ended 31 December 2018

1. STATUTORY INFORMATION

BNF Bank p.l.c. is a public limited liability company domiciled and incorporated in Malta. The Bank was incorporated on 27 March 2007 and started operating as a fully-fledged retail bank during January 2008.

The Bank as a standalone financial services institution – as from December 2015 – complies with the disclosure requirements laid down in Part Eight of the Capital Requirements Regulation ('CRR'). The Additional Regulatory Disclosures ('ARD') are aimed at providing the Bank's stakeholders further insight to the Bank's capital structure and adequacy. The Bank publishes these disclosures on an annual basis as part of the Annual Report.

The 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 ('MFSA'). Banking Rule BR/07 follows the disclosure requirements of Directive 2013/36/EU (Capital Requirements Directive) and EU Regulation No 575/2013 (Capital Requirements Regulation) of the European Parliament and of the Council of 26 June 2013. As outlined in the requirements of banking regulations, these disclosures are not subject to an external audit, except to the extent that any disclosures are equivalent to those made in the Financial Statements, which have been prepared in accordance with the requirements of International Financial Reporting Standards ('IFRS') as adopted by the EU. The Bank, through its internal verification procedures, is satisfied that the ARD are presented fairly.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1. Basis of Preparation

The Bank's financial statements are prepared in accordance with the requirements of International Financial Reporting Standards (IFRSs) as adopted by the EU and with the requirements of the Banking Act (Chap. 371 of the Laws of Malta), 1994 and the Companies Act, 1995 (Chap. 386 of the Laws of Malta). These financial statements are prepared under the historical cost convention, as modified by the fair valuation of financial assets and financial liabilities.

The preparation of financial statements in conformity with IFRSs as adopted by the EU requires the use of certain accounting estimates. It also requires the Directors to exercise their judgment in the process of applying the Bank's accounting policies (see Note 4.1 – Critical accounting estimates, and judgments in applying the Bank's accounting policies).

Restatement of Comparative financial information

Comparative figures presented in the Bank's Income Statement and in the Statement of Changes in Equity have been restated to conform with the current year's presentation format for the purpose of fairer presentation. Interest payable on perpetual capital notes issued by the Bank (refer to Note 17), which are treated as equity, has been recognised and reflected as a dividend directly in equity during 2018 to reflect the substance of the instrument and interest payments thereon, rather than interest expense within profit or loss. During 2017, this interest payable was recognised within profit or loss and accordingly the comparative figures have been restated in this respect. The detailed impacts of this restatement are disclosed within Note 36 to the financial statements.

2.2. Standards, interpretations and amendments to published standards effective in 2018

In 2018, the Bank adopted amendments and interpretations to existing standards that are mandatory for the Bank's accounting period beginning on 1 January 2018.

In 2018, the Bank has adopted IFRS 9 as issued by the IASB in July 2014 with a date of transition of 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognised in the financial statements. The Bank did not early adopt any of IFRS 9 in previous periods.

As permitted by the transitional provisions of IFRS 9, the Bank has elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognised in the opening retained earnings of the current period.

The Bank has also elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9.

Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures have also only been applied to the current period. The comparative period notes disclosures repeat those disclosures made in the prior year.

The adoption of IFRS 9 has resulted in changes in accounting policies for recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments such as IFRS 7 'Financial Instruments: Disclosures'.

Set out below are disclosures relating to the impact of the adoption of IFRS 9 on the Bank. Further details of the specific IFRS 9 accounting policies applied in the current period (as well as the previous IAS 39 accounting policies applied in the comparative period) are described in more detail in section 2 below.

a. Classification and measurement of financial assets

The measurement category and the carrying amount of financial assets and liabilities in accordance with IAS 39 and IFRS 9 at 1 January 2018 are compared as follows:

	IAS 39		IFRS 9	
	Measurement category	Carrying amount	Measurement category	Carrying amount
		€000		€000
Balances with Central Bank of Malta and cash	Amortised cost (Loans and receivables)	22,734	Amortised cost	22,709
Cheques in course of collection	Amortised cost (Loans and receivables)	2,259	Amortised cost	2,259
Financial investments	Fair value through other comprehensive Income (Available-for-sale)	67,663	Fair value through other comprehensive income	67,663
Loans and advances to banks	Amortised cost (Loans and receivables)	69,911	Amortised cost	69,882
Loans and advances to customers	Amortised cost (Loans and receivables)	382,314	Amortised cost	381,101

Instruments which were previously classified as available-for-sale are now classified as measured at fair value through other comprehensive income (FVOCI) with no changes to their measurement basis.

There were no changes to the classification and measurement of financial liabilities.

b. Reconciliation of Statement of Financial Position balances from IAS 39 to IFRS 9

The Bank performed a detailed analysis of its business models for managing financial assets and their cash flow characteristics. Please refer to note 2.6 for more detailed information regarding the new classification requirements of IFRS 9.

The following table reconciles the carrying amounts of financial assets, from their previous measurement category in accordance with IAS 39 to their new measurement categories upon transition to IFRS 9 on 1 January 2018:

	IAS 39 CARRYING AMOUNT	REMEASUREMENTS	IFRS 9 CARRYING AMOUNT
	31 December 2017	(Expected credit loss allowances)	1 January 2018
	€000	€000	€000
Amortised cost			
Balances with Central Bank of Malta and cash	22,734	(25)	22,709
Cheques in course of collection	2,259	-	2,259
Loans and advances to banks	69,911	(29)	69,882
Loans and advances to customers	382,314	(1,213)	381,101
Total financial assets measured at amortised cost	**474,959**	**(1,267)**	**473,689**
FVOCI (2017: Available-for-sale)			
Investment securities	67,663	-	67,663
Total financial assets measured at FVOCI	**67,663**	**-**	**67,663**

The remeasurement loss of €1,267,000 relates to an expected credit loss allowance recognised in opening retained earnings on 1 January 2018 upon transition to IFRS 9. On 1 January 2018, the Bank also recognised an expected credit loss allowance of €239,000 on investment securities classified as FVOCI in opening retained earnings.

c. Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles the prior period's closing impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model at 1 January 2018:

	LOAN LOSS ALLOWANCE UNDER IAS 39/ PROVISIONS UNDER IAS 37	REMEASUREMENTS	LOAN LOSS ALLOWANCE UNDER IFRS 9
	€000	€000	€000
Loans and receivables (IAS 39)/ Financial assets at amortised cost (IFRS 9)			
Balances with Central Bank of Malta and cash	-	25	25
Cheques in course of collection	-	-	-
Loans and advances to banks	-	29	29
Loans and advances to customers	8,998	827	9,825
Total	**8,998**	**881**	**9,879**
Available-for-sale financial instruments (IAS 39)/ Financial assets at FVOCI (IFRS 9)			
Investment securities	-	239	239
Total	**-**	**239**	**239**
Loan commitments and financial guarantee contracts			
Loans and advances to customers			
• Loan commitments	52	264	316
• Financial guarantees	35	122	157
Total	**87**	**386**	**473**
Total allowance	**9,085**	**1,506**	**10,591**

Further information on the measurement of the impairment allowance under IFRS 9 can be found in note 3.2.4.

2.3. Standards, interpretations and amendments to published standards that are not yet adopted

Certain new standards, amendments and interpretations to existing standards which are mandatory for accounting periods beginning after 1 January 2019 have been published by the date of authorisation for issue of this financial information. The Bank's directors are of the opinion that, with the exception of the below, there are no requirements that will have a possible significant impact on the Bank's financial statements in the period of initial application.

IFRS 16 'Leases'

IFRS 16, 'Leases' is effective for annual periods beginning on or after 1 January 2019. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for a consideration. IFRS 16 requires lessees to recognise a lease liability reflecting future lease payments and a 'right-of-use' asset for virtually all lease contracts. The assets will be amortised over the length of the lease, and the financial liability measured at amortised cost. An optional exemption is available for certain short-term leases and leases of low-value assets. Lessor accounting remains substantially the same as under IAS 17.

At 1 January 2019, the Bank expects to adopt the standard using a modified retrospective approach where the cumulative effect of initial application is recognised as an adjustment to the opening balance of retained earnings and comparatives are not restated. The implementation is expected to increase assets and increase financial liabilities by the same amount with no effect on net assets or retained earnings. The Bank is still in the process of quantifying the impact of IFRS 16.

2.4. Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Board of Directors which is the Bank'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.

2.5. Foreign currency translation

2.5.1 Functional and presentation currency

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

2.5.2 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.

2.6. Financial assets

2.6.1 Initial recognition and measurement

The Bank 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 Bank commits to purchase or sell the asset. Accordingly, the Bank uses trade date accounting for regular way contracts when recording financial asset transactions.

At initial recognition, the Bank measures a financial asset at its fair value plus or minus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset, such as fees and commissions. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss. With effect from 1 January 2018, immediately after initial recognition, an expected credit loss allowance (ECL) is recognised for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, which results in an accounting loss being recognised in profit or loss when an asset is newly originated.

When the fair value of financial assets differs from the transaction price on initial recognition, the Bank recognises the difference as follows:

- When the fair value is evidenced by a quoted price in an active market for an identical asset (i.e. a Level 1 input) or based on a valuation technique that uses only data from observable markets, the difference is recognised as a gain or loss.
- In all other cases, the difference is deferred and the timing of recognition of deferred day one profit or loss is determined individually. It is either amortised over the life of the instrument, deferred until the instrument's fair value can be determined using market observable inputs, or realised through settlement.

2.6.2 Classification and subsequent measurement (applicable from 1 January 2018)

From 1 January 2018, the Bank has applied IFRS 9 and classifies its financial assets in the following measurement categories:

- Fair value through profit or loss (FVPL);
- Fair value through other comprehensive income (FVOCI); or
- Amortised cost.

The classification requirements for debt and equity investments are described below.

2.6.2.1 Debt Instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds and trade receivables purchased from clients in factoring arrangements without recourse.

With effect from 1 January 2018, classification and subsequent measurement of debt instruments depend on:

- the Bank's business model for managing the asset; and
- the cash flow characteristics of the asset.

Based on these factors, the Bank classifies its debt instruments into one of the following three measurement categories:

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI'), and that are not designated at FVPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in note 3.2.4. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.
- Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVPL, are measured at fair value through other comprehensive income (FVOCI). Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss within 'Gain on disposal of investments measured at FVOCI'. Interest income from these financial assets is included in 'Interest receivable and similar income' using the effective interest rate method.
- Fair value through profit or loss: Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognised in profit or loss and presented in the Income Statement within 'Net trading income' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately within 'Net investment income'. Interest income from these financial assets is included in 'Interest receivable and similar income' using the effective interest rate method.

The amortised cost is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability.

The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired ('POCI') financial assets - assets that are credit-impaired (see definition on note 3.2.4.2) at initial recognition - the Bank calculates the credit-adjusted effective interest rate, which is calculated based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

When the Bank revises the estimates of future cash flows, the carrying amount of the respective financial assets or financial liability is adjusted to reflect the new estimate discounted using the original effective interest rate. Any changes are recognised in profit or loss.

The Bank reclassifies debt instruments when and only when its business model for managing those assets changes. The reclassification takes place from the start of the first reporting period following the change. Such changes are expected to be very infrequent and none occurred during the period.

a. Business model

Key management personnel determine the Bank's business model by considering the way financial instruments are managed in order to generate cash flows. That is, whether the Bank's objective is solely to collect the contractual cash flows from the assets or to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVPL. Such assessment is performed at a 'portfolio level' as it best reflects the way the business is managed and information is provided to management. The information that will be considered in such assessment includes:

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

Financial assets that are held for trading and those that are managed and whose performance is evaluated on a fair value basis will be measured at FVPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. Securities held for trading are held principally for the purpose of selling in the near term or are part of a portfolio of financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.

The Bank may also irrevocably designate financial assets at fair value through profit or loss if doing so significantly reduces or eliminates a mismatch created by assets and liabilities being measured on different bases.

b. Cash flows that represent solely payments of principal and interest (SPPI)

In respect of assets where the intention of the business model is to hold the financial assets to collect the contractual cash flows or to hold to collect and to sell, the Bank assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the Bank considers whether the contractual cash flows are consistent with a basic lending agreement. 'Principal' is the fair value of the financial asset at initial recognition. It is not the amount that is due under the contractual terms of an instrument. 'Interest' is the compensation for time value of money and credit risk of a basic lending-type return. A basic lending-type return could also include consideration for other basic lending risks (for example, liquidity risk) and consideration for costs associated with holding the financial asset for a particular period of time (for example, servicing or administrative costs) and/or a profit margin. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Unlike the business model assessment, the SPPI assessment is performed for each individual product or portfolio of products. The following considerations are made when assessing consistency with SPPI:

- contingent events that would change the amount and timing of cash flows such as contractual term resetting interest to a higher amount in the event of a missed payment;
- leverage features, being contractual cash flow characteristics that increase the variability of the contractual cash flows with the result that they do not have economic characteristics of interest;
- contractual terms that allow the issuer to prepay (or the holder to put a debt instrument back to the issuer) before maturity and the prepayment amount substantially represents unpaid amounts of principal and interest, which may include reasonable compensation for early termination of the contract;
- contractual terms that allow the issuer or holder to extend the contractual term and the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest, which may include reasonable compensation for the extension of the contract; and
- features that modify consideration for the time value of money (for example, periodic reset of interest rates).

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payment of principal and interest.

2.6.2.2 Equity instruments

Equity instruments are instruments that meet the definition of equity from the issuer's perspective; that is, instruments that do not contain a contractual obligation to pay and that evidence a residual interest in the issuer's net assets. Examples of equity instruments include basic ordinary shares.

The Bank subsequently measures all equity investments at fair value through profit or loss, except where the Bank's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Bank's policy is to designate equity investments at FVOCI when those investments are held for purposes other than to generate investment returns. This election is made on investment-by-investment basis. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss, including on disposal.

Impairment losses (and reversal of impairment losses) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in profit or loss as other income when the Bank's right to receive payments is established.

Gains and losses on equity investments at FVPL are included in the 'Net trading income' line in the Income Statement.

2.6.2.3 Classification and measurement under IAS 39 (applicable until 31 December 2017)

Until 31 December 2017, the Bank classified its financial assets in the following categories: at fair value through profit or loss, loans and receivables, and available-for-sale investments. The classification depends on the purpose for which the financial assets were acquired. Management determined the classification of its financial assets at initial recognition.

a. Financial assets at fair value through profit or loss

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

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

Derivatives were also categorised as held for trading unless they were designated and effective as hedging instruments.

Financial instruments included in this category were recognised initially at fair value; transaction costs were taken directly to profit or loss. Gains and losses arising from changes in fair value were included directly in profit or loss and are reported as part of 'net trading income'. Interest income and dividend income on financial assets held for trading are also included in 'net trading income'.

The Bank may have designated certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation was not subsequently changed. According to IAS 39, the fair value option was 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.

b. Loans and receivables

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

- those that the Bank intends to sell immediately or in the short term, which are classified as held for trading, and those that the Bank upon initial recognition designates as at FVPL;
- those that the Bank 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 arose when the Bank provided money, goods or services directly to a debtor with no intention of trading the asset. Loans and receivables mainly consisted of balances with Central Bank of Malta, loans and advances to banks and customers, other debt securities classified as loans and receivables together with other assets.

Loans and receivables were 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 was 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 was included in profit or loss and was reported as 'Interest receivable and similar income'. In the case of an impairment, the impairment loss was reported as a deduction from the carrying value of the loan and receivable and recognised in profit or loss as 'credit impairment losses'.

c. Available-for-sale investments

Available-for-sale investments were financial assets that were 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 were not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

Available-for-sale financial assets were 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 was derecognised. If an available-for-sale financial asset was determined to be impaired, the cumulative gain or loss previously recognised in other comprehensive income was reclassified to profit or loss.

Interest income was calculated using the effective interest method, and was 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 were 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 were recognised in profit or loss, and other changes in carrying amount were recognised in other comprehensive income. Dividends on available-for-sale equity instruments were recognised in profit or loss in 'dividend income' when the Bank's right to receive payment was established.

The fair values of quoted investments were based on current bid prices. If the market for a financial asset was not active (and for unlisted securities), the Bank established fair value by using valuation techniques. These included the use of recent arm's length transactions, reference to other instruments that were 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.

2.6.3 Impairment of financial assets

2.6.3.1 Applicable from 1 January 2018

The Bank assesses on a forward-looking basis the expected credit losses ('ECL') associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Bank recognises a loss allowance for expected credit losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Note 3.2.4 provides more detail of how the expected credit loss allowance is measured.

Expected credit loss allowances are presented in the Statement of Financial Position as follows:

- Financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- Loan commitments and financial guarantee contracts: generally, as a provision;
- Financial Instrument with both a drawn and undrawn component, whereby the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components, as a deduction from the gross carrying amount of the drawn component; and
- Debt instruments measured at FVOCI: no loss allowance is recognised in the Statement of Financial position against the carrying amount of the asset because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve, i.e. presented within other comprehensive income.

2.6.3.2 Applicable until 31 December 2017

a. Assets carried at amortised cost

The Bank assessed at each reporting date whether there was objective evidence that a financial asset or group of financial assets was impaired. A financial asset or a group of financial assets was impaired and expected losses were incurred only if there was 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) had an impact on the estimated future cash flows of the financial asset or group of financial assets that could be reliably estimated.

The criteria that the Bank used to determine that there was 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 was 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 could not 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 was determined by management for each identified portfolio. In general, the periods used vary between three months and twelve months; in exceptional cases, longer periods were warranted.

The Bank first assessed whether objective evidence of impairment existed individually for financial assets that were individually significant, and individually or collectively for financial assets that were not individually significant. If the Bank determined that no objective evidence of impairment existed for an individually assessed financial asset, whether significant or not, it included the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that were individually assessed for impairment and for which an impairment loss was or continued to be recognised were not included in a collective assessment of impairment.

The amount of the loss was measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that had not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset was reduced through the use of an allowance account and the amount of the loss was recognised in profit or loss. If a loan or held-to-maturity investment had a variable interest rate, the discount rate for measuring any impairment loss was the current effective interest rate determined under the contract.

As a practical expedient, the Bank 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 reflected the cash flows that could result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure was probable.

For the purposes of a collective evaluation of impairment, financial assets were grouped on the basis of similar credit risk characteristics (i.e., on the basis of the Bank's grading process that considers asset type, collateral type, past-due status and other relevant factors). Those characteristics were 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 were collectively evaluated for impairment were 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 Bank. Historical loss experience was 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 was based and to remove the effects of conditions in the historical period that did not currently exist.

Estimates of changes in future cash flows for groups of assets were reflected 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 were reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreased and the decrease was 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 was reversed by adjusting the allowance account. The amount of the reversal was recognised in profit or loss.

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

Forborne loans

A forborne loan was categorised as impaired when:

- there had been a change in contractual cash flows as a result of a concession which the Bank would otherwise not consider; and
- it was 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 were treated as impaired where the customer was experiencing, or was very likely to experience, difficulty in meeting a payment obligation to the Bank (i.e. due to current credit distress) and the Bank was 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 were typically assessed for impairment individually. The individual impairment assessment took into account the higher risk of the non-payment of future cash flows inherent in forborne loans. Loans subject to individual impairment assessment, which had been subject to a forbearance measure, were subject to ongoing review to determine whether they remained impaired.

Loans subject to collective impairment assessment which had been subject to a forbearance measure were 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 indicated an increased propensity to default and higher losses on such accounts; these factors were taken into account when calculating impairment allowances. A basic formulaic approach based on historical loss rate experience was used by the Bank. When the Bank considered that there were additional risk factors inherent in the portfolio that may not be fully reflected in the historical experience, these risk factors were taken into account by adjusting the impairment allowances derived solely from historical experience.

The forborne loan was disclosed as impaired until there was sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, and there were no other indicators of impairment. For loans that were assessed for impairment on a collective basis, the evidence typically included a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that were assessed for impairment on an individual basis, all available evidence was assessed on a case-by-case basis. The minimum period of payment performance required depended on the nature of the loan in the portfolio, but was not less than twelve months. The period of performance varied 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 was considered to have improved. Forborne loans were not returned to a non-impaired grade when a specific impairment allowance remained against any of the customer's credit facilities.

Forborne loans were not classified as impaired where the forbearance had resulted from significant concern about a borrower's ability to meet their contractual payment terms but the modified terms were based on current market rates and contractual cash flows were expected to be collected in full following the renegotiation. Non-impaired forborne loans also included 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 retained this designation until payment performance had been observed for an extended period of time. When principal payments were modified resulting in permanent forgiveness, or when it was otherwise considered that there was no longer a realistic prospect of recovery of outstanding principal, the affected balances were written off.

A loan that was subject to forbearance measures was derecognised if the existing agreement was cancelled and a new agreement made on substantially different terms, or if the terms of an existing agreement were modified, such that the renegotiated loan was substantially a different financial instrument. When determining whether a loan that was restructured should be derecognised and a new loan recognised, the Bank considered the extent to which the changes to the original contractual terms resulted in the renegotiated loan, considered as a whole, being a substantially different financial instrument.

Circumstances that were likely to result in this test being met and derecognition accounting being applied comprised modified terms under the new or modified contract that were substantially different from those under the original contract.

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

b. Assets classified as available-for-sale

The Bank assessed at each reporting date whether there was objective evidence that a financial asset or a group of financial assets was impaired taking cognisance of the criteria referred to in 2.6.3.2 (a).

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 existed 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 – was removed from equity and recognised in profit or loss. Impairment losses recognised in profit or loss on equity instruments were not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increased and the increase objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss was 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 had considered the fact that its available-for-sale equity instruments comprised a limited number of investments.

2.6.4 Modification of loans and advances to customers

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

The Bank renegotiates loans and advances to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms, and the debtor is expected to be able to meet the revised terms. The revised terms usually include extending the maturity, revision of interest rate and changing the timing of interest payments. Both retail and corporate loans are subject to the forbearance policy.

When modification happens, the Bank assesses whether or not the new terms are substantially different to the original terms. The Bank does this by considering, among others, the following factors:

- If the borrower is in financial difficulty, whether the modification merely reduces the contractual cash flows to amounts the borrower is expected to be able to pay.
- Whether any substantial new terms are introduced.
- Significant extension of the loan term when the borrower is not in financial difficulty.
- Significant change in the interest rate.
- Insertion of collateral, other security or credit enhancements that significantly affect the credit risk associated with the loan.

If the terms are substantially different, the Bank derecognises the original financial asset and recognises a 'new' asset at fair value, and recalculates a new effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a significant increase in credit risk has occurred. However, the Bank also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Bank recalculates the gross carrying amount based on the revised cash flows of the financial asset and recognises a modification gain or loss in profit or loss.

The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets). The impact of modifications of financial assets on the expected credit loss calculation is discussed in note 3.2.11.

2.6.5 Derecognition of financial assets (other than on a modification)

Financial assets, or a portion thereof, are derecognised when the contractual rights to receive the cash flows from the assets have expired, or when they have been transferred and either (i) the Bank transfers substantially all the risks and rewards of ownership, or (ii) the Bank neither transfers nor retains substantially all the risks and rewards of ownership and the Bank has not retained control.

2.7. Derivative financial instruments

The Bank deploys no hedging strategies that achieve hedge accounting in terms of IAS 39.

Derivative financial instruments, such as cross-currency swaps and forward foreign exchange contracts 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.

The Bank uses derivatives such as cross currency swaps and forward foreign exchange contracts.

2.8. Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the 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.

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 Bank 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.

2.9. Property and equipment

All property and equipment used by the Bank 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 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 to their residual values over their estimated useful lives, as follows:

	YEARS
Land and Buildings	
- Freehold	20-50
- Leasehold	10
Computer Equipment	4
Other Equipment	3-10

The asset's residual value, useful life and method are reviewed, and adjusted if appropriate, at each financial period end. Changes in the expected useful life are accounted for by changing the depreciation period or method, as appropriate, and treated as changes in accounting estimates.

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 2.11).

Property and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period the asset is derecognised.

2.10. Intangible assets

Intangible assets consist of computer software and other intangibles, which include licences. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at each financial period end.

Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates.

The amortisation expense on intangible assets with finite lives is recognised in the Income Statement in the expense category consistent with the function of the intangible asset. Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual values over their estimated useful lives. Computer software is amortised over 4 and 6 years.

Intangible assets with indefinite useful lives are not amortised, but are tested for impairment annually either individually or at the cash generating unit level. The assessment of indefinite life is reviewed annually to determine whether the indefinite life continues to be supportable. If not, the change in useful life from indefinite to finite is made on a prospective basis. Other intangibles are assessed as having an indefinite useful life.

2.11. 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.

2.12. Property acquired through judicial action

In certain circumstances, property is acquired by the Bank in satisfaction of debt following judicial action. Such properties are measured at the lower of carrying amount and fair value less costs to sell.

2.13. Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively. The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the 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 Bank 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.

2.14. 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.

2.15. Additional Tier 1 capital securities

Perpetual capital notes which qualify as Additional Tier 1 capital instruments are undated and subordinated obligations on which coupon payments may be cancellable at the Bank's discretion and are accounted for as equity in the Statement of Financial Position.

2.16. Financial liabilities

2.16.1 Initial recognition and measurement

The Bank recognises a financial liability on its Statement of Financial Position when it becomes a party to the contractual provisions of the instrument. 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.

2.16.2 Classification and subsequent measurement (applicable from 1 January 2018)

Financial liabilities are classified as subsequently measured at amortised cost, except for:

- Financial liabilities at fair value through profit or loss: this classification is applied to derivatives, financial liabilities held for trading (e.g. short positions in the trading booking) and other financial liabilities designated as such at initial recognition. Gains or losses on financial liabilities designated at fair value through profit or loss are presented partially in other comprehensive income (the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability, which is determined as the amount that is not attributable to changes in market conditions that give rise to market risk) and partially profit or loss (the remaining amount of change in the fair value of the liability). This is unless such a presentation would create, or enlarge, an accounting mismatch, in which case the gains and losses attributable to changes in the credit risk of the liability are also presented in profit or loss;
- Financial liabilities arising from the transfer of financial assets which did not qualify for derecognition, whereby a financial liability is recognised for the consideration received for the transfer. In subsequent periods, the Bank recognises any expense incurred on the financial liability; and
- Financial guarantee contracts and loan commitments (see note 2.24).

Financial liabilities measured at amortised cost comprise principally amounts owed to banks, amounts owed to customers, debt securities in issue together with other liabilities.

2.16.3 Classification and subsequent measurement (applicable until 31 December 2017)

The Bank's financial liabilities were classified as financial liabilities which were not at fair value through profit or loss (classified as 'Other liabilities') under IAS 39. These liabilities were subsequently measured at amortised cost.

2.16.4 Derecognition

The Bank 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.

The exchange between the Bank and its original lenders of debt instruments with substantially different terms, as well as substantial modifications of the terms of existing financial liabilities, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. In addition, other qualitative factors, such as the currency that the instrument is denominated in, changes in the type of interest rate, new conversion features attached to the instrument and change in covenants are also taken into consideration. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.

2.17. Repurchase and reverse repurchase agreements

Securities sold under agreements to repurchase at a specified future date are not derecognised from the Statement of Financial Position as the Bank retains substantially all of the risks and rewards of ownership. The corresponding cash received is recognised in the Statement of Financial Position as an asset with a corresponding obligation to return it, including accrued interest as a liability, reflecting the transaction's economic substance as a loan to the Bank. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of agreement using the effective interest rate.

When the counterparty has the right to sell or repledge the securities, the Bank reclassifies those securities in its Statement of Financial Position to financial assets held for trading pledged as collateral or to financial investments available-for-sale pledged as collateral, as appropriate.

Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the Statement of Financial Position. The consideration paid, including accrued interest, is recorded in the Statement of Financial Position, reflecting the transaction's economic substance as a loan by the Bank. The difference between the purchase and resale prices is recorded in net interest income and is accrued over the life of the agreement using the effective interest rate.

If securities purchased under agreement to resell are subsequently sold to third parties, the obligation to return the securities is recorded as a short sale within financial liabilities held for trading and measured at fair value with any gains or losses included in net trading income.

2.18. 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. Trade and other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.19. Provisions for legal and other claims

Provisions for legal and other claims are recognised when the Bank 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.

2.20. Provisions for pension obligations

The Bank contributes towards the government pension defined contribution plan in accordance with local legislation and to which it has no commitment beyond the payment of fixed contributions. These obligations are recognised as an expense in the Income Statement as they accrue. The Bank does not contribute towards any other retirement benefit plans.

2.21. 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.

2.21.1 Applicable from 1 January 2018

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset (i.e. its amortised cost before any impairment allowance) or to the amortised cost of a financial liability.

The calculation does not consider expected credit losses and includes transaction costs, premiums or discounts and fees and points paid or received that are integral to the effective interest rate, such as origination fees. For purchased or originated credit-impaired ('POCI') financial assets - assets that are credit-impaired (see definition on note 3.2.4.2) at initial recognition - the Bank calculates the credit-adjusted effective interest rate, which is based on the amortised cost of the financial asset instead of its gross carrying amount and incorporates the impact of expected credit losses in estimated future cash flows.

Interest income is calculated by applying the effective interest rate to the gross carrying amount of financial assets, except for:

- POCI financial assets, for which the original credit-adjusted effective interest rate is applied to the amortised cost of the financial asset;
- Financial assets that are not 'POCI' but have subsequently become credit-impaired (or 'stage 3'), for which interest revenue is calculated by applying the effective interest rate to their amortised cost (i.e. net of the expected credit loss provision).

2.21.2 Applicable until 31 December 2017

The effective interest rate was the rate that discounted 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 Bank estimated cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but did not consider future credit losses. The calculation included all fees and points paid or received between parties to the contract that were 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 had been written down as a result of an impairment loss, interest income was recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

2.22. Fees and commissions

Fees and commissions 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.

Fees and commissions income, comprising account servicing fees, investment management fees, placement fees and other similar fees, are recognised as the related services are performed. Loan commitment 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. Fees and commissions expense, relating mainly to transaction and service fees, are expensed as the services are received.

2.23. Dividend income

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

2.24. Net trading income

The line item includes fair value changes, interest, dividends and foreign exchange differences attributable to financial instruments measured at FVPL. Net income from derivatives (such as cross-currency swaps and forward exchange contracts) is included within this line item.

2.25. Leases

The determination of whether an arrangement is a lease, or it contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

2.25.1 Bank 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.

2.26. Financial guarantee contracts and loan commitments

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.

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances.

2.26.1 Applicable from 1 January 2018

Financial guarantee contracts are initially measured at fair value and subsequently measured at higher of:

- The amount of the loss allowance (calculated as described in note 3.2.4); and
- The premium received on initial recognition less income recognised in accordance with the principles of IFRS 15.

'Loan commitments' are the Bank's commitments to provide credit under pre-specified terms and conditions, and are measured as the amount of the loss allowance (calculated as described in note 3.2.4).

For loan commitments and financial guarantee contracts, the loss allowance is recognised as a provision. However, for contracts that include both a loan and an undrawn commitment and the Bank cannot separately identify the expected credit losses on the undrawn commitment component from those on the loan component, the expected credit losses on the undrawn commitment are recognised together with the loss allowance for the loan. To the extent that the combined expected credit losses exceed the gross carrying amount of the loan, the expected credit losses are recognised as a provision.

2.26.2 Applicable until 31 December 2017

Financial guarantees were 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 was zero because all guarantees were 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 was recognised. Subsequent to initial recognition, the Bank's liabilities under such guarantees were 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 were determined based on experience of similar transactions and history of past losses, supplemented by the judgement of management. The premium received was recognised in the Income Statement in 'Fees and commission income' on a straight line basis over the life of the guarantee. Any increase in the liability relating to guarantees was recognised in profit or loss.

2.27. 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.

2.28. Dividend distribution

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

3. FINANCIAL RISK MANAGEMENT

3.1. Introduction

3.1.1 Preamble

The Bank's business involves taking on risks in a targeted manner and managing them professionally. 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 untimely or non repayment of existing and contingent obligations by the Bank's counterparties, resulting in the loss of equity and profit. It is the risk that deterioration in the financial condition of a borrower would 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: The 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 arises from:
  - Market (product) liquidity risk: risk of losses arising from the inability to easily offset or eliminate a position without significantly affecting the market price because of inadequate market depth or market disruption; and
  - 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 and the inadequacy of 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 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 risk practices. The Bank's aim is to achieve an appropriate balance between risk and return and minimise potential adverse effects on the Bank's financial performance.

The Bank considers risk management a top priority. It aims to manage all major types of risk by applying methods that meet best practice, and considers it important to have a clear distribution of responsibilities within the area of risk management. One of the main tasks of the Bank's Board is to set the framework for this area. 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 entity. The Bank's internal risk management processes support this objective.

Risk management within the Bank is mainly carried out on a unified basis, using an integrated and entity-wide framework. This framework is based on local and international guidelines, such as the Basel III Accord, corresponding Directives and Regulations of the European Union, including technical standards, as well as contemporary international banking practices.

3.1.2 Organisation

The Bank has an appropriate organisational structure for planning, executing, controlling and monitoring business operations in order to achieve Bank objectives. The Board of Directors assumes responsibility for ensuring that significant business risks are identified and appropriately managed.

The Board is responsible for setting out the overall risk policies and limits for all material risk types of the Bank. It provides written principles for overall risk management and approves policies covering specific areas.

The Board is also responsible for calibrating the Bank's risk appetite. The risk appetite represents the level of risk that the Bank is prepared to accept while pursuing its business strategy, recognising a range of possible outcomes as business plans are implemented. Thus, risk appetite sets the 'tone from the top' and provides a basis for ongoing dialogue between the Bank's management and Board with respect to the Bank's current and evolving risk profile, allowing strategic and financial decisions to be made on an informed basis. In deciding the level of risk the Bank is willing to accept, the Bank takes into consideration the following:

- Risk Culture: risk management principles which should be followed in line with internal governance responsibilities and processes;
- Risk Appetite and Tolerance: the risk profile and the risk level the Bank will be considering as acceptable;
- Risk Methodology: risk taxonomy for the Bank, as well as quantitative and qualitative approaches used for each risk; and
- Capital Planning: capital requirements with respect to the level of risk the Bank has considered as acceptable.

The Bank 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 Committee, are kept informed on an ongoing basis of developments in the asset portfolio, such matters as non-performing loans and other relevant information.

The Bank's Board of Directors is also responsible for ensuring that adequate processes and procedures exist to ensure effective internal control systems. 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.

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 and operations in the Executive Committee, which is made up of the Chief Executive Officer and the other Chief Officers, in order to ensure effective communication between the Board and the Executive Committee. The Board has also delegated its responsibilities of reviewing processes and procedures on the effectiveness of the Bank's system of internal control to the Audit Committee, the Risk Committee, the Compensation Committee and Nomination Committee, and the Credit Approval Committee. The Risk Committee also ensures the implementation of the Board's risk strategy by management.

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 Board is responsible for the Bank's overall risk appetite, risk tolerance and risk management framework, taking into consideration current and prospective macroeconomic and financial environment, and drawing on financial stability assessments such as those published by local regulatory authorities or other authoritative sources that may be relevant for the Bank's risk policies.

3.2. Credit Risk

3.2.1 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 mainly arises from interbank, commercial and consumer loans and advances, loan commitments arising from such lending activities, and credit enhancement provided, such as financial guarantees, documentary credits, endorsements and acceptances.

The Bank is also exposed to other credit risks arising from amounts due from banks, investments in debt securities and derivatives as well as settlement balances with market counterparties.

Credit risk is the single largest financial risk for the Bank's business. In this regard, as part of the second line of defence function, management set up the risk function, which is responsible for various elements of credit risk. Such structure comprises two fully independent and segregated units, namely:

i. Credit Analysis Unit: responsible for Credit risk management activities by way of analysis of credit requests, implementation of credit policies, and participation in credit committees where credit decisions are taken by consensus; and

ii. Risk Control & Oversight Unit: responsible for Credit, concentration, and correlation risk control and oversight activities without any active participation in credit decisions to maintain a detached approach. The function is also responsible for the maintenance of credit policies, risk models, metrics, tools, and reporting on adherence or otherwise to Bank's Risk Appetite Framework on credit and other risks.

The above mentioned functions, report to the Chief Risk Officer (CRO) who also forms part of the Bank's Executive Committee. In terms of the organizational macrostructure, the CRO also has a duty to report inter-alia to the Risk Committee and the Audit Committee.

Credit decisions are taken consensually within credit committees where, at each discretionary level, the risk function is represented. Furthermore, the Board of Directors also delegated oversight functions related to credit risk to a number of Board committees, such as the Credit Approval Committee, the Audit Committee and the Risk Committee.

3.2.2 Credit risk management

Lending decisions should achieve a reasonable balance between the risks and returns of extending credit to a customer. The Bank has a credit authorisation structure, made up of four physical credit committee levels; ranging from Level 1, which includes authorisation by a Branch Manager, an Area Manager/Head of Unit and an officer from the Credit Analysis Unit within the Internal Control Department to the highest level, being Level 4, at which the Executive Committee is in place. Each credit committee level is assigned a sanctioning limit, under which it can operate within specific guidelines. Within its discretionary limit, a credit committee can approve new credit, increase, reduce or otherwise amend the terms and conditions of existing facilities and simply renew existing facilities without altering the terms and conditions of sanction. A credit committee has the onus to ensure that the facility carries acceptable credit risk and meets credit rating requirements. Lending is not based on the existence of collateral but on the customer's perceived ability to repay the exposure from the primary repayment source.

At the same time, the existence of security acts as a fall back option available in case of need. The Bank makes sure that the security held is perfected. Facilities are generally adequately secured either by cash, financial assets, property and/or guarantees. The Bank maintains the necessary procedures to ensure the perfection of security. Facilities are generally reviewed periodically. In a facility review, the Bank makes an analysis of a number of factors such as: the customer profile, the credit quality, non-financial considerations, adherence to internal policies and procedures and the present and future profitability of the relationship.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has in place, three credit policies relating to personal credit, business credit and credit risk mitigation, which enhance its sound internal control mechanism.

The Bank rigorously applies a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular revisions to collateral.

In addition, exposures which are still technically performing but exhibit early signs of deterioration (i.e. past due below 90 days and/or other early warning signals), are separately analysed on a monthly basis by the Risk Control and Oversight Unit in liaison with the business units. This results in prompt revision of individual risk rating, more up-to-date expected loss quantification (provisioning process) and further instigates early corrective action (before the financial assets transit to Doubtful status).

3.2.3 Credit risk measurement

The measurement of credit exposure for risk management purposes considers that an exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Bank measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9. Refer to note 3.2.4 for more details.

a. Loans and advances to customers

The Bank uses internal credit risk gradings (note 3.2.8) to reflect its assessment of the probability of default of individual counterparties. Internal credit risk gradings are based on payment behaviour, loan specific information and expert judgement.

Information considered by the Bank when determining the internal credit risk grades includes the payment behaviour of the borrower and other information about borrowers which impact their creditworthiness, including level of income and/or financial performance.

The internal credit risk gradings are calibrated such that the risk of default increases exponentially at each higher risk grade. For example, this means that the difference in the probability of default between an A2 and A3 rating grade is lower than the difference in the probability of default between a B and C rating grade.

Corporate

For corporate business, the rating is determined at the borrower level. A Bank official will incorporate any updated or new information/credit assessments into the Bank's credit system on an ongoing basis. In addition, a Bank's official will also update information about the creditworthiness of the borrower from sources such as financial statements.

The creditworthiness of the borrower is considered in every periodic review - normally every six months; by exception on a yearly basis. This will determine the updated internal credit risk grading.

Retail

After the date of initial recognition, for retail business, the payment behaviour of the borrower is monitored on an ongoing basis. Any other known information about the borrower which impacts their creditworthiness - such as unemployment and previous delinquency history - is also captured.

b. Other financial assets

Other financial assets include Balances with Central Bank of Malta, investments and loans and advances to banks. The Bank uses external risk grades to reflect its assessment of the probability of default of individual counterparties. These published grades are continuously monitored and updated. The PDs associated with each grade are determined based on realized default rates over the prior 12 months, as published by the rating agency.

In determining the probability of default of individual counterparties, the Bank distinguishes between exposures considered 'investment-grade' defined by recognized external rating agencies as a rating between AAA-BBB- (Standard & Poor's, Fitch) and Aaa-Baa3 (Moody's), and 'non-investment grade' exposures.

3.2.4 Expected credit loss measurement

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

- A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Bank;
- If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit - impaired. Please refer to note 3.2.4.1 for a description of how the Bank determines when a significant increase in credit risk has occurred;
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 3.2.4.2 for a description of how the Bank defines credit-impaired and default;
- Financial instruments in 'Stage 1' have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in 'Stage 2' or 'Stage 3' have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 3.2.4.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL;
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward looking information. Note 3.2.4.4 includes an explanation of how the Bank has incorporated this in its ECL models; and
- Purchased or originated credit-impaired financial assets are those financial assets that are credit impaired on initial recognition. Their ECL is always measured on a lifetime basis ('Stage 3').

Further explanation is also provided of how the Bank determines appropriate groupings of loans and advances to customers for ECL measurement (refer to note 3.2.4.5).

The expected credit loss requirements apply to financial assets measured at amortised cost and FVOCI, and certain loan commitments and financial guarantee contracts. At initial recognition, an impairment allowance (or provision in the case of commitments and guarantees) is required for ECL resulting from default events that are possible within the next 12 months ("12-month ECL"). In the event of a significant increase in credit risk, an allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ("lifetime ECL").

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

The following diagram summarises the impairment requirements under IFRS 9 (other than purchased or originated credit-impaired financial assets):

Change in credit quality since initial recognition

'Stage 1'	'Stage 2'	'Stage 3'
(Initial recognition)	(Significant increase in credit risk since initial recognition)	(Credit impaired assets)
12-month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses

3.2.4.1 Significant increase in credit risk (SICR)

To determine whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information. Such analysis is based on the Bank's historical experience, credit assessment and forward-looking information.

The Bank primarily identifies whether a SICR has occurred for an exposure within the loans and advances to customers, through the Bank's internal risk gradings. The Bank allocates each exposure to an internal rating grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. These factors vary depending on the nature of the exposure and the type of borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different internal rating grade. The Bank identifies SICR and classifies non-defaulted exposures into 'Stage 2', which fulfil at least one of the following conditions:

i. the exposure is considered forborne;

ii. the credit quality of any other exposure(s) of the same customer is/are not considered 'regular' (except where otherwise stated in the Bank's Credit Policy e.g. cash covered facilities); and

iii. the borrower's internal rating grade is not considered 'high-grade', as defined in note 3.2.8.

The monitoring typically involves use of the following data:

CORPORATE EXPOSURES

- Information obtained during periodic review of customer files – e.g. audited financial statements, management accounts, budgets and projections. Examples of areas of particular focus are: gross profit margins, financial leverage ratios, debt service coverage, compliance with contractual conditions, quality of management and senior management changes.
- Data from credit reference agencies, press articles
- Actual and expected significant changes in the political, regulatory and technological environment of the borrower or in its business activities

RETAIL EXPOSURES

- Internally collected data on customer behaviour – e.g. utilisation of credit card facilities
- Affordability metrics
- External data from credit reference agencies including industry-standard credit scores

ALL EXPOSURES

- Payment record – this includes overdue status as well as a range of variables about payment ratios
- Utilization of the granted limit
- Requests for and granting of forbearance
- Existing and forecast changes in business, financial and economic conditions

The assessment of SICR incorporates forward-looking information (refer to note 3.2.4.4 for further information) and is performed at the counterparty level and on a periodic basis. The criteria used to identify SICR are monitored and reviewed periodically for appropriateness by the independent Credit Risk team.

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

In the case of other financial assets (including loans and advances to banks and investments in debt securities), the Bank applies the low credit risk simplification to all its exposures considered 'investment-grade', thus they are not subject to the SICR assessment. Moving from 'investment-grade' to 'non-investment grade' does not automatically mean that there has been a SICR.

3.2.4.2 Definition of default and credit-impaired assets

The Bank's assessment to determine the extent of increase in credit risk of a financial instrument since initial recognition is performed by considering the change in the risk of default occurring over the remaining life of the financial instrument. As a result, the definition of default is important.

The Bank applies the definition of default in a consistent manner with internal credit risk management practice for the relevant instruments and the definition considers qualitative and quantitative factors where appropriate.

The Bank defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the criteria below.

The Bank determines that a financial instrument is credit-impaired (or in default and accordingly stage 3 for IFRS 9 purposes) by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days for any material credit obligations to the Bank;
- there are other indicators that the borrower is unlikely to pay, such as that a concession has been granted to the borrower for economic or legal reasons of an enduring nature relating to the borrower's financial condition (unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty); and
- the loan is otherwise considered to be in default.

If unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due.

Therefore, the definitions of credit-impaired and default are aligned so that stage 3 represents all loans which are considered defaulted or credit-impaired.

In assessing whether a borrower is in default, the Bank will consider indicators that are:

- qualitative – such as non-adherence to terms and conditions of sanction and/or other breaches of covenant;
- quantitative – such as overdue status and non-payment of another obligation of the same obligor to the Bank; and
- based on data developed internally and obtained from external sources.

The default definition has been applied consistently to model the probability of default (PD), exposure at default (EAD) and Loss Given Default (LGD) throughout the Bank's expected loss calculations.

Except for forborne exposures, an instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of three months. This period has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

In the case of forborne exposures, the cure period comprises 12 consecutive monthly repayments made in a timely manner with a minimal grace period of one day (i.e. one or more repayments may be made no more than one day late).

The Bank considers other financial assets to be in default when a payment due including a coupon payment is not effected.

3.2.4.3 Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The Expected Credit Loss (ECL) is measured on either a 12-month (12M) or on a lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit impaired. Expected credit losses are the discounted product of the PD, EAD and LGD.

The ECL is determined by projecting the PD, LGD and EAD for each future month and for each individual exposure. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier month). This effectively calculates an ECL for each future month, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated on a similar basis for the residual life of the exposure.

The PD, EAD and LGD parameters are derived from internally developed statistical models and other historical data, adjusted to reflect forward-looking information as described below.

The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of default and credit-impaired assets" above), either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation. Accordingly, the 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument, respectively.

PD estimates are estimates at a certain date, which, for the loans and advances to customers, are calculated based on statistical rating models and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models are based on internally-compiled data comprising both quantitative and qualitative factors. With respect to the retail portfolio (including mortgages, credit cards and other consumer credit facilities), the PD calculation is based on fitting theoretical distribution to historical default rates in particular periods after origination ('months on book') for each homogeneous portfolio, to produce term structure of point-in-time PD. In the case of the corporate portfolio (as defined in note 3.2.4.5), the PD calculation is based on a transition matrix approach. The main assumptions underlying such approach is that the PD does not depend on 'months on book' and that the future PD depends only on current characteristics of the exposure or borrower. Default is considered to be an absorbing state, whereby if an exposure is defaulted, it remains in this state during all next years. Market data is used for the PD of loans and advances to banks and investment securities. If a counterparty or exposure migrates between internal rating grades or external credit ratings, then this will lead to a change in the associated PD.

The Lifetime PD is developed as follows:

- Retail portfolio: Obtaining an average PD profile for homogenous groups by fitting a parametric distribution to the Bank's historical default rates. Homogenous grouping is based on similar months on book, days past due and internal ratings. The average PD profile is adjusted to consider forward-looking information through macroeconomic modelling.
- Corporate portfolio: Obtaining a transition matrix which shows the probability of a borrower's transition from one internal rating class to another (or staying in the same class) within a given horizon, raised to a particular power. The conditional PD is adjusted to consider forward-looking information through macroeconomic modelling.

EAD represents the expected exposure in the event of a default (including any expected drawdowns of committed facilities). The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract including amortisation. The EAD of a financial asset is the gross carrying amount at default.

The 12-month and lifetime EADs are determined based on the expected payment profile, which varies by product type:

- For amortising products and bullet repayment loans, this is based on the contractual repayments owed by the borrower over a 12 month or lifetime basis;
- For revolving products, the exposure at default is predicted by taking current drawn balance and adding a "credit conversion factor" which allows for the expected drawdown of the remaining limit by the time of default. These assumptions vary by product type and current limit utilisation band, based on analysis of the Bank's recent default data.

Loss Given Default (LGD) represents the Bank's expectation of the extent of loss on a defaulted exposure. Hence, the LGD represents expected credit losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money. The 12 month and lifetime LGD are determined based on the factors which impact the recoveries made post default.

For secured products, this is primarily based on collateral type and projected collateral values, historical discounts to market/book values due to forced sales, time to repossession and recovery costs observed. The LGD for exposures secured by real estate will be derived from the adjusted loan-to value ratio of the individual facilities, and takes into account the expected recovery by applying the haircuts for the cost to sell the property together with the sales ratio and the sales ratio volatility, and by discounting (using the effective interest rate or an approximation thereof) the updated market value of the property after haircuts, over a period of time equivalent to the projected time to sell. The sales ratio resembles a market value haircut while the sales ratio volatility captures the standard deviation of the sales ratio. The LGD for other exposures will be based on the Bank's projected risk on the collateral. For unsecured products, LGD's are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers. These LGD's are influenced by collective strategies.

The ECL is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the Bank is exposed to credit risk. With respect to non-revolving credit facilities, the contractual life of the facility is considered. In the case of revolving credit facilities, provided that such facilities do not have a fixed term or repayment structure, the Bank considers the lifetime of such exposures to be 6 months, in cases where the next substantive credit review is within the next 6 months. Otherwise, for the purpose of measuring ECL, the Bank considers a lifetime of 12 months. In cases of revolving credit facilities that are considered 'High-grade' in line with the Bank's internal credit policies and procedures, the lifetime of such assets may be longer than 12 months. For the credit cards portfolio, the Bank considers a lifetime of 36 months.

Forward-looking economic information is also included in determining the 12-month and lifetime PD and LGD. Refer to note 3.2.4.4 for an explanation of forward-looking information and its inclusion in ECL calculations.

The assumptions underlying the ECL calculations are monitored and reviewed on a regular basis.

There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

3.2.4.4 Forward-looking information incorporated in the ECL model

The calculation of ECL incorporates forward-looking information. The Bank performs a historical analysis to identify the key economic variables affecting credit risk and expected credit losses for each portfolio. These economic variables and their associated impact on the PD, EAD and LGD may vary by portfolio.

In this respect, the Bank has identified key drivers of credit risk and credit losses for each portfolio of financial instruments and using an analysis of historical data, has analysed relationships between macro-economic variables, credit risk and credit losses. These key drivers include the Real Gross Domestic Product (GDP), the Gross Fixed Capital Formation (GFCF), the Real Estate Price Index (REPI) and the unemployment rate for the corporate portfolio, the GDP, the Average Gross Salary and the REPI for the retail portfolio.

The impact of these economic variables on the PD has been determined by performing statistical regression analysis to understand the impact that changes in these variables have had historically on default rates.

Three possible scenarios are considered to capture non-linearity across credit portfolios. The 'Baseline' scenario represents the most-likely outcome. It is based on authoritative sources forecasting these economic variables referred to above and providing the best estimate view of the economy over the next three years. Apart from the 'Baseline' scenario, the Bank will consider two other macro-economic scenarios – 'Upside' and 'Downside' scenarios – which respectively represent a more optimistic and a more pessimistic outcome. Such scenarios reflect the current top and emergent risks and opportunities. The more optimistic and more pessimistic scenarios are economically plausible and will not necessarily be as severe as scenarios used in stress testing.

Each scenario is weighted by a probability of occurrence, determined by a combination of macroeconomic research and expert credit judgment, taking account the range of possible outcomes each chosen scenario represents. The Bank measures ECL as either a probability weighted 12-month ECL (Stage 1), or a probability weighted lifetime ECL (Stages 2 and 3). These probability-weighted ECLs are determined by running each scenario through the relevant ECL model and multiplying it by the appropriate scenario weighting (as opposed to weighting the inputs).

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

The most significant period-end assumptions used for the ECL estimate as at 31 December 2018 are set out below. The 'Baseline', 'Upside' and 'Downside' scenarios were used for all portfolios.

- The 'Baseline' scenario captures business-as-usual macroeconomic expectations, whereby the current rhythm of economic activity is maintained;
- The 'Downside' scenario is based on a subdued level of economic activity hypothesized to correspond to an economic recession;
- The 'Upside' scenario is based on the assumption that it would be possible to marginally improve further over the already benign economic conditions.

AS AT 31 DECEMBER 2018

	2019	2020	2021
Real Gross Domestic Product (GDP) (YoY)*			
- 'Baseline'	5.10%	4.60%	4.10%
- Range of forecasts for alternative scenarios	[2.5 – 6.4]%	[0 – 5.7]%	[-2.0 – 5.1]%
Gross Fixed Capital Formation (GFCF)			
- 'Baseline'	7.90%	12.50%	10.10%
- Range of forecasts for alternative scenarios	[-3.0 – 8.9]%	[5.3 – 14.1]%	[2.9 – 11.4]%
Unemployment rate			
- 'Baseline'	4.30%	4.30%	4.30%
- Range of forecasts for alternative scenarios	[4.0 – 5.7]%	[3.6 – 6.4]%	[3.3 – 7.0]%
Average gross salary (YoY)*			
- 'Baseline'	3.60%	0.40%	-0.80%
- Range of forecasts for alternative scenarios	[2.4 – 5.5]%	[-0.9 – 2.6]%	[-2.2 – 1.4]%
Real Estate Price Index (REPI)			
- 'Baseline'	1.40%	2.60%	2.70%
- Range of forecasts for alternative scenarios	[-1.3 – 5.0]%	[-0.7 – 6.6]%	[-0.6 – 6.7]%

AS AT 1 JANUARY 2018

	2018	2019	2020
Real Gross Domestic Product (GDP) (YoY)*			
- 'Baseline'	6.54%	5.33%	4.30%
- Range of forecasts for alternative scenarios	[5.2 – 8.2]%	[2.3 – 6.7]%	[-0.8 – 5.4]%
Gross Fixed Capital Formation (GFCF)			
- 'Baseline'	2.83%	6.60%	3.96%
- Range of forecasts for alternative scenarios	[-16.3 – 3.4]%	[-7.7 – 7.4]%	[-5.6 – 4.4]%
Unemployment rate			
- 'Baseline'	4.00%	4.06%	4.16%
- Range of forecasts for alternative scenarios	[3.7 – 4.7]%	[3.3 – 5.7]%	[2.9 – 6.7]%
Average gross salary (YoY)*			
- 'Baseline'	-0.50%	-0.24%	-0.40%
- Range of forecasts for alternative scenarios	[-1.3 – 0.9]%	[-1.2 – 1.4]%	[-1.6 – 1.4]%
Real Estate Price Index (REPI)			
- 'Baseline'	1.03%	-1.58%	-1.84%
- Range of forecasts for alternative scenarios	[-1.3 – 4.6]%	[-4.5 – 2.6]%	[-5.4 – 2.9]%

The weightings assigned to each economic scenario were 60% for the 'Baseline' scenario, 30% for the 'Downside' scenario and 10% for the 'Upside' scenario. The number of scenarios used is based on the analysis of each major product type to ensure that non-linearities are captured. The number of scenarios and their attributes are reassessed at each reporting date. The economic scenarios were simulated over a full economic cycle.

Such weightings take into account the current strong performance of the Maltese economy over the foreseeable future and that at this relatively strong level of performance, further ameliorations would be affected by the law of diminishing returns. The Board considers that the probability weightings assigned to the respective scenarios reflect an unbiased evaluation of range of possible outcomes.

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on an ongoing basis.

The most significant assumptions affecting the ECL allowance are:

i. Corporate exposures: the GDP and the GFCF, given the significant impact they have on the performance of corporate entities; the REPI, given the significant impact it has on collateral values and the Unemployment Rate;

ii. Retail exposures: the GDP and the average gross salary, given the significant impact they have on secured and unsecured borrowers obliged to meet their contractual repayments, and the REPI, given the significant impact it has on collateral values.

3.2.4.5 Categorisation of loans and advances to customers for ECL measurement

As part of the ECL model, the Bank classifies its exposures to loans and advances to customers into groups with similar characteristics that include instrument type. In this respect, the Bank considers the following categories when measuring ECL:

- Corporate portfolio, which includes loans and advances to business entities;
- Retail portfolio, which includes loans and advances to individual customers such as mortgages, credit cards and other consumer credit.

3.2.5 Maximum exposure to credit risk

An 'exposure' is defined as the amount at risk arising from the Bank's assets and off-balance sheet items. The Bank's maximum credit risk with respect to assets and off-balance sheet items can be classified into the following categories:

- Financial assets recognised on-balance sheet comprising principally balances with Central Bank of Malta, financial investments and loans and advances to banks and customers. The maximum exposure to credit risk of these financial assets equals their gross carrying amounts.
- Documentary credits and guarantee obligations incurred on behalf of third parties. The latter carry the same credit risk as loans, whilst documentary credits are collateralised by the underlying shipments of goods to which they relate, and therefore carry less risk than a loan to a customer. The maximum exposure to credit risk is the full amount that the Bank would have to pay if the guarantees are called upon or if documentary credits are exercised.
- 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. 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 in respect of loans and advances.

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 include the following:

	2018		2017	
	GROSS EXPOSURE	ECL ALLOWANCE	GROSS EXPOSURE	IMPAIRMENT ALLOWANCE
	€000	€000	€000	€000
Credit risk exposure relating to on-balance sheet assets:				
Subject to IFRS 9 impairment allowance				
Financial assets measured at amortised cost:				
Balances with Central Bank of Malta	95,996	(23)	22,734	-
Cheques in course of collection	677	-	2,259	-
Loans and advances to banks	57,552	(36)	69,911	-
Loans and advances to customers				
- Corporate	226,861	(8,952)	136,267	(6,581)
- Retail	305,333	(2,497)	255,132	(2,504)
Accrued income	1,696	-	1,547	-
Financial investments measured at FVOCI (2017: available-for-sale)	68,263	(147)	67,663	-
Not subject to IFRS 9 impairment allowance				
Derivative financial instruments held-for-trading	122	-	-	-
Credit risk exposure	**756,500**	**(11,655)**	**555,513**	**(9,085)**

	2018		2017	
	GROSS EXPOSURE	ECL ALLOWANCE	GROSS EXPOSURE	IMPAIRMENT ALLOWANCE
	€000	€000	€000	€000
Credit risk exposure relating to off-balance sheet instruments:				
Contingent liabilities	11,199	-	8,820	-
Undrawn commitments to lend:				
- Corporate	90,447	(400)	70,442	-
- Retail	68,023	(16)	42,243	-
	158,470	(416)	112,685	-
Credit risk exposure	**169,669**	**(416)**	121,505	-

Accrued income substantially arises from loans and advances to customers. Expected credit losses in respect of accrued income, which are not deemed material, have been allocated to loans and advances to customers.

3.2.6 Credit concentration risk

Within the Bank, concentration risk of losses results from inadequate diversification of the credit exposures. This risk is managed by actively measuring, reporting and monitoring on a regular and ongoing basis risk concentration levels against reasonable thresholds for industry sectors, counterparties, products, and collateral types.

Credit concentration risk by industry sector

The Bank's financial investments measured at FVOCI (gross of credit loss allowance) are composed of local and foreign government debt securities, and other debt instruments as shown in the following table:

	2018	2017
	€000	€000
Governments	**29,408**	39,318
Corporate		
• Financial services	**38,514**	26,637
• Other sectors	**-**	1,367
	67,922	67,322

The industry sector analysis of the Bank's loans and advances to customers (gross of credit loss allowance) is described in the following table:

	2018	2017
	€000	€000
Manufacturing	**15,996**	6,882
Financial services	**31,834**	9,412
Households and individuals	**326,403**	275,641
Construction	**31,773**	20,978
Wholesale and retail	**40,341**	32,274
Other sectors	**85,847**	46,212
Gross loans and advances to customers	**532,194**	391,399

Credit concentration risk for counterparties

As at 31 December 2018, no loans and advances to customers were deemed to be prohibited large exposures in accordance with the requirements of Part Four: Large Exposures, of the CRR. A limited number of customers amount to over 10% of the Bank's regulatory own funds, which customers are monitored and reported more frequently and rigorously.

Within its daily operations, the Bank also transacts with counterparty 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 of existing and future obligations by counterparty banks. To mitigate this risk, the Bank places short-term funds solely with pre-approved counterparties subject to pre-established limits determined on the basis of the respective institution's credit rating. The positions are checked against the limits on a daily basis and in real time.

Credit concentration risk by geographical region

The Bank also monitors credit concentration risk by geographical region. The majority of the Bank's exposures are in Malta in view of the Bank's operations being conducted in Malta. Moreover, the Bank also holds balances with correspondent banks in foreign jurisdictions and investments in debt securities issued by foreign entities, as shown in the following tables:

	2018	2017
	€000	€000
Financial investments measured at FVOCI		
Malta	23,944	24,384
Croatia	-	5,603
Japan	5,343	5,497
Poland	-	5,104
Portugal	5,464	5,594
United Arab Emirates	-	5,189
United Kingdom	22,935	10,237
United States	10,236	5,714
	67,922	67,322
Loans and advances to banks		
Malta	16	70
Austria	-	20,001
Belgium	16,469	15,365
Canada	-	6,692
France	-	20,013
Portugal	-	9
United Kingdom	31,949	7,761
United States	9,118	-
Gross loans and advances to banks	57,552	69,911

3.2.7 Information on credit quality of balances with banks and debt securities

During 2018, the Bank held debt securities and similar instruments issued by sovereign and non-sovereign counterparties having a strong financial background. The issuers are approved and regularly reviewed, focusing on market developments. The debt securities held by the Bank are listed on the Malta Stock Exchange, a regulated market in Malta, or on other recognised stock exchanges.

Loans and advances to banks included money market placements maturing within one month and balances held with counterparty banks.

At the end of the reporting period, none of these financial assets mentioned were past due or impaired.

The following tables set out information about the credit quality of financial assets measured at amortised cost and financial investments measured at FVOCI (2017: available-for-sale financial investments). The credit quality of the financial assets is determined by credit ratings applicable to issuers or counterparties based on Moody's and Fitch ratings. Explanation of the terms, 12-month ECL, lifetime ECL and credit impaired are included in Note 3.2.4.

	Stage 1 12-month ECL 2018	Stage 2 Lifetime ECL 2018	Stage 3 Lifetime ECL 2018	Total 2018	Total 2017
	€000	€000	€000	€000	€000
Balances with Central Bank of Malta at amortised cost					
Gross carrying amount	95,996	-	-	95,996	22,734
Loss allowance	(23)	-	-	(23)	-
Carrying amount	95,973	-	-	95,973	22,734

The credit rating of Malta was reported at A3 by Moody's (published on 29 January 2019) and A+ by Fitch (published on 1 February 2019).

	Stage 1 12-month ECL 2018	Stage 2 Lifetime ECL 2018	Stage 3 Lifetime ECL 2018	Total 2018	Total 2017
	€000	€000	€000	€000	€000
Financial investments measured at FVOCI					
AAA to AA-	5,050	-	-	5,050	5,155
A+ to A-	57,749	-	-	57,749	51,311
BBB+ to BBB-	5,464	-	-	5,464	11,197
Carrying amount – fair value	68,263	-	-	68,263	67,663
Loss allowance	(147)	-	-	(147)	-
Carrying amount – net of loss allowance	**68,116**	**-**	**-**	**68,116**	**67,663**
Loans and advances to banks at amortised cost					
AAA to AA-	50,116	-	-	50,116	6,883
A+ to A-	7,420	-	-	7,420	42,956
BBB+ to BBB-	11	-	-	11	20,068
Unrated	5	-	-	5	4
Carrying amount – fair value	57,552	-	-	57,552	69,911
Loss allowance	(36)	-	-	(36)	-
Carrying amount – net of loss allowance	**57,516**	**-**	**-**	**57,516**	**69,911**

As at 31 December 2018, there were no Purchased Credit-Impaired assets.

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.

3.2.8 Information on credit quality of loans and advances to customers

The credit quality of loans and advances to customers is managed by the Bank using internal credit ratings. The Bank applies an internal rating system ('IRS') which encapsulates the risk profile associated with each and every lending relationship on its banking book.

The IRS comprises 13 credit rating levels which constitute a continuum of progressively increasing risk profiles ranging from A1 (best rating, least risky) to E (loss, worst case representing full risk materialisation). The rating of every lending relationship (including groups of connected customers) is an important tool that helps management to identify both non-performing exposures and the better-performing borrowing customers.

The Bank's IRS is split as follows:

Performing

- High Grade (Internal rating of A1 to A3)

  A customer having an internal risk rating between A1 to A3 generally would not have any interest and/or capital payments overdue by more than 30 days. Also, no recent history of default would exist. Moreover, the Bank does not foresee any losses or non-performance of these customers.

- Standard (Internal rating of A4 and B)

  The Bank assigns an internal risk rating of A4 to corporate customers with either overdraft facilities experiencing hardcore elements, or with a high loan-to-value, and/or who also show signs of unlikeliness to pay. A4 customers deem to exhibit higher risk than other corporate customers within the High-Grade Category.

  Loans and advances having an internal risk rating of B relate to those customers for which the Bank starts to pay more attention to, generally having interest and/or capital payments past due by more than 30 days but less than 60 days.

- Substandard (Internal rating of C)

  Customers having an internal risk rating of C, thus classified within the 'Substandard' category, generally have interest and/or capital payments overdue by more than 60 days but not overdue by more than 90 days. In this light, such loans and advances would have inherent weaknesses that could put at risk the repayment of the debt, and thus give rise to a greater probability of losses for the Bank.

Non-performing

- Doubtful (Internal rating of D1 to D6 and E)

  Loans and advances within this category relate to those facilities in respect of which the Bank considers the repayment of the principal as improbable as a result of deteriorating conditions. These loans and advances are generally past due by more than 90 days and comprise those exposures which are deemed by the Bank as defaulted or credit impaired (see definition in note 3.2.4.2).

  Hence, credit impaired loans and advances are advances which the Bank has determined as 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's credit impaired loans and advances mainly relate to a number of independent customers which are not meeting repayment obligations or deemed by the Bank as unlikely to pay their obligations to the Bank without recourse by the Bank to realising the collateral.

  The following tables set out information about the credit quality of loans and advances to customers measured at amortised cost. Explanation of the terms: 12-month ECL, lifetime ECL and credit-impaired are included in Note 3.2.4.

	2018 STAGE 1 12-MONTH ECL €000	2018 STAGE 2 LIFETIME ECL €000	2018 STAGE 3 LIFETIME ECL €000	2018 TOTAL €000	2017 TOTAL €000
Loans and advances to customers at amortised cost					
Corporate					
High grade	189,338	1,819	-	191,157	108,014
Standard	-	13,496	-	13,496	3,984
Substandard	-	117	-	117	74
Doubtful	-	-	22,091	22,091	24,195
Gross carrying amount	**189,338**	**15,432**	**22,091**	**226,861**	**136,267**
Loss allowance	(996)	(1,248)	(6,708)	(8,952)	(6,581)
Carrying amount	**188,342**	**14,184**	**15,383**	**217,909**	**129,686**
Retail					
High grade	295,622	659	-	296,281	245,138
Standard	-	2,653	-	2,653	2,389
Substandard	-	343	-	343	348
Doubtful	-	-	6,056	6,056	7,257
Gross carrying amount	**295,622**	**3,655**	**6,056**	**305,333**	**255,132**
Loss allowance	(289)	(169)	(2,039)	(2,497)	(2,504)
Carrying amount	**295,333**	**3,486**	**4,017**	**302,836**	**252,628**
Total loans and advances to customers					
High grade	484,960	2,478	-	487,438	353,152
Standard	-	16,149	-	16,149	6,373
Substandard	-	460	-	460	422
Doubtful	-	-	28,147	28,147	31,452
Gross carrying amount	**484,960**	**19,087**	**28,147**	**532,194**	**391,399**
Loss allowance	(1,285)	(1,417)	(8,747)	(11,449)	(9,085)
Carrying amount	**483,675**	**17,670**	**19,400**	**520,745**	**382,314**

The following table sets out information about the credit quality of loans and advances to customers, including guarantees, documentary credits and undrawn commitments to lend:

	2018 STAGE 1 12-MONTH ECL	2018 STAGE 2 LIFETIME ECL	2018 STAGE 3 LIFETIME ECL	2018 TOTAL	2017 TOTAL
	€000	€000	€000	€000	€000
High grade	651,442	2,481	-	653,923	473,817
Standard	-	18,725	-	18,725	6,911
Substandard	-	534	-	534	463
Doubtful	-	-	28,681	28,681	31,714
Gross carrying amount	**651,442**	**21,740**	**28,681**	**701,863**	**512,905**
Loss allowance	(1,543)	(1,531)	(8,791)	(11,865)	(9,085)
Carrying amount	**649,899**	**20,209**	**19,890**	**689,998**	**503,820**

As at 31 December 2018, there are no purchased credit-impaired assets.

The following table analyses the credit impaired loans and advances, gross of credit loss allowances, by industry sector:

	2018	2017
	€000	€000
Manufacturing	1,767	1,759
Households and individuals	7,927	9,647
Construction	2,837	2,011
Wholesale and retail	7,559	8,017
Other	8,057	10,018
	28,147	**31,452**

The following table provides a detailed analysis of the credit quality of the Bank's lending portfolio at 31 December 2018:

	NON-FORBORNE EXPOSURES 2018 €000	FORBORNE EXPOSURES 2018 €000	TOTAL 2018 €000
Performing - Stage 1 (High grade)			
Loans which are not past due	479,020	-	479,020
Loans which are past due by less than 30 days	5,940	-	5,940
	484,960	-	484,960
Underperforming - Stage 2			
Loans which are not past due			
High grade	-	2,445	2,445
Standard	12,578	1,185	13,763
Substandard	327	85	412
	12,905	3,715	16,620
Loans which are past due by less than 90 days			
Past due by less than 30 days	2,137	51	2,188
Past due by less than 60 days	237	-	237
Past due by less than 90 days	42	-	42
	2,416	51	2,467
	15,321	3,766	19,087
Non-performing - Stage 3			
Past due loans by more than 90 days and credit impaired loans	14,146	14,001	28,147
Gross loans and advances	**514,427**	**17,767**	**532,194**
12-month ECL	(1,285)	-	(1,285)
Lifetime ECL	(7,278)	(2,886)	(10,164)
Net loans and advances	**505,864**	**14,881**	**520,745**

Interest income recognised during the financial year ended 31 December 2018 in respect of forborne exposures amounted to €851,000 (2017: €968,000).

The following table provides a detailed analysis of the credit quality of the Bank's lending portfolio at 31 December 2017:

	NON-FORBORNE EXPOSURES 2017	FORBORNE EXPOSURES 2017	TOTAL 2017
	€000	€000	€000
Performing			
• Neither past due nor impaired			
- High grade	347,420	1,614	349,034
- Standard	4,151	355	4,506
- Substandard	248	3	251
	351,819	1,972	353,791
• Past due loans by less than 90 days but not impaired			
- Past due by less than 30 days	4,051	67	4,118
- Past due by less than 60 days	1,766	101	1,867
- Past due by less than 90 days	168	3	171
	5,985	171	6,156
Non-performing			
• Past due loans by more than 90 days			
- Specifically impaired, gross of specific impairment allowances	8,961	4,779	13,740
- Past due by 90 days but not specifically impaired	4,063	7,796	11,859
	13,024	12,575	25,599
• Other non-performing loans, but not specifically impaired	918	4,935	5,853
Gross loans and advances	**371,746**	**19,653**	**391,399**
Specific impairment allowances applied to specifically impaired exposures reflected above	(4,513)	(2,397)	(6,910)
Collective impairment allowances	(1,810)	(365)	(2,175)
Net loans and advances	**365,423**	**16,891**	**382,314**

Past due but not impaired

Until 31 December 2017, past due but not impaired loans included loans and advances where contractual interest or principal payments were past due, but the Bank believed that impairment is not appropriate based on the level of collateral available and/or the stage of collection of amounts owed to the Bank. Related credit losses, which may arise, if any, were partly covered through collective impairment allowances.

3.2.9 Modification of financial assets

The contractual terms of a loan may be revised for a number of reasons, including changes in market conditions, customer retention and other factors that are 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 customer's 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 customer is currently in default on any of its debt;
- the customer has declared or is in the process of declaring bankruptcy or entering into a similar process;
- there is significant doubt as to whether the customer will continue to be a going concern; and
- the Bank forecasts that the customer'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 are employed by the Bank 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 procedures in this area allow the Bank to provide a customer with terms and conditions that are more favourable than those provided initially. Loan forbearance is only granted in situations where the customer has shown a willingness to repay the loan and is expected to be able to meet the revised obligations. The Bank's credit risk management policies set 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 could be regarded as concessionary in cases where the customer is in financial difficulty:

- 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, namely 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 are reviewed and the customer's ability to meet the terms in relation to the revised obligations 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.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk.

The risk of default of modified assets after forbearance is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset (refer to note 2.6.5).

The Bank monitors the subsequent performance of modified assets and may determine that the credit risk has significantly improved after restructuring.

- Modified assets are moved from Stage 3 (Lifetime ECL) to Stage 1 (12-month ECL) only if they have performed in accordance with the new terms for 9 consecutive months or more. The gross carrying amount of such assets held as at 31 December 2018 was €574.
- Modified assets are moved from Stage 2 (Lifetime ECL) to Stage 1 (12-month ECL) only if they have performed in accordance with the new terms for 6 consecutive months or more. The gross carrying amount of such assets held as at 31 December 2018 was €626,688.

The Bank continues to monitor if there is a subsequent significant increase in credit risk in relation to modified assets that moved from Stage 3 (Lifetime ECL) or Stage 2 (Lifetime ECL) to Stage 1.

There were no material changes to the Bank's policies and procedures regarding forbearance or forborne loans in 2018.

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

	FORBORNE EXPOSURES	
	2018	2017
	€000	€000
At 1 January	19,653	19,195
Loans to which forbearance measures have been extended during the year	1,869	2,646
Repayments	(1,559)	(966)
Retired from forborne	(2,196)	(1,222)
At 31 December	**17,767**	**19,653**

The net modification gain or loss from financial assets with lifetime ECL whose cash flows were modified during the period as part of the Bank's restructuring activities was insignificant.

Forborne loans, gross of credit loss allowances, are analysed by industry sector as follows:

	2018	2017
	€000	€000
Manufacturing	1,258	1,261
Financial services	2,608	2,660
Households and individuals	3,495	4,142
Construction	2,271	2,320
Wholesale and retail	5,576	5,062
Other sectors	2,559	4,208
	17,767	**19,653**

As at 31 December 2018 and 2017, forborne loans mainly comprise exposures to customers based in Malta.

3.2.10 Loss allowances

3.2.10.1 Loss allowances under IAS 39 (applicable until 31 December 2017)

Until 31 December 2017, the Bank estimated an impairment allowance for any possible incurred losses within its lending portfolio. The Bank performed an assessment for the calculation of specific provisions when a review of credit facilities revealed that the creditworthiness of a borrower had undergone a significant deterioration and that, as a result, recovery of a credit facility was in serious doubt. The Bank made an assessment for specific impairment for those credit facilities being overdue by 90 days, amongst other qualitative factors, and provided if there was a shortfall. The shortfall or surplus was calculated as the difference between the individual loans' carrying amounts and the present value of future cashflows, discounted at the loans' original effective interest rate.

Impaired loans and advances are advances which the Bank has determined as probable that it will be unable to collect all principal and interest due according to the contractual terms of the loans and advances agreements.

The calculation of the present value of estimated future cashflows considered the estimated time period to liquidation of the collateral, the costs involved in obtaining and selling the collateral, as well as an appropriate haircut on the market value of the collateral.

The Bank assumed that all its exposures were individually significant. The Bank reviewed all credit exposures on a case by case basis and also on a collective basis, if the exposure was not deemed individually impaired, in order to consider the likelihood that the Bank might have been exposed to losses on loans and advances and with a view to taking early recovery action. Accordingly, allowances were assessed collectively for individually significant loans and advances where there was no objective evidence of individual impairment as yet.

Financial guarantees and letters of credit were assessed and provision was made in a similar manner as for loans and advances.

The following tables represent a reconciliation of changes in the specific and collective impairment allowances of the Bank.

	NON-FORBORNE EXPOSURES	FORBORNE EXPOSURES	TOTAL
	€000	€000	€000
Specific impairment allowance			
At 1 January 2017	4,476	2,260	6,736
Additions	764	443	1,207
Reversals	(727)	(306)	(1,033)
At 31 December 2017	**4,513**	**2,397**	**6,910**
Collective impairment allowance			
At 1 January 2017	1,907	128	2,035
Additions	855	310	1,165
Reversals	(952)	(73)	(1,025)
At 31 December 2017	**1,810**	**365**	**2,175**

Write-offs during the period ended 31 December 2017 were €4,000.

3.2.10.2 Loss allowances under IFRS 9 (applicable from 1 January 2018)

Reconciliation of 12-month and lifetime ECL provision

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit impaired in the period, and the consequent "step up" (or "step down") between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognised during the period, as well as releases for financial instruments derecognised in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;
- Impacts on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Financial assets derecognised during the period and write-offs of allowances related to assets that were written off during the period.

The following tables explain the changes in the loss allowance between the beginning and the end of the annual period:

	2018 STAGE 1 12-MONTH ECL	2018 STAGE 2 LIFETIME ECL	2018 STAGE 3 LIFETIME ECL	2018 TOTAL
	€000	€000	€000	€000
Balances with Central Bank of Malta at amortised cost				
Loss allowance as at 1 January 2018	25	-	-	25
New financial assets originated or purchased	2	-	-	2
Changes to risk parameters (model inputs: PDs/LGDs/EADs)	(4)	-	-	(4)
Total net P&L charge during the year	(2)	-	-	(2)
Loss allowance as at 31 December 2018	**23**	**-**	**-**	**23**
Financial investments measured at FVOCI				
Loss allowance as at 1 January 2018	239	-	-	239
New financial assets originated or purchased	23	-	-	23
Changes to risk parameters (model inputs: PDs/LGDs/EADs)	(19)	-	-	(19)
Financial assets derecognised during the year	(96)	-	-	(96)
Total net P&L charge during the year	(92)	-	-	(92)
Loss allowance as at 31 December 2018	**147**	**-**	**-**	**147**

	2018 STAGE 1 12-MONTH ECL	2018 STAGE 2 LIFETIME ECL	2018 STAGE 3 LIFETIME ECL	2018 TOTAL
	€000	€000	€000	€000
Loans and advances to banks at amortised cost				
Loss allowance as at 1 January 2018	29	-	-	29
New financial assets originated or purchased	1	-	-	1
Changes to risk parameters (model inputs: PDs/LGDs/EADs)	19	-	-	19
Financial assets derecognised during the year	(13)			(13)
Total net P&L charge during the year	7	-	-	7
Loss allowance as at 31 December 2018	**36**	**-**	**-**	**36**

Remeasurement of loss allowance arising from foreign-exchange movements was not considered significant.

	STAGE 1 12-MONTH ECL	STAGE 2 LIFETIME ECL	STAGE 3 LIFETIME ECL	TOTAL
	€000	€000	€000	€000
Loans and advances to customers at amortised cost				
Corporate				
Loss allowance as at 1 January 2018	**335**	**1,015**	**5,966**	**7,316**
Transfers of financial instruments				
- Transfer from Stage 1 to Stage 2	(18)	373	-	355
- Transfer from Stage 1 to Stage 3	-	-	13	13
- Transfer from Stage 2 to Stage 1	26	(65)	-	(39)
- Transfer from Stage 2 to Stage 3	-	(7)	273	266
- Transfer from Stage 3 to Stage 2	-	-	(5)	(5)

	STAGE 1 12-MONTH ECL	STAGE 2 LIFETIME ECL	STAGE 3 LIFETIME ECL	TOTAL
Total remeasurement of loss allowance arising from transfers in stages	8	301	281	590
New financial assets originated or purchased	668	4	-	672
Changes to risk parameters (model inputs PDs/LGDs/EADs)	32	114	422	568
Changes due to modification of contractual cash flows and financial assets	-	52	78	130
Financial assets derecognised during the year	(47)	(238)	(34)	(319)
Write-offs	-	-	(5)	(5)
Total net P&L charge during the year	**661**	**233**	**742**	**1,636**
Loss allowance as at 31 December 2018	**996**	**1,248**	**6,708**	**8,952**
Retail				
Loss allowance as at 1 January 2018	**150**	**113**	**2,246**	**2,509**
Transfers of financial instruments				
- Transfer from Stage 1 to Stage 2	(2)	90	-	88
- Transfer from Stage 1 to Stage 3	-	-	60	60
- Transfer from Stage 2 to Stage 1	1	(47)	-	(46)
- Transfer from Stage 2 to Stage 3	-	(6)	68	62
- Transfer from Stage 3 to Stage 1	-	-	(3)	(3)
- Transfer from Stage 3 to Stage 2	-	5	(15)	(10)
Total remeasurement of loss allowance arising from transfers in stages	(1)	42	110	151
New financial assets originated or purchased	102	1	-	103
Changes to risk parameters (model inputs PDs/LGDs/EADs)	51	23	(85)	(11)
Changes due to modification of contractual cash flows and financial assets	-	34	39	73
Financial assets derecognised during the year	(12)	(44)	(270)	(326)
Write-offs	(1)	-	(1)	(2)
Total net P&L charge during the year	**139**	**56**	**(207)**	**(12)**
Loss allowance as at 31 December 2018	**289**	**169**	**2,039**	**2,497**

	STAGE 1 12-MONTH ECL	STAGE 2 LIFETIME ECL	STAGE 3 LIFETIME ECL	TOTAL
	€000	€000	€000	€000
Total loans and advances to customers at amortised cost				
Loss allowance as at 1 January 2018	**485**	**1,128**	**8,212**	**9,825**
Transfers of financial instruments				
- Transfer from Stage 1 to Stage 2	(20)	463	-	443
- Transfer from Stage 1 to Stage 3	-	-	73	73
- Transfer from Stage 2 to Stage 1	27	(112)	-	(85)
- Transfer from Stage 2 to Stage 3	-	(13)	341	328
- Transfer from Stage 3 to Stage 1	-	-	(3)	(3)
- Transfer from Stage 3 to Stage 2	-	5	(20)	(15)
Total remeasurement of loss allowance arising from transfers in stages	**7**	**343**	**392**	**741**
New financial assets originated or purchased	770	5	-	775
Changes to risk parameters (model inputs PDs/LGDs/EADs)	83	137	337	557
Changes due to modification of contractual cash flows and financial assets	-	86	117	203
Financial assets derecognised during the year	(59)	(282)	(304)	(645)
Write-offs	(1)	-	(6)	(7)
Total net P&L charge during the year	**800**	**289**	**535**	**1,624**
Loss allowance as at 31 December 2018	**1,285**	**1,417**	**8,747**	**11,449**

Remeasurement of loss allowance arising from foreign-exchange movements was not considered significant.

	STAGE 1 12-MONTH ECL	STAGE 2 LIFETIME ECL	STAGE 3 LIFETIME ECL	TOTAL
	€000	€000	€000	€000
Total loans and advances to customers at amortised cost, guarantees, documentary credits and undrawn commitments to lend				
Loss allowance as at 1 January 2018	**566**	**1,442**	**8,290**	**10,298**
Transfers of financial instruments				
- Transfer from Stage 1 to Stage 2	(20)	463	-	443
- Transfer from Stage 1 to Stage 3	-	-	73	73
- Transfer from Stage 2 to Stage 1	192	(311)	-	(119)
- Transfer from Stage 2 to Stage 3	-	(17)	371	354
- Transfer from Stage 3 to Stage 1	-	-	(10)	(10)
- Transfer from Stage 3 to Stage 2	-	5	(20)	(15)
Total remeasurement of loss allowance arising from transfers in stages	**172**	**140**	**414**	**726**
New financial assets originated or purchased	796	83	-	879
Changes to risk parameters (model inputs PDs/LGDs/EADs)	81	152	302	535
Changes due to modification of contractual cash flows and financial assets	-	86	117	203
Financial assets derecognised during the year	(71)	(372)	(326)	(769)
Write-offs	(1)	-	(6)	(7)
Total net P&L charge during the year	**977**	**89**	**501**	**1,567**
Loss allowance as at 31 December 2018	**1,543**	**1,531**	**8,791**	**11,865**

Changes in the gross carrying amount that contributed to changes in loss allowance

The significant change in the gross carrying amount of financial assets that contributed to changes in loss allowances was mainly due to growth in the loan book, which was aligned with the Bank's growth objectives.

The following tables explain changes in the gross carrying amount of the financial assets to help explain their significance to the changes in the loss allowance for the same portfolios as discussed above

	2018 STAGE 1 12-MONTH ECL	2018 STAGE 2 LIFETIME ECL	2018 STAGE 3 LIFETIME ECL	2018 TOTAL
	€000	€000	€000	€000
Balances with Central Bank of Malta				
Gross carrying amount as at 1 January 2018	22,734	-	-	22,734
New financial assets originated or purchased	53,143	-	-	53,143
Changes in gross carrying amount due to facilities present as at 1 January 2018	20,119	-	-	20,119
Gross carrying amount as at 31 December 2018	**95,996**	**-**	**-**	**95,996**
Financial investments measured at FVOCI				
Gross carrying amount as at 1 January 2018	67,322	-	-	67,322
New financial assets originated or purchased	17,887	-	-	17,887
Changes in gross carrying amount due to facilities present as at 1 January 2018	(24)	-	-	(24)
Financial assets derecognised during the year	(17,263)	-	-	(17,263)
Gross carrying amount as at 31 December 2018	**67,922**	**-**	**-**	**67,922**
Loans and advances to banks at amortised cost				
Gross carrying amount as at 1 January 2018	69,911	-	-	69,911
New financial assets originated or purchased	47,079	-	-	47,079
Changes in gross carrying amount due to facilities present as at 1 January 2018	(46,706)	-	-	(46,706)
Financial assets derecognised during the year	(12,732)	-	-	(12,732)
Gross carrying amount as at 31 December	**57,552**	**-**	**-**	**57,552**

	STAGE 1 12-MONTH ECL €000	STAGE 2 LIFETIME ECL €000	STAGE 3 LIFETIME ECL €000	TOTAL €000
Loans and advances to customers at amortised cost				
Corporate				
Gross carrying amount as at 1 January 2018	100,638	12,463	22,975	136,076
Transfers of financial instruments				
• Transfer from Stage 1 to Stage 2	(5,022)	8,296	-	3,274
• Transfer from Stage 1 to Stage 3	(108)	-	108	-
• Transfer from Stage 2 to Stage 1	3,371	(2,651)	-	720
• Transfer from Stage 2 to Stage 3	-	(1,231)	1,198	(33)
• Transfer from Stage 3 to Stage 2	-	707	(1,055)	(348)
Total transfers in stages	(1,759)	5,121	251	3,613
New financial assets originated or purchased	111,406	15	-	111,421
Changes in gross carrying amount due to facilities present as at 1 January 2018	695	(1,157)	(1,098)	(1,560)
Changes due to modification of contractual cash flows and financial assets	-	1,232	230	1,462
Financial assets derecognised during the year	(21,642)	(2,242)	(262)	(24,146)
Write-offs	-	-	(5)	(5)
Total net change during the period	**88,700**	**2,969**	**(884)**	**90,785**
Gross carrying amount as at 31 December 2018	**189,338**	**15,432**	**22,091**	**226,861**

	STAGE 1 12-MONTH ECL €000	STAGE 2 LIFETIME ECL €000	STAGE 3 LIFETIME ECL €000	TOTAL €000
Loans and advances to customers at amortised cost				
Retail				
Gross carrying amount as at 1 January 2018	243,992	4,073	7,257	255,322
Transfers of financial instruments				
• Transfer from Stage 1 to Stage 2	(1,879)	1,865	-	(14)
• Transfer from Stage 1 to Stage 3	(200)	-	191	(9)
• Transfer from Stage 2 to Stage 1	849	(942)	-	(93)
• Transfer from Stage 2 to Stage 3	-	(102)	93	(9)
• Transfer from Stage 3 to Stage 1	2	-	(3)	(1)
• Transfer from Stage 3 to Stage 2	-	92	(94)	(2)
Total transfers in stages	(1,228)	913	187	(128)
New financial assets originated or purchased	80,986	5	-	80,991
Changes in gross carrying amount due to facilities present as at 1 January 2018	(10,186)	(143)	(69)	(10,398)
Changes due to modification of contractual cash flows and financial assets	(278)	253	81	56
Financial assets derecognised during the year	(17,663)	(1,446)	(1,399)	(20,508)
Write-offs	(1)	-	(1)	(2)
Total net change during the period	**51,630**	**(418)**	**(1,201)**	**50,011**
Gross carrying amount as at 31 December 2018	**295,622**	**3,655**	**6,056**	**305,333**

	STAGE 1 12-MONTH ECL	STAGE 2 LIFETIME ECL	STAGE 3 LIFETIME ECL	TOTAL
	€000	€000	€000	€000
Total loans and advances to customers at amortised cost				
Gross carrying amount as at 1 January 2018	344,630	16,536	30,232	391,398
Transfers of financial instruments				
• Transfer from Stage 1 to Stage 2	(6,901)	10,161	-	3,260
• Transfer from Stage 1 to Stage 3	(308)	-	299	(9)
• Transfer from Stage 2 to Stage 1	4,220	(3,593)	-	627
• Transfer from Stage 2 to Stage 3	-	(1,333)	1,291	(42)
• Transfer from Stage 3 to Stage 1	2	-	(3)	(1)
• Transfer from Stage 3 to Stage 2	-	799	(1,149)	(350)
Total transfers in stages	(2,987)	6,034	438	3,485
New financial assets originated or purchased	192,392	20	-	192,412
Changes in gross carrying amount due to facilities present as at 1 January 2018	(9,491)	(1,300)	(1,167)	(11,958)
Changes due to modification of contractual cash flows and financial assets	(278)	1,485	311	1,518
Financial assets derecognised during the year	(39,305)	(3,688)	(1,661)	(44,654)
Write-offs	(1)	-	(6)	(7)
Total net change during the period	**140,330**	**2,551**	**(2,085)**	**140,796**
Gross carrying amount as at 31 December 2018	**484,960**	**19,087**	**28,147**	**532,194**

Changes in gross carrying amount arising from foreign-exchange movements were not significant.

	STAGE 1 12-MONTH ECL	STAGE 2 LIFETIME ECL	STAGE 3 LIFETIME ECL	TOTAL
	€000	€000	€000	€000
Total loans and advances to customers at amortised cost, guarantees, documentary credits and undrawn commitments to lend				
Gross amount as at 1 January 2018	460,736	21,673	30,494	512,903
Transfers of financial instruments				
• Transfer from Stage 1 to Stage 2	(11,115)	10,720	-	(395)
• Transfer from Stage 1 to Stage 3	(324)	-	320	(4)
• Transfer from Stage 2 to Stage 1	6,541	(6,127)	-	414
• Transfer from Stage 2 to Stage 3	-	(1,479)	1,607	128
• Transfer from Stage 3 to Stage 1	25	-	(26)	(1)
• Transfer from Stage 3 to Stage 2	-	799	(1,149)	(350)
Total transfers in stages	(4,873)	3,913	752	(208)
New financial assets originated or purchased	308,701	356	-	309,057
Changes in gross carrying amount due to facilities present as at 1 January 2018	(17,393)	(817)	(1,140)	(19,350)
Changes due to modification of contractual cash flows and financial assets	(277)	1,485	311	1,519
Financial assets derecognised during the year	(95,451)	(4,870)	(1,730)	(102,051)
Write-offs	(1)	-	(6)	(7)
Total net change during the period	**190,706**	**67**	**(1,813)**	**188,960**
Gross amount as at 31 December 2018	**651,442**	**21,740**	**28,681**	**701,863**

3.2.11 Write-off policy

The Bank writes off loans and advances to customers when it determines that these are uncollectible, usually it has exhausted all practical recovery efforts and has concluded there is no reasonable expectation of recovery. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-offs.

The Bank may write-off financial assets that are still subject to enforcement activity. The outstanding contractual amounts of such assets written-off during the year ended 31 December 2018 was insignificant. The Bank still seeks to recover amounts it is legally owed in full, but which have been partially written off due to no reasonable expectation of full recovery.

3.2.12 Collateral

The Bank employs a range of policies and practices to mitigate credit risk. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. The Bank's Board establishes a policy regarding the acceptability of types of collateral and valuation parameters.

Longer-term finance and lending to corporate entities are generally secured; revolving individual credit facilities are generally unsecured.

The main types of collateral obtained are as follows:

- For corporate lending, charges over real estate properties, cash or securities;
- For retail lending (including home loans and consumer credit), mortgages over residential properties, cash or securities; and
- For exposures arising from reverse repurchase transactions, a pledge on liquid sovereign debt securities.

Collateral held as security for financial assets other than loans and advances depends on the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured.

Management assesses the market value of collateral as part of the loan origination process. This assessment is reviewed periodically through ongoing credit file reviews. The Bank requests additional collateral in accordance with the underlying agreement when necessary.

The Bank's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Bank since the prior period.

A portion of the Bank's financial assets, secured by cash, have no loss allowance being recognised in accordance with the Bank's expected credit loss model. The carrying amount of such financial assets is €7,807,000.

The extendible value of the collateral is the lower of the fair value of a pledged asset for lending purposes and the gross carrying amount of the secured loans.

The Bank closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Bank will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

AS AT 31 DECEMBER 2018

	Gross carrying amount	Impairment allowance	Carrying amount	Extendible value of collateral held
Credit-impaired assets	**€000**	**€000**	**€000**	**€000**
Retail:				
- Credit Cards	2	1	1	2
- Fixed Term Loans	914	104	810	906
- Mortgages	4,013	808	3,205	4,013
Corporate:				
- Small and medium-sized enterprises (SMEs)	20,660	5,513	15,147	19,067
- Sole traders	310	73	237	310
Total credit-impaired assets	**25,899**	**6,499**	**19,400**	**24,298**

Financial assets that are credit impaired and no collateral is held are shown below:

	AS AT 31 DECEMBER 2018		
	Gross carrying amount	Impairment allowance	Carrying amount
Credit-impaired assets	**€000**	**€000**	**€000**
Retail:			
- Overdrafts	184	184	-
- Credit Cards	323	323	-
- Fixed Term Loans	519	519	-
- Mortgages	101	101	-
Corporate:			
- Small and medium-sized enterprises (SMEs)	1,100	1,100	-
- Sole traders	21	21	-
Total credit-impaired assets	**2,248**	**2,248**	**-**

The following tables show the distribution of LTV ratios for the Bank's credit-impaired loans and advances to customers secured by immovable property:

Gross carrying amount of credit-impaired loans and advances to customers as at 31 December 2018

	Corporate exposures	Mortgages	Retail exposures credit cards	Consumer credit
	€000	**€000**	**€000**	**€000**
Lower than 25%	3,583	25	-	58
25 to 50%	5,230	172	-	223
51 to 75%	5,847	978	-	416
76 to 100%	640	2,721	1	147
Higher than 100%	5,651	89	-	63
Total	**20,951**	**3,986**	**1**	**907**

Gross carrying amount of credit-impaired loans and advances to customers at 31 December 2017

	Corporate exposures	Mortgages	Retail exposures Credit cards	Consumer credit
	€000	**€000**	**€000**	**€000**
Lower than 25%	5,415	-	-	357
25 to 50%	4,672	221	-	246
51 to 75%	5,552	1,263	1	426
76 to 100%	2,636	3,290	5	202
Higher than 100%	3,565	89	-	66
Total	**21,840**	**4,863**	**6**	**1,297**

It is the Bank's policy to dispose of properties acquired through judicial action in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy properties acquired through judicial action for business use.

The following is an analysis of the extendible value of the collateral and other credit enhancements held by the Bank against exposures of loans and advances to customers.

	NON-FORBORNE EXPOSURES	FORBORNE EXPOSURES
	2018	2018
	€000	€000
Performing – Stage 1		
– Loans which are not past due		
Total maximum exposure	**479,020**	**-**
Extendible value of collateral:		
• Secured by cash and quasi cash	(13,854)	-
• Residential immovable property	(334,080)	-
• Commercial immovable property	(77,839)	-
• Other collateral	(16,107)	-
Total extendible value of collateral	(441,880)	-
Residual exposure	37,140	-
Loss Allowance	(1,215)	-
– Past due by less than 30 days		
Total maximum exposure	5,940	-
Extendible value of collateral:		
• Secured by cash and quasi cash	(119)	-
• Residential immovable property	(4,025)	-
• Commercial immovable property	(1,315)	-
Total extendible value of collateral	(5,459)	-
Residual exposure	481	-
Loss Allowance	(70)	-

	NON-FORBORNE EXPOSURES	FORBORNE EXPOSURES
	2018	2018
	€000	€000
Underperforming – Stage 2		
– Loans which are not past due		
Total maximum exposure	**12,906**	3,714
Extendible value of collateral:		
• Secured by cash and quasi cash	(678)	(43)
• Residential immovable property	(2,386)	(1,294)
• Commercial immovable property	(6,850)	(2,031)
• Other collateral	(6)	(1)
Total extendible value of collateral	(9,920)	(3,369)
Residual exposure	2,986	345
Loss Allowance	(1,198)	(112)
– Past due by less than 90 days		
Total maximum exposure	2,415	52
Extendible value of collateral:		
• Secured by cash and quasi cash	(36)	(7)
• Residential immovable property	(1,450)	(11)
• Commercial immovable property	(746)	-
• Other collateral	(4)	(2)
Total extendible value of collateral	(2,236)	(20)
Residual exposure	179	32
Loss Allowance	(99)	(8)

	NON-FORBORNE EXPOSURES	FORBORNE EXPOSURES
	2018	2018
	€000	€000
Non-performing – Stage 3		
Total maximum exposure	**14,145**	14,002
Extendible value of collateral:		
• Secured by cash and quasi cash	(44)	-
• Residential immovable property	(9,465)	(5,808)
• Commercial immovable property	(1,956)	(7,025)
Total extendible value of collateral	(11,465)	(12,833)
Residual exposure	2,952	1,169
Loss Allowance	(5,981)	(2,766)

	NON-FORBORNE EXPOSURES	FORBORNE EXPOSURES
	2017	2017
	€000	€000
Performing		
- Neither past due nor impaired		
Total maximum exposure	**351,819**	1,972
Extendible value of collateral:		
Secured by cash and quasi cash	(11,983)	(60)
Residential immovable property	(247,492)	(554)
Commercial immovable property	(50,090)	(960)
Other collateral	(834)	(1)
Total extendible value of collateral	(310,399)	(1,575)
Residual exposure	41,420	397
Loss Allowance	(1,319)	(217)
- Past due by less than 90 days but not impaired		
Total maximum exposure	5,985	171
Extendible value of collateral:		
• Secured by cash and quasi cash	(448)	-
• Residential immovable property	(4,088)	(3)
• Commercial immovable property	(524)	(135)
Total extendible value of collateral	(5,060)	(138)
Residual exposure	925	33
Loss Allowance	(45)	(1)

	NON-FORBORNE EXPOSURES	FORBORNE EXPOSURES
	2017	2017
	€000	€000
Non-performing		
Total maximum exposure	**13,942**	17,510
Extendible value of collateral:		
• Secured by cash and quasi cash	(52)	(9)
• Residential immovable property	(8,909)	(8,024)
• Commercial immovable property	(1,688)	(6,397)
Total extendible value of collateral	(10,649)	(14,430)
Residual exposure	3,293	3,080
Loss Allowance	(4,960)	(2,543)

3.3. Market risk

Market risk is the risk that the fair value of future cash flows of financial instruments will fluctuate due to changes in market variables such as prices and interest rates, the correlations between them and their levels of volatility.

Market risk for the Bank comprises two types of risks, namely:

- Interest rate risk, which results from fluctuations in the future cash flows of financial assets and liabilities and fair value of financial instruments due to interest rate repricing gaps, changes in the yield curves and volatilities in the market interest rates; and
- Foreign exchange risk, which results from exposure to changes in prices, spot or forward, and volatility of currency rates.

3.3.1 Management of market risk

The primary objective of market risk management is to ensure that the risk-reward relationship entrenched in managing the Bank's resources is optimised in a manner that it does not expose the Bank to losses over and above its risk appetite. To achieve this objective, the Bank establishes limits and controls positions rigorously. The Bank carries out regular assessments of how the outcome of business activities in terms of multiple risk metrics impacts financial results.

The Bank´s market risk appetite is defined by the Board of Directors and implemented by the Treasury Unit, which coordinates the setup of risk limits and controls the Bank´s market exposures in the financial markets. The exposures and limits are reviewed on a regular basis by senior management in the Executive Committee and in the 'ALCO' (Asset and Liabilities Committee).

3.3.2 Interest rate risk

Interest rate risk arises in the Bank's operations due to interest rate fluctuations resulting from interest-earning assets and interest-bearing liabilities, which mature or are repriced at different times or in different amounts. Floating rate assets and liabilities are also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices. 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. As outlined previously, 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 adopts a policy to match the currency and maturity of predominantly transactions through treasury operations, as much as is practicable, to minimise the risk of adverse fluctuations in interest rates affecting financial assets and financial liabilities. 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, through its Treasury function, also invests in highly liquid quality assets, namely listed government and corporate debt securities, 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 Bank's ALCO is primarily responsible for oversight over the Bank's interest rate risk management process and monitors actively the interest rate risk measures utilised by the Bank. Credit facilities and commitments to lend funds to customers are granted at prevailing market interest rates at drawdown date.

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

As at 31 December 2018	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 and cash	99,853	(0.40%)	95,973	-	-	-	3,880
Financial investments measured at FVOCI	67,922	0.10%	-	2,653	53,115	12,154	-
Loans and advances to banks	57,516	0.07%	57,511	-	-	-	5
Loans and advances to customers	520,745	4.00%	498,081	22,664	-	-	-
Total financial assets	**746,036**	**-**	**651,565**	**25,317**	**53,115**	**12,154**	**3,885**
Financial liabilities							
Amounts owed to banks	90	0%	49	-	-	-	41
Amounts owed to customers	677,272	0.64%	456,903	104,840	115,529	-	-
Total financial liabilities	**677,362**		**456,952**	**104,840**	**115,529**	**-**	**41**
Interest repricing gap			**194,613**	**(79,523)**	**(62,414)**	**12,154**	**3,844**
Cumulative gap			**194,613**	**115,090**	**52,676**	**64,830**	

	Carrying amount	Effective interest rate	Less than 3 months	Between 3 months and 1 year	Between 1 year and 5 years	More than 5 years	Non-interest bearing
As at 31 December 2017	**€000**	**%**	**€000**	**€ 000**	**€000**	**€000**	**€000**
Financial assets							
Balances with Central Bank of Malta and cash	26,777	(0.40%)	22,734	-	-	-	4,043
Financial investments available-for-sale	67,322	2.95%	-	-	54,802	12,520	-
Loans and advances to banks	69,911	0.12%	69,908	-	-	-	3
Loans and advances to customers	382,314	4.28%	370,966	11,348	-	-	-
Total financial assets	**546,324**		**463,608**	**11,348**	**54,802**	**12,520**	**4,046**
Financial liabilities							
Amounts owed to banks	290	0.02%	287	-	-	-	3
Amounts owed to customers	513,851	0.95%	363,961	78,152	71,738	-	-
Total financial liabilities	**514,141**		**364,248**	**78,152**	**71,738**	**-**	**3**
Interest repricing gap			99,360	(66,804)	(16,936)	12,520	4,043
Cumulative gap			99,360	32,556	15,620	28,140	

Interest rate profile

The table below analyses interest-earning assets and interest-bearing liabilities between those that have a fixed rate and a variable rate.

	2018		2017	
	Fixed	Variable	Fixed	Variable
	€000	€000	€000	€000
Interest-earning assets				
Financial investments measured at FVOCI (2017: available-for-sale)	**50,240**	**17,682**	67,322	-
Balances with Central Bank of Malta	**53,141**	**42,832**	-	22,734
Loans and advances to banks	**37,959**	**19,552**	46,707	23,201
Loans and advances to customers	**51,323**	**469,422**	1,967	380,347
	192,663	**549,488**	115,996	426,282
Interest-bearing liabilities				
Amounts owed to banks	**-**	**49**	-	287
Amounts owed to customers	**345,332**	**331,940**	223,205	290,646
	345,332	**331,989**	223,205	290,933

Fair value sensitivity for fixed rate instruments

Financial instruments issued at fixed rates potentially expose the Bank to fair value interest rate risk. Loans and advances to customers and to banks and amounts owed to customers and to banks are measured at amortised cost and are not expected to be disposed of, and are therefore not subject to fair value interest rate risk.

The Bank's instruments exposing the Bank to fair value interest rate risk consist of quoted debt securities measured at FVOCI (2017: available-for-sale), as described in note 7, since these are fair valued with fair value changes recognised in other comprehensive income. Considering the nature of the investments, a sensitivity analysis disclosing how debt securities would have been affected by changes in interest rates that were reasonably possible at the end of the reporting period is not deemed necessary.

Cash flow sensitivity for variable rate instruments

The Bank is exposed to cash flow interest rate risk principally in respect of the financial assets and liabilities which are subject to floating interest rates. Financial assets and liabilities issued at variable rates expose the Bank to cash flow interest rate risk.

Taking cognisance of the nature of the Bank's financial assets and liabilities as described above, under the requirements of IFRS 7, a sensitivity analysis in respect of interest rate changes is required in relation to the Bank's net floating rate assets.

At the end of the reporting period, if interest rates had increased by 100 basis points (assuming a parallel shift of 100 basis points in yields) with all other variables held constant, in particular foreign currency rates, the post-tax result for the year would increase by €2,175,000 (2017: €1,353,000). Likewise, if interest rates had decreased by 100 basis points (assuming a parallel shift of 100 basis points in yields) with all other variables held constant, in particular foreign currency rates, the post-tax result for the year would decrease by €2,175,000 (2017: €1,353,000).

3.3.3 Currency risk

Currency risk is the risk of the exposure of the Bank's financial position and cash flow to adverse movements in foreign exchange rates.

The Bank manages currency 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.

The Directors have set limits on the level of exposure by currency and in total, which are monitored daily, and hedging strategies are used to ensure that positions are maintained within established limits.

The Bank also enters into forward exchange contracts with customers in the normal course of its business. It is the Bank's policy to cover the exposure arising from such forward contracts.

The following table summarises the Bank's exposures to foreign currency risk at 31 December. Included in the tables are the Bank's financial instruments at carrying amounts, categorised by currency.

As at 31 December 2018	TOTAL €000	EUR €000	GBP €000	USD €000	OTHER €000
Financial assets					
Balances with Central Bank of Malta and cash	99,853	46,543	44,425	8,792	93
Financial investments designated at FVOCI	68,263	68,263	-	-	-
Loans and advances to banks	57,516	1,781	20,858	33,648	1,229
Loans and advances to customers	520,745	519,748	-	997	-
Other assets	6,566	6,227	14	325	-
Total financial assets	**752,943**	**642,562**	**65,297**	**43,762**	**1,322**
Financial liabilities					
Amounts owed to banks	90	88	-	2	-
Amounts owed to customers	677,272	591,792	65,685	18,933	862
Other liabilities	12,109	11,881	49	179	-
Total financial liabilities	**689,471**	**603,761**	**65,734**	**19,114**	**862**
Net on-balance sheet financial position			**(437)**	**24,648**	**460**
Notional of derivative financial instruments				**(28,437)**	
Residual exposure			**(437)**	**(3,789)**	**460**

As at 31 December 2017	TOTAL €000	EUR €000	GBP €000	USD €000	OTHER €000
Financial assets					
Balances with Central Bank of Malta and cash	26,777	26,679	12	48	38
Financial investments classified as available-for-sale	67,663	67,663	-	-	-
Loans and advances to banks	69,911	51,004	8,046	9,006	1,855
Loans and advances to customers	382,314	380,979	-	1,335	-
Other assets	5,954	5,932	1	1	20
Total financial assets	**552,619**	**532,257**	**8,059**	**10,390**	**1,913**
Financial liabilities					
Amounts owed to banks	290	29	-	261	-
Amounts owed to customers	513,851	497,744	7,134	7,633	1,340
Other liabilities	7,545	5,446	146	1,186	767
Total financial liabilities	**521,686**	**503,219**	**7,280**	**9,080**	**2,107**
Net currency position			**779**	**1,310**	**(194)**

In view of the levels of net currency positions reflected in the tables above, a sensitivity analysis for foreign exchange risk disclosing how profit or loss and equity would have been affected by changes in foreign exchange rates that were reasonably possible at the end of the reporting periods would not reflect significant impacts (after hedging transactions).

In fact, under the scenario that the euro appreciates by 20% against all currencies the effect would be a gain of €753,000 (2017: a loss of €379,000) in the carrying amount of financial instruments with the adverse impact recognised in profit or loss. Should the euro depreciate against all currencies by 20%, the effect would be a loss of €753,000 (2017: a gain of €379,000) in the carrying amount of financial instruments and the favourable impact would be recognised in profit or loss.

3.4. Liquidity Risk

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

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

Liquidity risk may result from the Bank's inability 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, as well as the inability to sell a financial asset quickly at close to its fair value. The Bank is exposed to daily calls on its available cash resources from overnight deposits, current and call deposits, maturing term deposits, loan drawdowns and guarantees.

Such risk is inherent in all banking operations, which is generally 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 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 manages its net interest spread by advancing credit to customers with longer terms to maturity than the liabilities funding such loans. To mitigate exposures arising in this respect, the Bank holds significant liquid assets in the form of listed debt securities, 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 76.9% (2017: 74.4%) at the end of the period under review reflects the Bank's prudent position in the context of liquidity management.

i. Liquidity Coverage Ratio

The LCR metric is designed to promote the short-term resilience of a bank's liquidity profile, and became a minimum regulatory standard from 1 October 2015, under European Commission ('EC') Delegated Regulation 2015/61. It aims to ensure that a bank has sufficient unencumbered high-quality liquid assets ('HQLA') to meet its liquidity needs in a 30-calendar-day liquidity stress scenario. HQLA consist of cash or assets that can be converted into cash at little or no loss of value in markets.

The LCR ratio as at 31 December 2018 was 337.27% (2017: 126.38%).

As at 31 December 2018 and 2017 the LCR ratio was within both the regulatory minimum and the risk appetite set by the bank.

ii. Net stable funding ratio

The NSFR requires institutions to maintain sufficient stable funding relative to required stable funding, and reflects a bank's long-term funding profile (funding with a term of more than a year). It is designed to complement the LCR.

The European calibration of NSFR is pending following the European Commission's proposal in November 2016. As a result, the bank calculates NSFR in line with Basel Committee on Banking Supervision publication 295, pending its implementation in Europe.

The NSFR ratio as at 31 December 2018 was 149.26%. (2017: 171.52%)

As at 31 December 2018 and 2017 the NSFR was within both the regulatory minimum and the risk appetite set by the bank.

The Bank's ALCO focuses on the Bank's management process with respect to market and funding liquidity risks. Compliance with established limits is monitored by the ALCO.

Accordingly the Bank's liquidity management process is summarised below:

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 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.

The following table discloses financial assets and liabilities at the end of the reporting period by remaining period to maturity:

AT 31 DECEMBER 2018	TOTAL	WITHIN 3 MONTHS	LESS THAN 1 YEAR	OVER 1 BUT LESS THAN 5 YEARS	OVER 5 YEARS	NO MATURITY DATE
	€000	€000	€000	€000	€000	€000
Financial assets						
Balances with Central Bank of Malta and cash	99,853	95,126	-	-	-	4,727
Financial investments designated as FVOCI	68,263	-	2,653	53,115	8,454	4,041
Loans and advances to banks	57,516	57,516	-	-	-	-
Loans and advances to customers	520,745	38,573	17,579	64,215	400,378	-
Other assets	6,566	2,583	-	-	-	3,983
Total financial assets	**752,943**	**193,798**	**20,232**	**117,330**	**408,832**	**12,751**
Financial liabilities						
Amounts owed to banks	90	90	-	-	-	-
Amounts owed to customers	677,272	458,771	102,976	115,525	-	-
Other liabilities	12,109	-	-	-	-	12,109
Total financial liabilities	**689,471**	**458,861**	**102,976**	**115,525**	**-**	**12,109**
Maturity gap		**(265,063)**	**(82,744)**	**1,805**	**408,832**	
Cumulative gap		**(265,063)**	**(347,807)**	**(346,002)**	**62,830**	

AT 31 DECEMBER 2017	TOTAL	WITHIN 3 MONTHS	LESS THAN 1 YEAR	OVER 1 BUT LESS THAN 5 YEARS	OVER 5 YEARS	NO MATURITY DATE
	€000	€000	€000	€000	€000	€000
Financial assets						
Balance with Central Bank of Malta and cash	26,777	23,310	-	-	-	3,467
Financial investments classified as available-for-sale	67,663	-	-	54,802	8,744	4,117
Loans and advances to banks	69,911	69,911	-	-	-	-
Loans and advances to customers	382,314	32,381	18,413	35,017	296,503	-
Other assets	5,954	2,336	-	-	-	3,618
Total financial assets	**552,619**	**127,938**	**18,413**	**89,819**	**305,247**	**11,202**
Financial liabilities						
Amounts owed to banks	290	290	-	-	-	-
Amounts owed to customers	513,851	357,040	76,264	80,547	-	-
Other liabilities	7,545	2,410	-	-	-	5,135
Total financial liabilities	**521,686**	**359,740**	**76,264**	**80,547**	**-**	**5,135**
Maturity gap		**(231,802)**	**(57,851)**	**9,272**	**305,247**	
Cumulative gap		**(231,802)**	**(289,653)**	**(280,381)**	**24,866**	

An amount of €3,700,000 (2017: €3,766,000) comprising financial investments measured at FVOCI (2017: available-for-sale) have been pledged in favour of the Depositor Compensation Scheme.

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.

AT 31 DECEMBER 2018	TOTAL	WITHIN 3 MONTHS	LESS THAN 1 YEAR	OVER 1 BUT LESS THAN 5 YEARS	OVER 5 YEARS
	€000	€000	€000	€000	€000
Financial liabilities					
Amounts owed to banks	90	90	-	-	-
Amounts owed to customers	684,740	459,031	104,251	121,458	-
Total financial liabilities	**684,830**	**459,121**	**104,251**	**121,458**	**-**

AT 31 DECEMBER 2017	TOTAL	WITHIN 3 MONTHS	LESS THAN 1 YEAR	OVER 1 BUT LESS THAN 5 YEARS	OVER 5 YEARS
Financial liabilities					
Amounts owed to banks	290	290	-	-	-
Amounts owed to customers	520,690	358,741	77,091	84,858	-
Total financial liabilities	**520,980**	**359,031**	**77,091**	**84,858**	**-**

Through the ILAAP the robustness of the Bank's liquidity and funding was assessed using various tools and metrics, including a risk assessment and a stress testing exercise. The ILAAP report concluded that the Bank's liquidity and funding profile is sound, and liquidity controls are sufficiently robust. The ILAAP report was duly submitted to the Regulator.

3.5. Operational risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events (including legal risk). When controls fail to perform or underperform, operational risks can cause damage to reputation, have legal or regulatory implications, and/or lead to financial loss. The Bank cannot realistically expect to eliminate all operational risks, but through its control framework and by monitoring and responding to potential risks, such risks can be prudently managed and mitigated. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the judicious use of internal audit findings.

The Bank maintains an Operational Risk Management Framework (ORMF). Each department is directly involved in the management of operational risk to the extent that an Operational Risk Manager (ORM) is appointed by each respective Unit within the Bank. In the case of the Retail Banking Unit within the Commercial Department, with effect from 2017, an ORM is appointed from each and every branch within the retail banking network in order to better capture operational risk events closer to the point of incidence. The Risk Control & Oversight Unit within the Internal Control Department (ICD-ROU) is responsible for the coordination of all operational risk activities within the Bank as well as their control and oversight. In terms of ORMF, every effort is made to ensure that operational risks are curtailed, minimised and/or mitigated to inhibit, or at least significantly reduce, the incidence of operational risks materialising into operational losses. The Framework comprises:

i. Risk identification. Relevant operational risks are identified through various execution tools. The latter include detailed questionnaires, ongoing reporting of operational risk events, near-misses and losses. At internal entity level, each entity's operational risk manager must gather, filter and report the data to the Risk Control & Oversight Unit in a standardised format.

ii. Operational Risk reporting threshold. All operational risks are reported i.e. the reporting threshold is officially €0. Aggregation is carried out centrally by the Risk Control & Oversight Unit to ensure that low-value, high frequency operational risk events are identified and properly managed.

iii. Operational Loss Database. The aforementioned reporting provides the basis for the compilation of an operational loss database. Regular updating of the database with newly emerging internal losses and/or near-misses keeps it up-to-date and enriches it over time.

iv. Operational risk measurement. Operational risk events are quantified on two dimensions in terms of monetary value, which denotes "severity", and quantity, signifying "frequency of occurrence". The product of these two dimensions yields the risk level which is then reported to top management, with mitigating action proposed and prioritised by risk level magnitude.

v. Operational risk and control assessment. The operational risk events are evaluated. Interactions with the internal stakeholders involved are held. Proposals are formulated for action intended to eliminate, reduce, and/or mitigate the impact and likelihood of recurrence. Decisions are then taken at the appropriate level.

vi. Monitoring and controlling. This is an ongoing process involving, inter alia, the reviewing of Key Risk Indicators (KRIs), loss and near-miss levels, and self-assessment procedures in place.

vii. Operational risk management tools. Operational risk events are batched and placed in a heat map. Any operational risk event batches with medium to high frequency, severity or both are identified and focused upon in order to practise active and ongoing risk mitigation. The toolkit includes use of Key Performance Indicators (KPIs) and KRIs metrics.

viii. Reporting. This involves the disclosure of losses and indicators of operational risks. A specific software application is used to ensure a methodical approach which generates consistent and standardised reporting.

The Bank applies the Basic Indicator Approach ('BIA') as defined in the CRR in order to quantify the regulatory capital charge. Accordingly, the Bank allocates 15% of the average of gross income over the previous three years as regulatory capital in respect of operational risk. The capital requirement for operational risk under this method was calculated at €2,012,000 (2017: €2,001,000).

During 2018, the actual level of operational risk materialisation recorded on the Bank's database was again compared to the regulatory capital quantification under the abovementioned BIA. This included all of the following event types: Settled, Near-Miss, Estimate and Potential. Only "Settled" events result in an income statement hit, but nonetheless all were considered. Their summation resulted in much a lower level of operational risk than calculated under the BIA (Pillar 1) and served as a useful benchmark to compare actual versus theoretical level of operational risk event materialization. Such comparison was further reinforced by means of an Operational Risk and Control Assessment (RCA). The RCA analysed all key processes across the institution and assessed the prevailing risk level, as well as the efficacy and performance of control measures in place for each and every process. Thus, it was possible to differentiate between inherent and residual risk levels, the latter ensuing upon taking into account the effectiveness of implemented controls. The final residual risk level was used to allocate Pillar 2 add-ons for sub-categories of operational risk.

A major plank in the Bank's efforts to properly manage and control operational risk, remains the Business Continuity Plan (BCP) which is formalised and in place and covers the whole organisation. The BCP is revised from time to time.

3.6. Capital risk management

It is the Bank's policy to actively manage its capital base to cover risks inherent in the business and at the same time to support the development of the business, to maximise shareholders' value and to meet all the regulatory requirements. Capital management policy is monitored by the Executive Committee and the ALCO.

Accordingly, the purpose of the Bank's capital management is essentially to ensure an efficient use of capital, taking cognisance of the Bank's risk appetite and profile as well as its objectives for business development. The Bank is a licensed credit institution 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 from the Capital Requirements Directive ('CRD') and Capital Requirements Regulation ('CRR'), as implemented by the Malta Financial Services Authority for supervisory purposes, as well as guidelines developed by the Basel Committee. The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. The Bank is required to maintain a ratio of total regulatory capital to risk-weighted assets (Total capital ratio) above the prescribed minimum level of 8%. On top of this, regulatory capital buffers such as the Capital Conservation Buffer, are also set aside.

The minimum capital requirements are calculated for credit, market and operational risks. During the year, the Bank utilised the Standardised Approach for credit risk, the Basic Indicator Approach for operational risk and the Standardised Approach for foreign exchange risk in order to calculate the Pillar 1 minimum capital requirements. For credit risk, under the Standardised Approach, risk weights are determined according to credit ratings provided by internationally recognised credit agencies such as Fitch or their equivalents and by using the applicable regulatory risk weights for unrated exposures. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income, while the Basic Method requires the Bank to allocate 8% of its overall net foreign exchange position to calculate the capital requirement for foreign exchange risk.

The sum of the capital requirement calculated under Pillar 1 and the additional requirement identified under Pillar 2 represents the total capital actually required under the CRR.

The following is an analysis of the Bank's capital base in accordance with the CRR's requirements applicable at 31 December 2018:

	2018	2017
	€000	€000
Common Equity Tier 1 (CET1) capital		
Share capital	67,044	39,544
Retained earnings	1,460	768
Reserve for general banking risks	992	992
Revaluation reserve	(532)	(248)
Adjustments:		
• Depositor Compensation Scheme Reserve	(3,667)	(3,667)
• Intangible assets	(1,044)	(1,124)
- Removal of Unrealised gains to Tier 2	-	(11)
- Deferred tax assets	-	(426)
- Amounts added back to CET1 due to IFRS9 TPs	1,408	-
	65,662	35,828
Additional Tier 1 Perpetual Capital Notes	7,500	5,000
Tier 2 capital		
Transitional adjustments	-	788
Revaluation reserve (unrealised gains)	-	11
	-	799
Total own funds	**73,162**	**41,627**

3.7. Fair values of financial assets and liabilities

3.7.1 Financial instruments measured at fair value

The Bank's financial instruments which are carried at fair value include the Bank's financial investments measured at FVOCI (2017: classified as available-for-sale), (Note 7). The Bank 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 13 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 following tables reflect an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

AT 31 DECEMBER 2018	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
	€000	€000	€000	€000
Financial assets				
Derivative financial instruments held-for-trading	-	122	-	122
Financial investments measured at FVOCI				
• Government debt, fixed income instruments	29,408	-	-	29,408
• Corporate debt, fixed income instruments	38,514	-	-	38,514
• Other equities	-	-	341	341
Total financial assets	**67,922**	**122**	**341**	**68,263**

Financial assets				
Financial investments available-for-sale				
• Government debt, fixed income instruments	39,318	-	-	39,318
• Corporate debt, fixed income instruments	28,004	-		28,004
• Other equities	-	-	341	341
Total financial assets	**67,322**	**-**	**341**	**67,663**

There were no transfers between levels 1, 2 and 3 during the year.

Financial instruments in Level 1

The fair value of instruments traded in active markets is based on quoted market prices at the end of the reporting period. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial instruments held by the Bank is the current bid price at 31 December of the respective year.

Instruments included in Level 1 financial investments consist of available-for-sale debt securities, composed of government debt issued by the Government of Malta, which is listed on the Malta Stock Exchange, other foreign sovereign listed debt, and other listed debt instruments issued by local and foreign corporates.

Financial instruments in Level 2

Fair values for the Bank's derivative contracts are generally determined utilising valuation techniques, involving primarily the use of discounted cash flow techniques. The fair values referred to are determined by reference to market prices or rates (forward foreign exchange rates) quoted at the end of the reporting period. The valuation techniques used are supported by observable market prices or rates since their variables include only data from observable markets. The Bank's derivative financial instruments are accordingly typically categorised as Level 2 instruments.

Financial instruments in Level 3

This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Instruments included in Level 3 consist of the Bank's interest in VISA Inc. preferred stock (refer to Note 7).

Financial instruments not measured at fair value

Loans and advances to banks and customers and amounts owed to banks and customers are carried at amortised cost in the Statement of Financial Position. The Board considers the carrying amounts of loans and advances to banks and customers 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 fair values of fixed interest deposits and amounts owed to banks are not deemed to be significantly different from their carrying amounts, based on discounted cash flows at current market interest rates, particularly due to the relatively short periods to maturity.

4. ACCOUNTING ESTIMATES AND JUDGEMENTS

4.1. Critical accounting estimates and judgements in applying the Bank'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 Bank 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 Bank'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.

4.2. Impairment losses on loans and advances

4.2.1 Measurement of the expected credit losses (applicable from 1 January 2018)

The measurement of the expected credit loss allowance for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions and credit behaviour. Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed in note 3.2.4.

A number of significant judgements are required in measurement of expected credit loss, such as:

- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL; and
- Establishing the number and relative weightings of forward-looking scenarios and associated ECL.

Detailed information about the judgements and estimates made by the Bank in the above areas is set out in note 3.2.4.

4.2.2 Measurement of the impairment losses (applicable until 31 December 2017)

The Bank reviewed its loan portfolio to assess impairment on an ongoing basis as relevant generic data was observed concerning risks associated with groups of loans with similar risk characteristics. In determining whether an impairment loss should be recorded in the Income Statement, the Bank made judgements as to whether there was 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 could be identified with that portfolio. This evidence includes observable data indicating that there had been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlated with defaults on assets in the group. Management used 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 were reviewed regularly to reduce any differences between loss estimates and actual loss experience.

4.3. Assessment of estimates and judgements

In the opinion of the directors, the accounting estimates and judgements made in the course of preparing these 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 3.2.4).

5. SEGMENTAL INFORMATION

The segment reporting of the Bank is made in terms of the business segments which it conducts its business in, as the risks and rates of return are affected predominantly by differences in the products and services produced. The Bank is currently organised into three main business segments:

Retail banking - Principally handling customers' deposits, providing consumer loans, overdrafts and funds transfer facilities.

Corporate banking - Principally handling loans and other credit facilities and deposit and current accounts for corporate and institutional customers.

Other - Principally treasury and other central functions.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss. Income taxes are managed on a group basis and are not allocated to operating segments.

Interest income is reported net as management primarily relies on net interest revenue as a performance measure, not the gross income or expense.

No reconciliation is required since there are no differences between the measurements of the reportable segments' profits or losses, assets and liabilities and the entity's profit or loss, assets and liabilities.

The following tables present income, profit and certain asset and liability information regarding the Bank's business segments for the years ended 31 December 2018 and 2017:

	Retail banking 2018	Corporate banking 2018	Other 2018	Total 2018
	€000	€000	€000	€000
Net operating income				
Net interest income	8,059	7,093	381	15,533
Net fees and commission income	882	1,822	13	2,717
Net trading income	-	-	828	828
Total operating income	**8,941**	**8,915**	**1,222**	**19,078**
Credit impairment losses	60	(1,719)	87	(1,572)
Net operating income	**9,001**	**7,196**	**1,309**	**17,506**
Employee compensation and benefits	(4,303)	(2,829)	(232)	(7,364)
Other administrative expenses	(3,417)	(2,142)	(229)	(5,788)
Depreciation of property and equipment and amortisation of intangible assets	(555)	(217)	(23)	(795)
Profit before tax				**3,559**
Income tax expense				(1,289)
Profit for the year				**2,270**
Assets and liabilities				
Segment assets	303,870	222,296	228,049	754,215
Unallocated assets				13,257
Total assets				**767,472**
Segment liabilities	469,668	208,020	91	677,779
Unallocated liabilities				13,230
Total liabilities				**691,009**

	Retail banking 2017	Corporate banking 2017	Other 2017	Total 2017
	€000	€000	€000	€000
Net operating income				
Net interest income	5,760	5,112	30	10,902
Net fees and commission income	877	1,488	(32)	2,333
Net trading income	-	-	1,423	1,423
Total operating income	**6,637**	**6,600**	**1,421**	**14,658**
Credit impairment losses	(465)	(52)	-	(517)
Net operating income	**6,172**	**6,548**	**1,421**	**14,141**
Employee compensation and benefits	(3,784)	(2,659)	(421)	(6,864)
Other administrative expenses	(2,411)	(1,961)	(377)	(4,749)
Depreciation of property and equipment and amortisation of intangible assets	(597)	(270)	(52)	(919)
Profit before tax				**1,609**
Income tax expense				(411)
Profit for the year				**1,198**
Assets and liabilities				
Segment assets	254,619	133,472	162,563	550,654
Unallocated assets				16,911
Total assets				**567,565**
Segment liabilities	363,691	150,160	290	514,141
Unallocated liabilities				7,545
Total liabilities				**521,686**

6. BALANCES WITH CENTRAL BANK OF MALTA AND CASH

	2018	2017
	€000	€000
Current		
Balances with Central Bank of Malta	95,996	22,734
Cash	3,880	4,043
	99,876	26,777
Less credit impairment losses	(23)	-
	99,853	**26,777**

The average balance of the reserve deposit required at year end in terms of Article 32 of the Central Bank of Malta Act, Cap. 204 of the Laws of Malta held with the Central Bank of Malta was €4,727,000 (2017: €3,467,000).

7. FINANCIAL INVESTMENTS

Financial investments measured at FVOCI include the following:

	2018	2017
	€000	€000
Equities (available-for-sale as at 31 December 2017)	341	341
Debt instruments (available-for-sale as at 31 December 2017)		
- Government debt securities		
Local and listed on the Malta Stock Exchange	23,944	23,017
Foreign and listed on other exchanges	5,464	16,301
- Other debt securities		
Local and listed on the Malta Stock Exchange	-	1,367
Foreign and listed on other exchanges	**38,514**	26,637
At 31 December	**68,263**	67,663

	2018	2017
	€000	€000
Non-current		
Debt and other fixed income instruments	**67,922**	67,322

The movement in financial investments is summarised as follows:

	2018	2017
	€000	€000
At 1 January	**67,663**	17,758
Acquisitions	**20,130**	84,592
Redemptions/maturities	-	(12,671)
Disposals	**(17,122)**	(20,189)
Amortisation	**(1,824)**	(904)
Fair value movements	**(584)**	(923)
At 31 December	**68,263**	67,663

As at 31 December 2018, the impairment allowance measured in accordance with the IFRS 9 expected loss model was €147,000.

Government debt securities with a carrying amount of €3,700,000 (2017: €3,766,000) have been pledged in favour of the Depositor Compensation Scheme.

Equity instruments referred to in the table above consisted of the investment as a result of the acquisition of Visa Europe Limited by Visa Inc., emanating from the bank receiving preferred stock of Visa Inc. in exchange for its membership in Visa Europe Limited. These instruments have been designated at FVOCI upon adoption of IFRS9 as they are held for purposes other than to generate investment returns.

The preference shares are convertible into ordinary shares of Visa Inc.; they have no maturity and represent a residual interest in the issuer's net assets. The holder of the preference shares is exposed to litigation risk borne by their issuer, and hence the value of these shares depends on the level and outcome of any future litigation, which is for obvious reasons impossible to accurately forecast.

The purpose of the preferred stock is to provide Visa Inc. with protection against all litigation risk associated with interchange fees linked to the activity of Visa Europe Limited.

Due to the lack of any more recent developments, it is not possible to create an actuarial model to assess the future litigation costs, and the estimation arrived at for the purposes of these financial statements therefore remains the best available forecast.

The disclosure requirements in paragraph 93 of IFRS 13 in respect of Level 3 fair value measurements were not deemed necessary by the directors taking cognisance of the insignificance of the carrying amount of the interest as at 31 December 2017 and 2018.

8. LOANS AND ADVANCES TO BANKS

	2018	2017
	€000	€000
Current		
Repayable on call and at short notice	33,022	23,204
Term placements	24,530	46,707
	57,552	69,911
Less credit impairment losses	(36)	-
Net loans and advances to banks	57,516	69,911

9. LOANS AND ADVANCES TO CUSTOMERS

	2018	2017
	€000	€000
Repayable on call and at short notice	**47,557**	66,737
Term loans and advances	**484,637**	324,662
Gross loans and advances to customers	**532,194**	391,399
Less expected credit loss allowances	**(11,449)**	(9,085)
Net loans and advances to customers	**520,745**	382,314

Impairment allowances		
Stage 1 (starting from 1 January 2018)	**1,285**	-
Stage 2 (starting from 1 January 2018)	**1,416**	-
Stage 3 (starting from 1 January 2018)	**8,748**	-
Collective (applicable until 31 December 2017)	**-**	6,910
Specific (applicable until 31 December 2017)	**-**	2,175
	11,449	9,085
Current	**57,826**	75,914
Non-current	**474,368**	315,485
Gross loans and advances to customers	**532,194**	391,399

10. PROPERTY AND EQUIPMENT

	LAND AND BUILDINGS	COMPUTER EQUIPMENT	OTHER EQUIPMENT	TOTAL
	€000	€000	€000	€000
At 1 January 2017				
Cost	8,486	1,836	1,455	11,777
Accumulated depreciation	(1,974)	(1,280)	(1,253)	(4,507)
Net book amount	6,512	556	202	7,270

	LAND AND BUILDINGS	COMPUTER EQUIPMENT	OTHER EQUIPMENT	TOTAL
	€000	€000	€000	€000
Year ended 31 December 2017				
At 1 January 2017	6,512	556	202	7,270
Acquisitions	6	160	46	212
Disposals	-	-	(5)	(5)
Depreciation charge for the year	(271)	(103)	(195)	(569)
At 31 December 2017	**6,247**	**613**	**48**	**6,908**
At 31 December 2017				
Cost	8,492	1,996	1,496	11,984
Accumulated depreciation	(2,245)	(1,383)	(1,448)	(5,076)
Net book amount	6,247	613	48	6,908

	LAND AND BUILDINGS	COMPUTER EQUIPMENT	OTHER EQUIPMENT	TOTAL
	€000	€000	€000	€000
Year ended 31 December 2018				
At 1 January 2018	6,247	613	48	6,908
Acquisitions	11	146	81	238
Reclassification to non-current assets held-for-sale	(743)	-	-	(743)
Depreciation charge for the year	(202)	(136)	(109)	(447)
Depreciation released upon reclassification	39	-	-	39
At 31 December 2018	**5,352**	**623**	**20**	**5,995**
At 31 December 2018				
Cost	7,760	2,142	1,577	11,479
Accumulated depreciation	(2,408)	(1,519)	(1,557)	(5,484)
Net book amount	**5,352**	**623**	**20**	**5,995**

At 31 December 2018, there was no future capital expenditure which was authorised by the Board, but has not yet been contracted for at year end (2017: €70,000). Additionally, at 31 December 2018, an amount of €47,000 had been contracted for but not provided for in the financial statements (Note 23). Property and equipment includes assets amounting to €139,000 (2017: €15,000) which were still not put to use at year end.

During 2018, the Bank resolved to dispose of property which is no longer utilised for operational purposes with the carrying value of €743,000 and has an action plan to dispose of it within twelve months.

11. INTANGIBLE ASSETS

	COMPUTER SOFTWARE & ROYALTIES	OTHER INTANGIBLES	TOTAL
	€000	€000	€000
At 1 January 2017			
Cost	3,096	146	3,242
Accumulated depreciation	(1,944)	-	(1,944)
Net book amount	1,152	146	1,298
Year ended 31 December 2017			
At 1 January 2017	1,152	146	1,298
Acquisitions	176	-	176
Amortisation for the year	(350)	-	(350)
At 31 December 2017	978	146	1,124
At 31 December 2017			
Cost	3,272	146	3,418
Accumulated amortisation	(2,294)	-	(2,294)
Net book amount	978	146	1,124
Year ended 31 December 2018			
At 1 January 2018	978	146	1,124
Acquisitions	268	-	268
Amortisation for the year	(348)	-	(348)
At 31 December 2018	**898**	**146**	1,044

	COMPUTER SOFTWARE & ROYALTIES	OTHER INTANGIBLES	TOTAL
	€000	€000	€000
At 31 December 2018			
Cost	3,540	146	3,686
Accumulated amortisation	(2,642)	-	(2,642)
Net book amount	898	146	1,044

At 31 December 2018, an amount of €90,000 had been contracted for but not provided for in the financial statements (Note 23). At 31 December 2018, computer software included assets amounting to €29,000 (2017: €91,000) which were still not put to use at year end.

12. DERIVATIVE FINANCIAL INSTRUMENTS

Under the cross-currency swaps entered into, the Bank carries out a spot transaction exchanging a specified amount in one currency with a specific amount in another currency and agrees to re-exchange at a specified rate and date in the future.

The table below shows the fair values of derivative financial instruments.

	2018		2017	
	Notional	Fair value	Notional	Fair value
	€000	€000	€000	€000
Derivatives held-for-trading				
Cross-currency swaps	25,000	122	-	-
	25,000	122	-	-

13. DEFERRED TAX

Deferred tax assets and liabilities are attributable to the following:

	ASSETS	LIABILITIES	NET	ASSETS	LIABILITIES	NET
	2018	2018	2018	2017	2017	2017
	€000	€000	€000	€000	€000	€000
Differences between depreciation and capital allowances	-	(285)	(285)	-	(267)	(267)
Impairment allowances	4,986	-	4,986	3,834	-	3,834
Fair value movements on securities	359	(14)	345	140	-	140
Unused tax losses	-	-	-	216	-	216
	5,345	(299)	5,046	4,190	(267)	3,923

Movement in temporary differences during the year 2018 related to:

	AT 31 DECEMBER 2017	IMPACT OF ADOPTING IFRS9 RECOGNISED IN RETAINED EARNINGS	RECOG-NISED IN PROFIT OR LOSS	RECOGNISED IN OTHER COMPRE-HENSIVE INCOME	AT 31 DECEMBER 2018
	€000	€000	€000	€000	€000
Differences between depreciation and capital allowances	(267)	-	(18)	-	(285)
Impairment allowances	3,834	527	594	31	4,986
Fair value movements on investments	140	-	-	205	345
Unused tax losses	216	-	(216)	-	-
	3,923	527	360	236	5,046

Movement in temporary differences during the year 2017 related to:

	AT 1 JANUARY 2017	RECOGNISED IN PROFIT OR LOSS	RECOGNISED IN OTHER COMPREHENSIVE INCOME	AT 31 DECEMBER 2017
	€000	€000	€000	€000
Differences between depreciation and capital allowances	(275)	8	-	(267)
Impairment allowances	3,472	362	-	3,834
Fair value movements on investments	(184)	-	324	140
Unused tax losses	997	(781)	-	216
	4,010	(411)	324	3,923

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 assets/liabilities reflected in other comprehensive income relate to the fair valuation of financial investments measured at FVOCI.

14. PREPAYMENTS AND ACCRUED INCOME

	2018	2017
	€000	€000
Current		
Prepayments	887	788
Accrued income	1,696	1,547
	2,583	2,335

15. OTHER ASSETS

	2018	2017
	€000	€000
Other financial assets	3,008	3,026
Other assets	2,620	1,325
	5,628	4,351
Current	3,983	3,619
Non-current	1,645	732
	5,628	4,351

'Other financial assets' represent amounts pledged in favour of a card scheme.

16. SHARE CAPITAL

	2018		2017	
	No. of shares	€	No. of shares	€
Authorised				
Ordinary shares of €0.7552 each	92,690,678	70,000,000	92,690,678	70,000,000
Issued and fully paid up				
Ordinary shares of €0.7552 each	88,776,483	67,044,000	52,362,289	39,544,001

By virtue of a resolution dated 20 January 2017, the Bank increased its issued share capital by €15,000,000 (divided into 19,862,289 shares of a nominal value of €0.7552 each) from €24,544,000 (divided into 32,500,000 ordinary shares of a nominal value of €0.7552 each) to €39,544,000 (divided into 52,362,289 shares of a nominal value of €0.7552 each).

By virtue of a resolution dated 18 January 2018, the Bank increased its issued share capital by €20,000,000 divided into 26,483,050 ordinary shares of a nominal value of €0.7552 each from €39,544,000 (divided into 52,362,289 ordinary shares of a nominal value of €0.7552 each) to €59,544,000 (divided into 78,845,340 shares of a nominal value of €0.7552 each).

By virtue of a resolution dated 7 December 2018, the Bank increased further its issued share capital by €7,500,000 divided into 9,931,144 ordinary shares of a nominal value of €0.7552 each from €59,544,000 (divided into 78,845,340 ordinary shares of a nominal value of €0.7552 each) to €67,044,000 (divided into 88,776,483 shares of a nominal value of €0.7552 each).

The issued ordinary shares rank pari passu for all purposes and, in the event that a poll is demanded, each share entitles the holder thereof to one vote.

17. PERPETUAL CAPITAL NOTES

On 4 October 2016, the Bank issued floating rate Perpetual Additional Tier 1 Capital Notes amounting to an aggregate amount of €5,000,000 to Al Faisal International for Investment Company Q.P.S.C..

The notes are subject to interest at the rate of 10% until 31 December 2016 and Euribor plus 10% thereafter, but all interest payments are cancellable at the discretion of the Bank.

By virtue of resolution dated 7 December 2018, the Board resolved to issue fixed rate Perpetual Additional Tier 1 Capital Notes amounting to €2,500,000 of a nominal value of €1,000 each to JUD Investment Group Limited (€2,441,000) and PG Holdings Limited (€ 59,000).

The notes are subject to interest at the rate of 8% on 30 June 2019 and at six month intervals thereafter. All interest payments are cancellable at the discretion of the Bank.

The notes constitute unsecured, undated and subordinated obligations of the Bank; these instruments are redeemable at par at the discretion of the issuer only on 31 December 2021 and at six month intervals thereafter. These capital instruments qualify as Additional Tier 1 instruments in accordance with the requirements of Article 52 of the Regulations (EU) No 575/2013 and are categorised as equity within the Bank's Statement of Financial Position under the requirements of IFRSs as adopted by the EU.

18. RESERVES

a. Retained earnings

Retained earnings represent earnings not paid out as dividends. Interim profits form part of regulatory Own Funds only once they are verified by an independent external auditor. The Bank may only make distributions out of eligible profits.

b. Revaluation reserve

The revaluation reserve is used to record movements in the fair value of equity shares and debt securities measured at FVOCI (2017: available-for-sale), net of deferred taxation thereon. The revaluation reserve is not available for distribution.

c. Reserve for General Banking Risks

The Reserve for General Banking Risks refers to the amount allocated by the Bank from its retained earnings, to a non-distributable reserve against potential risks linked to the Bank's non-performing loans and advances. The allocation to this reserve occurred over a three year period, of which the Bank allocated 40% during the financial year 2013, 30% during the financial year 2014 and the remaining allocation of the total estimated amount during the financial year 2015. During the year ended 2016 the methodology for calculating this reserve was updated in line with the requirements of BR/09/2016 issued by the Malta Financial Services Authority.

19. AMOUNTS OWED TO BANKS

	2018	2017
	€000	€000
Current		
Term loans and advances	45	24
Repayable on demand	45	266
	90	290

20. AMOUNTS OWED TO CUSTOMERS

	2018	2017
	€000	€000
Term deposits	345,332	223,205
Repayable on demand	331,940	290,646
	677,272	513,851
Current	561,743	442,113
Non-current	115,529	71,738
	677,272	513,851

Included in 'Amounts owed to customers' are deposits of €27,846,000 (2017: €27,378,000) held as collateral for loan commitments, irrevocable commitments under guarantees and import letters of credit.

21. OTHER LIABILITIES

	2018	2017
	€000	€000
Bills payable	4,041	2,597
Accounts payable and sundry creditors	858	410
Obligations under guarantees and other documentary credits	3,373	1,342
Expected credit losses arising on off-balance sheet items	416	-
	8,688	4,349

The movement in 'Obligations under guarantees and other documentary credits' is as follows:

	2018	2017
	€000	€000
At 1 January	1,342	1,175
Arising during the year	4,308	1,935
Utilised	(1,363)	(740)
Unused amounts reversed	(914)	(1,028)
At 31 December	3,373	1,342

22. ACCRUALS AND DEFERRED INCOME

	2018	2017
	€000	€000
Current		
Accrued interest	1,602	2,410
Accrued operating expenditure	1,588	649
Accrued capital expenditure	158	137
Deferred income	73	-
	3,421	3,196

Accrued operating expenditure mainly relates to amounts in relation to the provision of day-to-day services and specific non-recurring expenditure.

23. CONTINGENT LIABILITIES AND COMMITMENTS

As part of its business activities, the Bank enters into various irrevocable commitments and contingent liabilities. Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods.

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed expiry dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements. The potential credit loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers meeting specific conditions. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Even though these obligations are not recognised on the Statement of Financial Position, they do contain credit risk and are therefore part of the overall risk of the Bank.

The total outstanding commitments and contingent liabilities are as follows:

	2018	2017
	€000	€000
Contingent liabilities		
Guarantees	9,763	8,003
Documentary credits	1,436	817
	11,199	8,820
Commitments		
Undrawn commitments to lend	158,470	112,685
Capital commitments		
Authorised but not contracted for	-	70
Contracted for	137	-
	137	70
Total commitments	158,607	112,755

Operating lease commitments - Bank as lessee

During 2018, the Bank did not enter into any new contracts of commercial lease for immovable property.

Details of all the contracts in force are as follows:

i. 10 year commercial lease for immovable property which is cancellable by giving one year's notice (starting 2008);

ii. 20-year term contract which is cancellable after the first 10 years of the contract by giving one year's notice (starting 2008);

iii. 5-year term contract with the option to extend the term for further periods of 12 months each (starting 2008);

iv. 15-year term contract, with the right to terminate the lease after 5 years to be used for retail purposes (starting 2010); and

v. 6-year term contract to be used as an extension to the current Head Office premises (starting 2011).

Future minimum lease payments under non-cancellable operating leases as at 31 December are as follows:

	2018	2017
	€000	€000
Within one year	376	364
	376	364

Legal claims

Litigation is a common occurrence in the banking industry due to the nature of the business. The Bank has an established protocol for dealing with such legal claims. Once professional advice has been obtained and the amount of damages reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claims may have on its financial position. At year end, there were no significant unresolved legal claims.

24. INTEREST RECEIVABLE AND SIMILAR INCOME

	2018	2017
	€000	€000
On loans and advances to banks	369	82
On loans and advances to customers	18,742	15,518
On balances with Central Bank of Malta	(34)	(282)
	19,077	15,318
On debt and other fixed income instruments	1,925	1,166
Net amortisation of discounts and premiums	(1,825)	(902)
	100	264
Total interest and similar income	19,177	15,582

25. INTEREST PAYABLE AND SIMILAR EXPENSE

	2018	2017
	€000	€000
On amounts owed to banks	55	35
On amounts owed to customers	3,589	4,645
	3,644	4,680

26. NET FEES AND COMMISSION INCOME

	2018	2017
	€000	€000
Fees and commission income		
Credit related fees and commissions	1,433	1,054
Other fees	2,196	1,931
	3,629	2,985
Fees and commission expense		
Credit related fees and commissions	(97)	-
Other fees	(815)	(652)
	(912)	(652)
Net fees and commission income	2,717	2,333

27. NET TRADING INCOME

	2018	2017
	€000	€000
Foreign exchange activities		
From derivatives	122	-
From commercial business activities	622	561
Net trading income	744	561

28. EMPLOYEE COMPENSATION AND BENEFITS

	2018	2017
	€000	€000
Directors and Executive officers' remuneration	867	989
Wages and salaries		
Managerial, supervisory and clerical	6,399	5,800
Others	98	75
Total employee compensation and benefits	7,364	6,864

The total fees payable to Non-Executive Directors amounted to €202,966 (2017: €147,700).

The average number of persons employed by the Bank during the years 2018 and 2017 was as follows:

	2018	2017
Managerial, supervisory and clerical	202	196
Others	5	5
	207	201

29. OTHER ADMINISTRATIVE EXPENSES

	2018	2017
	€000	€000
Auditors' remuneration – annual statutory audit	56	53
Information system and communications	1,597	1,208
Business development	914	259
Corporate services	1,376	1,281
Regulatory expenses	392	357
Other	1,453	1,591
	5,788	4,749

Other remuneration payable to the auditors include assurance related services of €106,000 (2017: €1,000). Tax advisory and compliance services provided during 2018 amounted to €30,000 (2017: €15,000).

Corporate services include operating lease payments amounting to €359,000 (2017: €337,000).

In total, from incorporation up to 31 December 2018, the Bank has contributed €1,922,000 in variable contributions to the Depositor Compensation Scheme. This represents 0.5% (2017: 0.4%) of the eligible deposits at 31 December 2018. The cash contribution paid during 2018 amounted to €275,000 (2017: €251,000) and is included under Regulatory expenses.

30. CREDIT IMPAIRMENT LOSSES

Credit impairment losses during 2018 were as follows:

	WRITE-DOWNS	REVERSALS OF WRITE-DOWNS	TOTAL
	€000	€000	€000
Balances with Central Bank of Malta and cash			
Stage 1	2	(4)	**(2)**
Financial investments measured at FVOCI			
Stage 1	37	(129)	**(92)**
Loans and advances to banks			
Stage 1	24	(17)	**7**
Loans and advances to customers			
Stage 1	1,153	(176)	**977**
Stage 2	830	(740)	**90**
Stage 3	1,971	(1,471)	**500**
Bad debts written-off	7	-	**7**
Total loans and advances to customers	**3,961**	**(2,387)**	**1,574**
Other provisions	85	-	**85**
Credit impairment losses	4,109	(2,537)	**1,572**

Credit impairment losses during 2017 were as follows:

	WRITE-DOWNS	REVERSALS OF WRITE-DOWNS	TOTAL
	€000	€000	€000
Loans and advances to customers			
Specific allowances	1,311	(938)	**373**
Collective allowances	1,165	(1,025)	**140**
Bad debts written off	4	-	**4**
Credit impairment losses	2,480	(1,963)	**517**

31. INCOME TAX EXPENSE

The components of income tax for the years ended 31 December 2018 and 2017 are:

	2018	2017
	€000	€000
Income Statement:		
Current income tax	**(1,648)**	-
Deferred tax income/(charge)	**359**	(411)
	(1,289)	(411)

The tax on profit and the result of accounting profit multiplied by the applicable tax rate in Malta of 35% are reconciled as follows:

	2018	2017
	€000	€000
Profit before tax	3,559	1,609
Tax at the applicable rate of 35%	1,246	563
Tax effect of:		
Non-deductible expenses	17	17
Other differences	26	12
Overprovision of deferred taxation	-	(181)
	1,289	411

32. EARNINGS PER SHARE

Earnings per share is calculated by dividing net profit attributable to the shareholders of the Bank as shown in the Income Statement divided by the weighted average number of ordinary shares outstanding during the year.

	2018	2017
Net profit attributable to shareholders (€000)	2,270	1,198
Weighted average number of ordinary shares in issue	77,539,327	51,273,944
Earnings per share (€ cents)	2c9	2c3

33. CASH AND CASH EQUIVALENTS

Analysis of balances of cash and cash equivalents as shown in the Statement of Cash Flows:

	2018	2017
	€000	€000
Cash (Note 6)	3,880	4,043
Balances with Central Bank of Malta (excluding Reserve Deposit) (Note 6)	91,268	19,267
Loans and advances to banks (Note 8)	57,552	69,911
Amounts owed to banks (Note 19)	(90)	(290)
Cash and cash equivalents	152,610	92,931
Adjustment to reflect balances with contractual maturity of more than three months	4,726	3,467
	157,336	96,398

As per Statement of Financial Position:

	2018	2017
Balances with Central Bank of Malta and cash	99,853	26,777
Loans and advances to banks	57,516	69,911
Amounts owed to banks	(90)	(290)
	157,279	96,398
Balances with contractual maturity of more than three months	(4,727)	(3,467)
Add credit impairment losses	58	-
Cash and cash equivalents	152,610	92,931

34. RELATED PARTIES

34.1. Identification of related parties

Since 4 October 2016, the majority shareholding of the Bank is held by JUD Investment Group Limited (previously known as Al Faisal International for Investment Malta Limited), a subsidiary of Al Faisal International for Investment Q.P.S.C. headquartered in Qatar.

All entities which are ultimately controlled by Al Faisal International for Investment Q.P.S.C., together with the other minority shareholders, are considered to be related parties.

The Bank's related party transactions mainly comprise transactions with shareholders and other entities controlled by the same shareholders. These transactions principally include loans, deposits and issuance of capital notes.

Related party transactions do not impact on the Bank's financial results and financial position taking cognisance of the normal commercial terms and conditions of such transactions.

34.2. Transactions with shareholders

a. Parent company JUD Investment Group Limited (previously known as Al Faisal International for Investment Malta Limited)

	2018	2017
	€000	€000
Income Statement		
Interest and similar expense	219	-
Statement of Financial Position		
Loans and advances to parent company	1	1
Amounts owed to parent company	67,241	16,993

As explained in note 17, on 4 October 2016 the Bank issued floating rate Perpetual Additional Tier 1 Capital Notes amounting to an aggregate of €5,000,000 to JUD Investment Group Limited (previously known as Al Faisal International for Investment Malta Limited).

By virtue of resolution dated 7 December 2018, the Board resolved to issue further fixed rate Perpetual Additional Tier 1 Capital Notes amounting to €2,441,000 of a nominal value of €1,000 each to JUD Investment Group Limited (previously known as Al Faisal International for Investment Malta Limited).

As disclosed in note 16, during 2018 the Bank issued new share capital, which was subscribed by the shareholders.

Total interest payable on these Notes during 2018 amounted to €495,000 (2017: €495,000).

b. Other shareholders

During the year under review, the following transactions were undertaken by the Bank with entities controlled by other shareholders:

	2018	2017
	€000	€000
Income Statement		
Interest and similar income	27	22
Other administrative expenses	353	173

Year end balances arising from such related party transactions comprise:

	2018	2017
	€000	€000
Statement of Financial Position		
Loans and advances to customers	9,341	469
Prepayments and accrued income	14	95
Amounts owed to customers	2,202	2,739
Accruals and deferred income	154	12

As explained in note 17, the Bank issued fixed rate Perpetual Additional Tier 1 Capital Notes amounting to €59,000 of a nominal value of €1,000 each to PG Holdings Ltd.

Total interest payable on these Notes during 2018 amounted to €12,000 (2017: €12,000).

34.3. Transaction arrangements and agreements involving key management personnel

During the year under review, the following banking transactions were carried out with Directors and personnel in senior management roles, who are deemed to be the Bank's key management personnel:

	2018	2017
	€000	€000
Income Statement		
Interest and similar income	62	32
Interest and similar expense	4	2

Statement of Financial Position		
Loans and advances to customers	3,255	1,038
Amounts owed to customers	2,748	2,123

The above mentioned outstanding balances arose from the ordinary course of business on substantially the same terms as for comparable transactions with persons of a similar standing, or where applicable, other employees.

34.4. Compensation to key management personnel

Directors' remuneration and salaries to Executive Officers, are separately disclosed in note 29.

35. EVENTS OCCURRING AFTER THE REPORTING PERIOD

Share issue

By virtue of a resolution dated 7 December 2018, the Board of Directors resolved to increase its share capital by €7,500,000 divided into 9,931,144 ordinary shares of a nominal value of €0.7552 each from €67,044,000 (divided into 88,776,483 shares of a nominal value of €0.7552 each) to €74,544,000 (divided into 98,707,627 shares of a nominal value of €0.7552 each), for subscription in cash by JUD Investment Group Limited (€7,321,612) and PG Holdings Limited (€178,388) and payable fully on 29 March 2019.

Perpetual Additional Tier 1 Capital Notes issue

By virtue of resolution dated 7 December 2018, the Board resolved to issue fixed rate Perpetual Additional Tier 1 Capital Notes amounting to €2,500,000 of a nominal value of €1,000 each to JUD Investment Group Limited (€2,441,000) and PG Holdings Limited (€ 59,000) and payable fully by 29 March 2019.

Dividends

Subsequent to the end of the reporting period, a net dividend of €0.00845 per nominal share of €0.7552, for a total amount of €750,000, is being proposed by the shareholders to be distributed for the twelve months ended 31 December 2018. A resolution to this effect will be proposed to the Annual General Meeting.

36. RESTATEMENT OF COMPARATIVE INFORMATION

Comparative figures presented in the Bank's Income Statement and in the Statement of Changes in Equity have been restated to conform with the current year's presentation format for the purpose of fairer presentation. Interest payable on perpetual capital notes issued by the Bank, which are treated as equity, has been recognised and reflected as a dividend directly in equity during 2018 to reflect the substance of the instrument and interest payments thereon, rather than interest expense within profit or loss. During 2017, this interest payable was recognised within profit or loss and accordingly the comparative figures have been restated in this respect. The following table summarises the impact of the restatement on the Bank's Income Statement and Statement of Changes in Equity for the year ended 31 December 2017:

	EFFECT OF RESTATEMENT 2017
	€
Statement of Financial Position	
Deferred tax asset	(177)
Income Statement	
Interest payable and similar expense	507
Income tax expense	177
Statement of Changes in Equity	
Transactions with owners	
Interest on perpetual capital notes	(507)

The above restatement has not had any impact on the Bank's equity position.

37. STATUTORY INFORMATION

BNF Bank p.l.c. is a limited liability company domiciled and resident in Malta.

The immediate parent company of BNF Bank p.l.c. is JUD Investments Group Limited (previously known as Al Faisal International for Investment Malta Limited) a company registered in Malta, with its registered address at 61, St Paul Street, Valletta.

The ultimate parent company of BNF Bank p.l.c. is Al Faisal International for Investment Company, Q.P.S.C., a Qatari Private Shareholding Company registered under the laws of Qatar with commercial registration number 43094, and with its registered office situated at 17th Floor, Marriot Marquis Centre, Doha, Qatar.

The ultimate controlling party of BNF Bank p.l.c. is H.E. Sheikh Feisal Qassim F. Th. Al-Thani.

Additional Regulatory Disclosures

Additional Regulatory Disclosures

For the year ended 31 December 2018

1. OVERVIEW

These Additional Regulatory Disclosures ('ARD') are prepared by the Bank in accordance with Part Eight of EU Regulation No 575/2013 ('Capital Requirements Regulation' or 'CRR'), and in accordance with 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 ('BR/07').

The Bank publishes these disclosures on an annual basis as part of the Annual Report. These disclosures are not subject to an external audit, except to the extent that any disclosures are equivalent to those made in the Financial Statements, which have been prepared in accordance with the requirements of International Financial Reporting Standards ('IFRS') as adopted by the EU. The Bank, through its internal verification procedures, is satisfied that these ARD are presented fairly.

These ARD should be read in conjunction with the Financial Statements and Notes to the Financial Statements.

2. RISK MANAGEMENT FRAMEWORK

The Bank operates a commercial banking model, the main business lines being retail and corporate banking. The Board's risk appetite is therefore to maintain a prudent and risk-averse position, the key financial risks being those set out in the Financial Statements and Notes to the Financial Statements.

The Risk Management Framework is an integral part of the Bank's organisational and governance structure, the details of which are set out in the Statement of Compliance with the Principles of Good Corporate Governance.

Risk Culture

The Board of Directors is responsible for the Bank's risk culture, and for outlining its long-term objectives. Furthermore, the Board has the responsibility for ensuring that the Executive Committee implements a strategy which enables the Bank to meet its objectives while respecting its risk appetite.

To this end, the Board of Directors continuously challenges the Bank's management and their performance and has delegated the responsibility of risk management to the Risk Committee. Through the Risk Committee the Board of Directors regularly and thoroughly engages in analysis of the Bank's risk situation. The primary tools used by the Risk Committee to address their responsibility are the Risk Appetite and the Risk Management Framework.

Risk Appetite

The Board has approved a risk appetite statement which sets out their tolerance to risk exposure with respect to all risks identified. This statement is translated into a system of risk limits for all risks which the Bank considers as material, to ensure that the Risk Appetite is fully embedded throughout the Bank.

Four Lines of Defence

The Bank's Risk Management Framework is modelled on the Four Lines of Defence Principle:

- The First Line of Defence

  The first line is also known as the frontline. The first line of defence comprises of the internal entities which own and manage risk. Such is composed of all the commercial, operational, and internal support departments;

- The Second Line of Defence

  The second line comprises of all functions providing oversight in the form of risk monitoring and control in support of management. The entities forming the second line include the risk function and the compliance function. The Asset and Liability Management Committee (ALCO), also carries out some oversight functions;

- The Third Line of Defence

  The third line of defence comprises the internal audit function. It provides assurance with a direct line to the Audit Committee, concerning the effectiveness of management of controls;

- The Fourth Line of Defence

  The fourth line comprises of external entities which provide fully independent audit and supervision, primarily the external auditors and supervisory authorities.

Risk Management Process

The Bank's risk management process forms an integral part of its Risk Management Framework, and is outlined as follows:

- Assessment of key vulnerabilities

  The Bank carries out an analysis of its business model and strategy on a regular basis. As part of that analysis, the Bank endeavours to identify its key vulnerabilities, being the areas that drive its risks and potential scenarios of stress.

- Risk identification and analysis of inherent risk drivers

  Using its key vulnerabilities as a point of reference, the Bank identifies risks and risk categories. The risk identification exercise uses as a guide the comprehensive list of risk categories and sub-categories outlined in the Supervisory Review and Evaluation Process (SREP) Guidelines and the European Central Bank (ECB) Expectations on ICAAP and ILAAP. Once relevant risks are identified, the Bank considers which risks which are material to its business model.

- Inherent Risk Assessment

Those risks which the Bank considers to be material are assessed to provide the Bank with an understanding of the extent to which the Bank is inherently exposed to such risks. The Bank then compares the inherent exposure for each risk to the Risk Appetite Statement as approved by the Board of Directors.

- Internal Controls Framework

The Bank's objective is to manage all material risks by means of its Internal Controls Framework, the priority risks being those assessed as inherently beyond the Board's risk appetite. The Internal Controls Framework is a detailed map of processes and controls designed to mitigate priority risks.

All material risks are assigned to Risk Owners, being entities falling within the first line of defence. Risk Owners are responsible for the day-to-day management and control of risks and are supported and overseen by the second line of defence.

- Residual Risk Assessment

Post-consideration of controls set out in the Internal Controls Framework, the Bank re-assesses material risks to determine their residual risk. If residual risk is within the Board's risk appetite, in most cases the Bank will accept the residual risk. In cases where residual risk remains beyond the Board's risk appetite or where the residual risk is not considered acceptable, further risk treatment is considered. Additionally, such risks are often targeted as part of the Bank's stress testing framework.

- Risk Treatment

Risk treatment for residual risks which are not considered acceptable typically consists of enhancements to the Internal Controls Framework, or, where possible, risk transfer by means of insurance. Where none of the former two approaches are possible, the Bank will finance the risks through Pillar 2 capital or liquidity buffers.

- Risk Reporting

The second line of defence is responsible for aggregating and reporting risks to executive and board level, and to the third and fourth lines of defence.

Qualitative and quantitative aspects of the Bank's risk position are regularly reported to and discussed by top management. This includes the Board of Directors and its sub-committees i.e. the Audit Committee and Risk Committee, the Executive Committee, as well as management committees, such as the ALCO.

Regulatory risk reporting also takes place regularly through the ICAAP and ILAAP reports and the Recovery Plan.

3. CAPITAL MANAGEMENT

The Bank is obliged to comply with regulatory capital requirements emanating primarily from the CRR, and also from various other local and European requirements. Compliance with such requirements is therefore a top priority of the Board, as is efficient capital management.

Capital management is monitored by the ALCO. The Bank manages its capital structure and adjusts it in the light of economic and business conditions, and the risk characteristics of its activities.

3.1. Own funds

The Bank's available capital and reserves for the purposes of capital adequacy is represented by the Bank's Own funds. In July 2013, the European Banking Authority ('EBA') issued its final draft Implementing Technical Standards ('ITS') on own funds disclosures. The disclosure requirements of these technical standards have been integrated within the Bank's disclosures set out below.

The Bank's regulatory Own Funds consist of Common Equity Tier 1 ('CET1') capital and Additional Tier 1 capital, which include the following items:

- ordinary share capital;
- retained earnings;
- revaluation reserve;
- reserve for general banking risks;
- perpetual capital notes; and
- other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes, including the treatment of deferred tax assets, deductions relating to amounts pledged in favour of the Depositor Compensation Scheme and deductions relating to intangible assets.

The Bank does not have Tier 2 capital.

Details of items which make up regulatory Own Funds are set out below:

a. Share capital

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

	2018	
	No. of shares	€
Authorised		
Ordinary shares of €0.7552 each	**92,690,678**	70,000,000
Issued		
Ordinary shares of €0.7552 each	**88,776,483**	67,044,000

Issued share capital increased by €15,000,000, €20,000,000 and €7,500,000 on 20 January 2017, 18 January 2018 and 07 December 2018 respectively. A further increase of €7,500,000 is expected in March 2019.

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. Perpetual Capital Notes

On 31 December 2018, the Bank issued additional floating rate Perpetual Additional Tier 1 Capital Notes amounting to an aggregate amount of €2,441,000 to JUD Investment Group Limited and €59,000 to PG Holdings Ltd. The notes are subject to interest at the rate of 8%, which interest payments are subject to cancellation at the discretion of the Bank.

	€000
AT 1 Notes issued in 2016	5,000
AT 1 Notes issued in 2018	2,500
Total AT 1 Notes	**7,500**

As described in the new regulations published by the European Commission, banks are required to complete a transitional disclosure template during the phasing in of regulatory adjustments from 1 January 2014 to 31 December 2018. The transitional disclosure template is set out below.

c. Retained earnings

Retained earnings represent earnings not paid out as dividends. Interim profits form part of regulatory Own Funds only once they are verified by an independent external auditor. The Bank may only make distributions out of eligible profits. Accumulated losses are deducted in full from the Bank's own funds.

d. Revaluation reserve

This represents the cumulative net change in fair values of equity shares and debt securities measured at FVOCI (2017: available-for-sale) held by the Bank, net of related deferred tax effects. The revaluation reserve is not available for distribution.

e. 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 Reserve for General Banking Risks refers to the amount allocated by the Bank from its retained earnings, to a non-distributable reserve against potential risks linked to the Bank's non-performing loans and advances. The allocation to this reserve occurred over a three-year period, of which the Bank allocated 40% during the financial year ended 2013, 30% during the financial year ended 2014, and the remaining allocation of the total estimated amount during the financial year ended 2015. During 2016 the methodology for calculating this reserve was updated in line with BR/09/2016 issued by the Malta Financial Services Authority.

3.2. Capital requirements

The Bank's minimum Pillar 1 capital requirements excluding buffer requirements are as follows:

- CET1 ratio of 4.5%;
- Capital Adequacy Ratio (CAR) of 8%.

Pillar 1 capital requirements are based on standard rules which state the minimum Own Funds requirements to cover credit risk, market risk and operational risk. The Bank uses the Standardised Approach to calculate credit risk, the Basic Indicator Approach for operational risk and the Standardised Approach with respect to market risk.

Banking Rule BR/15: 'Capital Buffers of Credit Institutions authorised under the Banking Act, 1994', sets out requirements for capital buffers. The two capital buffers applicable to the Bank are the capital conservation buffer and the countercyclical buffer.

As from 1 January 2019 the capital conservation requirement will be of 2.5%, fully comprised of CET1 capital. At 31 December 2018 the capital conservation buffer was being phased in and was of 1.875%.

The countercyclical buffer requirement will range between 0 - 2.5%, based on the country's exposure to cyclical risk. Since most of the Bank's exposures are in Malta, the institution-specific countercyclical buffer as determined by Article 140 (1) of Directive 2013/36/EU, results in a percentage of 0.04%, and is calculated as the weighted average of the individual countercyclical buffer rates applicable in each country where the Bank's exposures are located.

The Bank's Own Funds and capital ratio calculations are set out below:

	AS AT 31 DECEMBER 2018
	€000
Common Equity Tier 1 (CET1) capital	
Common Equity Tier 1 (CET1) capital: instruments and reserves	
Share capital	67,044
Retained earnings	(2,206)
Funds for general banking risk	992
Accumulated other comprehensive income (and other reserves)	(532)
CET1 capital before regulatory adjustments	65,298
Common Equity Tier 1 (CET1) capital: regulatory adjustments	
Intangible assets	(1,044)
Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met)	-
Deferred tax assets that rely on future profitability and arise from temporary Differences	-
Amounts added back to CET 1 due to IFRS 9 TPs	1,408
Total regulatory adjustments to CET1	364
CET1 capital	65,662
Additional Tier 1 capital	7,500
Tier 1 capital	73,162

	AS AT 31 DECEMBER 2018
	€000
Tier 2 capital	
Tier 2 capital before regulatory adjustments	
Capital instruments and subordinated loans	-
Transitional adjustments to tier 2 capital	-
Tier 2 capital: regulatory adjustments	
Regulatory adjustments relating to unrealised gains pursuant to Article 481	
Total Tier 2 capital	-
Total Own Funds	73,162
Total risk weighted assets	426,672
Capital ratios	%
CET1 ratio	15.39%
Tier 1 ratio	17.15%
Total Capital Adequacy Ratio	17.15%

	AS AT 31 DECEMBER 2018
	€000
Institution specific buffer requirement	**1.915**
• of which: capital conservation buffer requirement	**1.875**
• of which: institution specific countercyclical capital buffer	**0.040**
CET 1 available to meet buffers, including Pillar 2	**10.89**
Items not deducted from own funds in accordance with Article 48 of CRR	**5,046**

	EXPOSURE VALUE	RISK WEIGHTED ASSETS	CAPITAL REQUIRED
At 31 December 2018	**€000**	**€000**	**€000**
Central governments or Central banks	72,153	-	-
Institutions	149,125	29,223	2,338
Corporate	101,310	98,958	7,917
Retail	70,069	47,397	3,792
Secured by mortgages on immovable property	305,527	103,113	8,249
Items associated with particularly high risk	51,288	76,932	6,155
Exposures in default	18,220	18,220	1,458
Equity	341	341	27
Other items	23,747	26,831	2,147
Credit risk	**791,780**	**401,015**	**32,083**
Operational risk		25,151	2,012
Foreign exchange risk		506	41
Total capital required		**426,672**	**34,136**

Own Funds	
Common Equity Tier 1	65,662
Additional Tier 1	7,500
Tier 2	-
Total Own Funds	**73,162**
Capital Adequacy Ratio	**17.15%**

4. LEVERAGE

The Leverage Ratio (LR) measures the relationship between the Bank's capital and its total exposure. The minimum LR requirement of 3% is aimed at preventing build-up of excessive leverage.

For the purposes of the LR, capital is defined as Tier 1 capital in line with article 25 of the CRR, whilst total exposure relates to the total on and off-balance sheet exposures, less deductions applied to Tier 1 capital.

The following table represents the Bank's leverage ratio determined in accordance with the requirements stipulated by Implementing Regulation EU 2016/200.

	2018
	€000
Tier 1 capital	73,162
Total exposure	817,363
Leverage ratio	**8.95%**

The total exposure measure for the purposes of the leverage ratio has been determined as follows:

	2018
	€000
Balance sheet items	767,920
Adjustments in determining Tier 1 capital	(1,044)
On-balance sheet exposure	**766,876**
Off-balance sheet exposures at gross notional amount	169,669
Adjustments in determining Tier 1 capital	(119,182)
Off-balance sheet exposure	**50,487**
Total exposure	**817,363**

The following table provides a reconciliation of accounting assets and leverage ratio exposures:

	2018
	€000
Total assets as per published financial statements	767,472
Adjustment for off-balance sheet items	50,487
Other adjustments	
Deduction of intangible assets	(1,044)
Other	448
Leverage ratio exposure	**817,363**

The Leverage Ratio is considered as part of the Bank's ICAAP.

5. ICAAP AND ILAAP

As part of its risk management the Bank performs an assessment of risks not adequately covered under Pillar 1 of the CRR, with a view to self-impose add-on requirements under Pillar 2. This process is referred to as the ICAAP and ILAAP process. The Bank's ICAAP and ILAAP process is compliant with requirements emanating from MFSA Banking Rule BR/12.

The Bank prepares a report of its ICAAP and ILAAP process annually, or more frequently as may be deemed necessary. ICAAP and ILAAP reporting is subject to Board approval and submitted to the regulator. ICAAP and ILAAP reporting is carried out in addition to regular risk reporting.

All assumptions and methodologies used in the ICAAP and ILAAP process are subject to internal validation by the Bank's control functions, in addition to validation of ICAAP and ILAAP reporting.

The Bank's Board of Directors is confident that all material risks applicable to the period under review were identified and assessed as part of the ICAAP and ILAAP process. Risks which the Bank considers to be material are described in further detail below.

6. CREDIT RISK

Note 3.2 to the Financial Statements defines credit risk and discloses detail on the Bank's credit risk management and measurement.

The tables below set out the Bank's maximum exposure to credit risk before consideration of collateral held or other credit enhancements:

	AVERAGE EXPOSURE	EXPOSURE AS AT 31 DECEMBER 2018
	€000	€000
As at 31 December 2018		
Central government or central banks	55,048	72,153
Institutions	101,377	149,125
Corporate exposures	86,393	101,310
Retail exposures	101,130	70,069
Secured by mortgages on immovable property	262,090	305,527
Items associated with particular high risk	33,369	51,288
Exposures in default	20,249	18,220
Equity	341	341
Other items	25,857	23,747
Total	**685,854**	**791,780**

	2018
	€000
Reconciliation of exposure to credit risk	
Exposure as per Statement of Financial Position	767,472
Less: deductions for assets that are not risk-weighted	(12,514)
Statement of Financial Position exposure after deductions	754,958
Off-balance sheet exposure before application of the credit conversion factor (CCF)	169,669
Less: CCF adjustment	(132,847)
Off-balance sheet exposure after deductions	36,822
Total maximum exposure to credit risk	**791,780**

The residual maturity breakdown by exposure class at 31 December 2018 was as follows:

	TOTAL	LESS THAN 1 YEAR	BETWEEN 1 AND 5 YEARS	OVER 5 YEARS	NO MATURITY DATE
	€000	€000	€000	€000	€000
At 31 December 2018					
Central government or central banks	72,153	2,653	13,887	7,404	48,209
Institutions	149,125	149,125	-	-	-
Corporate	101,310	14,439	9,637	77,185	49
Retail	70,069	13,380	12,745	39,474	4,470
Secured by mortgages on immovable property	305,527	12,675	8,585	284,249	18
Items associated with particular high risk particular high risk	51,288	2,459	48,624	205	-
Exposures in default	18,220	5,191	3,934	8,980	115
Equity	341	-	-	-	341
Other items	23,747	8,817	5,046	5,995	3,889
Total	**791,780**	**208,739**	**102,458**	**423,492**	**57,091**

6.1. Concentration risk

Note 3.2.6 to the Financial Statements defines credit concentration risk and discloses detail on the Bank's areas of credit concentration.

6.1.1 Credit concentration risk analysed by industry sector

An industry sector analysis of the Bank's exposure amounts split by exposure class is shown in the following table:

	TOTAL	MANUFACTURING	FINANCIAL SERVICES	HOUSEHOLDS & INDIVIDUALS	CONSTRUCTION	WHOLESALE AND RETAIL	OTHER SECTORS
	€000	€000	€000	€000	€000	€000	€000
At 31 December 2018							
Central government or central banks	72,153	-	-	-	-	-	72,153
Institutions	149,125	-	149,125	-	-	-	-
Corporate	101,310	4,049	21,285	719	5,091	15,988	54,178
Retail	70,069	1,912	1,724	47,143	3,570	8,299	7,421
of which: SME	*19,200*	*1,536*	*994*	-	*3,343*	*8,171*	*5,156*
Secured by mortgages on immovable property	305,527	7,301	6,119	266,608	8,245	6,846	10,408
of which: SME	*24,496*	*3,688*	*5,720*	-	*2,294*	*5,807*	*6,987*
Items associated with particular high risk	51,288	-	-	2,369	25,230	-	23,689
of which: SME	*33,539*	-	-	-	*15,710*	-	*17,829*
Exposures in default	18,220	871	2,788	6,358	260	4,513	3,430
Equity	341	-	-	-	-	-	341
Other items	23,747	-	23,747	-	-	-	-
Total	**791,780**	**14,133**	**204,788**	**323,197**	**42,396**	**35,646**	**171,620**

6.1.2 Credit concentration risk analysed by geographical region

The geographical concentration of the Bank's exposure classes as at the end of the reporting period are analysed in the following table.

	TOTAL	MALTA	PORTUGAL	UNITED KINGDOM	BELGIUM	OTHER
	€000	€000	€000	€000	€000	€000
At 31 December 2018						
Central Government or central banks	72,153	66,689	5,464	-	-	-
Institutions	149,125	53,154	-	54,884	16,468	24,619
At 31 December 2018						
Corporate	101,310	101,187	-	-	-	123
Retail exposures	70,069	70,010	-	-	-	59
Secured by mortgages on immovable property	305,527	303,514	-	-	-	2,013
Items associated with particular high risk	51,288	51,288	-	-	-	-
Exposures in default	18,220	18,220	-	-	-	-
Equity	341	-	-	-	-	341
Other items	23,747	23,747	-	-	-	-
Total	**791,780**	**687,809**	**5,464**	**54,884**	**16,468**	**27,155**

6.2. Credit quality

6.2.1 Balances with banks and debt securities

Note 3.2.7 to the Financial Statements discloses detail on credit quality of balances with banks and debt securities.

6.2.2 Loans and advances to customers

Note 3.2.8 to the Financial Statements discloses detail on credit quality of loans and advances to customers and impairment allowances thereon. Further detail on loss allowances is also disclosed in note 3.2.10 to the Financial Statements.

The following table presents a reconciliation of changes in the impairment allowances of the Bank which are considered as Specific Credit Risk Adjustments (SCRAs) in respect of the Bank's loan portfolio:

STAGE 3 IMPAIRMENT ALLOWANCES	TOTAL	MANUFACTURING	HOUSEHOLDS & INDIVIDUALS	CONSTRUCTION	WHOLESALE & RETAIL	OTHER
	€000	€000	€000	€000	€000	€000
At 1 January 2018 after adoption of IFRS 9	8,291	489	2,669	65	3,677	1,391
Additions	1,971	60	359	364	418	770
Reversals	(1,471)	(29)	(725)	(1)	(656)	(60)
At 31 December 2018	**8,791**	**520**	**2,303**	**428**	**3,439**	**2,101**

STAGE 1 & 2 IMPAIRMENT ALLOWANCES	TOTAL	MANUFACTURING	HOUSEHOLDS & INDIVIDUALS	CONSTRUCTION	WHOLESALE & RETAIL	OTHER
	€000	€000	€000	€000	€000	€000
At 1 January 2018 after adoption of IFRS 9	2,008	41	372	126	915	554
Additions	1,844	46	430	186	342	840
Reversals	(777)	(20)	(167)	(96)	(183)	(311)
At 31 December 2018	**3,075**	**67**	**635**	**216**	**1,074**	**1,083**

Past due but not impaired loans include loans and advances where contractual interest or principal payments are past due, but the Bank believes that impairment is not appropriate based on the stage of collection of amounts owed to the Bank. The Bank accounts for expected credit losses on these balances.

Loans and advances to customers are analysed into impaired, past due and other exposures as follows:

	2018
	€000
Gross loans and advances to customers	
- Impaired	28,147
- Past due but not impaired	8,408
- Neither past due nor impaired	495,639
	532,194

The following table analyses the impaired and the past due but not impaired gross loans and advances to customers by industry sector:

	IMPAIRED	PAST DUE BUT NOT IMPAIRED
At 31 December 2018	€000	€000
Gross loans and advances by industry		
Manufacturing	1,767	8
Households and individuals	7,927	3,883
Construction	2,837	796
Wholesale and retail	7,559	2,807
Other sectors	8,057	914
	28,147	8,408

The Bank's impaired and past due but not impaired loans and advances to customers were primarily concentrated in Malta during 2018.

The Bank's write-off policy is disclosed in note 3.2.11 to the Financial Statements.

6.2.3 Use of External Credit Assessment Institutions (ECAI)

The Bank applies the Standardised Approach for credit risk. The Standardised Approach is defined in the CRR and applies a standardised methodology to calculate credit risk weighted assets under Pillar 1.

Credit risk weighted assets are determined through credit quality steps set out in the CRR. Determining the credit quality step for a particular exposure depends primarily on the type of exposure and whether it is externally rated.

In the case that an exposure is externally rated the Bank determines credit quality steps by applying the most conservative credit rating identified. The Bank only uses widely accepted and recognized ECAI such as Fitch, Moody's, and Standard & Poor's. The table below sets out credit quality steps for loans and advances to banks at 31 December 2018:

AT 31 DECEMBER 2018

Ratings	Credit quality steps	Total Exposure
		€000
AAA to AA-	1	55,165
A+ to A-	2	64,828
BBB+ to BBB-	3	5,475
Unrated		5
Total		125,473

6.3. Counterparty credit risk on derivatives

The Bank's policies and procedures set out limits on acceptable currencies, maximum transaction size, acceptable counterparties, counterparty creditworthiness, and types of derivative contracts.

Insofar as types of derivative contracts are concerned, the Bank's limits only allow forward contracts or swap transactions. Derivative transactions are governed by the European Market Infrastructure Regulation (EMIR).

6.4. Collateral and other credit enhancements

Note 3.2.12 to the Financial Statements discloses detail on collateral as a credit risk mitigant, and a detailed analysis of collateral held at 31 December 2018.

The table below represents for each exposure class, the total exposure value that is covered by eligible collateral, analysed into residential immovable property, commercial immovable property and other eligible collateral. The Bank also holds other eligible collateral classified as funded credit protection, such as cash and life insurance policies, as well as liquid sovereign debt securities held as pledge on reverse repurchase transactions.

The following table discloses total maximum credit exposure by type of collateral held:

	TOTAL EXPOSURE VALUE	RESIDENTIAL IMMOVABLE PROPERTY	COMMERCIAL IMMOVABLE PROPERTY	OTHER ELIGIBLE COLLATERAL	RESIDUAL VALUE
	€000	€000	€000	€000	€000
At 31 December 2018					
Central governments or Central Banks	72,153	-	-	-	72,153
Institutions	149,125	-	-	-	149,125
Corporate	101,310	1,643	74,971	2,250	22,446
Retail exposures	70,069	19,635	19,409	907	30,118
Secured by mortgages on immovable property	305,527	305,492	35	-	-
Items associated with particularly high risk	51,288	47,327	3,701	-	260
Exposures in default	18,220	11,031	6,924	-	265
Equity exposures	341	-	-	-	341
Other items	23,747	-	-	-	23,747
Total	**791,780**	**385,128**	**105,040**	**3,157**	**298,455**

	TOTAL EXPOSURE VALUE	RESIDENTIAL IMMOVABLE PROPERTY	COMMERCIAL IMMOVABLE PROPERTY	OTHER ELIGIBLE COLLATERAL	RESIDUAL VALUE
	€000	€000	€000	€000	€000
At 31 December 2018					
Central governments or Central Banks	72,153	-	-	-	72,153
Institutions	149,125	-	-	-	149,125
Corporate	101,310	1,643	74,971	2,250	22,446
Retail exposures	70,069	19,635	19,409	907	30,118
Secured by mortgages on immovable property	305,527	305,492	35	-	-
Items associated with particularly high risk	51,288	47,327	3,701	-	260
Exposures in default	18,220	11,031	6,924	-	265
Equity exposures	341	-	-	-	341
Other items	23,747	-	-	-	23,747
Total	**791,780**	**385,128**	**105,040**	**3,157**	**298,455**

7. LIQUIDITY RISK

Note 3.4 to the Financial Statements defines liquidity risk and discloses detail on the Bank's liquidity risk management and measurement. Note 3.4 also discloses details of the Bank's regulatory liquidity requirements at 31 December 2018.

Liquidity risk disclosures are also included in this section in respect of asset encumbrance in accordance with Banking Rule 07, which transposes the EBA Guidelines on Disclosure of Encumbered and Unencumbered Assets (EBA/GL/2014/03).

This disclosure is intended to highlight the available and unrestricted assets available to sustain potential funding requirements. An asset is deemed to be encumbered when it is pledged as collateral in respect of an existing liability and consequentially is rendered out of reach to the Bank. The Bank is not able to sell encumbered assets or pledge them as collateral to raise funds.

	CARRYING AMOUNT OF ENCUMBERED ASSETS	FAIR VALUE OF ENCUMBERED ASSETS	CARRYING AMOUNT OF UNENCUMBERED ASSETS	FAIR VALUE OF UNENCUMBERED ASSETS	TOTAL CARRYING AMOUNT	RISK WEIGHTED ENCUMBERED ASSETS	RISK WEIGHTED UNENCUMBERED ASSETS	TOTAL RISK WEIGHTED AMOUNT
	€000	€000	€000	€000	€000	€000	€000	€000
At 31 December 2018								
Central governments or Central Banks made up of:	8,427	8,427	63,726		72,153			-
- Reserve deposit	4,728	4,728						
- Securities pledged for DCS	3,700	3,700						
Institutions			149,125	149,204	149,125		29,223	29,223
Corporate			101,310	122,775	101,310		98,958	98,958
Retail			70,069	166,335	70,069		47,397	47,397
Secured by mortgages on immovable property			305,527	312,419	305,527		103,113	103,113
Items associated with particularly high risk			51,288	73,983	51,288		76,932	76,932
Exposures in default			18,220	26,012	18,220		18,220	18,220
Equity			341	341	341		341	341
Other items	3,008	3,008	20,739	31,786	23,747		26,831	26,831
- of which: Visa collateral	3,008	3,008				3,008		
Total credit risk	**11,435**	**11,435**	**780,345**	**882,885**	**791,781**		**401,015**	**401,015**

8. MARKET RISK

Note 3.3 to the Financial Statements defines market risk and discloses details and analysis on the types of market risk the Bank is exposed to, as well as disclosing details on market risk management.

8.1. Exposure in Equities Not Included in Trading Book

The Bank holds shares in one position the intention of which is not one of profit, but a strategic position which has a bearing on the Bank's operations. Further details on this holding is disclosed in note 7 to the Financial Statements.

8.2. Securitization Position

As at balance sheet date, the Bank did not hold any securitization positions.

8.3. Interest Rate Risk (IRR)

Note 3.3.2 to the Financial Statements defines and discloses details on interest rate risk.

8.4. Currency risk

Note 3.3.3 to the Financial Statements defines and discloses details on currency risk.

9. OPERATIONAL RISK

Note 3.5 to the Financial Statements defines operational risk and discloses details on the types of operational risk the Bank is exposed to, as well as disclosing details on operational risk management.

The Bank uses the Basic Indicator Approach (BIA) to estimate unexpected losses relating to operational risk. As a matter of good practice, it also simulates the capital charge under a hypothetical, more sophisticated, Standardized Approach (SA).

As at balance sheet date, the following figures applied:

Operational Risk Capital Charge	€000
Standardized Approach (simulation)	1,875
Basic Indicator Approach (actual)	2,012
Difference	**137**

10. REMUNERATION POLICY

The Bank's Compensation and Nomination Committee is responsible for reviewing the remuneration policy of the Bank and to make any recommendations as the Committee deems appropriate in the light of the general strategic interests of the Bank and the regulations. It also determines and reviews the Remuneration Policy applicable to the Bank's 'Identified Staff' in terms of Commission Delegated Regulation 604/2014.

10.1. Board of Directors

The Bank's Chairman and Non-Executive Directors are not eligible to receive a performance incentive. Accordingly, none of these directors were entitled to profit sharing, share options, pension benefits, variable remuneration or any other remuneration or related payments in their capacity as Directors of the Bank. The fees paid to Non-Executive Board members during 2018 amounted to € 202,966.

10.2. Executive Committee

Executive Committee members are engaged on an indefinite contract of employment, following a period of probation.

Annual salary increases are considered every year for the Executive Committee members, together with bonuses, which are generally based on the individual performance during the previous financial year. No bonus payments made to Executive Committee members exceed 100% of their fixed remuneration.

Non-cash benefits include health insurance as well as death-in-service benefits.

Total emoluments received by Executive Committee members during the period ended 31 December 2018 amounted to €604,331.

11. BOARD OF DIRECTORS

11.1. Board Recruitment and Selection Policy

The shareholders appoint or remove Directors after each Annual General Meeting, taking into consideration diversity of knowledge, judgement and experience.

11.2. Board Diversity Policy

The Board adopted a Board Diversity Policy with regards to the selection of the members of the Board of Directors.

The Diversity Policy covers diversity aspects in terms of gender, age, ethnicity and culture.

It is the opinion of the Board of Directors that the diversity objectives set in the Board Diversity Policy are met.

11.3. Number of directorships held by the Board of Directors

Further to article 91 of the CRD IV, the Bank is listing the number of directorships held by the members of the Board of Directors (including those held with the Bank). The number of directorships, both for the Executive Directorship (ED) and Non-Executive Directorship (NED) forming part of the same group are considered as one directorship.

Dr Michael Frendo	1 ED + 3 NED
Sheikh Mohamed Faisal Q.F. Al Thani	1 ED + 1 NED
Mr Michael Anthony Collis	1 ED
Ms Juanita Bencini	2 NED
Mr Charles Borg	1 ED + 15 NED
Mr Mario P Galea	10 NED
Mr Kenneth Mizzi	3 ED + 3 NED
Chev. Maurice Mizzi	4 ED + 1 NED
Mr Mark Portelli	10 NED
Mr Mohamed Ahmed Shafiek Mohamed Ahmed	1 ED + 1 NED
Sheikh Turki Faisal Q.F. Al-Thani	1 ED + 1 NED

Five Year Summary

Statements of Financial Position
As at 31 December

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
ASSETS					
Balances with Central Bank of Malta and cash	99,853	26,777	113,530	81,650	29,008
Cheques in course of collection	677	2,259	1,894	737	2,097
Financial investments measured at FVOCI	-	-	-	-	21,464
Financial investments	68,263	67,663	17,758	5,291	2,254
Loans and advances to banks	57,516	69,911	29,695	50,185	166,745
Loans and advances to customers	520,745	382,314	341,595	360,254	378,154
Property and equipment	5,995	6,908	7,270	7,740	8,062
Intangible assets	1,044	1,124	1,298	820	1,071
Deferred tax asset	5,046	3,923	4,010	3,003	4,561
Derivative financial instruments	122	-	-	23	899
Prepayments and accrued income	2,583	2,335	1,595	1,704	2,091
Other assets	5,628	4,351	4,262	5,500	2,663
TOTAL ASSETS	**767,472**	**567,565**	**522,907**	**516,907**	**619,069**

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
EQUITY					
Share capital	**67,044**	39,544	24,544	32,500	32,500
Perpetual Capital Note	**7,500**	5,000	5,000	-	-
Retained earnings	**1,460**	591	(100)	(10,008)	(10,457)
Revaluation reserve	**(533)**	(248)	352	2,026	317
Reserve for General Banking Risks	**992**	992	992	844	446
TOTAL EQUITY	**76,463**	**45,879**	**30,788**	**25,362**	**22,806**
LIABILITIES					
Amounts owed to banks	**90**	290	71	3,577	214
Amounts owed to customers	**677,272**	513,851	482,964	474,294	579,203
Derivative financial instruments	**-**	-	-	448	840
Debt securities in issue	**-**	-	-	5,000	5,000
Current tax liability	**1,538**	-	-	-	-
Other liabilities	**8,688**	4,349	5,220	3,952	4,722
Accruals and deferred income	**3,421**	3,196	3,864	4,274	6,284
TOTAL LIABILITIES	**691,009**	**521,686**	**492,119**	**491,545**	**596,263**
TOTAL EQUITY AND LIABILITIES	**767,472**	**567,565**	**522,907**	**516,907**	**619,069**
MEMORANDUM ITEMS					
Contingent liabilities	**11,199**	8,820	8,331	10,842	11,536
Commitments	**158,607**	112,755	63,248	61,953	62,279

Income Statements for
the year ended 31 December

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
Interest receivable and similar income					
• on loans and advances and balances with the Central Bank of Malta	19,077	15,318	15,926	19,693	22,899
• on debt and other fixed income instruments	100	264	103	93	102
Interest payable and similar expense	(3,644)	(4,680)	(6,403)	(9,499)	(14,260)
Net interest income	15,533	10,902	9,626	10,287	8,741
Fees and commission income	3,629	2,985	2,609	2,886	2,704
Fees and commission expense	(912)	(652)	(730)	(690)	(588)
Net fees and commission income	2,717	2,333	1,879	2,196	2,116
Net trading income and other income	744	561	740	1,363	3,071
Other income	24	-	-	-	-
Gain on disposal of investments measured at FVOCI (2017: available-for-sale)	60	862	3,105	-	-
Net operating income	19,078	14,658	15,350	13,846	13,928

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
Employee compensation and benefits	**(7,364)**	(6,864)	(5,642)	(5,395)	(5,287)
Other administrative expenses	**(5,788)**	(4,749)	(4,726)	(4,721)	(4,538)
Depreciation of property and equipment	**(447)**	(569)	(575)	(569)	(540)
Amortisation of intangible assets	**(348)**	(350)	(320)	(305)	(341)
Credit impairment losses	**(1,572)**	(517)	(1,857)	(1,369)	(1,820)
Profit before tax	**3,559**	1,609	2,230	1,487	1,402
Income tax expense	**(1,289)**	(411)	(130)	(640)	(544)
Profit for the year	**2,270**	1,198	2,100	847	858
Earnings per share	**2c9**	2c3	6c5	2c6	2c6

Statements of Cash Flows for the year ended 31 December

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
Cash flows from operating activities					
Interest, fees and commission received	22,374	18,402	18,882	22,682	25,548
Interest, fees and commission paid	(5,365)	(4,946)	(7,712)	(11,936)	(15,494)
Proceeds/cash losses from trading activities	652	561	315	1,668	1,824
Payments to employees and suppliers	(12,245)	(12,315)	(10,539)	(10,315)	(9,836)
Net interest on financial assets	2,108	619	-	-	-
Cash flows from operating profit before changes in operating assets and liabilities	**7,524**	2,322	946	2,099	2,042
(Increase)/decrease in operating assets:					
Reserve deposit with Central Bank of Malta	(1,260)	(439)	1,770	520	(356)
Loans and advances to banks	-	-	-	-	80,000
Loans and advances to customers	(140,974)	(41,032)	17,140	16,534	(40,965)
Other loans and receivables	-	-	-	-	3,333
Other assets	1,187	(434)	(25)	(1,621)	(1,145)
(Decrease)/increase in operating liabilities:					
Amounts owed to banks	-	-	-	-	(5,000)
Amounts owed to customers	163,421	30,887	8,670	(104,909)	25,196
Other liabilities	3,869	(872)	1,268	(583)	2,210
	33,767	**(9,568)**	**29,769**	**(87,960)**	**65,315**
Income tax paid	(111)	-	(234)	-	-
Net cash flows from operating activities	**33,656**	**(9,568)**	**29,535**	**(87,960)**	**65,315**

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
Cash flows from investing activities					
Property, plant and equipment and intangible assets	(481)	(388)	(903)	(421)	(1,447)
Purchase of investments	(20,130)	(84,592)	(20,099)	(409)	-
Proceeds on disposal and redemption of investments held-to-collect and sell	17,141	32,860	8,162	-	-
Financial investments held-for-trading	-	-	-	21,937	(14,732)
Proceeds from sale of held-for-trading investments	-	-	-	-	11,093
Interest received on available-for-sale investments	-	-	(29)	91	104
Net cash flows used in investing activities	**(3,470)**	(52,120)	(12,869)	21,198	(4,982)
Cash flows from financing activities					
Issue of perpetual capital notes	2,500	-	5,000	-	-
Repayment of subordinated debt	-	-	(5,000)	-	-
Issue of share capital	27,500	15,000	-	-	-
Interest on perpetual capital notes	(507)	(507)	-	-	-
Net cash flows used in financing activities	**29,493**	14,935	-	-	-
Net increase in cash and cash equivalents	**59,679**	(47,195)	16,666	(66,762)	60,333
Cash and cash equivalents at beginning of year	92,931	140,126	123,460	190,222	129,889
Cash and cash equivalents at end of year	**152,610**	92,931	140,126	123,460	190,222

Accounting Ratios

	2018	2017	2016	2015	2014
	%	%	%	%	%
Net interest income and other operating income to total assets	**2.49**	2.58	2.94	2.68	2.25
Operating expenses to total assets	**1.82**	2.21	2.15	2.13	1.73
Cost to income ratio	**73.10**	85.50	73.38	79.37	76.87
Profit/(loss) before tax to total assets	**0.46**	0.28	0.43	0.29	0.22
Profit/(loss) before tax to equity	**4.66**	3.51	7.24	5.86	6.14
Profit/(loss) after tax to equity	**2.97**	2.61	6.82	3.34	3.76

Shares in issue (millions)	**88.78**	52.36	32.5	32.5	32.5
Net assets per share (€0 cents)	**86**	88	95	78	70
Profit/(loss) per share (€0 cents)	**2.56**	2.29	6.46	2.61	2.64

Supplementary Financial Information

Supplementary Financial Information

Shareholding Information

As at 31 December 2018, the issued share capital stood at €67,044,000 (2017: €39,544,001), made up of 88,776,483 (2017: 52,362,289) fully paid up ordinary shares of €0.7552 (2017: €0.7552) each.

The ordinary shares are held as follows:

	NO. OF SHARES
JUD Investment Group Limited (previously known as Al Faisal International for Investment Malta Limited (C74331))	81,540,271
PG Holdings Limited (C 8569)	1,986,212
Virtu Investments Limited (C 42860)	1,750,000
Mizzi Organisation Limited (C 813)	1,750,000
SAK Limited (C 3240)	1,750,000
	88,776,483

The percentage holdings stand as follows:

	%
JUD Investment Group Limited (previously known as Al Faisal International for Investment Malta Limited (C74331))	91.85
PG Holdings Limited (C 8569)	2.24
Virtu Investments Limited (C 42860)	1.97
Mizzi Organisation Limited (C 813)	1.97
SAK Limited (C 3240)	1.97
	100.00

Each of the shareholders are entitled to appoint one Director in line with the Bank's Articles of Association. Each ordinary share entitles the shareholder to one voting right.