



# Annual Report

Company Registration No. C 41030  
BNF BANK P.L.C. (previously known  
as Banif Bank (Malta) p.l.c.)

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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)
Sheikh Turki Faisal Q.F. Al-Thani	Non-Executive Board Member (appointed with effect from 9 February 2018)
Mohamed Ahmed Shafiek Mohamed Ahmed	Non-Executive Board Member
Michael Anthony Collis	Executive Board Member (previously non-Executive Board Member, appointed as Executive Board member with effect from 23 August 2017)
Maurice Mizzi	Non-Executive Board Member
Kenneth Mizzi	Non-Executive Board Member
Mark Portelli	Non-Executive Board Member
Mario P Galea	Non-Executive Board Member
Charles Borg	Non-Executive Board Member (appointed with effect from 7 April 2017)
Juanita Bencini	Non-Executive Board Member (appointed with effect from 9 February 2018)
Joaquim Francisco Da Silva Pinto	Chief Executive Officer (resigned with effect from 23 August 2017)

Change in name

By virtue of a resolution dated 20 October 2017, the Bank changed its name from Banif Bank (Malta) p.l.c. to BNF Bank p.l.c.

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 FRENDU, NON-EXECUTIVE CHAIRMAN

Chairman of the Board since May 2013. A former Speaker of the House of Representatives and a former Minister responsible for various portfolios including Foreign Affairs, Information and Communication Technologies, and the Arts, 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, sits on the Advisory Board of the University of East Anglia's London Academy of Diplomacy and is a member of the European Group of Public Law. Dr Frendo has been nominated on 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 Khaliiji 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 member of the Institute of Chartered Accountants in England and Wales and a graduate from the University of Manchester, he has served as a member of the Board of a number of companies and public entities.



#### 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 2017.

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

## CHANGE IN NAME

By virtue of a resolution dated 20 October 2017, the Bank changed its name from Banif Bank (Malta) p.l.c. to BNF Bank p.l.c.

## PRINCIPAL ACTIVITIES

BNF Bank p.l.c. (the "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. Subsequently, 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.

The Bank provides a full range of Commercial Banking services to both residents and non-residents through a network of twelve branches and three corporate and business banking units. In 2017, BNF Bank plc concluded its tenth year of business activity in Malta. Notwithstanding a general instability across the Eurozone, the Bank has maintained its position in the local market as a reliable financial services provider, assisted by more favourable local economic conditions.

## REVIEW OF BUSINESS DEVELOPMENT AND FINANCIAL POSITION.

### Business development

In January 2017, the Bank increased its share capital by €15,000,000 through a rights issue, in line with the majority shareholder's pre-acquisition plans for the Bank, strengthening further the Bank's capital regulatory position. This increase resulted in a holding of 86.6% of the issued share capital of the Bank by Al Faisal International of Investment Malta Limited. January 2018 marked a further increase in the issued share capital of €20,000,000 bringing Al Faisal's holding in the Bank to 91.1%.

Notwithstanding 2017 being a challenging year, marked with low and negative interest rates and increasing compliance and regulatory requirements, the Bank retained its positive momentum. The Bank continued reaching out to all its stakeholders and the wider community in which it conducts its business. In its tenth year of operations, the Bank has continued to enhance its corporate governance and to adopt prudent banking and risk mitigation procedures as well as ensure strict compliance with regulatory requirements at all levels.

### Rebranding

In October 2017, the Bank became BNF Bank, complete with a new logo and a fresh exciting Brand Identity. This exercise was implemented quickly and seamlessly in our physical and digital distribution channels with no disruption to customer service. This was achieved thanks to the dedication and excellence of our staff.

During the year under review, BNF Bank embarked on a reorganisation of its departmental structures. The measures were designed to strengthen the Bank's retail and corporate business organization and to set a platform for future growth. The appointment of a Chief Risk Officer and a Chief Operating Officer demonstrate the Bank's focus on ensuring the best possible adherence to European standards of Compliance, Corporate Governance and Risk Management.

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

At the same time, the Board welcomes 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.

BNF Bank continues to enjoy high levels of customer confidence. Its reputation is built on transparency, engagement in the community

and the delivery of excellence in the provision of services. The Bank acknowledges that its strongly motivated workforce has been instrumental to its success, delivering the high-quality service that customers have come to expect.

### The Market Environment

The Maltese economy exhibited strong growth in 2017 and contributed to the country's financial stability. Labour market conditions, business and consumer confidence were all positive.

Conditions in the European Union showed encouraging signs of improvement, however, European Central Bank (ECB) rates remained negative, a legacy of the global financial crisis. Whilst European economic growth has accelerated, uncertainty surrounding Brexit continues to impact financial markets.

Global economic growth remained largely consistent but was counterbalanced by geopolitical concerns in the Korean peninsula and the wider MENA territories. Emerging countries experienced a downturn in economic activity with corresponding volatility in Capital Markets.

### Financial performance

In 2017, the Bank registered a profit after tax of €0.9 million (2016: €2.1 million). In total, net operating income covered 108% of the operating expenses including net impairment provision (2016: 117.0%). The ratio decreased when compared to 2016, mainly due to the gain on disposal of available-for-sale financial investments in 2016.

Total assets of the Bank amounted to €568 million at the end of 2017. The Bank placed excess liquidity which was not transformed into loans, in financial investments.

Gross loans and advances to customers increased by €41 million, reaching €391.4 million by end of 2017, whilst deposits increased by €30.9 million, reaching €513.9 million by end of 2017. The deposit transformation ratio as at end of 2017 stood at 74.4%, compared with 70.7% as at end of 2016.

### Operating income

The Bank generated a total operating income of

€14.2 million, (2016: €15.4 million). 2016 benefitted from the one-off 'Visa transaction' and therefore the underlying growth trend for 2017 was positive. Net interest income from business carried out with customers and banks amounted to €10.4 million (2016: €9.6 million).

Net fee and commission income amounted to €2.3 million (2016: €1.9 million). Fee and commission income was driven by fees generated from credit processing and related legal services, as well as an improvement in payments, cards and other banking services.

Trading income amounted to €1.4 million (2016: €0.7 million) which consisted mainly of gains on financial assets and foreign exchange income.

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 in this Annual Report describes the non-financial key performance indicators relevant to the bank, including information relating to environmental and employee matters.

#### Gain on disposal of available-for-sale financial investments.

The transaction announced by Visa Inc. during 2015 had been concluded during 2016. Consequently, the Bank received its portion of up-front consideration comprising of €2,623,000 in cash, 952 units of preferred stock convertible into Visa Inc. class 'A' common stock amounting to €682,000, and an additional deferred cash consideration of €215,000 will also be receivable following the third anniversary.

Total operating expenses excluding impairment increased by 11.2%, from €11.3 million in 2016 to €12.5 million in the year under review. Expenses relating to employee compensation and benefits, including Directors, amounted to €6.9 million,

representing 54.8% (2016: 50.1%) of the total operating costs, general administrative expenses amounted to €4.7 million, 37.8% (2016: 42.0%), and amortization and depreciation €0.9 million, 7.4% (2016: 7.9%).

#### Impairment

Since inception, the Bank has used market probability of defaults to assess portfolio quality and provisioning. The Bank has subsequently continued to converge its methodology to the use of own data of losses for the purposes of carrying out its collective impairment assessment, using own probability of defaults and loss given defaults analysed by the different segments of loan products offered.

During 2017 provisioning for impairment increased by a net amount of €0.5 million to a total of €9.1 million.

The gross increase in provision amounted to €2.5 million (2016: €4.2 million) whilst reversals of write-downs amounted to €2.0 million (2016: €2.3 million). Total provision for impairment as a percentage of gross loans and advances to customers stood at 2.3% as at end of December 2017 (2016: 2.5%).

Credit facilities that were assessed individually for impairment essentially remained in line, from €31.4 million as at 31 December 2016 to €31.5 million at 31 December 2017. The amount of specific provisions as a percentage of the non-performing loans stood at 22% as at end of 2017 (2016: 21.5%). Non-performing business credit facilities represented 76.9% of the total non-performing credit facilities (2016: 76.2%).

#### Tax

The Bank registered a profit before tax of €1.1 million (2016: €2.2 million). This attracted a tax charge of €0.2 million (2016: €0.1 million). As a result of the reversal in the fair value of available-for-sale financial investments upon sale and of higher impairment provisions, the net deferred tax asset increased by €0.9 million and amounted to €4.1 million by end of December 2017 (2016: €4.0 million). Furthermore, the Bank still has unutilised tax losses carried forward and available in future years.

#### Financial and regulatory position

The Bank closed the year under review with a total asset base of €567.7 million (2016: €522.9 million). The largest component of assets was still represented by loans and advances to customers, which amounted to €391.4 million (2016: €350.4 million) gross of impairment allowances. The investment portfolio designated at inception as 'available-for-sale' increased significantly from €17.8 million as at end of 2016 to €67.7 million as at the end of the year under review. The portfolio includes an amount of €3.8 million which are pledged in favour of the Depositor Compensation Scheme in terms of Legal Notices 109 of 2010, 159 and 340 of 2012 amending the Depositor Compensation Scheme Regulations of 2003 and the investment of shares held in VISA.

In line with its strategies and plans, the Bank maintained broadly the same level of investment in property for the Bank's use, equipment and intangible assets. As at end of December 2017, the carrying amount of property and equipment amounted to €6.9 million (2016: €7.3 million), whilst that of intangible assets amounted to €1.1 million (2016: €1.3 million).

On 26 June 2013, the European Union published Regulation (EU) 575/2013 and Directive 2013/36/EU, referred to as the Capital Requirements Regulation ('CRR') and Capital Requirements Directive ('CRD') respectively, collectively known as the 'CRD IV package'. Regulations emanating from the CRR came into force as from 1 January 2014, whilst the Directive will be transposed into national legislation between 1 January 2014 and 31 December 2019. The Bank has carried out various assessments over the past few years to ensure that it is able to meet the requirements emanating from this legislation. The Bank continues to exercise sound asset and liability management with a view to ensure sustainable regulatory ratios in terms of liquidity and capital adequacy.

The Bank's total Capital Adequacy Ratio stood at 14.1% as at end of December 2017, whilst Core Equity Tier 1 Capital ratio stood at 12.2%. Throughout the year, the Bank continued to manage its business diligently keeping in view the regulatory capital constraints and placed itself in

a position to withstand regulatory constraints by a constant margin.

The Bank's liquidity ratio of 32.42% under BR05 was comfortably above regulatory minimums whilst under the new regulatory liquidity requirements, LCR stands at 126.38% for the same period, compared to 56.9% and 280.34% in December 2016, respectively. This was largely as a result of Balance Sheet growth and greater operational efficiency.

#### Outlook Moving Forward

Following a significant injection of capital, the Bank is positioned to grow. Its core strategy is to be a reliable partner in the local economy, both at retail and at corporate level, and to put its customers first.

During 2018 the Bank will continue investing in product propositions as well as in its retail network, e-channels and IT systems. New products will be designed to suit the modern lifestyle of our customers, which is also in line with what customers expect, as the Bank aims to understand the needs of each customer.

Malta's geographic location represents a significant opportunity and the Bank is currently formulating its strategy towards international business.

The Bank will continue to invest in its human capital, providing external and in-house training to ensure our staff have the skills and knowledge necessary to enable them to deliver outstanding customer service whilst observing the highest regulatory standards.

In 2018, the Bank's key priorities will be to deliver value and high-quality experiences for customers, alongside strong and sustainable financial performance for its shareholders, within a prudent risk and conduct framework.

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

During the year ended 31 December 2017, 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;
- 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 plc 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 29 March 2018 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

*Every listed Company should be headed by an effective board, which should lead and control the company.*

#### Main Principle – The Code

The affairs of the Bank are managed by the Board of Directors.

The Bank's Directors includes a mix of individuals with a solid academic and professional background 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 delegates certain responsibilities to the Executive Committee, the Audit Committee, the Risk Committee and the Compensation and Nominations Committee. Further detail in relation to the mentioned Committees can be found under Principle 4 below.

### PRINCIPLE 2 – CHAIRMAN AND CHIEF EXECUTIVE

There should be a clear division of responsibilities at the head of the Company between the running of the board and the executive responsibility for the running of the company's business. No one individual or small group of individuals should have unfettered powers of decision.

### Main Principle – The Code

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, 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 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 – COMPOSITION OF THE BOARD

The board should not be so large as to be unwieldy. The board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the board's composition can be managed without undue disruption. The board should be composed of executive and non-executive Directors, including independent non-executives.

#### Main Principle – The Code

The Board is composed of a non-executive Chairman, one Executive Director (the Chief Executive Officer) and seven non-executive Directors.

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
- Sheikh Mohamed Faisal Q.F. Al-Thani – Deputy Chairman
- Mr Joaquim Da Silva Pinto<sup>1</sup>
- Mr Michael Anthony Collis<sup>2</sup>
- Mr Charles Borg<sup>3</sup>
- Mr Mario P Galea
- Mr Kenneth Mizzi
- Chev. Maurice Mizzi
- Mr Mark Portelli
- Mr Mohamed Ahmed Shafiek Mohamed Ahmed
  1. Resigned with effect from 23 August 2017
  2. Previously non-Executive Board Member, appointed as Executive Board member with effect from 23 August 2017
  3. Appointed with effect from 7 April 2017

In line with Principle 3 of the Code, the Bank considers that at any time during the period under review the Board had two independent non-executive Directors, Dr Michael Frendo (the Chairman) and Mr Mario P Galea.

The remuneration paid to the Directors is as established by the Bank's shareholders.

**Disclosures in terms of EU Regulation No 575/2013 (Capital Requirements Regulation) of European Parliament and the Council of the 26 June 2013 on the prudential requirements for credit institutions**

#### Recruitment and Selection Policy

As already indicated above, 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. Therefore, a recruitment and selection policy for the members of the Board of Directors is not required.

### Policy on Diversity

In March 2017, 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.

The Directors are appointed on the meritocracy criteria. It is the opinion of the Board of Directors that the diversity objectives set in the Policy are met.

### PRINCIPLE 4 – THE RESPONSIBILITIES OF THE BOARD

The board has the first level responsibility of executing the four basic roles of corporate governance namely; accountability, monitoring, strategy formulation and policy development.

#### Main Principle – The Code

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, such Directors shall inform the same Board, the nature of their interest at the meeting and shall not participate and vote in respect of that decision. As detailed below, the Board of Directors have delegated certain responsibilities to various committees, with specific responsibilities, as follows:-

#### The Executive Committee

The Executive Committee meets on a weekly basis to oversee the overall management of the

Bank. The Executive Committee was composed of four members, the Chief Executive Officer, the Chief Commercial Officer, the Chief Financial Markets and Investments Officer and the Chief Officer Corporate Services until October 2017. During the subsequent months, the composition of the Executive Committee changed and is now composed of three members, the Chief Executive Officer, the Chief Operations Officer and the Chief Risk Officer.

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.

The Executive Committee also appointed the following committees within the Bank, namely, the Assets and Liabilities Committee (ALCO), the Budget and Planning Committee, the Credit Committee, the Global Risk Committee and the Products Committee.

#### The Audit Committee

The Audit Committee monitors and reviews the effectiveness of the Bank's control functions, including internal audit and monitors the financial reporting process and review the Bank's internal financial controls.

The Audit Committee makes recommendations to the Board of Directors regarding the appointment of the Bank's external auditors, their remuneration and terms of engagement.

#### The Risk Committee

The Risk Committee monitors and reviews the Bank's risks as identified and quantified by the Bank's risk and compliance functions. It also advises and supports the Board on the monitoring of the institution's overall actual and future risk appetite and strategy considering all types of risks.

### The Compensation Committee

With effect from March 2017, this committee has been delegated additional functions relating to, amongst others, diversity policy and review of the Board's composition.

The overarching purpose of the Committee is to review the remuneration policy of the Bank and make any recommendations as it deems appropriate considering the general strategic interests of the Bank and regulations.

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

- a. Review the Bank's Remuneration Policy;
- b. Monitor the Bank's Remuneration Policy;
- c. Report and provide assurance on the Bank's Remuneration Policy;
- d. Implementation of the Board's Diversity Policy;
- e. Review and assessment of the composition of the Board; and
- f. Oversight of the conduct of the annual review of the effectiveness of the Board.

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

### 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.

In turn, the Executive Committee appointed the following management committees:

### The Assets and Liabilities Committee

During the year under review the Assets and Liabilities Committee (ALCO) started to meet 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 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 Properties Committee

During the year under review, the Bank dissolved this committee since its functions are no longer required in terms of the Bank's strategy.

### The Budget and Planning Committee

The purpose of the Budget and Planning Committee is to liaise closely with the members of the Executive Committee of the Bank in transposing the vision and strategic objectives adopted by the Board of Directors into detailed plans. The Committee is responsible for coordinating and assisting in the preparation of the budgets of all the commercial departments and all supporting back-office units.

Furthermore, the Committee takes care of communicating the budgets, once these are approved by the Board of Directors, and also oversees the actual implementation of the Bank's financial plans.

This Committee meets regularly and is made up of the Members of the Executive Committee, and the Heads of the Commercial Department, Treasury Department, Business Development Department, Corporate Services Department, Operations Department, Information and Systems

Department and representatives from the Internal Control Department and Financial Management Department.

The Credit 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 Executive Committee on credit facilities which exceed its upper discretionary threshold.

The Committee is also coordinated at its different levels according to the Credit Policy. It meets regularly and is chaired by the responsible person as indicated in the Bank’s Credit Policy.

The Products Committee

The purpose of the Products Committee is to maintain a structured approach towards assessing and developing new products. New product development is divided into two phases, the Conception Phase and the Implementation Phase.

During the Conception Phase, the Products Committee focuses on the concepts and ideas that address the business needs. During such Phase, the Committee is made up of the members of the Executive Committee, the Head of Commercial Management Department and the Head of Business Development Department.

Once a product concept is defined, the Products Committee moves to the Implementation Stage, during which the objective is to implement the proposed product in an efficient manner.

During this stage, the Committee is made up of representatives from the following units, namely the Marketing & Communications Unit, the Legal and Compliance Unit, the Financial and Management Accounting Unit, the Regulatory Unit, the Risk Control and Oversight Unit, the Information Technology Unit, the Business Analysis Unit, Business Strategy Unit, the General Operations Unit and the Treasury Department.

This Committee was redesignated as Products Oversight Committee with effect from 8th March 2018. In addition, the functions of the committee

were streamlined with the aim to improve the governance relating to product development in line with modern regulatory standards.

The Global Risk Committee

The Global Risk Committee (‘GRC’) deals with and reports to the EC on the Bank’s overall risk appetite, risk tolerance and risk management framework, taking account of the current and prospective macroeconomic and financial environment and drawing on financial stability assessments which may be relevant for the Bank’s risk policies; oversees and advises the Bank on the current risk exposures; keeps under review the Bank’s overall risk assessment processes, ensuring that both qualitative and quantitative metrics are used; discusses all risk strategies on both an aggregated basis and by type of risk; and keeps under review the effectiveness of the Bank’s internal controls and risk management systems.

The GRC is composed of the EC members and the Heads of the Commercial Department, Corporate Services Department, Operations Department, Information Systems Department, Treasury Department, Business Development Department, Internal Audit Unit, Legal and Compliance Unit and Risk Control and Oversight Unit. The Head of Regulatory Unit and Financial and Management Accounting Units are also invited. The Committee meets on a quarterly basis.

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

PRINCIPLE 5 – BOARD MEETINGS

The board should meet regularly to discharge its duties effectively. Board members should be given ample opportunity during meetings to discuss issues set on the board agenda and convey their opinions.

Main Principle – The Code

The Board meets as regularly as deemed possible, 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 2017 the Board of Directors met 6 times. Directors’ Attendance at Board Meetings during 2017 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
Mr Joaquim Da Silva Pinto	4 out of 4
Mr Charles Borg	5 out of 5
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	5 out of 6

PRINCIPLE 6 – INFORMATION AND PROFESSIONAL DEVELOPMENT

The board should:

- Appoint the Chief Executive Officer;
- Actively participate in the appointment of senior management;
- Ensure that there is adequate training in the Company for Directors, management and employees;
- Establish a succession plan for senior management; and
- Ensure that all Directors are supplied with precise, timely and clear information so that they can effectively contribute to board decisions.

Main Principle – The Code

The Board of Directors appoints the Chief Executive Officer as well as 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 management to progress in their career streams as well as to maintain high levels of morale amongst the Bank staff members.

On 21st February 2018, the Board formally approved Board Induction and Training Policy



which regulates the training and professional development which should be undertaken by the Directors of the Bank.

PRINCIPLE 8 (CODE PROVISION 8 A) – COMPENSATION COMMITTEE

Compensation Committee

The Board should establish a remuneration policy for Directors and senior executives. It should also set up formal and transparent procedures for developing such a policy for establishing the remuneration packages of individual Directors.

The Compensation Committee (now redesignated as Compensation and Nominations 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.

During 2017, the Compensation Committee met 6 times. The Committee was made up of three non-executive Directors wards. Their attendance at Committee’s meetings during 2017 was as follows:

MEMBERS	ATTENDED
Mr. Mohamed Ahmed Shafiek Mohamed Ahmed – Chairman1	1 out of 2
Mr Michael Anthony Collis – Chairman2	4 out of 4
Mr Mario P Galea	6 out of 6
Mr Kenneth Mizzi	6 out of 6

1. Appointed with effect from 15 August 2017
2. Resigned with effect from 11 August 2017

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 8 (CODE PROVISION 8 B)

There should be a formal and transparent procedure for the appointment of new directors to the board. The procedure shall ensure inter

alia, adequate information on the personal and professional qualifications of the candidates.

Main Principle – The Code

With effect from March 2017, the Compensation Committee (now redesignated as Compensation and Nominations Committee) has been made responsible for the diversity policy, review and assessment of the Board’s composition and oversight of the conduct of the annual review of the effectiveness of the Board.

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

The board shall serve the legitimate interests of the company, account to shareholders fully and ensure that the Company communicates with the market effectively. The board should as far as possible be prepared to enter into a satisfactory dialogue with institutional shareholders and market intermediaries based on the mutual understanding of objectives. The board shall use the general meeting to communicate with shareholders.

Main Principle 9 – The Code

The term ‘institutional shareholders’ should be interpreted widely and includes any person who by profession, whether directly or indirectly, takes a position in investments as principal, or manager or holds funds for or on behalf of others and includes custodians, banks, financial institutions, fund managers, stockbrokers, investment managers and others.

Main Principle 10 – The Code

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 the market 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

Directors’ primary responsibility is always to act in the interest of the Company and its shareholders as a whole irrespective of who appointed them to the board.

Main Principle – The Code

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 frank 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

Directors should seek to adhere to accepted principles of corporate social responsibility in their day-to-day management practices of their company.

Main Principle – The Code

BNF’s brand values pervade all the Bank’s areas of operations. They are shared by the Members of the Board and passed down, as well as laterally, to the whole team. Ethical business practices are a backbone of the Bank, setting an example to be emulated by employees, in all their day-to-day dealings, be it finance related or otherwise.

The strength of the BNF brand lies in its people. The Bank recognises this and invests heavily in development, training, career paths and opportunity. Efforts are in place to keep fostering a culture of open communication and empowerment, supported by equal opportunities and excellent working conditions.

Always attentive to its carbon footprint, the Bank regularly reviews its purchasing policies, its physical infrastructures and its impact on the environment.

BNF Bank strongly believes in its responsibility to share in the community’s development and values. Leading by example, it undertakes initiatives to contribute towards sections of society that are lacking in education, opportunity and inclusion. The Bank’s CSR Policy apportions a fund that is utilised to support projects of different natures including philanthropy, culture, art, heritage, youth, sports and education.

SECTION 2 – NON-COMPLIANCE WITH THE CODE

PRINCIPLE 4 (CODE PROVISION 4.2.7)

Code provision 4.2.7 recommends that the Board, “develop 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”.

Given the fact that the Directors are appointed directly and exclusively by the Bank’s shareholders, the Bank does not consider the necessity to develop a succession policy for the Directors.

PRINCIPLE 7

Principle 7 recommends that “The board should undertake an annual evaluation of its own performance and that of its committees”.

So far the Bank has not undertaken such evaluation of the Board and its committees; however, any actions undertaken by the Board and its committees are indirectly evaluated through the results obtained by 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. No significant changes were made in 2017. 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 approves 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 Rules 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 encourages 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 the deferred payment of such reward. Malus and clawback have not, to date, 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 Bank paid Non-Executive Directors compensation for the year 2017 as follows:

Chairman	€ 35,000
Other Members	€112,713

Executive Directors

The Bank’s Executive Committee was made up of one Executive Director and three Chief Officers up to September 2017, and one Executive Director and two Chief Officers thereafter. Remuneration payable to the Executive Directors for the year was:

Fixed Remuneration	€370,593
Variable remuneration	€0

Material Risk Takers (MRTs) Remuneration

Fixed and variable remuneration paid to MRTs is detailed in the table below and is aggregated by a 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
Number of employees	9	21
Fixed	€ 950,930	€ 1,181,616
Variable	€ 9,229	€ 30,326

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, the consultant to the CEO 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 2017.

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 procedures to control and/or mitigate material operational risks. Such policies are subject to a periodic review so as to adjust the process in accordance with the current operational risk profile. These Rules and Procedures are circulated and adhered to by staff at all times. In addition, such Rules 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 a 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 (redesignated from Risk Management Unit with effect from March 2017), which is entrusted with setting 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 Risk Control and Oversight Unit. 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.

Risk officials are precluded from interacting directly with customers thereby safeguarding full objectivity and avoiding the incidence of customer-induced bias. Such insularity coupled with functional independence and segregation of risk activity into distinct functions as outlined above, ensure that the risks to which the Bank is exposed are tackled in a holistic manner designed to make the entire organisation aware of the nature, scale and degree of intensity of the risks involved in conducting the Bank's operations. Segregation of risk control/oversight from risk management ensures that those who set risk policy, procedures and metrics (i.e. officials from the Risk Control and Oversight Unit) do not "go native" by becoming dealmakers rather than deal questioners (though being involved in the individual credit decisions).

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 Budget and Planning 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 SOCIAL RESPONSIBILITY

### INTRODUCTION

BNF Bank puts Corporate Social Responsibility on top of its agenda, adhering to its strategy to give back to the community it operates in.

### PHILANTHROPY

In all CSR activities, BNF espouses its core values of ambition, responsibility and empathy. Since it started its operations in Malta, the Bank has focused its commitment to contribute to key areas where it operates.

Through various partnerships with influential NGOs and charities, the Bank continued to implement its CSR strategy.

BNF Bank has been the main sponsor of the President's Fun Run for the past nine consecutive years. Last year was another incredible feat of organising and participating in this event, as thousands of people from all walks of life showed solidarity with vulnerable people in our society. Indeed, 'One Nation, One Heartbeat' has now permeated Malta's psyche.

In 2017, a total amount of €313,515 was raised during the Fun Run and the funds were passed on to the Malta Community Chest Fund Foundation (MCCFF) during I-Istrina. BNF Bank additionally contributes to the MCCFF through its support of the Rockestra concert.

BNF Bank employees continued their commitment to support the Malta Hospice Movement. Cancer affects one in four people at some point in their lives and the NGO in question offers support to over 1,000 cancer patients, as well as people suffering from motor neurone disease and other degenerative conditions. Through another in-house tradition, BNF employees contributed a total of €1,500 which were donated at the end of the year. The Bank also supports the Hospice Midnight Walk event through sponsorship and team participation.

Casual Fridays have been doing very well in terms of donations. Employees voluntarily pay a contribution by donating money for coming



purposefully to work in casual clothing every last Friday of each month. The amount collected this year through this initiative aggregates to €5,300, which were donated to the various NGOs proposed by the staff themselves.

BNF Bank has carried on a three-year sponsorship with the Service Dogs Malta Foundation and is currently supporting three dogs in their development from puppyhood to their full certification as therapy or service dogs. The Service Dogs Malta Foundation is an NGO that helps people living with a disability or condition by giving them a certified service dog to help them in their daily tasks. Service dogs are trained to carry out a variety of tasks with the aim of making life easier for a person living with this condition or disability. Through this sponsorship, the Bank will be financially assisting this NGO to cover training costs such as vaccinations, vet fees, insurance and trainer costs.

### EDUCATION

BNF Bank continued to show its support to the National Literacy Agency of the Ministry for Education with Rakkonti, a literacy project for pre-school and primary school children. Rakkonti features traditional Maltese tales re-enacted through animations, music and puppet shows by the renowned author Trevor Zahra accompanied by the local composer Manolito Galea. This







project gives students the opportunity to learn through different media sources. Through this sponsorship a reenactment of Rakkonti was organized for employees' children at the Bank's Siggiewi branch.

The partnership with MCAST Institute of Creative Arts and its 'Life Case' projects are still ongoing. This project exposes Bachelor of Arts students following courses in Photography, Fine Arts and Photography Game Art and Visual Design to commission their works of art to prospective clients. In 2017, the project 'It all starts here' showcased highly creative work done by the said students in an exhibition open to the public.

### HERITAGE

BNF Bank is a proud corporate sponsor of Fondazzjoni Wirt Artna (FWA), the cultural heritage preservation NGO. In the past, BNF Bank contributed to FWA's mission to promote an understanding and appreciation of Malta's heritage by supporting the restoration of the 18<sup>th</sup> Century Mistrà Battery.

In 2016, the Bank entered into a three-year sponsorship agreement with FWA to fund various projects lined up by the NGO.

Another ongoing sponsorship is the restoration of a Medieval Altarpiece being undertaken by Flimkien għal Ambjent Aħjar, located at the Augustinian Priory in Rabat.

### ENVIRONMENT

Towards the end of March, the Bank observes Earth Hour by switching off all ancillary lighting across its branch network. Earth Hour is a worldwide initiative organised by the World-Wide Fund for Nature (WWF). The event encourages individuals, communities, households and businesses to turn off their lights for one hour, from 8:30 to 9:30 p.m., as a symbolic action in fulfilling their commitment to the planet.

The Bank also organised a Car Free Day whereby many employees walked, took the bus, ran, cycled or carpooled. This coincided with the EU Mobility Week intended to highlight the issues of pollution, reduction in emissions and air quality, by getting cars off the road.



### EMPLOYEE ENGAGEMENT

The Bank believes that its contribution to the community should have the BNF Bank team at its core. Through involvement and engagement, the Bank encourages employees to collaborate in initiatives that have the scope not only of reaching social segments in need of development but also of creating a domino effect.

Long service awards were given to 17 employees who worked at the Bank since its inception. The award reflects the Bank's appreciation for the dedicated years of service and personal achievements. Motivational events intended to make BNF Bank a great place to work, were organized frequently throughout all of 2017.

The Bank's Sports and Social Committee spearheads such social initiatives intended to bring team members together in an informal set-up and on different occasions.

BNF Bank also organises annual awards to give recognition to employees for their efforts throughout the year. The Employee of the Year award is given to the employee who delivers in terms of results, effort and conscientious approach. The nominations are cast by colleagues. BNF Bank believes that this is a further manifestation of its dedication to the development of its staff and the team spirit within the organisation.

Employees are also encouraged to share their ideas and suggestions to improve the Bank's various operations. It does this through the 'All Ideas Matter' platform. Each and every



suggestion and idea is presented to the Executive Committee and, every six months, a winning idea is picked and the person who came up with it, is rewarded. This Platform gives mutual benefits both to the employee and the Bank through active participation and open communication channels.

### 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 29 March 2018 by:

*Michael Anthony Collis*

**Michael Anthony Collis**

Chief Executive Officer

*Michael Frendo*

**Michael Frendo**

Chairman

# Independent auditor's report





## 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 2017, 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 31 to 112 comprise:

- the statement of financial position as at 31 December 2017;
- 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.

#### 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 the IESBA Code.



## Independent auditor's report - continued

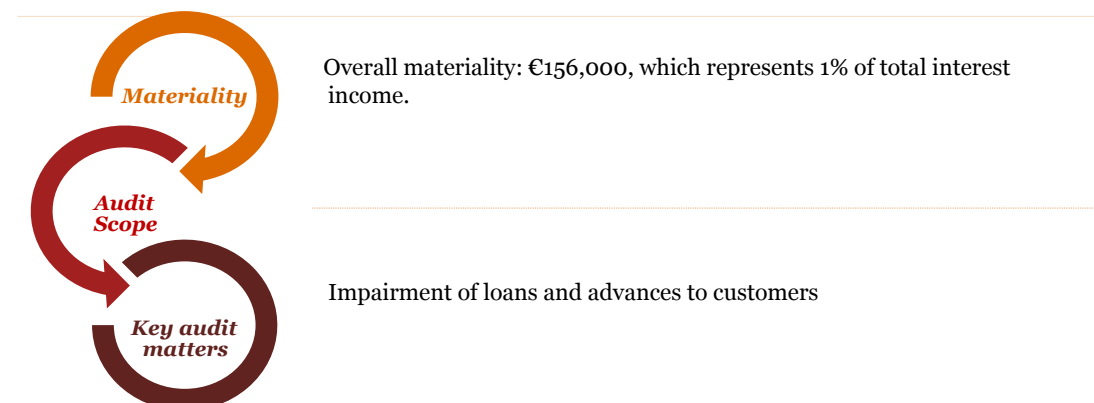
To the Shareholders of BNF Bank p.l.c.

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 to 31 December 2017, are disclosed in Note 28 to the financial statements.

#### Our audit approach

##### Overview



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.

#### 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.



Independent auditor’s report - continued

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

Overall materiality	€156,000
How we determined it	1 % of total interest income
Rationale for the materiality benchmark applied	We chose interest income as the benchmark because, in our view, and in the context of the particular circumstances of the Bank, 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 1% 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 €8,000 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
<p><i>Impairment of loans and advances to customers</i></p> <p>Impairment allowances in respect of loans and advances to customers represent management's best estimate of the losses incurred within the loan portfolios at the statement of financial position date.</p> <p>Impairment losses are calculated on an individual basis for loans and on a collective basis to cover losses which have been incurred but have not yet been identified on loans subject to individual assessment.</p> <p>The calculation of both collective and individual impairment allowances is inherently judgemental; judgement is applied to determine appropriate parameters and assumptions used to calculate impairment.</p> <p>Collective impairment allowances are calculated using a statistical model, which approximates the impact of current economic and credit conditions on portfolios of loans. For incurred but not yet identified impairments, this model is based on the probabilities of default and loss given default parameters taking into account the Bank's historical experience as well as the estimated emergence period between impairment occurring and loss recognition. The inputs to these models are subject to management judgement and model overlays are often required. Key assumptions and judgements include the probabilities of default based on the transition from one credit grade to another and the loss given default based on the type of collateral secured in relation to the respective credit facility.</p> <p>The methodology used by the Bank to calculate collective impairment allowances is relatively standard which means that modelling risk is low but changes in individual inputs can have a significant bearing on the impairment charge.</p> <p>For specific impairments, judgement is required to determine when an impairment event has occurred and then to estimate the expected future cash flows related to that loan, which are dependent on parameters or assumptions such as the valuation of collateral for secured lending. Discounted cash flow models are utilised in this respect.</p> <p>We focused on impairment due to the subjective nature of the calculations and the subjective judgements involved in both timing of recognition of impairment and the estimation of the size of any such impairment.</p> <p>Relevant references in the Annual Report and Financial Statements:</p> <ul style="list-style-type: none"><li>Accounting policy: Note 2.7.1;</li><li>Credit risk management: Note 3.2;</li><li>Note on Loans and advances to customers: Note 9;</li><li>Note on Net impairment losses: Note 29;</li><li>Accounting estimates and judgements: Note 4.2.</li></ul>	<p>The policies and methodologies used by the Bank in respect of impairment of loans and advances to customers were discussed with the Audit Committee. Changes to inputs within the collective allowance models as well as individually significant loan impairments are discussed at Audit Committee meetings.</p> <p>For collective allowances the appropriateness of the modelling policy and methodology used was independently assessed by reference to the requirements of accounting standards and market practices.</p> <p>We understood and critically assessed the model used for collective allowances. Since, modelling assumptions and parameters are based on historic data, we assessed whether historic experience was representative of current circumstances and of the recent losses incurred within the portfolios. The appropriateness of management's judgements was also independently considered in respect of calculation methodologies and judgemental overlays. Model calculations were tested through re-performance.</p> <p>We tested the completeness and accuracy of data extracted from underlying systems that is utilised in the model.</p> <p>Based on the evidence obtained, we found the model assumptions, data used within the model and overlays to be reasonable.</p> <p>For specific allowances the appropriateness of provisioning methodologies and policies was independently assessed. We understood and evaluated the processes for identifying impairment events, as well as the impairment assessment processes.</p> <p>The controls management has established to identify which loans and advances are impaired were tested. For specific impairment charges on individual loans this includes controls over the credit file review processes. In particular, we tested the design and operating effectiveness of the key controls to determine which loans and advances are impaired, including testing controls over the timely identification of impaired loans and advances. We determined that we could rely on these controls for the purposes of our audit.</p> <p>We assessed critically the criteria used for determining whether an impairment event had occurred and therefore whether there was a requirement to compute a specific impairment allowance. We haphazardly selected a sample of loans to challenge whether impairment events had actually occurred and to assess whether impairment events had been identified by management in a timely manner. For a sample of individually impaired loans we understood the latest developments at the level of the borrower and the basis of measuring the impairment provisions, and considered whether key judgments were appropriate given the borrowers' circumstances. An independent view was formed on the levels of provisions booked based on the detailed loan and customer information in the credit file. Calculations within the discounted cash flow models were re-performed. In addition, we tested key inputs to the impairment calculation including the expected future cash flows and valuation of collateral held, and challenged management to demonstrate that the valuations were up to date, consistent with the strategy being followed in respect of the particular borrower and appropriate for the purpose.</p> <p>Testing the estimation of the future expected cash flows from customers from realisation of collateral held for a sample of loans, involved assessing the work performed by external experts used by the Bank to value the collateral or to assess the estimates of future cash flows. We used our experts to assess the appropriateness of valuations and estimates utilised.</p> <p>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.</p>



### *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 thereon).

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).



### *Independent auditor's report - continued*

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

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

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

In addition, in light of the knowledge and understanding of the 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.

### *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.



### *Independent auditor's report - continued*

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

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.

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



### *Independent auditor's report - continued*

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

#### 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 4 years.

#### **PricewaterhouseCoopers**

78, Mill Street  
Qormi  
Malta

Fabio Axisa  
Partner

29 March 2018

# Statement of Financial Position



STATEMENT OF FINANCIAL POSITION As at 31 December 2017		NOTES	2017	2016
			€000	€000
<b>Assets</b>				
Balances with Central Bank of Malta and cash	6		26,777	113,530
Cheques in course of collection			2,259	1,894
Financial investments classified as available-for-sale	7		67,663	17,758
Loans and advances to banks	8		69,911	29,695
Loans and advances to customers	9		382,314	341,595
Property and equipment	10		6,908	7,270
Intangible assets	11		1,124	1,298
Deferred tax assets	12		4,100	4,010
Prepayments and accrued income	13		2,335	1,595
Other assets	14		4,351	4,262
<b>Total Assets</b>			<b>567,742</b>	<b>522,907</b>
<b>EQUITY</b>				
Share capital	15		39,544	24,544
Perpetual capital notes	16		5,000	5,000
Revaluation reserve	17		(248)	352
Reserve for General Banking Risks	17		992	992
Retained earnings/(accumulated losses)	17		768	(100)
<b>Total Equity</b>			<b>46,056</b>	<b>30,788</b>

STATEMENT OF FINANCIAL POSITION As at 31 December 2017		NOTES	2017	2016
			€000	€000
<b>Liabilities</b>				
Amounts owed to banks	18		290	71
Amounts owed to customers	19		513,851	482,964
Other liabilities	20		4,349	5,220
Accruals and deferred income	21		3,196	3,864
<b>TOTAL LIABILITIES</b>			<b>521,686</b>	<b>492,119</b>
<b>TOTAL EQUITY AND LIABILITIES</b>			<b>567,742</b>	<b>522,907</b>
<b>Memorandum items</b>				
Contingent liabilities	22		8,820	8,331
Commitments	22		112,755	63,248

The accounting policies and explanatory notes on pages 36 to 112 form an integral part of the financial statements. The financial statements on pages 31 to 112 were approved and authorised for issue by the Board of Directors and signed on its behalf on 29 March 2018 by:



**Michael Anthony Collis**

Chief Executive Officer



**Michael Frendo**

Chairman

**INCOME STATEMENT**  
 For the year ended 31 December 2017

	NOTES	2017	2016
		€000	€000
Interest receivable and similar income			
• on loans and advances, balances with Central Bank			
– of Malta and other instruments	23	15,318	15,926
• on debt and other fixed income instruments	23	264	103
Interest payable and similar expense	24	(5,187)	(6,403)
<b>Net interest income</b>		<b>10,395</b>	9,626
Fees and commission income	25	2,985	2,609
Fees and commission expense	25	(652)	(730)
<b>Net fees and commission income</b>		<b>2,333</b>	1,879
<b>Net trading income</b>	26	<b>561</b>	740
<b>Gain on disposal of available-for-sale financial investments</b>	7	<b>862</b>	3,105
<b>Net operating income</b>		<b>14,151</b>	15,350
Employee compensation and benefits	27	(6,864)	(5,642)
Other administrative expenses	28	(4,749)	(4,726)
Depreciation of property and equipment	10	(569)	(575)
Amortisation of intangible assets	11	(350)	(320)
Net impairment losses	29	(517)	(1,857)

**INCOME STATEMENT**  
 For the year ended 31 December 2017

	NOTES	2017	2016
		€000	€000
<b>Profit before tax</b>		<b>1,102</b>	2,230
Income tax expense	30	(234)	(130)
<b>Profit for the year</b>		<b>868</b>	2,100
Earnings per share	31	1c7	6c5

The accounting policies and explanatory notes on pages 36 to 112 form an integral part of the financial statements.

**STATEMENT OF COMPREHENSIVE INCOME**  
 For the year ended 31 December 2017

	2017	2016
	€000	€000
<b>Profit for the year</b>	<b>868</b>	2,100
<b>Other comprehensive income</b>		
Items that may be subsequently reclassified to profit or loss		
Available-for-sale investments:		
• Net changes in fair value, before tax	(390)	(114)
• Reclassification adjustments – net		
– amounts reclassified to profit or loss, before tax	(534)	(2,461)
Income taxes	324	901
<b>Other comprehensive income for the year, net of tax</b>	<b>(600)</b>	(1,674)
<b>Total comprehensive income for the year, net of tax</b>	<b>268</b>	426

The accounting policies and explanatory notes on pages 36 to 112 form an integral part of the financial statements.

**STATEMENT OF CHANGES IN EQUITY**  
 For the year ended 31 December 2017

	NOTES	SHARE CAPITAL	PERPETUAL CAPITAL NOTES	REVALUATION RESERVE	RESERVE FOR GENERAL BANKING RISKS	ACCUMULATED LOSSES/RETAINED EARNINGS	TOTAL
		€000	€000	€000	€000	€000	€000
At 1 January 2016		32,500	-	2,026	844	(10,008)	25,362
<b>Comprehensive income</b> Profit for the year		-	-	-	-	2,100	2,100
<b>Other comprehensive income</b>							
Fair valuation of available-for-sale							
Financial assets							
• net changes in fair value arising during the year	7	-	-	(75)	-	-	(75)
• reclassifications - net classified to profit or loss		-	-	(1,599)	-	-	(1,599)
Transfers and other movements		-	-	-	148	(148)	-
Total other comprehensive income for the year		-	-	(1,674)	148	(148)	(1,674)
<b>Total comprehensive income</b>		-	-	(1,674)	148	1,952	426
<b>Transactions with owners</b>							
Reduction in share capital effected through offset of Accumulated losses							
• through offset of accumulated losses		(7,956)	-	-	-	7,956	-
• Issue of perpetual Additional Tier 1 Capital notes		-	5,000	-	-	-	5,000
<b>Total transactions with owners</b>		(7,956)	5,000	-	-	7,956	5,000

(continued on the next page)

STATEMENT OF CHANGES IN EQUITY For the year ended 31 December 2017		NOTES	SHARE CAPITAL	PERPETUAL CAPITAL NOTES	REVALUATION RESERVE	RESERVE FOR GENERAL BANKING RISKS	ACCUMULATED LOSSES/RETAINED EARNINGS	TOTAL
			€000	€000	€000	€000	€000	€000
<b>At 31 December 2016</b>			24,544	5,000	352	992	(100)	<b>30,788</b>
At 1 January 2017			<b>24,544</b>	<b>5,000</b>	<b>352</b>	<b>992</b>	<b>(100)</b>	<b>30,788</b>
<b>Comprehensive income</b>								
Profit for the year			-	-	-	-	868	<b>868</b>
Other comprehensive income								
Fair valuation of available-for-sale financial assets:								
• net changes in fair value arising during the year	7		-	-	(253)	-	-	<b>(253)</b>
• reclassifications - net amounts classified to profit or loss			-	-	(347)	-	-	<b>(347)</b>
Total other comprehensive income for the year			-	-	(600)	-	-	<b>(600)</b>
<b>Total comprehensive income</b>			-	-	(600)	-	868	<b>268</b>
<b>Transactions with owners</b>								
Issue of share capital		15	15,000	-	-	-	-	<b>15,000</b>
<b>Total transactions with owners</b>			15,000	-	-	-	-	<b>15,000</b>
<b>At 31 December 2017</b>			<b>39,544</b>	<b>5,000</b>	<b>(248)</b>	<b>992</b>	<b>768</b>	<b>46,056</b>

The accounting policies and explanatory notes on pages 36 to 112 form an integral part of the financial statements.

**STATEMENT OF CASH FLOWS**

For the year ended 31 December 2017

	NOTES	2017	2016
		€000	€000
<b>Cash flows from operating activities</b>			
Interest, fees and commission received		18,402	18,882
Interest, fees and commission paid		(5,454)	(7,712)
Net return from investment and trading		1,180	286
Payments to employees and suppliers		(12,313)	(10,539)
<b>Cash flows from operating profit before changes in operating assets and liabilities</b>		1,815	917
Increase/(decrease) in operating assets:			
• Balances with Central Bank of Malta		(439)	1,770
• Loans and advances to customers		(41,032)	17,140
• Other assets		(434)	(25)
Increase/(decrease) in operating liabilities			
• Amounts owed to customers		30,887	8,670
• Other liabilities		(872)	1,268
<b>Net cash flows (used in)/generated from operating activities before tax</b>		(10,075)	29,740
Tax paid		-	(234)
<b>Net cash flows (used in)/generated from operating activities</b>		(10,075)	29,506

**STATEMENT OF CASH FLOWS**

For the year ended 31 December 2017

	NOTES	2017	2016
		€000	€000
<b>Cash flows from investing activities</b>			
Purchase of property, equipment and assets		(388)	(903)
Purchase of available-for-sale investments		(84,592)	(20,099)
Proceeds from disposal and redemption of available-for-sale investments		32,860	8,162
<b>Net cash flows used in investing activities</b>		(52,120)	(12,840)
<b>Cash flows from financing activities</b>			
Repayment of subordinated debt	16	-	(5,000)
Issue of perpetual capital notes	16	-	5,000
Issue of share capital	15	15,000	-
<b>Net cash flows from financing activities</b>		15,000	-
<b>Net (decrease)/increase in cash and cash equivalents</b>		(47,195)	16,666
Cash and cash equivalents at beginning of year		140,126	123,460
<b>Cash and cash equivalents at end of year</b>	32	92,931	140,126

The accounting policies and explanatory notes on pages 36 to 112 form an integral part of the financial statement.



# Notes to Financial Statements

# Notes to Financial Statements

For the year ended 31 December 2017

## 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.

By virtue of a resolution dated 20 October 2017, the Bank changed its name from Banif Bank (Malta) p.l.c. to BNF Bank p.l.c.

On 20 December 2015, the Bank's majority shareholder at that date, Banif – Banco Internacional do Funchal, S.A., (BNF S.A.) was subject to resolution measures in Portugal. The said procedure was pursuant to the Portuguese General Banking Law and the Directive 2001/24/EC on the re-organisation and winding up of credit institutions as amended by Article 117 of the Directive 2014/59/EU which published the framework for the recovery and resolution of credit institutions and investment firms. Such resolution measures applied in one European Member State shall be duly effective in accordance with the legislation of that Member State throughout the European Union without further formalities. As part of this regulatory re-structuring process, shares in the Bank previously held by Banif S.A. were taken over by Oitante S.A.

On 4 October 2016, an announcement was made in relation to the fact that following the successful conclusion of the regulatory screening process undertaken by the Malta Financial Services Authority, the majority shareholding in the Bank held by Oitante S.A. was purchased by Al Faisal International for Investment Malta Limited, a subsidiary of Al Faisal International for Investment Company Q.P.S.C., headquartered in Qatar. As explained in Note 15, on 9 December 2016, the shareholders of the Bank resolved to offset €7.96 million of its accumulated losses against its share capital, thereby effecting a reduction in share capital, and subsequently, in January 2017, increased the issued share capital by €15 million, following a capital injection by the new controlling shareholder, in line with its pre-acquisition plans for the Bank, which strengthened further the Bank's capital regulatory position. In January 2018, the Bank increased its issued share capital by a further €20 million (Note 15).

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'). These Additional Regulatory Disclosures ('ARDs') 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 these ARDs 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 available-for-sale financial assets, financial assets and financial liabilities at fair value through profit or loss (including all derivative financial instruments).

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).

### 2.2. Standards, interpretations and amendments to published standards effective in 2017

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

### 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 2018 have been published by the date of authorisation for an 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.

#### 2.3.1 IFRS 9 'Financial Instruments'

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

### Classification and measurement

The classification and measurement of financial assets under IFRS 9 reflects both the business model in which assets are managed and their cash flow characteristics. The existing IAS 39 financial instrument classifications are replaced with the IFRS 9 classifications of amortised cost, fair value through other comprehensive income ("FVOCI") and fair value through profit and loss ("FVTPL"). IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

A financial asset not designated as at FVTPL is measured at amortised cost if it is held within a business model whose objective is to hold assets to collect contractual cash flows and its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI") on the principal amount outstanding.

A financial asset not designated as at FVTPL is measured at FVOCI only if it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and its contractual terms give rise on specified dates to cash flows that are SPPI on the principal amount outstanding.

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

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

### Business model assessment

Key management personnel determine the Bank's business model by considering the way financial instruments are managed in order to generate cash flows. Such assessment is performed at a 'portfolio level' as it best reflects the way the business is managed and the information is provided to management. The information that will be considered in such assessment includes:

- i. 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;
- ii. the method for the evaluation of the performance of the portfolio and how such performance is reported to the Bank's management;
- iii. 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
- iv. 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 FVTPL because they are neither held

to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

### Assessment of whether contractual cash flows are 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 cash flow characteristics of these assets meet the SPPI requirements of IFRS 9. '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.

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:

- i. 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;
- ii. 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;
- iii. 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;
- iv. 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
- v. features that modify consideration for the time value of money (for example, periodic reset of interest rates).

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

- i. loans and advances to banks and to customers that are classified as loans and receivables under IAS 39 will be measured at amortised cost under IFRS 9;
- ii. debt investment securities classified as available-for-sale under IAS 39 will be classified at FVOCI under IFRS 9, given that the objective of the business model is achieved by both the collection of contractual cash flows and selling of the financial assets; and
- iii. equity securities will remain measured at fair value, with fair value movements recognised in other comprehensive income, since the equity securities currently held by the Bank are held for reasons other than to generate a capital return.

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

#### Impairment

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

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, and certain loan commitments and financial guarantee contracts. 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"). Financial assets where 12-month ECL is recognised are considered 'stage 1'. Financial assets which are considered to have experienced a significant increase in credit risk would be classified as 'stage 2' and financial assets for which there is objective evidence of impairment, thus considered to be in default or otherwise credit impaired, would be classified as 'stage 3'.

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

#### Significant increase in credit risk (SICR)

Under IFRS 9, when determining whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Bank will consider reasonable and supportable information that is relevant and available without undue cost or effort, including both quantitative and qualitative information. Such analysis will be based on the Bank's historical experience, credit assessment and forward-looking information.

The Bank will primarily identify whether a SICR has occurred for an exposure within the loans and advances to customers, through the Bank's internal rating grades. The Bank will allocate 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 may vary depending on the nature of the exposure and the type of borrower. Exposures will be subject to ongoing monitoring, which may result in an exposure being moved to a different internal rating grade. Identification of SICR and classification into stage 2 is performed for those non-defaulted exposures, 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 'regular'.

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

In the case of loans and advances to banks and investments in debt securities, the Bank will apply 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.

#### Definition of default and credit impaired

The assessment required by IFRS 9 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.

IFRS 9 does not specifically define default, but requires it to be applied on a consistent basis with internal credit risk management practice for the relevant instruments and requires consideration of qualitative factors where appropriate. In addition, IFRS 9 also introduces a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless there is reasonable and supportable information to demonstrate that a more lagging criterion is more appropriate.

In this respect, the Bank determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- i. contractual payments of either principal or interest are past due for more than 90 days;
- ii. there are other indications 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; and
- iii. the loan is otherwise considered to be in default. If such unlikelihood 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 as far as possible so that stage 3 represents all loans, which are considered defaulted or otherwise credit-impaired.

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

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

#### Modified loans and advances to customers

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

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.

#### Measurement of ECL

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

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 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, will be calculated based on statistical rating models and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models will be based on internally-compiled data comprising both quantitative and qualitative factors. 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 homogenous portfolio, to produce term structure of point-in-time PD. In the case of the Corporates portfolio, 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. The default is considered to be an absorbing state, whereby if an exposure defaults, it remains in this state during all next years. Market data will be 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 LGD represents expected 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 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 and the sales volatility, and by discounting (using the effective interest rate) the updated market value of the property after haircuts, over a period of time equivalent to the perceived time to sell. The LGD for other exposures will be based on the Bank's perceived risk on the collateral.

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

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 will define the lifetime of such exposures as the period to the expected date of the next substantive credit review, which normally is performed every 6 months. In cases of revolving credit facilities that are considered 'regular' 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 will consider a lifetime of 36 months.

#### Forward-looking information

Under IFRS 9, the Bank will incorporate forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since initial recognition and its measurement of ECL. The Bank performs a historical analysis to identify the key economic variables affecting credit risk and 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 macroeconomic variables, credit risk and credit losses. These key drivers include the average gross salary, the gross fixed capital formation and unemployment rates.

Three scenarios will be considered to capture non-linearity across credit portfolios. The 'base line' scenario will represent the mostlikely outcome. It will be based on authoritative sources. Apart from the 'base line' scenario, the Bank will consider two other macroeconomic scenarios – Upside and Downside scenarios – which respectively represent a more optimistic and a more pessimistic outcome. Such are supported by scenario narratives that reflect the current top and emergent risks. The more optimistic and more pessimistic scenarios are economically plausible and will not necessarily be as severe as scenarios used in stress testing.

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



### Presentation of ECL in the statement of financial position (SOPF)

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

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

### Transition and impact on CET1

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The mandatory application date for the standard as a whole is 1 January 2018. The Bank has not restated its comparative periods. Accordingly, all adjustments resulting from the transition have been applied by adjusting the opening balance sheet as at 1 January 2018.

Based on assessments undertaken to date, adoption is expected to reduce net assets of the Bank at 1 January 2018, net of deferred tax, in view of the application of ECL requirements. The Bank is in the final stages of determining the amount of the impact. As at the date of approval of these financial statements, the Bank is confident to anticipate that this amount is unlikely to exceed €1,500,000.

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

### Disclosures

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

### Hedge accounting

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

### 2.3.2 IFRS 16 'Leases'

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

beginning on or after 1 January 2019. The Bank is assessing the impact that IFRS 16 will have on the financial statements.

### 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

The Bank classifies 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 determines the classification of its financial assets at initial recognition.

#### 2.6.1 Initial recognition and derecognition

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.

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

#### 2.6.2 Financial assets at fair value through profit or loss

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

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

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

Financial instruments included in this category are recognised initially at fair value; transaction costs are taken directly to profit or loss. Gains and losses arising from changes in fair value are included directly in profit or loss and are reported as 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 designate certain financial assets upon initial recognition as at fair value through profit or loss (fair value option). This designation cannot subsequently be changed. According to IAS 39, the fair value option is only applied when the following conditions are met:

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

### 2.6.3 Loans and receivables

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

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

Loans and receivables arise when the Bank provides money, goods or services directly to a debtor with no intention of trading the asset. Loans and receivables mainly consist 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 are initially recognised at fair value – which is the cash consideration to originate or purchase the loan including any transaction costs – and measured subsequently at amortised cost using the effective interest rate method. Amortised cost is the initial measurement amount adjusted for the amortisation of any difference between the initial and maturity amounts using the effective interest method. Interest on loans and receivables is included in profit or loss and is reported as 'Interest receivable and similar income'. In the case of an impairment, the impairment loss is reported as a deduction from the carrying value of the loan and receivable and recognised in profit or loss as 'net impairment losses'.

### 2.6.4 Available-for-sale investments

Available-for-sale investments are financial assets that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices, or that are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

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

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

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

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

## 2.7. Impairment of financial assets

### 2.7.1 Assets carried at amortised cost

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

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

- significant financial difficulty of the issuer or obligor;
- a breach of contract, such as a default or delinquency in interest or principal payments;
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;

- it becomes probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the portfolio, including:
  - adverse changes in the payment status of borrowers in the portfolio; and
  - national or local economic conditions that correlate with defaults on the assets in the portfolio.

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

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

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the 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 reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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

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

and to remove the effects of conditions in the historical period that do not currently exist.

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

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

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

A forborne loan is categorised as impaired when:

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

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

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

#### 2.7.1.1 Forborne loans

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

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

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

Loans that have been identified as forborne retain this designation until payment performance has been observed for an extended period of time. When principal payments are modified resulting in permanent forgiveness, or when it is otherwise considered that there is no longer a realistic prospect of recovery of outstanding principal, the affected balances are written off.

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

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

#### 2.7.1.2 Assets classified as available-for-sale

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired taking cognisance of the criteria referred to in 2.7.1.

In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment resulting in the recognition of an impairment loss. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost (or amortised cost as applicable) and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised

in profit or loss. Impairment losses recognised in profit or loss on equity instruments are not reversed through profit or loss. If in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss.

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

### 2.8. Derivative financial instruments

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

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

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

### 2.9. 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.

### 2.10. 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.

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.

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:

LAND AND BUILDINGS

Freehold	20 – 50 years
Leasehold	10 years
Computer equipment	4 years
Other equipment	3 – 10 years

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 2.13).

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.

2.11. 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 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 least 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.

2.12. 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.

2.13. 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.

2.14. 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.



**2.15. 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.

**2.16. 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.

**2.17. Financial liabilities**

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

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

**2.18. 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.

**2.19. 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.

**2.20. Provisions**

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.

**2.21. 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.

**2.22. Interest income and expense**

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

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

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

**2.23. Fees and commissions**

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

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

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

#### 2.24. Dividend income

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

#### 2.25. Net trading income

Results arising from trading activities include all gains and losses from changes in fair value and related interest income or expense and dividends for financial assets and financial liabilities 'held for trading'.

#### 2.26. 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.

##### 2.26.1 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.

#### 2.27. Financial guarantee contracts

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

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

Financial guarantees are initially recognised in the financial statements at fair value on the date the guarantee was given. The fair value of a financial guarantee at the time of signature is zero because all guarantees are agreed on arm's length terms and the value of the premium agreed corresponds to the value of the guarantee obligation. No receivable for the future premiums is recognised. Subsequent to initial recognition, the Bank's liabilities under such guarantees are measured at the higher of the initial amount, less amortisation of fees recognised in accordance

with IAS 18, and the best estimate of the amount required to settle the guarantee. These estimates are determined based on the experience of similar transactions and history of past losses, supplemented by the judgement of management. The premium received is 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 is recognised in profit or loss.

#### 2.28. 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.

#### 2.29. 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 non-prompt repayment or non-payment of existing and contingent obligations by the Bank's counterparties, resulting in the loss of equity and profit. It 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 (the Bank is not exposed to the latter).
- **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 defines risk as the possibility of losses or profits foregone, which may be caused by internal or external factors.

The Bank considers risk management a core competency that helps produce high returns for its various stakeholders. 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, such as foreign exchange risk, interest rate risk and credit risk.

Accordingly, the Board is 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 and the Compensation 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 Executive Committee also established the Global Risk Committee, whose role is to report to the Executive Committee on 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. This Committee is composed of all Chief Officers, all Departmental Heads, Internal Audit and the Head of the Risk Management Unit.

The Global Risk Committee is supported by all Bank Units but especially, from an internal control and risk governance perspective, by the Internal Control Department, which performs a risk control and oversight function, with its main objective being to identify, quantify and report the various risks to which the Bank is exposed to, and making appropriate risk mitigation recommendations for the consideration of top senior management.

## 3.2. Credit risk

### 3.2.1 Introduction to credit risk

Credit risk is the risk that a counterparty will be unable to fulfil the terms of his/her obligations when due. In view of the nature of its business, the Bank's financial assets are inherently and predominantly subject to credit risk. Thus, Management has put in place internal control systems to evaluate, approve and monitor credit risks relating to both investment and loan portfolios.

The Bank’s credit risk arises from various components of the statement of financial position, namely amounts due from banks, loans and advances to customers, investments in debt securities, accrued income and commitments. However, the largest credit risk arises from the Bank’s lending and investment operations, which results from the risk of counterparty default, with the maximum exposure being equal to the carrying amount of the relevant instrument.

3.2.2 Credit risk management

Lending decisions should achieve a reasonable balance between the risks and returns of extending credit to a customer. 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.

During 2017, the Bank had in place, three credit policies relating to personal credit, business credit and credit risk mitigation, which further enhanced 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 Management Unit within the Internal Control Department in liaison with the business units. This results in a 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 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 on- 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 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 as disclosed in Note 22 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 as disclosed in Note 22. 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 following table analyses the Bank’s credit risk exposures relating to on-balance sheet assets by IAS 39 categorisation and off-balance sheet instruments, reflecting the maximum exposure to credit risk before collateral held or other credit enhancements.

	2017	2016
	€000	€000
Credit risk exposures relating to on-balance sheet assets:		
• Loans and receivables		
- Balances with Central Bank of Malta	22,734	108,798
- Cheques in course of collection	2,259	1,894
- Loans and advances to banks	69,911	29,695
- Loans and advances to customers	382,314	341,595
- Accrued income	1,547	903
Financial investments available-for-sale		
	67,322	17,417
	546,087	500,302
Credit risk exposures relating to off-balance sheet instruments:		
Contingent liabilities	8,820	8,331
Undrawn commitments to lend	112,685	63,116

The on-balance sheet exposures set out above are based on carrying amounts as reported in the statement of financial position.

### 3.2.4 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 are composed of local and foreign government debt securities, and other debt instruments as shown in the following table:

	2017	2016
	€000	€000
<b>Government</b>	<b>39,318</b>	17,417
<b>Corporate</b>		
• Financial services	26,637	-
• Other sectors	1,367	-
	<b>67,322</b>	17,417

Industry sector analysis of the Bank's loans and advances to customers before deducting impairment allowances (Gross loans and advances to customers) is shown in the following table:

	2017	2016
	€000	€000
<b>Manufacturing</b>	<b>6,882</b>	<b>7,282</b>
<b>Financial services</b>	<b>9,412</b>	<b>11,992</b>
<b>Households and individuals</b>	<b>275,641</b>	<b>252,045</b>
<b>Construction</b>	<b>20,978</b>	<b>9,123</b>
<b>Wholesale and retail</b>	<b>32,274</b>	<b>30,455</b>
<b>Other sectors</b>	<b>46,212</b>	<b>39,470</b>
<b>Gross loans and advances to customers</b>	<b>391,399</b>	<b>350,367</b>

### Credit concentration risk for counterparties

In terms of Part Four of the CRR 'Large Exposures', the total amount of exposures which exceeded 10% of eligible capital represented 17.26% of the total loan portfolio as at end of 2017 (2016: 11.8%). These exposures are strictly monitored by management and every reasonable step is taken to reduce this concentration and spread risk over a wider customer base with further growth in the loan portfolio.

The maximum on-balance sheet credit exposure to any client, group of connected clients or counterparty as at 31 December 2017 amounted to €9,116,000 (2016: €5,304,000) before taking account of collateral or other credit enhancements.

Within its daily operations, the Bank 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. This concentration risk is not considered material given that 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 equities and debt securities issued by foreign entities.

### 3.2.5 Information on credit quality of balances with banks and debt securities

The Bank holds debt securities that are issued by the local government and other international sovereign debt. During 2017, the Bank acquired debt securities and similar instruments issued by 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. The counterparty banks with which funds are held are principally credit rated BB or above based on S&P ratings.

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

The following tables analyse the credit quality of the financial assets mentioned above as the determined by credit ratings applicable to issuers or counterparties based on S&P's ratings:



	AAA TO A-	BBB+ TO BB	UNRATED	TOTAL
	€000	€000	€000	€000
<b>At 31 December 2017</b>				
• Loans and receivables				
- Balances with the Central Bank of Malta	22,734	-	-	<b>22,734</b>
- Loans and advances to banks	49,831	20,076	4	<b>69,911</b>
	72,565	20,076	4	<b>92,645</b>
<b>Available-for-sale financial assets</b>	54,757	11,198	1,367	<b>67,322</b>
	127,322	31,274	1,371	<b>159,967</b>

	AAA TO A-	BBB+ TO BB	UNRATED	TOTAL
	€000	€000	€000	€000
<b>At 31 December 2016</b>				
• Loans and receivables				
- Balances with the Central Bank of Malta	108,798	-	-	<b>108,798</b>
- Loans and advances to banks	15,738	13,952	5	<b>29,695</b>
	124,536	13,952	5	<b>138,493</b>
• Available-for-sale financial assets	17,417	-	-	<b>17,417</b>
	141,953	13,952	5	<b>155,910</b>

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.

### 3.2.6 Information on credit quality of loans and advances to customers

The credit quality of loans and advances is managed by the Bank using internal credit ratings. The Bank applies a 12-step internal rating system ('IRS') which encapsulates the risk profile associated with each and every lending relationship on its banking book.

The IRS comprises 12 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)
- Standard (Internal rating of B)
- Substandard (Internal rating of C)

#### Non-performing

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

#### High Grade

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

Loans and advances classified within this category, and thus 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

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.

#### Doubtful

Loans and advances in 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 those customers which are deemed by the Bank as specifically impaired, in accordance with the requirements of IFRSs as adopted by the EU.

Impaired loans and advances

The Bank reviews all credit exposures on a case by case basis and also on a collective basis if the exposure is not deemed individually impaired, in order to consider the likelihood that the Bank may be exposed to losses on loans and advances and with a view to taking early recovery action.

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 individually 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 Bank estimates an impairment allowance for any possible incurred losses within its lending portfolio. The Bank performs an assessment for the calculation of specific provisions when a review of credit facilities reveals that the creditworthiness of a borrower has undergone a significant deterioration and that, as a result, recovery of a credit facility is in serious doubt. The Bank makes an assessment for specific impairment for those credit facilities being overdue by 90 days, amongst other qualitative factors, and provides if there is a shortfall. The shortfall or surplus is 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. The calculation of the present value of estimated future cashflows takes into account the estimated time value 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 assumes that all its exposures are individually significant. Accordingly, allowances are assessed collectively for individually significant loans and advances where there is no objective evidence of individual impairment as yet.

Financial guarantees and letters of credit are assessed and provision is made in a similar manner as for loans.

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

	2017	2016
	€000	€000
Manufacturing	443	435
Households and individuals	6,207	6,570
Construction	146	132
Wholesale and retail	5,447	6,909
Other	1,497	2,170
	13,740	16,216

Past due but not impaired

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 level of collateral available and/or the stage of collection of amounts owed to the Bank. Related credit losses, which may arise, if any, are partly covered through collective impairment allowances.

Forbearance measures and forborne loans

The contractual terms of a loan may be revised for a number of reasons, including changes in market conditions, customer retention and other factors 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 are regarded as concessionary:

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

Term extension is the most common type of modification granted by the Bank. Other types of concession, 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.

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

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

	FORBORNE EXPOSURES 2017	FORBORNE EXPOSURES 2016
	€000	€000
<b>At 1 January</b>	<b>19,195</b>	22,586
Loans to which forbearance measures have been extended during the year	<b>2,646</b>	1,610
Repayments	<b>(966)</b>	(2,162)
Retired from forborne	<b>(1,222)</b>	(2,839)
<b>At 31 December</b>	<b>19,653</b>	19,195

	FORBORNE EXPOSURES 2017	FORBORNE EXPOSURES 2016
	€000	€000
Manufacturing	<b>1,261</b>	1,330
Financial services	<b>2,660</b>	2,941
Households and individuals	<b>4,142</b>	3,981
Construction	<b>2,320</b>	2,518
Wholesale and retail	<b>5,062</b>	5,090
Other sectors	<b>4,208</b>	3,335
	<b>19,653</b>	19,195

As at 31 December 2017 and 2016, forborne loans mainly comprise exposures to customers based in Malta.

#### Write-off policy

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

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

	NON-FORBORNE EXPOSURES 2017	FORBORNE EXPOSURES 2017	TOTAL 2017	NON-FORBORNE EXPOSURES 2016	FORBORNE EXPOSURES 2016	TOTAL 2016
	€000	€000	€000	€000	€000	€000
<b>Performing</b>						
• Neither past due nor impaired						
- High grade	347,420	1,614	349,034	301,347	1,835	303,182
- Standard	4,151	355	4,506	7,981	1,121	9,102
- Substandard	248	3	251	379	20	399
	351,819	1,972	353,791	309,707	2,976	312,683
• Past due loans by less than 90 days but not impaired						
- Past due by less than 30 days	4,051	67	4,118	3,364	256	3,620
- Past due by less than 60 days	1,766	101	1,867	1,738	838	2,576
- Past due by less than 90 days	168	3	171	63	-	63
	5,985	171	6,156	5,165	1,094	6,259
<b>Non-performing</b>						
• Past due loans by more than 90 Days						
- Specifically impaired, gross of specific impairment allowances	8,961	4,779	13,740	10,652	5,564	16,216
- Past due by 90 days but not specifically impaired	4,063	7,796	11,859	4,363	6,474	10,837
	13,024	12,575	25,599	15,015	12,038	27,053
• Other non-performing loans, but not specifically impaired	918	4,935	5,853	1,285	3,087	4,372
<b>Gross loans and advances</b>	<b>371,746</b>	<b>19,653</b>	<b>391,399</b>	331,172	19,195	350,367
- Specific impairment allowances applied to specifically impaired exposures reflected above	(4,513)	(2,397)	(6,910)	(4,476)	(2,260)	(6,736)
- Collective impairment allowances	(1,810)	(365)	(2,175)	(1,907)	(129)	(2,036)
<b>Net loans and advances</b>	<b>365,423</b>	<b>16,891</b>	<b>382,314</b>	324,789	16,806	341,595

Interest income recognised during the financial year ended 31 December 2017 in respect of forborne exposures amounted to €968,000 (2016: €1,034,000).

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

SPECIFIC IMPAIRMENT ALLOWANCE	NON-FORBORNE	FORBORNE	TOTAL
	€000	€000	€000
At 1 January 2016	3,163	1,489	4,652
Additions	1,833	998	2,831
Reversals	(520)	(227)	(747)
<b>At 31 December 2016</b>	4,476	2,260	6,736
At 1 January 2017	4,476	2,260	6,736
Additions	764	443	1,207
Reversals	(727)	(306)	(1,033)
<b>At 31 December 2017</b>	4,513	2,397	6,910

COLLECTIVE IMPAIRMENT ALLOWANCE	NON-FORBORNE	FORBORNE	TOTAL
	€000	€000	€000
At 1 January 2016	2,435	165	2,600
Additions	901	51	952
Reversals	(1,429)	(87)	(1,516)
<b>At 31 December 2016</b>	1,907	129	2,036
At 1 January 2017	1,907	129	2,036
Additions	855	313	1,168
Reversals	(952)	(77)	(1,029)
<b>At 31 December 2017</b>	1,810	365	2,175

Write-offs during the period under review were €4,000 (2016: €45,000).

### 3.2.7 Collateral

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.

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.

Management monitors the market value of collateral, obtained during its review of the adequacy of the allowance for impairment losses, and requests additional collateral in accordance with the underlying agreement when necessary.

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 extendible value of the collateral is the net fair value of a pledged asset for lending purposes, after applying a precautionary margin to its market value.

The following is an analysis of the value of the extendible collateral and other credit enhancements held by the Bank against exposures of loans and advances to customers. The amounts disclosed in the table represent the lower of the value of the extendible collateral and the carrying amount of the respective secured loans.

	NON- FORBORNE EXPOSURES 2017	FORBORNE EXPOSURES 2017	NON- FORBORNE EXPOSURES 2016	FORBORNE EXPOSURES 2016
	€000	€000	€000	€000
<b>Performing</b>				
• Neither past due nor impaired				
- Total maximum exposure	351,819	1,972	309,707	2,976
Extendible value of collateral:				
Secured by cash and quasi cash	(11,983)	(60)	(11,521)	(144)
Residential immovable property	(247,492)	(554)	(217,583)	(1,410)
Commercial immovable property	(50,090)	(960)	(36,407)	(1,116)
Other collateral	(834)	(1)	(1,358)	(2)
Total extendible value of collateral	(310,399)	(1,575)	(266,869)	(2,672)
Residual exposure	41,420	397	42,838	304
• Past due by less than 90 days but not impaired				
- Total maximum exposure	5,985	171	5,165	1,094

	NON- FORBORNE EXPOSURES 2017	FORBORNE EXPOSURES 2017	NON- FORBORNE EXPOSURES 2016	FORBORNE EXPOSURES 2016
	€000	€000	€000	€000
Extendible value of collateral:				
Secured by cash and quasi cash	(448)	-	(121)	(12)
Residential immovable property	(4,088)	(3)	(2,413)	(177)
Commercial immovable property	(524)	(135)	(1,443)	(843)
Other collateral	-	-	(9)	-
Total extendible value of collateral	(5,060)	(138)	(3,986)	(1,032)
Residual exposure	925	33	1,179	62

#### Non-performing

- Total maximum exposure	13,942	17,510	16,300	15,125
Extendible value of collateral:				
Secured by cash and quasi cash	(52)	(9)	(114)	(2)
Residential immovable property	(8,909)	(8,024)	(11,574)	(6,113)
Commercial immovable property	(1,688)	(6,397)	(1,364)	(7,228)
Total extendible value of collateral	(10,649)	(14,430)	(13,052)	(13,343)
Residual exposure	3,293	3,080	3,248	1,782

#### 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 individual 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 of 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.

	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
	€000	%	€000	€000	€000	€000	€000
<b>As at 31 December 2017</b>							
<b>Financial assets</b>							
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	-	-	-
<b>Total financial assets</b>	546,324		463,608	11,348	54,802	12,520	4,046
<b>Financial liabilities</b>							
Amounts owed to banks	290	0.02%	287	-	-	-	3
Amounts owed to customers	513,851	0.95%	363,961	78,152	71,738	-	-
<b>Total financial liabilities</b>	514,141		364,248	78,152	71,738	-	3
<b>Interest repricing gap</b>			99,360	(66,804)	(16,936)	12,520	4,043
<b>Cumulative gap</b>			99,360	32,556	15,620	28,140	

	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
	€000	%	€000	€000	€000	€000	€000
<b>As at 31 December 2017</b>							
<b>Financial assets</b>							
Balances with Central Bank of Malta and cash	113,530	(0.40%)	108,798	-	-	-	4,732
Financial investments available-for-sale	17,417	3.67%	-	11,034	2,695	3,688	-
Loans and advances to banks	29,695	0.10%	29,690	-	-	-	5
Loans and advances to customers	341,595	4.57%	341,328	267	-	-	-
<b>Total financial assets</b>	<b>502,237</b>		<b>479,816</b>	<b>11,301</b>	<b>2,695</b>	<b>3,688</b>	<b>4,737</b>
<b>Financial liabilities</b>							
Amounts owed to banks	71	-	-	-	-	-	71
Amounts owed to customers	482,964	1.25%	278,904	89,392	114,668	-	-
<b>Total financial liabilities</b>	<b>483,035</b>		<b>278,904</b>	<b>89,392</b>	<b>114,668</b>	<b>-</b>	<b>71</b>
<b>Interest repricing gap</b>			<b>200,912</b>	<b>(78,091)</b>	<b>(111,973)</b>	<b>3,688</b>	<b>4,666</b>
<b>Cumulative gap</b>			<b>200,912</b>	<b>122,821</b>	<b>10,848</b>	<b>14,536</b>	

**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.

	2017	2017	2016	2016
	Fixed	Variable	Fixed	Variable
	€000	€000	€000	€000
<b>Interest-earning assets</b>				
Financial investments available-for-sale	67,322	-	17,417	-
Balances with Central Bank of Malta	-	22,734	-	108,798
Loans and advances to banks	46,707	23,201	6,649	23,041
Loans and advances to customers	1,967	380,347	2,519	339,076
	115,996	426,282	26,585	470,915
<b>Interest-bearing liabilities</b>				
Amounts owed to banks	-	287	-	-
Amounts owed to customers	223,205	290,646	244,070	238,894
	223,205	290,933	244,070	238,894

**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 available-for-sale quoted debt securities (also refer to note 7) since these are fair valued with fair value changes recognised in other comprehensive income. Considering the nature 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 €1,353,000 (2016: €1,508,000). 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 €1,353,000 (2016: €1,508,000).

**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 on the following page which present this matching process.

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 table below 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.

	TOTAL	EUR	GBP	USD	OTHER
	€000	€000	€000	€000	€000
<b>As at 31 December 2017</b>					
<b>Financial assets</b>					
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	5,953	5,931	1	1	20
<b>Total financial assets</b>	<b>552,618</b>	<b>532,256</b>	<b>8,059</b>	<b>10,390</b>	<b>1,913</b>
<b>Financial liabilities</b>					
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
<b>Total financial liabilities</b>	<b>521,686</b>	<b>503,219</b>	<b>7,280</b>	<b>9,080</b>	<b>2,107</b>
<b>Net currency position</b>			<b>779</b>	<b>1,310</b>	<b>(194)</b>

	TOTAL	EUR	GBP	USD	OTHER
	€000	€000	€000	€000	€000
<b>As at 31 December 2016</b>					
<b>Financial assets</b>					
Balances with Central Bank of Malta and cash	113,530	113,410	48	58	14
Financial investments classified as available-for-sale	17,758	17,758	-	-	-
Loans and advances to banks	29,695	6,657	9,011	12,472	1,555
Loans and advances to customers	341,595	339,634	-	1,961	-
Other assets	5,287	3,573	-	1,687	27
<b>Total financial assets</b>	<b>507,865</b>	<b>481,032</b>	<b>9,059</b>	<b>16,178</b>	<b>1,596</b>
<b>Financial liabilities</b>					
Amounts owed to banks	71	71	-	-	-
Amounts owed to customers	482,964	458,866	8,248	14,471	1,379
Other liabilities	9,084	8,092	967	20	5
<b>Total financial liabilities</b>	<b>492,119</b>	<b>467,029</b>	<b>9,215</b>	<b>14,491</b>	<b>1,384</b>
<b>Net currency position</b>			<b>(156)</b>	<b>1,687</b>	<b>212</b>

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 loss of €379,000 (2016: a loss of €348,000) in the carrying amount of financial instruments with the adverse impact recognised in profit or loss. Should the euro depreciate

against all currencies by 20%, the effect would be a gain of €379,000 (2016: a gain of €348,000) 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 74.4% (2016: 70.7%) at the end of the period under review reflects the Bank's prudent position in the context of liquidity management. Also, the proportion of liquid assets to short-term liabilities at 31 December 2017 is 32.42% (2016: 56.9%).

#### 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 2017 was 126.38% (2016: 280.34%)

As at 31 December 2017 and 2016 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 2017 was 171.52%. (2016: 182.08%)

As at 31 December 2017 and 2016 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 those projections is an analysis of the contractual maturity of the financial liabilities and the expected collection date of the financial assets;
- maintaining a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- monitoring the liquidity ratios of the Bank against internal and regulatory requirements; and
- managing the concentration and profile of debt maturities.

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

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

	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
<b>At 31 December 2017</b>						
<b>Financial assets</b>						
Balances with Central Bank of Malta and cash	26,777	23,310	-	-	-	3,467
Financial investments classified						
as available-for-sale	67,663	-	-	54,802	12,520	341
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	5,953	2,335	-	-	-	3,618
<b>Total financial assets</b>	<b>552,618</b>	<b>127,937</b>	<b>18,413</b>	<b>89,819</b>	<b>309,023</b>	<b>7,426</b>
<b>Financial liabilities</b>						
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
<b>Total financial liabilities</b>	<b>521,686</b>	<b>359,740</b>	<b>76,264</b>	<b>80,547</b>	<b>-</b>	<b>5,135</b>
<b>Maturity gap</b>		(231,803)	(57,851)	9,272	309,023	
<b>Cumulative gap</b>		(231,803)	(289,654)	(280,382)	28,641	

	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
<b>At 31 December 2016</b>						
<b>Financial assets</b>						
Balance with Central Bank of Malta and cash	113,530	110,502	-	-	-	3,028
Financial investments classified as available-for-sale	17,758	-	11,034	2,695	3,688	341
Loans and advances to banks	29,695	29,695	-	-	-	-
Loans and advances to customers	341,595	31,957	14,374	31,966	263,298	-
Other assets	5,287	1,595	-	-	-	3,692
<b>Total financial assets</b>	<b>507,865</b>	<b>173,749</b>	<b>25,408</b>	<b>34,661</b>	<b>266,986</b>	<b>7,061</b>
<b>Financial liabilities</b>						
Amounts owed to banks	71	71	-	-	-	-
Amounts owed to customers	482,964	279,373	88,943	114,648	-	-
Other liabilities	9,084	2,674	-	-	-	6,410
<b>Total financial liabilities</b>	<b>492,119</b>	<b>282,118</b>	<b>88,943</b>	<b>114,648</b>	<b>-</b>	<b>6,410</b>
<b>Maturity gap</b>		<b>(108,369)</b>	<b>(63,535)</b>	<b>(79,987)</b>	<b>266,986</b>	
<b>Cumulative gap</b>		<b>(108,369)</b>	<b>(171,904)</b>	<b>(251,891)</b>	<b>(15,095)</b>	

An amount of €3,766,000 (2016: €4,515,000) comprising financial investments 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.

	TOTAL	WITHIN 3 MONTHS	LESS THAN 1 YEAR	OVER 1 LESS THAN 5 YEARS	OVER 5 YEARS
	€000	€000	€000	€000	€000
At 31 December 2017					
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	-
At 31 December 2016					
Financial liabilities					
Amounts owed to banks	71	71	-	-	-
Amounts owed to customers	486,757	279,373	88,944	118,440	-
Total financial liabilities	486,828	279,444	88,944	118,440	-

During 2017, the Bank revised its Internal Liquidity Adequacy Assessment Process (ILAAP) in line with best practice methodology. Such revision was heavily influenced by the need to achieve integration with other important regulatory reports such as the Internal Capital Adequacy Assessment Process (ICAAP), the Recovery Plan and the Nonperforming Loans Reduction Plan. Thus, in line with the requirements of the Supervisory Review and Evaluation Process (SREP), a holistic approach was taken which logically links the underlying building blocks of the different reports although with different customizations as deemed appropriate for each report. Within the said holistic approach, the ILAAP was drawn up under a going concern concept but with an increased focus on stress testing which was more robustly modelled and whose horizon was lengthened to a two-year period.

Through the ILAAP, the level of liquidity and funding risks sustained by the institution were methodically analysed using various tools and metrics essentially over three different time

horizons: intraday, one month and one year.

The final outcome revealed a very tenable and sound liquidity and funding risk profile and the full Report was duly submitted to the Regulator in the normal course.

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 €2,001,000 (2016: €1,994,000).

In the 2017 ICAAP, 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 institution-wide Risk and Control Assessment (RCA) which was conducted for the first time. The RCA analysed twenty-five 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 aggregated residual risk level was used to fine-tune the Pillar 2 operational risk capital charge inherent in the ICAAP as well as the stressed economic capital charge whose horizon was raised to a two-year period (in line with other risks).

It is important to highlight that such honing was applied only for Pillar 2 economic capital quantification. The Pillar 1 regulatory capital requirement for operational risk was unaffected and as aforesaid, retained an overly prudent and conservative approach in full compliance with applicable BIA requirements.

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, the ALCO and the Global Risk Committee.

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 Basic Method 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 2017:

	2017	2016
	€000	€000
<b>Common Equity Tier 1 (CET1) capital</b>		
Share capital	39,544	24,544
Retained earnings/(accumulated losses)	768	(100)
Reserve for general banking risks	992	992
Revaluation reserve	(248)	352
• Adjustments:		
- Depositor Compensation Scheme Reserve	(3,667)	(4,079)
- Intangible assets	(1,124)	(1,298)
- Removal of Unrealised gains to Tier 2	(11)	(141)
- Deferred tax assets	(426)	(1,570)
	35,828	18,700
<b>Additional Tier 1 Perpetual Capital Notes</b>	5,000	5,000
<b>Tier 2 capital</b>		
Transitional adjustments	788	946
Revaluation reserve (unrealised gains)	11	141
	799	1,087
<b>Total own funds</b>	41,627	24,787

Following the injection of the new share capital of €15 million in January 2017, the Bank positioned itself away from a situation of regulatory marginality as reflected in the table above. As a consequence of this transaction, the capital adequacy ratios moved to a position where a reasonable cushion in excess of the regulatory floors was achieved.

On 4 October 2016, following the non-objection of the European Central Bank, the majority shareholding in the Bank owned by Oitante S.A. was purchased by Al Faisal International

for Investment Malta Limited, a subsidiary of Al Faisal for Investment Company Q.P.S.C. headquartered in Qatar.

On the same date, as explained in Note 16, 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. The Notes constitute unsecured, undated and subordinated obligations of the Bank; these instruments are redeemable at par at the discretion of the Bank 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.

During December 2016, the Bank resolved to offset €7.96 million of its accumulated losses against its share capital, thereby effecting a reduction in share capital, and subsequently, in January 2017 and January 2018, increased the issued share capital by €15 million and €20 million respectively, following a capital injection by the new controlling shareholder, in line with the terms of the Share Purchase Agreement.

### 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 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 a level of the fair value hierarchy:

	LEVEL 1	LEVEL 3	TOTAL
	€000	€000	€000
At 31 December 2017			
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

	LEVEL 1	LEVEL 3	TOTAL
	€000	€000	€000
At 31 December 2016			
Financial assets			
Financial investments available-for-sale			
Government debt, fixed income instruments	17,417	-	17,417
Other equities	-	341	341
Total financial assets			
	17,417	341	17,758

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 period 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

The Bank reviews its loan portfolios to assess impairment on an ongoing basis as relevant generic data is observed concerning risks associated with groups of loans with similar risk characteristics. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgements as to whether there is any observable data indicating an impairment trigger followed by a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.
- 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 2.7, 9 and 29).

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 2017 and 2016:

	RETAIL BANKING	CORPORATE BANKING	OTHER	TOTAL
	2017	2017	2017	2017
	€000	€000	€000	€000
<b>Net operating income</b>				
- Net interest income	5,760	5,112	(477)	<b>10,395</b>
- Net fees and commission income	877	1,488	(32)	<b>2,333</b>
- Net trading income	-	-	1,423	<b>1,423</b>
Total operating income	6,637	6,600	914	<b>14,151</b>
Net impairment losses	(465)	(52)	-	<b>(517)</b>
<b>Net operating income</b>	6,172	6,548	914	<b>13,634</b>
Employee compensation and benefits	(1,953)	(716)	(4,195)	<b>(6,864)</b>
Other administrative expenses	(772)	(223)	(3,754)	<b>(4,749)</b>
Depreciation of property and equipment and amortisation of intangible assets	(366)	(25)	(528)	<b>(919)</b>
<b>Profit before tax</b>				<b>1,102</b>
Income tax expense				<b>(234)</b>
<b>Profit for the year</b>				<b>868</b>

	RETAIL BANKING	CORPORATE BANKING	OTHER	TOTAL
	2017	2017	2017	2017
	€000	€000	€000	€000
<b>Assets and liabilities</b>				
Segment assets	254,619	133,472	162,563	<b>550,654</b>
Unallocated assets				<b>17,088</b>
<b>Total assets</b>				<b>567,742</b>
Segment liabilities	363,691	150,160	290	<b>514,141</b>
Unallocated liabilities				<b>7,545</b>
<b>Total liabilities</b>				<b>521,686</b>



	RETAIL BANKING 2016	CORPORATE BANKING 2016	OTHER 2016	TOTAL 2016
	€000	€000	€000	€000
<b>Net operating income</b>				
- Net interest income	7,462	5,536	(3,372)	<b>9,626</b>
- Net fees and commission income	802	1,058	19	<b>1,879</b>
- Net trading income	-	-	740	<b>740</b>
- Gain on disposal of available-for-sale financial investments	-	-	3,105	<b>3,105</b>
Total operating income	8,264	6,594	492	<b>15,350</b>
Net impairment losses	221	(2,078)	-	<b>(1,857)</b>
<b>Net operating income</b>	<b>8,485</b>	<b>4,516</b>	<b>492</b>	<b>13,493</b>
Employee compensation and benefits	(1,828)	(500)	(3,314)	<b>(5,642)</b>
Other administrative expenses	(1,539)	(1,080)	(2,107)	<b>(4,726)</b>
Depreciation of property and equipment and amortisation of intangible assets	(392)	(22)	(481)	<b>(895)</b>
<b>Profit before tax</b>				<b>2,230</b>
Income tax expense				<b>(130)</b>
<b>Profit for the year</b>				<b>2,100</b>

	RETAIL BANKING 2016	CORPORATE BANKING 2016	OTHER 2016	TOTAL 2016
	€000	€000	€000	€000
<b>Assets and liabilities</b>				
Segment assets	236,727	110,950	157,333	<b>505,010</b>
Unallocated assets				<b>17,897</b>
<b>Total assets</b>				<b>522,907</b>
Segment liabilities	365,865	117,099	71	<b>483,035</b>
Unallocated liabilities				<b>9,084</b>
<b>Total liabilities</b>				<b>492,119</b>

## 6. BALANCES WITH CENTRAL BANK OF MALTA AND CASH

	2017	2016
	€000	€000
<b>Current</b>		
Balances with Central Bank of Malta	<b>22,734</b>	108,798
Cash	<b>4,043</b>	4,732
	<b>26,777</b>	113,530

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 €3,467,000 (2016: €3,028,000).

## 7. FINANCIAL INVESTMENTS CLASSIFIED AS AVAILABLE-FOR-SALE

Financial investments classified as 'available-for-sale' include the following:

	2017	2016
	€000	€000
<b>Equities</b>	<b>341</b>	<b>341</b>
Government debt securities		
- Local and listed on the Malta Stock Exchange	23,017	17,417
- Foreign and listed on other exchanges	16,301	-
Other debt securities		
- Local and listed on the Malta Stock Exchange	1,367	-
- Foreign and listed on other exchanges	26,637	-
<b>At 31 December</b>	<b>67,663</b>	<b>17,758</b>

	2017	2016
	€000	€000
Non-current		
Debt and other fixed income instruments	67,322	17,417

	2017	2016
	€000	€000
At 1 January	17,758	5,291
Acquisitions	84,592	20,304
Redemptions/maturities	(12,671)	(4,000)
Disposals	(20,189)	(922)
Amortisation	(904)	(340)
Fair value movements	(923)	(2,575)
<b>At 31 December</b>	<b>67,663</b>	<b>17,758</b>

Government debt securities with a carrying amount of €3,766,000 (2016: €4,515,000) have been pledged in favour of the Depositor Compensation Scheme.

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

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

As at 31 December 2015, the Bank increased the carrying amount of its €10 share in Visa Europe Limited by €2,461,000 to reflect the value emanating from the proposed transaction.

The transaction was subsequently completed during the first six months of 2016 as the Bank received up-front cash consideration of €2,623,450 and preferred stock convertible into Visa Inc. class A common stock amounting to a maximum of €681,844. Additional deferred cash consideration of €214,600 will also be receivable upon the third anniversary of the closing of the transaction.

The investment was fair valued at €3,105,475 reflecting the above-mentioned terms secured upon completion of the transaction. The investment was in substance disposed of upon completion, and the revaluation reserve amounting to €3,105,475 was classified to profit or loss upon disposal. The remaining interest, subsequent to completion, in respect of the preferred stock and deferred cash consideration elements, has been recognised at the amount of

€482,028 (with the latter element recognised within other assets), reflecting the fair value upon completion and unchanged as at 31 December 2016 and 2017.

As at 31 December 2016 and 2017, the fair value of the components of the interest referred to above was categorised as Level 3 of the 'Fair Value Hierarchy' with 'IFRS 13 – Fair value measurement', since the valuation technique utilised was mainly based on unobservable inputs.

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 2016 and 2017.

The investment in the equity instrument as a result of the acquisition of Visa Europe Limited by Visa Inc., emanates from the bank receiving preferred stock of Visa Inc. in exchange for its membership in Visa Europe Limited.

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.

The level of exposure of Visa Inc. and Visa Europe Limited is uncertain due to legal proceedings remaining in an embryonic stage. The conversion rate will be periodically adjusted to reflect any change in the litigation risk, in order to reimburse Visa Inc. for the costs of any successful claims; so that over time, the litigation risk and accordingly the outstanding preferred stock should decrease.

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.

## 8. LOANS AND ADVANCES TO BANKS

	2017	2016
	€000	€000
Current		
- Repayable on call and at short notice	23,204	23,046
- Term placements	46,707	6,649
	69,911	29,695

## 9. LOANS AND ADVANCES TO CUSTOMERS

	2017	2016
	€000	€000
Repayable on call and at short notice	66,737	50,241
Term loans and advances	324,662	300,126
Gross loans and advances to customers	391,399	350,367
Less allowances for impairment losses	(9,085)	(8,772)
Net loans and advances to customers	382,314	341,595
<b>Impairment allowances</b>		
Specific impairment allowances	6,910	6,736
Collective impairment allowances	2,175	2,036
	9,085	8,772
Current	75,914	72,229
Non-current	315,485	278,138
Gross loans and advances to customers	391,399	350,367

The aggregate gross amount of impaired loans and advances to customers at at 31 December 2017 amounted to €13,740,000 (2016: €16,216,000). Specific impairment allowances at the end of the reporting period include €477,000 (2016: €479,000), reflected in the table above, in respect of interest in suspense.

**10. PROPERTY AND EQUIPMENT**

	LAND AND BUILDINGS	COMPUTER EQUIPMENT	OTHER EQUIPMENT	TOTAL
	€000	€000	€000	€000
<b>At 1 January 2016</b>				
Cost	8,490	1,754	1,428	<b>11,672</b>
Accumulated depreciation	(1,687)	(1,215)	(1,030)	<b>(3,932)</b>
Net book amount	6,803	539	398	<b>7,740</b>
<b>Year ended 31 December 2016</b>				
At 1 January 2016	6,803	539	398	<b>7,740</b>
Acquisitions	4	82	27	<b>113</b>
Disposals	(8)	-	-	<b>(8)</b>
Depreciation charge for the year	(287)	(65)	(223)	<b>(575)</b>
At 31 December 2016	6,512	556	202	<b>7,270</b>
<b>At 31 December 2016</b>				
Cost	8,486	1,836	1,455	<b>11,777</b>
Accumulated depreciation	(1,974)	(1,280)	(1,253)	<b>(4,507)</b>
Net book amount	6,512	556	202	<b>7,270</b>
<b>Year ended 31 December 2017</b>				
At 1 January 2017	6,512	556	202	<b>7,270</b>
Acquisitions	6	160	46	<b>212</b>
Disposals	-	-	(5)	<b>(5)</b>
Depreciation charge for the year	(271)	(103)	(195)	<b>(569)</b>
At 31 December 2017	6,247	613	48	<b>6,908</b>

	LAND AND BUILDINGS	COMPUTER EQUIPMENT	OTHER EQUIPMENT	TOTAL
	€000	€000	€000	€000
<b>At 31 December 2017</b>				
Cost	8,492	1,996	1,496	<b>11,984</b>
Accumulated depreciation	(2,245)	(1,383)	(1,448)	<b>(5,076)</b>
Net book amount	6,247	613	48	<b>6,908</b>

Future capital expenditure which was authorised by the Board, but has not yet been contracted for at year end, amounted to €70,000 (2016: €132,000). Property and equipment includes assets amounting to €15,000 (2016: €58,000) which were still not put to use at year end.

**11. INTANGIBLE ASSETS**

	COMPUTER SOFTWARE & ROYALTIES	OTHER INTANGIBLES	TOTAL
	€000	€000	€000
<b>At 1 January 2016</b>			
Cost	2,297	146	<b>2,443</b>
Accumulated depreciation	(1,623)	-	<b>(1,623)</b>
Net book amount	674	146	<b>820</b>
<b>Year ended 31 December 2016</b>			
At 1 January 2016	674	146	<b>820</b>
Acquisitions	805	-	<b>805</b>
Disposals	(7)	-	<b>(7)</b>
Amortisation for the year	(320)	-	<b>(320)</b>
At 31 December 2016	1,152	146	<b>1,298</b>
<b>At 31 December 2016</b>			
Cost	3,095	146	<b>3,241</b>
Accumulated amortisation	(1,943)	-	<b>(1,943)</b>
Net book amount	1,152	146	<b>1,298</b>
<b>Year ended 31 December 2017</b>			
At 1 January 2017	1,152	146	<b>1,298</b>
Acquisitions	176	-	<b>176</b>
Amortisation for the year	(350)	-	<b>(350)</b>
At 31 December 2017	978	146	<b>1,124</b>

	COMPUTER SOFTWARE & ROYALTIES	OTHER INTANGIBLES	TOTAL
	€000	€000	€000
<b>At 31 December 2017</b>			
Cost	3,271	146	<b>3,417</b>
Accumulated amortisation	(2,293)	-	<b>(2,293)</b>
Net book amount	978	146	<b>1,124</b>

At 31 December 2017, computer software included assets amounting to €91,000 (2016: €386,000) which were still not put to use at year end.

**12. DEFERRED TAX ASSETS**

Deferred tax assets and liabilities are attributable to the following:

	ASSETS	LIABILITIES	NET	ASSETS	LIABILITIES	NET
	2017	2017	2017	2016	2016	2016
	€000	€000	€000	€000	€000	€000
Differences between depreciation and capital allowances	-	(267)	(267)	-	(275)	(275)
Loan impairment allowances	3,834	-	3,834	3,472	-	3,472
Fair value movements on investments	140	-	140	-	(184)	(184)
Unused tax losses	393	-	393	997	-	997
	<b>4,367</b>	<b>(267)</b>	<b>4,100</b>	<b>4,469</b>	<b>(459)</b>	<b>4,010</b>



Movement in temporary differences related to:

	AT 1 JANUARY 2016	RECOGNISED IN PROFIT OR LOSS	RECOGNISED IN OTHER COMPREHENSIVE INCOME	AT 31 DECEMBER 2016	RECOGNISED IN PROFIT OR LOSS	RECOGNISED IN OTHER COMPREHENSIVE INCOME	AT 31 DECEMBER 2017
	€000	€000	€000	€000	€000	€000	€000
Differences between depreciation and capital allowances	(186)	(89)	-	(275)	8	-	(267)
Loan impairment allowances	2,538	934	-	3,472	362	-	3,834
Fair value movements on investments	(1,085)	-	901	(184)	-	324	140
Unused tax losses	1,736	(739)	-	997	(604)	-	393
	3,003	106	901	4,010	(234)	324	4,100

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 classified as available-for-sale.

Unused tax losses do not expire. Based on the Bank's operating trends and forecasts, this deferred tax asset is expected to be utilised from available taxable profits in the foreseeable future.

### 13. PREPAYMENTS AND ACCRUED INCOME

	2017	2016
	€000	€000
Current		
Prepayments	788	692
Accrued income	1,547	903
	2,335	1,595

### 14. OTHER ASSETS

	2017	2016
	€000	€000
Other financial assets	3,026	3,039
Other assets	1,325	1,223
	4,351	4,262
Current	3,619	3,692
Non-current	732	570
	4,351	4,262

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

## 15. SHARE CAPITAL

	2017	2017	2016	2016
	No. of shares	€	No. of Shares	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	52,362,289	39,544,001	32,500,000	24,544,000

By virtue of a resolution dated 4 October 2016 the Board resolved to increase the authorised share capital of the Bank by €20,000,000 from €50,000,000 divided into 50,000,000 ordinary shares of a nominal value of €1 each to €70,000,000 divided into 70,000,000 ordinary shares of a nominal value of €1 each.

By virtue of another resolution dated 9 December 2016, the Board resolved to offset €7,956,000 of its accumulated losses in the Statement of Financial Position of the Bank as at 31 October 2016, through a reduction in the nominal value of each Ordinary Share in the issued share capital of the Bank 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 Bank 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 Bank, 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.

On 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).

On 18 January 2018, the Bank increased further its issued share capital by €20,000,000 (divided into 26,483,051 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).

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.

## 16. 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.

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.

## 17. RESERVES

### a. Retained earnings/accumulated losses

In 2016, the accumulated losses represented losses registered since the incorporation of the Bank. The majority of these losses are attributable to costs incurred in the setting up of the banking operations. As explained in Note 15, during 2016 the Bank resolved to offset €7,956,000 of its accumulated losses through a reduction in share capital. As from 2017, the Bank registered a sufficient level of profits to offset the opening accumulated losses.

Retained earnings include an amount of €3,667,000 (2016: €4,079,000) allocated to the Depositor Compensation Scheme Reserve. This Reserve is excluded for the purposes of the Own Funds calculation (refer to Note 3.6).

### b. Revaluation reserve

The revaluation reserve is used to record movements in the fair value of available-for-sale equity shares and debt securities, 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.

## 18. AMOUNTS OWED TO BANKS

	2017	2016
	€000	€000
<b>Current</b>		
Term loans and advances	24	-
Repayable on demand	266	71
	290	71

**19. AMOUNTS OWED TO CUSTOMERS**

	2017	2016
	€000	€000
Term deposits	223,205	244,069
Repayable on demand	290,646	238,895
	513,851	482,964
Current	442,113	368,296
Non-current	71,738	114,668
	513,851	482,964

Included in 'Amounts owed to customers' are deposits of €27,378,000 (2016: €29,391,000) held as collateral for loan commitments, irrevocable commitments under guarantees and import letters of credit.

**20. OTHER LIABILITIES**

	2017	2016
	€000	€000
Bills payable	2,597	2,695
Accounts payable and sundry creditors	410	1,350
Obligations under guarantees and other documentary credits	1,342	1,175
	4,349	5,220

The movement in 'Obligations under guarantees and other documentary credits' is as follows:

	2017	2016
	€000	€000
At 1 January	1,175	892
Arising during the year	1,935	2,677
Utilised	(740)	(292)
Unused amounts reversed	(1,028)	(2,102)
At 31 December	1,342	1,175

**21. ACCRUALS AND DEFERRED INCOME**

	2017	2016
	€000	€000
Accrued interest	2,410	2,797
Accrued operating expenditure	649	843
Accrued capital expenditure	137	224
	3,196	3,864

Accrued operating expenditure mainly relates to amounts in relation to the provision of day-to-day services and specific non-recurring expenditure.

**22. 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 in 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:

	2017	2016
	€000	€000
<b>Contingent liabilities</b>		
Guarantees	8,003	8,153
Documentary credits	817	178
	8,820	8,331
<b>Commitments</b>		
Undrawn commitments to lend	112,685	63,116
<b>Capital commitments (note 10)</b>		
Authorised but not contracted for	70	132
<b>Total commitments</b>	112,755	63,248

- Operating lease commitments – Bank as lessee

During 2017, the Bank did not enter into any new contracts of commercial lease for immovable property.

Details of all the contracts entered into to date are as follows:

- 10-year commercial lease for immovable property which is cancellable by giving one year's notice (starting 2008);
- 20-year term contract which is cancellable after the first 10 years of the contract by giving one year's notice (starting 2008);
- 5-year term contract with the option to extend the term for further periods of 12 months each (starting 2008);
- 15-year term contract, with the right to terminate the lease after 5 years to be used for retail purposes (starting 2010); and
- 6-year term contract to be used as an extension to the current Head Office premises.

Future minimum lease payments under non-cancellable operating leases as at 31 December are as follows:

	2017	2016
	€000	€000
Within one year	364	238
	364	238

- 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.

## 23. INTEREST RECEIVABLE AND SIMILAR INCOME

	2017	2016
	€000	€000
On loans and advances to banks	82	30
On loans and advances to customers	15,518	16,210
On balances with Central Bank of Malta	(282)	(314)
	15,318	15,926
On debt and other fixed income instruments	1,166	450
Net amortisation of discounts and premiums	(902)	(347)
	264	103
<b>Total interest and similar income</b>	15,582	16,029

Interest income on loans and advances to customers includes income generated from impaired financial assets which amounted to €1,736,000 (2016: €2,135,000).

**24. INTEREST PAYABLE AND SIMILAR EXPENSE**

	2017	2016
	€000	€000
On amounts owed to banks	35	7
On amounts owed to customers	4,645	5,888
On debt securities in issue	-	381
On perpetual capital notes	507	127
	5,187	6,403

**25. NET FEES AND COMMISSION INCOME**

	2017	2016
	€000	€000
<b>Fees and commission income</b>		
Credit related fees and commissions	1,054	696
Other fees	1,931	1,913
	2,985	2,609
<b>Fees and commission expense</b>		
Other fees	(652)	(730)
<b>Net fees and commission income</b>	<b>2,333</b>	<b>1,879</b>

**26. NET TRADING INCOME**

	2017	2016
	€000	€000
<b>Foreign exchange activities</b>		
From derivatives	-	425
From commercial business activities	561	315
<b>Net trading income</b>	<b>561</b>	<b>740</b>

**27. EMPLOYEE COMPENSATION AND BENEFITS**

	2017	2016
	€000	€000
<b>Directors' remuneration</b>	<b>989</b>	<b>481</b>
<b>Wages and salaries</b>		
Executive officers and senior managerial	495	354
Other managerial, supervisory and clerical	4,934	4,426
Others	68	39
<b>Social security costs</b>		
Executive officers and senior managerial	13	11
Other managerial, supervisory and clerical	359	328
Others	6	3
	5,875	5,161
<b>Total employee compensation and benefits</b>	<b>6,864</b>	<b>5,642</b>

The total fees payable to non-executive directors amounted to €147,700 (2016: €137,400).

The average number of persons employed by the Bank during the years 2017 and 2016 was as follows:

	2017	2016
Executive officers and senior managerial	6	6
Other managerial, supervisory and clerical	190	153
Others	5	2
	201	161

**28. OTHER ADMINISTRATIVE EXPENSES**

	2017	2016
	€000	€000
Auditors' remuneration	53	50
Information system and communications	1,208	1,203
Business development	259	421
Corporate services	1,281	1,285
Regulatory expenses	357	556
Other	1,591	1,211
	4,749	4,726

Other remuneration payable to the auditors include assurance related services of €1,000 (2016: €20,000), payable to the Bank's auditors. Tax, advisory and compliance services provided during 2017 amounted to €15,000 (2016: €12,600).

Corporate services include operating lease payments amounting to €337,000 (2016: €339,000).

In total, from incorporation up to 31 December 2017, the Bank has contributed €1,647,000 in variable contributions to the Depositor Compensation Scheme. This represents 0.4% (2016: 0.4%) of the eligible deposits at 31 December 2017. The cash contribution paid during 2017 amounted to €251,000 (2016: €451,000) and is included under Regulatory expenses.

**29. NET IMPAIRMENT LOSSES**

	2017	2016
	€000	€000
<b>Write-downs</b>		
Loans and advances to customers		
- specific allowances	1,311	2,939
- collective allowances	1,165	1,221
- bad debts written off	4	45
	2,480	4,205

	2017	2016
	€000	€000
<b>Reversals of write-downs</b>		
Loans and advances to customers		
- specific allowances	(938)	(854)
- collective allowances	(1,025)	(1,494)
	(1,963)	(2,348)
<b>Net impairment losses</b>	517	1,857

**30. INCOME TAX EXPENSE**

The components of income tax for the years ended 31 December 2017 and 2016 are:

	2017	2016
	€000	€000
Income statement:		
Current income tax	-	(236)
Deferred income tax	(234)	106
	(234)	(130)



The tax on profit and the result of accounting profit multiplied by the applicable tax rate in Malta of 35% are reconciled as follows:

	2017	2016
	€000	€000
<b>Profit before tax</b>	<b>1,102</b>	2,230
<b>Tax at the applicable rate of 35%</b>	<b>386</b>	781
<b>Tax effect of:</b>		
Non-deductible expenses	17	191
Other differences	12	11
Income not subject to tax	-	(853)
Overprovision of deferred taxation	(181)	-
	<b>234</b>	130

### 31. EARNINGS PER SHARE

Earnings per share are 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.

	2017	2016
Net profit attributable to shareholders (€000)	868	2,100
Weighted average number of ordinary shares in issue	51,273,944	32,500,000
Earnings per share (€ cents)	1c7	6c5

### 32. CASH AND CASH EQUIVALENTS

Analysis of balances of cash and cash equivalents as shown in the statement of cash flows:

	2017	2016
	€000	€000
Cash (Note 6)	4,043	4,732
Balances with Central Bank of Malta (excluding reserve Deposit) (Note 6)	19,267	105,770
Loans and advances to banks (Note 8)	69,911	29,695
Amounts owed to banks (Note 18)	(290)	(71)
Cash and cash equivalents	92,931	140,126
Adjustment to reflect balances with contractual maturity of more than three months	3,467	3,028
	<b>96,398</b>	143,154

#### As per statement of financial position:

Balances with Central Bank of Malta and cash	26,777	113,530
Loans and advances to banks	69,911	29,695
Amounts owed to banks	(290)	(71)
	<b>96,398</b>	143,154
Balances with contractual maturity of more than 3 months	(3,467)	(3,028)
<b>Cash and cash equivalents</b>	<b>92,931</b>	140,126

### 33. RELATED PARTIES

#### 33.1. Identification of related parties

On 4 October 2016, it was announced that following regulatory approval, the Bank's majority shareholding held by Oitanta S.A. since 20 December 2015 was purchased by Al Faisal International for Investment Limited, a subsidiary of Al Faisal International for Investment Q.P.S.C. headquartered in Qatar.

Subsequent to 4 October 2016, all entities which are ultimately controlled by Al Faisal International for Investment Company, Q.P.S.C. are considered to be related parties.

The Bank's related party transactions mainly comprise transactions with the shareholders and other entities controlled by the same shareholders. These transactions principally include 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.

### 33.2. Transaction arrangements and agreements involving key management personnel

During the year under review, the following banking transactions were carried out with key management personnel:

	2017	2016
	€000	€000
<b>Income statement</b>		
Interest and similar income	32	216
Interest and similar expense	2	2
<b>Statement of financial position</b>		
Loans and advances to customers	1,038	1,315
Amounts owed to customers	2,123	2,054

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.

### 33.3. Entities controlled by non-executive directors

During the year under review, the following transactions were undertaken by the Bank with entities controlled by non-executive directors:

	2017	2016
	€000	€000
<b>Income statement</b>		
Interest and similar income	22	9
Other administrative expenses	173	233

Year end balances arising from such related party transactions comprise:

	2017	2016
	€000	€000
<b>Statement of financial position</b>		
Loans and advances to customers	469	47
Prepayments and accrued income	95	52
Amounts owed to customers	2,739	1,517
Accruals and deferred income	12	16

### 33.4. Compensation to key management personnel

Directors' remuneration and salaries to executive officers are separately disclosed in Note 27.

### 33.5. Transaction with other related parties

#### 33.5.1 Parent company up until 4 October 2016 – Oitante S.A.

Between 20 December 2015 and 4 October 2016, the Bank did not transact with its parent of that period.

33.5.2 Parent company as from 4 October 2016 – Al Faisal International for Investment Limited

	2017	2016
	€000	€000
Statement of financial position		
Loans and advances to parent company	1	3
Amounts owed to parent company	16,993	222

As explained in Note 16, on 4 October 2016 the Bank issued floating rate Perpetual Additional Tier 1 Capital Notes amounting to an aggregate of €5,000,000 to Al Faisal International for Investment Company Q.S.P.C.

Moreover, transactions affecting the Bank’s Share Capital are disclosed in Note 15.

34. STATUTORY INFORMATION

BNF Bank p.l.c. (previously known as Banif Bank (Malta)) plc is a limited liability company domiciled and resident in Malta.

The immediate parent company of BNF Bank p.l.c. is 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 Faisal Qassim F. Th. Al- Thani.

# Additional Regulatory Disclosures

# Additional Regulatory Disclosures

For the year ended 31 December 2017

## 1. OVERVIEW

These Additional Regulatory Disclosures ('ARDs') are aimed at providing the Bank's stakeholders further insight into the Bank's capital structure and adequacy. The disclosures outlined below 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.

In addition, as a standalone financial services institution – as from December 2015 – the Bank hereby complies with the disclosure requirements laid down in Part Eight of the Capital Requirements Regulation ('CRR').

The Bank publishes these disclosures on an annual basis as part of the Annual Report. 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 these ARDs are presented fairly.

## 2. RISK MANAGEMENT FRAMEWORK

These Additional Regulatory Disclosures on the Bank's Risk Management Framework should also be read in conjunction with Note 3.1 in the Notes to the Financial Statements.

The different institutional activities involve, to different degrees, the assumption of calculated risks in order to reap reasonable returns. On the other hand, a number of risks are not actively sought but are an inescapable side effect of banking activity; this applies in particular to operational and reputational risks.

As from 2017, the Bank implements the Four Lines of Defence Principle which is an upgrade to the Three Lines model practised in previous years. Through the Four Lines principle, all the key entities/stakeholders are involved in the risk capital management framework. By adding a fourth line, this model actively promotes a stronger interaction – particularly with respect to enhancing dialogue with the board and senior management on the governance of risk, including the development of an institution's risk appetite framework and an assessment of its risk culture – between supervisors and audit functions. Succinctly, the said Principle as implemented in the Bank comprises:

- Top level corporate governance entities: Board of Directors, Risk Committee, Audit Committee.
- First line: "The Frontline" – This involves the internal entities which own, and manage risk and control activities i.e. front line operating units. Such is composed mainly of the Commercial Department, Operations Department and the Treasury Department.
- Second line: "Oversight" – Internal entities which monitor risk and control in support of management. This relates to risk, control, and compliance functions put in place by management, mainly the Risk Control & Oversight Unit, the Legal and Compliance Unit, and the Credit Analysis Unit. This line also includes the Asset and Liability Management Committee (ALCO), and the Global Risk Committee (GRC).
- Third line: "Independent assurance" to the Board and senior management concerning the effectiveness of management of risk and control; effectively this involves the internal audit function vested in the Internal Audit Unit.
- Fourth line: external audit and supervisory authorities.

The Internal Control Department (ICD) plays a pivotal role in the risk management framework. ICD is an independent first-level function which also interacts directly on an ongoing basis with the Bank's Audit Committee and Risk Committee. ICD comprises three constituent units which are the Risk Control & Oversight Unit, the Legal and Compliance Unit and the Credit Analysis Unit. The Bank's Internal Audit Unit responds directly to the Audit Committee.

As implied by its name, the Risk Control & Oversight Unit discharges a very important role in the risk management framework. It identifies, measures, reports, and suggests mitigating action on the different risks to which the Bank is currently exposed or, taking a forward-looking perspective, reasonably expected to be exposed in the near and medium terms. Amongst its very wide area of activity, it is responsible for setting and updating most risk-related policies, operating manuals and circulars such as credit, operational risk, concentration, customer complaints policies and solvency risk operating manual and various other risk-related internal documents.

Although the Bank is still in a somewhat early stage of its organizational lifecycle, as from 2017, it was deemed expedient to augment the risk function structure by branching out in additional formally-delineated third-level entities. Accordingly, the Risk Control & Oversight Unit was reconfigured into a number of specialized Offices whilst maintaining maximum flexibility in the deployment, allocation and focus of the risk-tasked headcount.

Accordingly, the Risk Control & Oversight function comprises the:

- Credit Risk Office – mainly responsible for formulating and maintaining policies relating to credit, concentration, and correlation risks on the loan portfolio of the banking book. Inter alia, various risk models, metrics, and internal thresholds are modelled, proposed for formalization, and subsequently updated from time to time. This Office contributes to the revision of the Bank's Nonperforming Loans Reduction Plan;
- Operational Risk Office – spearheads the Operational Risk Management Framework within the Bank whereby operational risk events are generated and reported from different sources which are internal reporting, customer complaints and – where relevant and scalable – external events. The Office is responsible for the Key Performance Indicators and Key Risk Indicator metrics used in the operational risk management toolkit;

- **Market Risk Office** – tasked with controlling and overseeing that business units optimize the risk-reward relationship and do not expose the institution to unacceptable losses outside the Bank’s risk appetite. The main risks controlled by this Office are interest rate risk, liquidity risk, and position risk on the Bank’s investment portfolio. In close and ongoing liaison with the Treasury Department, this Office is heavily involved in the regular updating of the Bank’s Internal Liquidity Adequacy Assessment Process (‘ILAAP’);
- **Residual Risks Office** – various other risks not mentioned separately above also fall within the Unit’s remit. Such include reputational risk, customer complaints investigation, and enterprise risk management. A very important role discharged by this Unit is that of leading Pillar 2 economic capital quantification through the regular updating of the Bank Internal Capital Adequacy Assessment Process (‘ICAAP’). This Office actively contributes to the revision of the institutional Recovery Plan.

The Bank’s position on the different risks is 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, and the Executive Committee, as well as more risk-focused committees including:

- **The Global Risk Committee; and**
- **The Assets and Liabilities Committee.**

Reporting relating to risks takes various forms depending on the intended audience and the level of detail required, ranging from quantitative metrics such as key risk indicators, qualitative reporting, dashboard-style reporting for top management and full-text reports for regulatory purposes such as the ICAAP and ILAAP reviews.

A conservative and risk-averse overall institutional risk profile is pursued on an ongoing basis. Briefly, a traditional retail banking model is followed whereby the main asset, lending to customers, is covered by the main liability – deposits from customers. Furthermore, beyond analysing the deposit transformation ratio, the term structure of the deposit base is regularly scrutinized and monitored to ensure a reasonable level of funding risk. Specifically, the on-demand and up-to-three-months buckets within the deposit base, are continually gauged to avoid an undue level of reliance on very short-term funding. Where deemed necessary, a timely corrective action is instigated by the ALCO and/or the Global Risk Committee.

The balance between return and risk level drives the institutional risk profile. A prudent and risk-averse bias is enforced through various policies, internal guidelines and other directive forms of control (e.g. operating manuals). Other documents define risk tolerance levels e.g. formally defined trading limits for the Treasury Department and others. Any excess over and above the threshold must be authorized at senior or top management level and triggers defined mitigating actions. Moreover, forward-looking analyses are used to avert exceeding the tolerance limits in the first place; one example relates to stress testing exercises by the Risk Control & Oversight Unit on the level of provisioning on the loan book should a downgrade in sectorial risk rating take place due to say, exogenous factors such as economic downturn in one or more macroeconomic sectors. Furthermore, it is worth highlighting that stress testing modelling takes a forward-looking and preventative approach whereby defined key risk indicator metrics are gauged against a predefined Early Warning Indicator (EWI) level. For instance, in modelling the Liquidity Coverage Ratio (LCR) levels for the near and medium terms, stress testing factors in the EWI threshold which is prudently set at a higher value than the statutory level of 100% (following full phase-in as required by the supervisory authorities).

Succinctly, the broad strategies used to manage risks are:

- **Risk decomposition:** Different risks are treated separately for analytical and risk mitigation purposes (although a silo-based approach is ultimately avoided through the enterprise risk management concept). The above list of risks, controlled and overseen by the Risk Control & Oversight Unit, provides a simple guide as to how this is practised in the Bank; to these, other risks might be added such as legal risk (tackled by the Legal and Compliance Unit), and avoiding open positions on derivatives entered into on behalf of customers (and which is normally mitigated through hedging operations conducted by the Treasury Department).
- **Risk aggregation:** This involves reducing overall institutional risk through diversification. For instance, the Risk Control & Oversight Unit monitors and reports to top management in respect of the level of single-name risk on the loan portfolio; the more contained the level of lending to individual customers (or groups of connected customers), the more diversified is the level of default and recovery risks in case of nonperforming exposures especially by the higher-magnitude obligors. This also applies to sectoral risk; ensuring a broadly diversified loan book across different economic sectors helps avoid taking big hits (in terms and provisions and bad debts) should one or more sectors experience a downturn. Similarly, the Risk Control & Oversight Unit monitors on an ongoing basis the level of single-name risk on the deposit base as well as the term structure of same, to contain liquidity and funding risks at all times.

### 3. CAPITAL MANAGEMENT

Given that the Bank is licensed to undertake the business of banking, it is obliged to comply with the relevant capital requirements emanating from the CRR and local regulations modelled on the requirements of the Capital Requirements Directive (‘CRD’).

In conjunction with the Bank’s objectives, the Board maintains the efficient management of the Bank’s capital as one of its top priorities, by striving to take on risk commensurate with its risk appetite which should be sufficient to comply with regulatory capital requirements.

#### 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.

For regulatory purposes, the Bank’s capital base is divided into Common Equity Tier 1 (‘CET1’) capital and Tier 2 capital.

The Bank’s CET1 capital includes the following items:

- **ordinary share capital;**
- **retained earnings;**
- **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's Tier 2 capital consists of:

- subordinated loan capital;
- other regulatory adjustments under Article 484 relating to grandfathering items; and
- a revaluation reserve made up of gains on the fair valuation of available-for-sale financial assets, net of deferred taxation.

a. Share capital

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

	2017	2017
	No. of shares	€
<b>Authorised</b>		
Ordinary shares of €0.7552 each	92,690,678	70,000,000
<b>Issued</b>		
Ordinary shares of €0.7552 each	52,362,289	39,544,001

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. Retained earnings

The retained earnings represent earnings not paid out as dividends. Interim profits form part of Own funds only if those profits have been verified by the Bank's independent external auditor. The Bank may only make distributions out of profits available for this purpose. Since the Bank has accumulated losses, any interim profits recognised during the year are considered undistributable. Accordingly, while accumulated losses are deducted in full from the Bank's own funds, interim profits for part of Own funds only if those profits have been verified by the Bank's independent external auditor.

Retained earnings include an amount of €3,667,000 (2016: €4,079,000) pledged in favour of the Depositor Compensation Scheme as at 31 December 2017, that is not available to the Bank for unrestricted and immediate use to cover risk of losses as soon as they occur. The Depositor Compensation Scheme Reserve is excluded for the purposes of the Own Funds calculation.

- 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.

- Revaluation reserve

This represents the cumulative net change in fair values of available-for-sale financial assets held by the Bank, net of related deferred tax effects. The revaluation reserve is not available for distribution.

- Subordinated loan capital

On 30 August 2012, the Bank had issued €5,000,000 10% unlisted subordinated unsecured bonds, which had been fully subscribed by BNF S.A. These were repaid at par on 4 October 2016.

- 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 December 2016 and EURIBOR plus 10% thereafter, but all interest payments are subject to cancellation at the discretion of the Bank.

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 2017. The transitional disclosure template is set out below.

	2017
	€000
As at 31 December 2017	
<b>Common Equity Tier 1 (CET1) capital</b>	
Common Equity Tier 1 (CET1) capital: instruments and reserves	
- Capital instruments and the related share premium accounts	39,544
- Retained earnings	(2,899)
- Funds for general banking risk	992
- Accumulated other comprehensive income (and other reserves)	(258)
CET1 capital before regulatory adjustments	37,379

**Common Equity Tier 1 (CET1) capital: regulatory adjustments**

Intangible assets	(1,124)
- 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)	(322)
- Deferred tax assets that rely on future profitability and arise from temporary differences	(105)
- Total regulatory adjustments to CET1	(1,551)
- CET1 capital	35,828
- Additional Tier 1 capital	5,000
<b>Tier 1 capital</b>	<b>40,828</b>

**Tier 2 capital**

Tier 2 capital before regulatory adjustments	
- Capital instruments and subordinated loans	-
- Transitional adjustments to tier 2 capital	799
Tier 2 capital: regulatory adjustments	
- Regulatory adjustments relating to unrealised gains pursuant to Article 481	-
<b>Total Tier 2 capital</b>	<b>799</b>

**Total risk weighted assets****294,723****Capital ratios****%**

CET1 capital	12.16
Tier 1 capital	13.85
<b>Total capital ratio</b>	<b>14.12</b>
Institution specific buffer requirement	5.75
- of which: capital conservation buffer requirement	1.25
CET 1 available to meet buffers	7.66
	€000
Items not deducted from own funds in accordance with Article 48 of CRR	3,593

Retained earnings form part of Own funds only if those profits have been verified by the Bank's independent external auditor as outlined previously. The Bank has demonstrated to the satisfaction of the competent authority that any foreseeable charge or dividend has been deducted from the amount of those profits.

**3.2. Capital requirements**

The Bank's policy is 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 is monitored by the Assets and Liabilities Committee (ALCO). The Bank manages its capital structure and adjusts 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%.

Pillar 1 capital requirements are based on standard rules and set the minimum own funds requirements to cover credit risk, market risk and operational risk of credit institutions. The Bank uses the Standardised Approach for credit risk, the Basic Indicator Approach for operational risk and the Basic Method with respect to market risk, in relation to the Bank's foreign exchange risk. Under the Standardised Approach, the Bank utilises risk weights determined by exposure class, credit risk mitigation and credit ratings as outlined in the CRR. Capital charge for foreign exchange risk using the Basic Method is calculated at 8% of the higher of the sum of all the net short positions and the sum of all the net long positions in each foreign currency. The Basic Indicator Approach requires that the Bank allocates capital for operational risk by taking 15% of the average gross income.

The Bank will be fully implementing the CRD IV capital requirements with effect from January 2019. In fact, the new Banking Rule BR/15: 'Capital Buffers of Credit Institutions authorised under the Banking Act, 1994', will require two additional buffers, known as the 'capital conservation buffer' and the 'countercyclical buffer'. With respect to the former, the Bank will be required to maintain a capital conservation buffer of 2.5%, made up of CET1 capital, on the risk-weighted exposures of the Bank as from 1 January 2019. This buffer is the process of being phased in over the period 1 January 2016 through 31 December 2018.

Additionally, the Bank may be required to maintain a 'countercyclical buffer'. This is expected to be set in the range of 0 - 2.5%, whereby the rate shall consist of the weighted average of the 'countercyclical buffer' rates that apply in the jurisdiction where the relevant exposures are located. However, given that the Bank's exposures are mainly contained within Malta, this buffer is expected to be marginal, since the deviation of Malta's credit-to-GDP ratio is not expected to be significant taking cognisance of its long-term trend.

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

	EXPOSURE VALUE	RISK WEIGHTED ASSETS	CAPITAL REQUIRED
	€000	€000	€000
<b>At 31 December 2017</b>			
Central governments or Central banks	62,052	-	-
Institutions	96,545	25,754	2,060
Corporates	48,723	47,991	3,839
Retail	67,969	48,107	3,849
Secured by mortgages on immovable property	237,758	81,984	6,559
Items associated with particularly high risk	10,928	16,392	1,311
Exposures in default	22,685	25,592	2,047
Equity	341	341	27
Other items	23,491	22,970	1,839
Credit risk	570,492	269,131	21,531
Operational risk		25,012	2,001
Foreign exchange risk		580	46
<b>Total capital required</b>		294,723	23,578

#### Own funds

Common Equity Tier 1	35,828
Additional Tier 1	5,000
Tier 2	799

#### Total own funds

41,627

#### Total capital ratio

14.12%

#### 3.2.1 Internal Capital Adequacy Assessment Process ('ICAAP')

In order to comply with Pillar 2 requirements emanating from MFSA Banking Rule BR/12 as well as to better manage its overall risk-taking activities, the Bank has continued to monitor other risks not adequately covered under Pillar 1 with a view to determining the necessary economic capital allocation through the ICAAP.

The ICAAP review exercise is supported through formal documentation, complete with the detailed description of all calculations performed, as well as assumptions and methodologies used in the process. This documentation is subject to internal validation by the different areas involved in ICAAP formulation and endorsed by the Chief Executive Officer.

The Bank formally reviews its ICAAP Report annually, or more frequently from time to time in abridged format. The latter is intended for internal use relating to solvency risk monitoring.

Throughout the year, the Bank continued to fine-tune procedures to ensure the adequacy of existing processes, the definition of control mechanisms and the development of new risk management practices.

For the material risk types identified in the ICAAP process, the risk quantification methodologies that were chosen took into consideration their adequacy in view of the risk management techniques in place and the availability of relevant information. The following risk types were considered material:

- credit risk;
- liquidity risk;
- interest rate risk;
- position risk on the Bank's investment portfolio;
- operational risk;
- IT risk;

- vii. strategy risk;
- viii. compliance risk;
- ix. reputational risk;
- x. concentration risk; and
- xi. business risk.

The economic capital calculation was carried out taking into consideration a 99.0% confidence level, in line with prevailing industry levels. The Bank maintained the same general methodology as in previous ICAAP exercises, whilst making appropriate refinements and fine-tuning.

From the risk quantification exercise in the 2017 ICAAP, the top three of the eleven risk types identified above were credit risk, interest rate risk and concentration risk. In the 2017 ICAAP review, concentration risk displaced strategy/business risk as the third-most capital consuming risk. In aggregate, the three most capital-intensive risks consumed 82.1% (2016: 74.8%) of the Bank’s overall baseline economic capital allocation. In line with expectations, credit risk retained the highest share of economic capital given that since January 2008, the Bank has developed a sound loan book through organic growth. During the four years ended in 2016, Interest Rate Risk maintained its place as the second largest risk, attributable largely to term structure risk, i.e. the possibility of a re-calibration of general interest rates in Malta relative to rates prevailing in Europe (mainly the Euribor), hypothetically resulting in a downward pressure on local base rates against interest paid on time deposits which can only be revised once such deposits mature in accordance with time buckets defined by residual term to maturity across the deposit portfolio. Needless to say, the need to optimize capital consumption and revenue generation is in tandem with the strategic thrust adopted to grow the Bank’s business, now that the new majority shareholder, has been ensconced at the institutional helm.

The Bank’s Board of Directors sustains that the ICAAP exercise carried out covered all material risks in order to determine the capital requirement over a three-year time horizon.

The following actively participate in the Bank’s ICAAP review exercise:

- Board of Directors through its executive arm the Executive Committee;
- Internal Control Department – Risk Control & Oversight Unit.

The ICAAP process and the final document was independently followed and evaluated by the Bank’s Internal Audit Unit.

During 2017, the Bank was heavily engaged in an exercise of further enhancing the ICAAP and Internal Liquidity Assessment Process (ILAAP). The aim is to gradually achieve a holistic approach whereby the ICAAP and ILAAP form part of an integrated process formally linked to the business model as promulgated by the regulatory authorities under the Supervisory Review and Evaluation Process (SREP). A significant degree of integration with the Recovery Plan and Nonperforming Loans Reduction Plan was already achieved. Further progress on the path to full adherence to SREP requirements is planned for 2018; inter alia this includes the formulation of the first Business Model Analysis exercise which would be updated from time to time in line with the other reports forming part of the SREP frameworks (in particular the ICAAP and the ILAAP).

The Bank has already achieved a high level of adherence to the SREP framework. It is expected that the Bank would, in substance, attain full compliance with SREP requirements during 2018.

4. LEVERAGE

With the introduction of the CRR, a new supervisory tool was introduced requiring credit institutions to calculate a non-risk based leverage ratio, in addition to the risk-based capital requirements discussed above. The leverage ratio measures the relationship between the Bank’s capital resources and its total assets. The introduction of this supervisory tool is aimed at preventing the build-up of excessive leverage, one of the causes of the banking crisis in 2008.

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 initial implementation of the current leverage ratio regime is to be effected as a Pillar 2 measure. The Commission was expected to present a report by 31 December 2017 on the impact and effectiveness of the leverage ratio to the European Parliament and the Council, which would eventually lead to the introduction of the leverage ratio as a binding measure as of 2018.

Following the purchase of the Bank’s majority shareholding on 4 October 2016 by Al Faisal International for Investment Limited, a subsidiary of Al Faisal International for Investment Q.P.S.C. headquartered in Qatar, the increase of issued share capital by €15,000,000 and a further increase of €20,000,000, as authorised by the Malta Financial Services Authority, effective on 20 January 2017 and 18 January 2018 respectively, will increase the Bank’s core equity Tier 1 capital, thus enhancing the Bank’s leverage ratio.

The following table represents the Bank’s estimated leverage ratio determined in accordance with the requirements stipulated by Implementing Regulation EU 2016/200.

	2017
	€000
Tier 1 capital	40,828
Leverage ratio total exposure measure	593,056
Leverage ratio	6.88%

The total exposure measure for the purposes of the leverage ratio has been determined as follows:

	2017
	€000
On-balance sheet items excluding intangible assets	568,792
Assets deducted in determining Tier 1 capital	(426)
<b>Total on-balance sheet exposures</b>	<b>568,366</b>
Off-balance sheet exposures at gross notional amount	121,505
Adjustments for conversion to credit equivalent amounts	(96,815)
<b>Other off-balance sheet exposures</b>	<b>24,690</b>

The following table provides a reconciliation of accounting assets and leverage ratio exposures:

	2017
	€000
Total assets as per published financial statements	567,742
Adjustment for off-balance sheet items	24,690
Other adjustments	
- Deduction for intangible assets	(1,124)
- Other	1,748
<b>Leverage ratio exposure</b>	<b>593,056</b>

The following table shows the different on-balance sheet exposures in relation to the calculation of the leverage ratio.

	2017
	€000
<b>Total on-balance sheet exposures (excluding derivatives and SFTs)</b>	<b>568,366</b>
Banking book exposures, of which:	
- Exposures treated as sovereigns	62,052
- Institutions	96,545
- Secured by mortgages of immovable property	233,348
- Retail exposures	74,196
- Corporate	44,827
- Exposures in default	22,735
- Other exposures	34,663

The Leverage Ratio (LR) is one of the key ratios monitored on an ongoing basis from time to time by the Bank. It is quantified regularly and reported in the Asset and Liability Management Committee (ALCO) which normally meets monthly but not less than eight times per annum. The minimum level of the LR per regulatory dictum is 3% as from 2018, but with effect from 2017, the Bank has proactively included an Early Warning Indicator (EWI) threshold of 7% in its Recovery Plan (RP). If the LR level falls below such level, an EWI alert is triggered and this is reported in the RP Indicators Dashboard submitted to the EC on a monthly basis.

Furthermore, the Leverage Ratio is also formally considered as part of the review of the Bank's Internal Capital Adequacy Assessment Process (ICAAP).

In the 2016 audited accounts Note 4, as at 31.12.2016 LR was reported at 4.4%.

As at 31.12.2017, LR rose to 6.88%. The change in level is attributable to the following factors:

- Capital measure: Own Funds rose by €15m during 2017;
- Exposure measure: The exposure measure rose by around €55.5m during 2017 to approximately €593.1m by year end. The bulk of such increase is attributable to "Loans and Advances to Customers". In fact, during 2017 the gross loan book rose from €350.4m to €391.4m (+€41m).
- Post-balance sheet event: during January 2018, the Bank Tier 1 capital was boosted by a further capital injection to the tune of €20m. Upon factoring in such increase, LR would have read 10.26% further attesting to the Bank's strong position on this key regulatory metric.

5. CREDIT RISK

5.1. Introduction to Credit risk

Credit risk is the risk that a counterparty would be unable to fulfil the terms of his/her/its obligations when due. In view of the nature of its business, the Bank’s financial assets are inherently and predominantly subject to credit risk. Thus, management has put in place internal control systems to evaluate, approve and monitor credit risks relating to both investment and loan portfolios.

The Bank’s credit risk arises from various components of the statement of financial position, namely amounts due from banks, loans and advances to customers and investment in debt securities.

5.2. Credit risk management

Lending decisions should achieve a reasonable balance between risks and returns of extending credit to a customer. A credit authorisation structure made up of six physical credit committee levels; ranging from Level 1, which includes authorisation by a Branch Manager, an Area Manager and an officer from the Credit Analysis Unit, to Level 4 which involves Executive Committee sanction, is in place. Beyond this, there are two additional layers viz. the Credit Approval Committee and, ultimately, the Board of Directors for credit requests deemed to exhibit the highest risk levels (on several dimensions mainly magnitude and degree of collateralization). Each credit committee level is assigned a sanctioning limit, under which it can operate within specific guidelines. Within its discretionary limit, a credit committee may 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 make sure 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 and 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.

During 2017 the Bank has streamlined its credit approval hierarchy relating to business lending proposals. Such endeavour was premised on providing a more seamless and prompt customer experience without unduly compromising the Bank’s assumed risk profile.

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.

During 2017, the Bank maintained its three credit policies relating to personal credit, business credit and credit risk mitigation, a central plank in the sound institutional internal control architecture.

The Bank’s Credit Risk Mitigation Policy inter alia contains a detailed chapter relating to the taking, perfection and maintenance of collateral as an important tool for attaining credit risk mitigation. Briefly, it includes the main attributes of good security, the main types of acceptable

collateral (e.g. cash and value cover, hypothecary charges, guarantees etc.), determination of haircuts on assets held as collateral and other matters of good practice such as, for example, taking independent Bank’s architect’s valuations on properties subjected to a hypothec at credit on-boarding stage, and periodically updating same at defined intervals during the life of the lending operation.

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.

The table below reflects the Bank’s maximum exposure to credit risk before collateral held or other credit enhancements in accordance with the regulatory information submitted to the MFSA, as follows:

	AVERAGE EXPOSURE	YEAR END EXPOSURE VALUE
	€000	€000
As at 31 December 2017		
Central Government or central banks	97,839	62,052
Institutions	70,736	96,545
Corporates	39,089	48,723
Retail exposures	62,662	67,969
Secured by mortgages on immovable property	228,646	237,758
Items associated with particular high risk	6,795	10,928
Exposures in default	23,156	22,685
Equity	341	341
Other items	22,576	23,491
Total	551,840	570,492



	YEAR END EXPOSURE VALUE
	€000
<b>As at 31 December 2017</b>	
On-balance sheet exposures	567,742
Less deductions for assets that are not risk-weighted	(10,550)
On Balance Sheet exposures after deductions	557,192
Off-balance sheet exposures before credit conversion factor (CCF)	121,505
Less deductions through CCF	(108,205)
On Balance Sheet exposures after deductions	13,300
<b>Total Exposure</b>	<b>570,492</b>

The residual maturity breakdown by exposure class at year-end was as follows:

	TOTAL	LESS THAN 1 YEAR	OVER 1 BUT LESS THAN 5 YEARS	OVER 5 YEARS	NO MATURITY
	€000	€000	€000	€000	€000
<b>At 31 December 2017</b>					
Central Government or central banks	62,052	-	11,864	11,153	39,035
Institutions	96,545	96,545	-	-	-
Corporates	48,723	10,231	2,328	35,692	472
Retail exposures	67,969	14,304	12,871	36,204	4,590
Secured by mortgages on immovable property	237,758	10,221	8,313	219,190	34
Items associated with particular high risk	10,928	3,013	7,162	753	-
Exposures in default	22,685	4,433	7,326	10,922	4
Equity exposures	341	-	-	-	341
Other items	23,491	8,947	3,593	6,908	4,043
<b>Total</b>	<b>570,492</b>	<b>147,694</b>	<b>53,457</b>	<b>320,822</b>	<b>48,519</b>

Within the Bank, concentration risk is the risk of losses resulting from inadequate diversification of the credit exposures. This risk is managed by setting risk concentration limits for counterparties and industry sectors, mainly in relation to loans and advances to customers. The Bank's geographical concentration risk is not deemed to be significant at the present time in view of the fact that the Bank's exposures are mainly in Malta, the country in which the Bank's operations are conducted, as well as in Portugal due to the Bank's previous relationship with the now defunct BNF Financial Group. The entry of a new majority shareholder based in Qatar, as from October 2016, is expected to yield opportunities to further diversify the Bank's operations on the geographical concentration risk dimension.

### 5.3. Credit concentration risk

#### 5.3.1 Credit concentration risk analysed by counterparty

In terms of Part Four of the CRR 'Large Exposures', the total amount of exposures which exceeded 10% of eligible capital represented 17.26% of the total loan portfolio as at end of 2017 (2016: 11.8%). These exposures are strictly monitored by management and every reasonable step is taken to reduce this concentration and spread risk over a wider customer base with further growth in the loan portfolio.

The maximum on-balance sheet credit exposure to any client, group of connected clients or

counterparty as at 31 December 2017 amounted to €10,000,000 (2016: €5,304,000) before taking account of collateral or other credit enhancements.

Within its daily operations, the Bank 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 as well as with its parent. The positions are checked against the limits on a daily basis and in real time.

As prescribed in article 400(2)(c), in light of the fact that both the parent and the Bank are subject to prudential supervision on a consolidated basis, the Bank's exposure arising from placements with its parent is exempt from limits to large exposures outlined in article 395(1) of the CRR. Similarly, the Bank invests in debt securities issued by Maltese and Portuguese government. Given that these exposures attract a 0% risk weight, they are also exempt from large exposure limits.

### 5.3.2 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 AND INDIVIDUALS	CONSTRUCTION	WHOLESALE AND RETAIL	OTHER SECTORS
	€000	€000	€000	€000	€000	€000	€000
<b>At 31 December 2017</b>							
Central Government or central banks	62,052	-	-	-	-	-	62,052
Institutions	96,545	-	96,545	-	-	-	-
Corporates	48,723	33	4,724	1,520	10,333	9,856	22,257
Retail exposures	67,969	1,074	677	46,611	2,537	7,862	9,208
- of which: SME	16,069	348	280	1	2,483	6,980	5,977
Secured by mortgages on immovable property	237,758	3,749	1,027	213,941	5,347	5,601	8,093
- of which: SME	16,717	3,668	343	-	4,400	4,155	4,151
Items associated with particular high risk	10,928	-	-	180	5,823	-	4,925
- of which: SME	7,733	-	-	-	4,013	-	3,720
Exposures in default	22,685	1411	2,932	7,381	145	4,577	6,239
Equity	341	-	-	-	-	-	341
Other items	23,491	-	23,491	-	-	-	-
<b>Total</b>	<b>570,492</b>	<b>6,267</b>	<b>129,396</b>	<b>269,633</b>	<b>24,185</b>	<b>27,896</b>	<b>113,115</b>

### 5.3.3 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	OTHER
	€000	€000	€000	€000
<b>At 31 December 2017</b>				
Central Government or central banks	62,052	62,052	-	-
Institutions	96,545	66,666	8,446	21,433
Corporates	48,723	48,723	-	-
Retail exposures	67,969	67,931	-	38
Secured by mortgages on immovable property	237,758	235,812	-	1,946
Items associated with particular high risk	10,928	10,928	-	-
Exposures in default	22,685	22,685	-	-
Equity	341	-	-	341
Other items	23,491	23,491	-	-
<b>Total</b>	<b>570,492</b>	<b>538,288</b>	<b>8,446</b>	<b>23,758</b>

#### 5.4. Credit quality

#### 5.4.1 Balances with banks and debt securities

The Bank holds debt securities that are issued by local government, having a debt rating A, based on Fitch ratings. The debt securities held by the Bank are listed on the Malta Stock Exchange, which is the only recognised investment exchange in Malta.

Through its daily operations, the Bank also transacts with various counterparty banks, with which the Bank places short-term funds and enters into foreign exchange derivative transactions subject to limits in place and subject to the respective institution's credit rating being within controlled parameters. In this light, the Bank runs the risk of losing funds due to possible delays in the repayment to the Bank of the existing and future obligations of the counterparty banks. Management monitors its exposures with counterparty banks on a daily basis and intervenes if deemed necessary, to adjust exposures within the controlled parameters. At 31 December 2016, loans and advances to banks mainly consisted of deposits with counterparty banks.

The counterparty banks with which funds are held are credit rated A or above based on Fitch ratings.

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

#### 5.4.2 Loans and advances to customers

The credit quality of loans and advances is managed by the Bank using internal credit ratings. The Bank applies a 12-step internal rating system ('IRS') which encapsulates the risk profile associated with each and every lending relationship on its banking book.

The IRS comprises 12 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 categorises exposures as follows:

- Performing

High Grade (Internal rating of A1 to A3)

Standard (Internal rating of B)

Substandard (Internal rating of C)

- Non-performing

Doubtful (Internal rating of D1 to D6 and E)

High Grade

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

Loans and advances classified within this category, and thus 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

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 risk the repayment of the debt, and thus a greater probability of losses for the Bank.

**Doubtful**

Loans and advances within this category relate to those facilities which the Bank considers the repayment of the principal as improbable as a result of deteriorating conditions. These loans and advances generally are past due by more than 90 days and include those customers which are assessed specifically for impairment by the Bank, in accordance with the requirements of IFRSs as adopted by the EU.

The table below analyses the credit quality of the Bank's loans and advances to customers according to its IRS:

2017	
€000	
Gross loans and advances	
High Grade	353,152
Standard	6,373
Substandard	422
Doubtful	31,452
	391,399

The Bank reviews all credit exposures on a case by case basis and also on a collective basis if the exposure is not deemed individually impaired, in order to consider the likelihood that the Bank may be exposed to losses on loans and advances and with a view to taking early recovery action.

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 individually 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.

Each year, the Bank estimates an impairment allowance for any possible incurred losses within its lending portfolio.

The Bank performs an assessment for the calculation of specific provisions when a review of credit facilities reveals that the creditworthiness of a borrower has undergone a significant deterioration and that, as a result, recovery of a credit facility is in serious doubt. The Bank makes an assessment for specific impairment for those credit facilities being overdue by 90 days and provides if there is a shortfall. The shortfall or surplus is 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. The calculation of the present value of estimated future cashflows takes into account the estimated time 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 assumes that all its exposures are individually significant. Accordingly, allowances are assessed collectively for individually significant loans and advances where there is not yet

objective evidence of individual impairment.

Financial guarantees and letters of credit are assessed and provision is made in a similar manner as for loans.

The following table presents a reconciliation of changes in the specific and collective impairment allowances of the Bank:

	TOTAL	MANUFACTURING	HOUSEHOLDS AND INDIVIDUALS	CONSTRUCTION	WHOLESALE AND RETAIL	OTHER
	€000	€000	€000	€000	€000	€000
<b>Specific impairment allowances</b>						
At 1 January 2017						
At beginning of year	6,736	255	2,222	157	3,327	775
Additions	1,207	103	570	14	441	79
Reversals	(1,033)	(25)	(375)	(1)	(488)	(144)
<b>At 31 December 2017</b>	<b>6,910</b>	<b>333</b>	<b>2,417</b>	<b>170</b>	<b>3,280</b>	<b>710</b>
	TOTAL	MANUFACTURING	HOUSEHOLDS AND INDIVIDUALS	CONSTRUCTION	WHOLESALE AND RETAIL	OTHER
	€000	€000	€000	€000	€000	€000
<b>Collective impairment allowances</b>						
At 1 January 2017						
At beginning of year	2,036	69	190	165	945	667
Additions	1,168	93	356	91	249	379
Reversals	(1,029)	(22)	(206)	(90)	(492)	(219)
<b>At 31 December 2017</b>	<b>2,175</b>	<b>140</b>	<b>340</b>	<b>166</b>	<b>702</b>	<b>827</b>

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. Related credit losses, which may arise, are partly covered through the Bank's assessment for collective impairment allowances.

Loans and advances to customers are analysed into impaired, past due and other exposures as follows:

	2017
	€000
<b>Gross loans and advances to customers</b>	
Impaired	13,740
Past due but not impaired	18,015
Neither past due nor impaired	359,644
	391,399

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
	€000	€000
<b>At 31 December 2017</b>		
Gross loans and advances by industry		
Manufacturing	443	1,300
Households and individuals	6,207	6,599
Construction	146	2,128
Wholesale and retail	5,447	1,695
Other sectors	1,497	6,293
	13,740	18,015

The Bank's impaired and past due but not impaired loans and advances to customers were primarily concentrated in Malta.

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

### 5.4.3 Use of External Credit Assessment Institutions (ECAIs)

The Bank applies the Standardized Approach for credit risk to calculate Pillar 1 minimum capital requirements in line with the CRR.

For credit risk, risk weights for the securities held as part of the trading book or pledged as collateral against banking facilities are determined by taking the worst credit rating by widely accepted and recognized ECAIs which are Fitch Ratings; Moody's Investors Service; and Standard & Poor's Financial Services LLC. Regulatory risk weights are used for unrated exposures and in respect of the part of loan book which is not collateralized by pledged ECAI-rated financial assets.

RATINGS	CREDIT QUALITY STEPS	LOANS AND ADVANCES TO BANKS
		€000
<b>At 31 December 2017</b>		
AAA to AA-	1	6,875
A+ to A-	2	42,956
BBB+ to BBB-	3	20,076
Unrated		4
<b>Total</b>		69,911

### 5.5. Counterparty credit risk on derivatives

In respect of derivative transactions, specific guidelines that are reviewed on an on-going basis, have been formalised. These guidelines prescribe the following parameters: the list of acceptable currencies, the maximum transaction size, the list of acceptable counterparties, counterparty creditworthiness, and the type of derivative contract that may be entered into.

Specifically, either forward contracts or swaps may be dealt in. Forward contracts are traded against a predefined collateral to mitigate against counterparty credit risk. Forward foreign exchange risk exposures are precluded. Counterparties with whom swaps are traded are pre-approved credit institutions with whom the Bank holds a mutual long-term relationship. Derivative transactions are governed by the European Market Infrastructure Regulation (EMIR).

The Bank did not have any exposure from derivative contracts as at 31 December 2017.

### 5.6. Collateral and other credit enhancements

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.

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.

The Bank's exposures arising from derivative transactions are considered marginal by the Bank. Accordingly, the Bank does not obtain credit risk mitigants and hence does not make use of netting agreements.

Management monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses and requests additional collateral in accordance with the underlying agreement when necessary.

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 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. In the case of exposure secured by mortgage on immovable property, the value is limited to 70% of the market value of the property or the mortgage lending value of the property in the case of residential property, and 50% of the market value of the property or 60% of the mortgage lending value of the property in the case of commercial property. 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, for which the Bank assigns a 0% risk weight when calculating its risk-weighted assets in accordance with Article 222(4). Before application of the 0% risk weight, the mark-to-market value of the sovereign paper collateralizing the reverse repos, is topped up by 20%. Effectively, in transferring the risk on the sovereign through the collateral, a 20% haircut is applied on the sovereign issuer.

	TOTAL EXPOSURE VALUE	RESIDENTIAL IMMOVABLE PROPERTY	COMMERCIAL IMMOVABLE PROPERTY	OTHER ELIGIBLE COLLATERAL	RESIDUAL VALUE
	€000	€000	€000	€000	€000
<b>At 31 December 2017</b>					
Central governments or Central Banks	62,052	-	-	-	62,052
Institutions	96,545	-	-	-	96,545
Corporates	48,723	648	41,650	3,315	3,110
Retail exposures	67,969	16,793	16,518	12,097	22,561
Secured by mortgages on immovable property	237,758	237,397	361	-	-
Items associated with					
particularly high risk	10,928	8,701	2,118	-	109
Exposures in default	22,685	13,817	7,639	62	1,167
Equity exposures	341	-	-	-	341
Other items	23,491	-	-	-	23,491
<b>Total</b>	<b>570,492</b>	<b>277,356</b>	<b>68,286</b>	<b>15,474</b>	<b>209,376</b>

## 6. LIQUIDITY RISK - ASSET ENCUMBRANCE

Further to Note 3.4 entitled "Liquidity Risk", the following disclosures are made in respect of asset encumbrance in compliance with Banking Rule 07 which transposes the EBA Guidelines on Disclosure of Encumbered and Unencumbered Assets (EBA/GL/2014/03).

The disclosure is intended to highlight the available and unrestricted assets that could, in extremis, be used to sustain potential funding needs at a future time, and / or collateral requirements. An asset is deemed to be encumbered when it is pledged as collateral in respect of an existing liability and in consequence is therefore rendered out of reach to the institution towards the purpose of raising funds, meeting collateral requirements or being sold to contain the need for funding.

	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
<b>At 31 December 2017</b>								
Central governments or Central Banks made up of:	7,233	7,233	54,819	54,819	62,052	-	-	-
- Reserve deposit	3,467	3,467						
- Securities pledged for DCS	3,766	3,766						
Institutions	-	-	96,545	96,545	96,545	-	25,754	25,754
Corporates	-	-	48,723	61,033	48,723	-	47,991	47,991
Retail	-	-	67,969	142,636	67,969	-	48,107	48,107
Secured by mortgages on immovable property	-	-	237,758	246,305	237,758	-	81,984	81,984
Items associated with particularly high risk	-	-	10,928	33,891	10,928	-	16,392	16,392
Exposures in default	-	-	22,685	29,907	22,685	-	25,592	25,592
Equity	-	-	341	341	341	-	341	341
Other items	3,026	3,026	20,465	30,677	23,491	3,026	19,944	22,970
- of which: Visa collateral	3,026	3,026				3,026		
<b>Total credit risk</b>	<b>10,259</b>	<b>10,259</b>	<b>560,233</b>	<b>560,233</b>	<b>570,492</b>	<b>3,026</b>	<b>266,105</b>	<b>269,131</b>

## 7. MARKET RISK

### 7.1. Exposure in Equities Not Included in Trading Book

As already referred in Note 7 entitled "Financial investments classified as available-for-sale", in 2016 the Bank has secured a gain of €3,105,000 as part of the process of acquisition by Visa Inc. of Visa Europe Ltd. During 2015, Visa Inc. announced its proposed acquisition of Visa Europe Limited, subject to regulatory approval. The bank was a member of Visa Europe Limited and held one ordinary share of €10, although only limited value was attached to the share. Voting and any economic rights relating to the shares were broadly based on the sales volumes of the particular member. As set out in the announcement by Visa Inc., there was an up-front consideration receivable on completion of the transaction which comprises cash and preferred stock convertible into Visa Inc. class 'A' common stock. Additional deferred cash consideration would also be receivable following the third anniversary of closing of the transaction subject to an earn-out mechanism. The preferred stock element of the consideration is contingent upon certain factors. As at 31 December 2015, the Bank increased the carrying amount of its €10

share in Visa Europe Limited by €2,461,000 to reflect the value emanating from the proposed transaction. The fair value of the Bank's interest in Visa Europe Limited has been assessed on the basis of the expected consideration to be received from the proposed sale to Visa Inc. Prior to the announcement of the proposed transaction, the Directors believed that there was no value to assign to the membership because there were no rights to consideration and accordingly the fair value attributable for the membership was not evident. Accordingly, prior to 31 December 2015, the Bank recognised the membership share at its nominal value.

The transaction was subsequently completed during the first six months of 2016 as the Bank received up-front cash consideration of €2,623,450 and preferred stock convertible into Visa Inc. class A common stock amounting to a maximum of €681,844. Additional deferred cash consideration of €214,600 will also be receivable upon the third anniversary of the closing of the transaction.

The investment was fair valued at €3,105,475 reflecting the above-mentioned terms secured

upon completion of the transaction. The investment was in substance disposed of upon completion, and the revaluation reserve amounting to €3,105,475 was classified to profit or loss upon disposal. The remaining interest, subsequent to completion, in respect of the preferred stock and deferred cash consideration elements, has been recognised at the amount of €482,028 (with the latter element recognised within other assets), reflecting the fair value upon completion and unchanged as at 31 December 2016 and 2017.

7.2. Securitization Position

As at balance sheet date, the Bank did not hold any securitization positions and accordingly, no own-funds requirement for specific interest rate risk of securitization positions arose.

7.3. Interest Rate Risk (IRR)

IRR reporting is regularly made to the MFSA as part of the “Other BRs” return.

The Bank’s exposure to IRR was duly considered in the Internal Capital Adequacy Assessment Process (ICAAP). The following considerations were made:

- The local banking scenario is effectively not tied to the prevailing Euribor rates applicable on the European mainland;
- Instead, local credit interest rates are set at a higher level of interest and lending base rates hover around 2.5% p.a.;
- Market pressure to converge interest rates towards the Euribor regime could be experienced at banking industry level.

With effect from the 2017 ICAAP review, interest rate risk on the banking book was modelled on two alternative approaches viz.: earnings measure (static gap mode gap analysis focused on repricing risk), and economic value measure (static mode modified duration method).

Furthermore, different interest rate scenarios were simulated:

TYPE	INTEREST RATES	
	Economic value approach	Earnings-based approach
Baseline	+2.00%; -0.50%	Scenario 1: -0.75% Scenario 2: +2.00% Scenario 3 (mild squeeze): liabilities* +1.00%; assets * +0%
Stress-testing Years 1, 2	+2.00%; -0.75%	Regulatory shock +2.0% on liabilities*, +0% on assets*

\* Main balance sheet liability is customer deposits; main asset item is advances to customers.

The method which yielded the most onerous (i.e. capital consuming) result was selected as the basis for quantifying IRR economic capital.

The effect on IRR of an adverse variation in earnings was also considered in the ICAAP exercise

by delving into the correlation between gross income and total costs over a 24-month historical time series.

The resultant unexpected losses from such scenarios were quantified as additional IRR economic capital requirement and duly included in the ICAAP.

7.4. Non-maturity deposits

The Bank regularly monitors the actual level of withdrawal of its on-demand deposits (mainly customer credit balances on current and savings accounts). Whilst the theoretical level is 100%, in practice, only a limited portion is actually drawn out on depositors. Weekly readings on on-demand deposits are gathered in a statistical database spanning a long historical “look-back” period. Such data are then used to calculate a value-at-risk (VaR) metric relating to the actual level of withdrawals under the historical simulation approach. An even more stringent metric, the Expected Shortfall (ES) is then calculated. Both metrics are deduced at a stringent confidence level of 99.0%. The ES is then stressed by a further 30% to construct a stressed metric which represents the “on-demand” deposits runoff rate.

Such rate was disclosed to the Regulator in the Internal Liquidity Adequacy Assessment Process (ILAAP); it registered a low level of actual withdrawal. The said runoff rate was stressed under a going concern approach in the ILAAP, and even more rigorously inflated under a gone concern perspective in the Recovery Plan. The runoff rate is regularly monitored, reported and considered by top-level committees i.e. the Assets and Liabilities Committee and the Global Risk Committee in order to take timely corrective action, if warranted, in respect of both IRR and Liquidity Risk.

7.5. Currency risk

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 which present this matching process.

	TOTAL	EUR	GBP	USD	OTHER
	€000	€000	€000	€000	€000
As at 31 December 2017					
Total financial assets	552,277	531,915	8,059	10,390	1,913
Total financial liabilities	521,686	503,219	7,280	9,080	2,107
Net currency exposure			779	1,310	(194)

## 8. OPERATIONAL RISK

Whilst 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)	1,874
Basic Indicator Approach (actual)	1,969
Difference	95

The more taxing approach, viz. BIA was applied.

Operational risk events are identified internally through regularly trained operational risk managers, positioned in all Bank units and also from validated customer complaints received. Additionally, scanning of major and relevant external events is carried out in order to consider such events for inclusion in the operational risk database.

The level of sophistication of operational risk activity is being enhanced on an ongoing basis; in 2017, the Key Performance Indicator and Key Risk Indicator tools were included in the operational risk management toolkit.

## 9. REMUNERATION POLICY

The Bank's Remuneration 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.

### 9.1. 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 2017 amounted to €147,713 which are analysed as follows:

	€
Chairman	35,000
Other Members	112,700
Total Directors' fees	147,700

### 9.2. Executive Committee

The Board feels that the current Executive Committee has the necessary skills and qualities to manage the affairs of the Bank and considers the packages offered to its members sufficient to ensure that the Bank attracts and retains senior staff capable of fulfilling their duties. The Bank's policy remains to engage these officials on an indefinite contract of employment, following a period of probation. All contracts are in line with the relevant legislation, with all terms and conditions being specified in the said contracts of employment.

Annual salary increases, which are not performance related, are considered every year for the Executive Committee members, together with annual bonuses, which are generally based on the individual performance during the previous financial year. Any bonus payments made to Executive Committee members do not exceed 100% of their fixed component of total remuneration for each individual.

Share options, share incentive schemes and profit sharing do not feature in the Bank's Remuneration policy. Provisions for termination payments and/or other payments linked to early termination are provided in the case of one Executive Committee member; otherwise, provisions for termination payments and/or other payments linked to early termination are those determined by the Law. Moreover, no pension benefits are currently payable by the Bank.

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 2017 amounted to €626,052, split as follows:

FIXED REMUNERATION	VARIABLE REMUNERATION
€616,823	€ 9,229

## 10. NUMBER OF DIRECTORSHIPS HELD BY THE MEMBERS OF 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 + 4 NED
Sheikh Mohamed Faisal Q.F. Al Thani	1 ED + 1 NED
Mr Michael Anthony Collis	1 ED
Mr Charles Borg	1 ED + 12 NED
Mr Mario P Galea	6 NED
Mr Kenneth Mizzi	3 ED + 1 NED
Chev. Maurice Mizzi	3 ED + 2 NED
Mr Mark Portelli	10 NED
Mr Mohamed Ahmed Shafiek Mohamed Ahmed	1 ED + 1 NED

# Five Year Summary

Statements of Financial Position As at 31 December	2017	2016	2015	2014	2013
	€000	€000	€000	€000	€000
<b>Assets</b>					
Balances with Central Bank of Malta and cash	26,777	113,530	81,650	29,008	93,898
Cheques in course of collection	2,259	1,894	737	2,097	1,642
Financial investments held-for-trading	-	-	-	21,464	16,254
Financial assets at fair value through profit or loss	-	-	-	-	-
Financial investments available-for-sale	67,663	17,758	5,291	2,254	1,900
Loans and advances to banks	69,911	29,695	50,185	166,745	121,645
Loans and advances to customers	382,314	341,595	360,254	378,154	342,341
Property and equipment	6,908	7,270	7,740	8,062	7,587
Intangible assets	1,124	1,298	820	1,071	899
Deferred tax asset	4,100	4,010	3,003	4,561	5,230
Derivative financial instruments	-	-	23	899	625
Prepayments and accrued income	2,335	1,595	1,704	2,091	1,954
Other assets	4,351	4,262	5,500	2,663	2,305
<b>Total assets</b>	<b>567,742</b>	<b>522,907</b>	<b>516,907</b>	<b>619,069</b>	<b>596,280</b>

Statements of Financial Position As at 31 December	2017	2016	2015	2014	2013
	€000	€000	€000	€000	€000
<b>Equity</b>					
Share capital	39,544	24,544	32,500	32,500	32,500
Perpetual Capital Note	5,000	5,000	-	-	-
Retained earnings	768	(100)	(10,008)	(10,457)	(11,059)
Revaluation reserve	(248)	352	2,026	317	87
Reserve for General Banking Risks	992	992	844	446	190
<b>Total Equity</b>	<b>46,056</b>	<b>30,788</b>	<b>25,362</b>	<b>22,806</b>	<b>21,718</b>
<b>Liabilities</b>					
Amounts owed to banks	290	71	3,577	214	5,999
Amounts owed to customers	513,851	482,964	474,294	579,203	554,007
Derivative financial instruments	-	-	448	840	192
Debt securities in issue	-	-	5,000	5,000	5,000
Other liabilities	4,349	5,220	3,952	4,722	2,686
Accruals and deferred income	3,196	3,864	4,274	6,284	6,678
<b>Total liabilities</b>	<b>521,686</b>	<b>492,119</b>	<b>491,545</b>	<b>596,263</b>	<b>574,562</b>
<b>Total equity and liabilities</b>	<b>567,742</b>	<b>522,907</b>	<b>516,907</b>	<b>619,069</b>	<b>596,280</b>
<b>Memorandum items</b>					
Contingent liabilities	8,820	8,331	10,842	11,536	8,101
Commitments	112,755	63,248	61,953	62,279	72,958

Income Statements For the year ended 31 December	2017	2016	2015	2014	2013
	€000	€000	€000	€000	€000
Interest receivable and similar income					
- on loans and advances and balances with the Central Bank of Malta	15,318	15,926	19,693	22,899	20,291
- on debt securities classified as loans and receivables	-	-	-	-	256
- on debt and other fixed income instruments	264	103	93	102	3,060
Interest payable and similar expense	(5,187)	(6,403)	(9,499)	(14,260)	(15,480)
<b>Net interest income</b>	<b>10,395</b>	9,626	10,287	8,741	8,127
Fees and commission income	2,985	2,609	2,886	2,704	2,204
Fees and commission expense	(652)	(730)	(690)	(588)	(510)
<b>Net fees and commission income</b>	<b>2,333</b>	1,879	2,196	2,116	1,694
Net trading income and other income	561	740	1,363	3,071	2,102
Net gain on sale of investment securities	-	-	-	-	161
Other operating income	-	-	-	-	29
Gain on disposal of available-for-sale financial investments	862	3,105	-	-	-
<b>Net operating income</b>	<b>14,151</b>	15,350	13,846	13,928	12,113
Employee compensation and benefits	(6,864)	(5,642)	(5,395)	(5,287)	(5,162)
Other administrative expenses	(4,749)	(4,726)	(4,721)	(4,538)	(4,650)
Depreciation of property and equipment	(569)	(575)	(569)	(540)	(471)
Amortisation of intangible assets	(350)	(320)	(305)	(341)	(258)
Net impairment losses	(517)	(1,857)	(1,369)	(1,820)	(1,319)

Income Statements For the year ended 31 December	2017	2016	2015	2014	2013
	€000	€000	€000	€000	€000
<b>Profit before tax</b>	<b>1,102</b>	2,230	1,487	1,402	253
Income tax (expense)/credit	(234)	(130)	(640)	(544)	(129)
<b>Profit/(loss) for the year</b>	<b>868</b>	2,100	847	858	12
Earnings per share	1c7	6c5	2c6	2c6	0c4



Statements of cash flows For the year ended 31 December	2017	2016	2015	2014	2013
	€000	€000	€000	€000	€000
<b>Cash flows from operating activities</b>					
Interest, fees and commission received	18,402	18,882	22,682	25,548	22,586
Interest, fees and commission paid	(5,454)	(7,712)	(11,936)	(15,494)	(14,277)
Proceeds/cash losses from trading activities	561	315	1,668	1,824	1,776
Payments to employees and suppliers	(12,315)	(10,539)	(10,315)	(9,836)	(9,812)
<b>Cash flows from operating profit before changes in operating assets and liabilities</b>	1,194	946	2,099	2,042	273
(Increase)/decrease in operating assets:					
- Reserve deposit with Central Bank of Malta	(439)	1,770	520	(356)	(836)
- Loans and advances to banks	-	-	-	80,000	(80,000)
- Loans and advances to customers	(41,033)	17,140	16,534	(40,965)	(26,584)
- Other loans and receivables	-	-	-	3,333	3,123
- Other assets	(430)	(25)	(1,621)	(1,145)	1,069
(Decrease)/increase in operating liabilities:					
- Amounts owed to banks	-	-	-	(5,000)	(7,800)
- Amounts owed to customers	30,886	8,670	(104,909)	25,196	123,011
- Other liabilities	(871)	1,268	(583)	2,210	366
	(10,693)	29,769	(87,960)	65,315	12,622
Income tax paid	-	(234)	-	-	-

Statements of cash flows For the year ended 31 December	2017	2016	2015	2014	2013
	€000	€000	€000	€000	€000
<b>Net cash flows from operating activities</b>	(10,693)	29,535	(87,960)	65,315	12,622
<b>Cash flows from investing activities</b>					
Property, plant and equipment and intangible assets	(388)	(903)	(421)	(1,447)	(2,122)
Financial investments available-for-sale	(84,592)	(20,099)	(409)	-	(528)
Proceeds on disposal and redemption of available-for sale investments	32,860	8,162	-	-	-
Financial investments held-for-trading	-	-	21,937	(14,732)	6,061
Financial assets at fair value through profit or loss	-	-	-	-	500
Proceeds from sale of held-for-trading investments	-	-	-	11,093	-
Interest received on available-for-sale investments	619	(29)	91	104	3,067
<b>Net cash flows used in investing activities</b>	(51,501)	(12,869)	21,198	(4,982)	6,978
<b>Cash flows from financing activities</b>					
Proceeds from issue of preference shares	-	-	-	-	-
Proceeds from issue of debt securities	-	-	-	-	-
Issue of perpetual capital notes	-	5,000	-	-	-
Repayment of subordinated debt	-	(5,000)	-	-	-
Issue of share capital	15,000	-	-	-	-

Statements of cash flows For the year ended 31 December	2017	2016	2015	2014	2013
	€000	€000	€000	€000	€000
Net cash flows used in financing activities	15,000	-	-	-	-
Net increase in cash and cash equivalents	(47,194)	16,666	(66,762)	60,333	19,600
Cash and cash equivalents at beginning of year	140,126	123,460	190,222	129,889	110,289
Cash and cash equivalents at end of year	92,932	140,126	123,460	190,222	129,889

Accounting Ratios	2017	2016	2015	2014	2013
	%	%	%	%	%
Net interest income and other					
Operating income to total assets	2.49	2.94	2.68	2.25	2.03
Operating expenses to total assets	2.21	2.15	2.13	1.73	1.77
Cost to income ratio	88.55	73.38	79.37	76.87	87.02
Profit/(loss) before tax to total assets	0.19	0.43	0.29	0.22	0.04
Profit/(loss) before tax to equity	2.38	7.24	5.86	6.14	1.16
Profit/(loss) after tax to equity	1.88	6.82	3.34	3.76	0.57
Shares in issue (millions)	52.36	32.5	32.5	32.5	32.5
Net assets per share (€0 cents)	88	95	78	70	66
Profit/(loss) per share (€0 cents)	1.66	6.46	2.61	2.64	0.38

# Supplementary Financial Information



# Supplementary Financial Information

## Shareholding Information

The issued share capital stood at €39,544,001 million as at 31 December 2017, made up of 52,362,289 (2016: 32,500,000) fully paid up ordinary shares of €0.7552 (2016: €0.7552) each.

The ordinary shares are held as follows:

	NO. OF SHARES
Al Faisal International for Investment Malta Limited (C74331)	45,362,289
PG Holdings Limited (C 8569)	1,750,000
Virtu Investments Limited (C 42860)	1,750,000
Mizzi Organisation Limited (C 813)	1,750,000
SAK Limited (C 3240)	1,750,000
	52,362,289

The percentage holdings stand as follows:

	%
Al Faisal International for Investment Malta Limited (C74331)	86.632
PG Holdings Limited (C 8569)	3.342
Virtu Investments Limited (C 42860)	3.342
Mizzi Organisation Limited (C 813)	3.342
SAK Limited (C 3240)	3.342
	100.00

Each of the shareholders owning three point thirty-four per centum (3.34%) of the ordinary issued share capital, 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.

