BANIF
BANK

ANNUAL REPORT 2016

CONTENTS

Vision Mission Values

OUR VISION

Our Vision lays down what we want to be and what the ambition of Banif is - to be a solid Bank that is recognised as a beacon in the market by being close to its customers and an example to the community.

OUR MISSION

Our Mission expresses who we are, what drives us and what our purpose is as a financial services institution - to be a bank in constant sustained growth working towards the creation of value, and a business and family partner that strives to value its assets, delight its customers and satisfy its employees, driven by the highest principles of ethical and social responsibility.

OUR VALUES

CONFIDENCE

Establish long lasting relationships, based on rigour, integrity and transparency, with respect for the interests of our shareholders and customers, believing in the continuity of our project, its goals and guiding principles.

HUMANISM

See customers and all those we have relations with as individuals with unique life stories, whom we wish to help achieve their expectations, with an attitude of commitment and social responsibility.

EFFECTIVENESS

Act at the right time, with innovation and quality of service, based on an understanding of the context and anticipating opportunities, always aiming at the common goal of value creation.

INNOVATION

Understand and interpret the new market trends, in order to anticipate differentiating solutions that are in tune with our customers' interests, confirming our capacity to compete and be an agent for change.

AMBITION

Have the 'Power to Believe', to make so-called 'impossible' dreams come true, build new futures, overcome difficulties without giving up or becoming discouraged, doing more and doing better, for everyone's benefit.

Chairman and CEO Statement

OPERATING IN THE MARKET

The performance of the Maltese economy remained robust in 2016, buoyed by positive labour market conditions as well as business and consumer confidence. This contributed to the Country's financial stability in tandem with high projected economic growth in 2017.

International conditions continue to be challenging, with emerging countries experiencing a downturn in economic activity, and geo-political events contributed to rendering economies instable and markets volatile. In this context, although European economic growth has picked up, Brexit uncertainty continues to dominate market news.

THE BANK'S PERFORMANCE

2016 was a particular year for the Bank, one which posed a framework dictated by the agreement of sale and purchase between the existing shareholder and the new one. This period also saw the Bank undergo, and successfully pass, a formal stress test required as part of the shareholding sale – an exercise that significantly tried the Bank's resources but also reaffirmed its resilience and reliability.

Despite this challenging context, the Bank maintained its positive momentum and upheld its commitments to all its stakeholders, extending it to the community it operates in.

This momentum, in our ninth year of business activity, continues to be achieved through good corporate governance and sensible banking and risk mitigation procedures while ensuring strict regulatory compliance at all levels.

Banif Bank embarked on a prudent budget and structural programme. The measures implemented by Banif included streamlining operations, strengthening retail and corporate business, and maintaining the balance between deposit and loan portfolios - all the while keeping the customer at the centre of our philosophy.

This approach has enabled us to offer a solid contribution to the economy without compromising our dedication to customers, stakeholders and local communities. Of course, the Bank's objectives and results were driven by none other than its dedicated team, who is always at the forefront, achieving the Bank's aims and goals to the highest of standards.

NEW MAJORITY SHAREHOLDER

Banif Bank gained a new strategic partner in Al Feisal International for Investments, the Financial Investment Company of Al Feisal Holding Company, one of Qatar's largest private diversified industry groups, Banif Bank is Al Feisal's first financial services investment in Europe, marking an important milestone for both parties.

Al Feisal has a strong and globally-renowned track record in investment across a broad spectrum. Naturally, the Group is extending its full support to the Bank which is already leveraging Al Feisal's experience, expertise and the opportunities put at its disposal through Al Feisal's global investments, to add value to the different arms of those Banif operations working towards focused diversification and expansion plans, with a bigger commitment to the local market.

POSITIVE FUTURE PROJECTIONS

This new impetus inspires us to, continue moving resolutely towards the implementation of our long term vision, as well as short to medium term goals. We take these steps with increased confidence, knowing that with Al Feisal as our majority shareholder and strategic partner, we can move into a new phase of growth and development. This new synergy will enable us to further develop and enhance the Bank's services and relationships with all stakeholders.

OUR PEOPLE

Banif continues to enjoy high levels of public confidence. Our reputation is built on transparency, engagement in the community and the delivery of excellence in service. Once again we acknowledge that Banif's employees have been instrumental to our success, through delivering the drive, motivation and quality of service that customers have come to expect from us.

The team has fully embraced the new shareholder and the opportunities that this significant change in the Bank's essence has brought about. We can all certainly look forward to the exciting times that lie ahead of us.

We look forward to plotting a more ambitious course for Banif Bank.

Board of Directors

Michael Frendo

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 Senior Lecturer in the Faculty of Laws at the University of Malta and teaches at the Mediterranean Academy of Diplomacy (Malta) and the London Academy of Diplomacy (University of Stirling). He has published widely on European, diplomatic and legal issues and currently practices as a lawyer and consultant.

Sheikh Mohamed Feisal Q.F. Al-Thani

Deputy Chairman

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

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

Mohamed Ahmed Shafiek Mohamed Ahmed

Director

Mr Mohamed Ahmed Shafiek Mohamed Ahmed joined the Al Feisal 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 Feisal Holding. Mr Mohamed Ahmed Shafiek Mohamed Ahmed is currently Managing Director of Al Feisal 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 USA and a Chartered Accountant from Egypt.

Joaquim Francisco Da Silva Pinto

Chief Executive Officer

Director on the Board since March 2007. Mr Silva Pinto started his career at Oporto University before moving into the financial services sector. In 1978 he joined UBP in the Foreign Department for Trade Finance Operations. In 1987 he joined BNP to launch business in northern Portugal, heading operations and leading trade business. In 1991 he joined Banif Group taking responsibility for banking operations, finance, HR and corporate services of the northern region. Mr Silva Pinto went on to become the National Managing Director for Operations and later National Managing Director for Procedures and Quality. He then became General Managing Director of Operations of the commercial banks within the Banif Group and represented the Bank on national committees. He was appointed Chief Executive Officer of Banif Bank (Malta) plc in 2007.

Michael Collis

Director

Mr Collis was appointed Chief Executive Officer of Al Feisal International for Investment in January 2016 and has over 30 years' banking experience in Corporate Finance, Corporate Banking, as a CEO and as a Board Member. He has worked for global institutions such as Lloyds Bank, the Bankers Trust and the Mizuho Group.

He was educated at the University of Edinburgh and the University of Pennsylvania.

Paulo E. Machado Fernandes

Executive Board Member

Director of the Board since February 2014. Mr Machado Fernandes began his professional activity in the banking sector in 1985, working in the areas of finance and international financial markets at Bank of Lisbon & South Africa, in Johannesburg. Later on he moved to Banif – Banco Internacional do Funchal, SA in Portugal, and was instrumental in the integration of the Treasury and Financial Markets Departments. In 1997 Mr Machado Fernandes joined the Santander Group, to perform similar functions in the Financial Markets and Asset Management, within the retail banking and investment banking fields. After ten years, Mr Machado Fernandes was invited by Banif Financial Group, to be part of the team responsible in setting up the Banif Bank project in Malta. He was appointed as Head of Treasury with the responsibility of setting up the Bank's Treasury and trading room capitalising on the extensive knowledge and expertise acquired in his career. Today he occupies the post of Chief Financial Markets and Investments Officer with responsibilities for Financial and Management Accounting, Regulatory Reporting as well as Treasury.

Luís Carlos Ferreira Avides Moreira

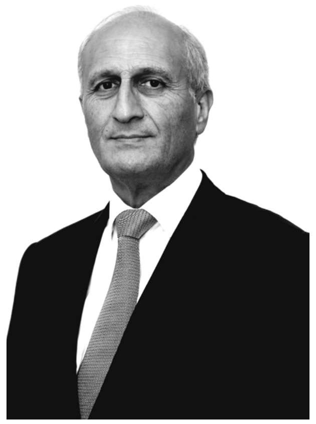
Executive Board Member

Director on the Board since December 2010. Joined Banif Financial Group in 1995 holding several senior management positions within Banif, SA. He headed the Corporate and Business Banking Unit of Banif Group and has vast experience in retail banking. Mr Moreira is a graduate in Economics and has an MBA in Financial Services from the University of Porto.

Adrian Coppini

Executive Board Member

Mr Coppini was appointed Director of the Board in July 2014. Mr Coppini joined Banif at its inception and was instrumental in the setting up of the Bank's operations in Malta where he led the Bank's HR and Corporate Services Departments. Today he occupies the post of Chief Officer Corporate Services with responsibilities for people management, properties, administration, marketing and communications. He serves on the Bank's Executive Committee. Mr Coppini held senior management positions in the airline, electronics and investment promotion sectors as Chief Officer HR & Corporate Services at Air Malta plc, Managing Director at Ero Electronic (Malta) Limited and Executive Company Secretary at Malta Enterprise Limited amongst others. He served as Director on the board of Air Malta plc and Société Internationale de Télécommunications Aéronautiques (SITA) and was elected SITA Council Deputy President. Mr Coppini holds a degree in Business Management from the University of Malta.



Mario P. Galea

Director

Mr Calea 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 Calea 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. He 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 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.

Maurice Mizzi

Non-Executive Board Member

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.

Kenneth Mizzi

Non-Executive Board Member

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.

Edward Cachia Caruana

Non-Executive Board Member

Director on the Board since March 2008. Mr Cachia Caruana is a fellow of the Association of Chartered Certified Accountants, UK and a member of the Malta Institute of Accountants. In 1976 he was appointed partner at Joseph Tabone & Co, certified public accountants and auditors, and in 1988 became Managing Partner retiring from the firm and from the accountancy profession in 1997. He took an active role in business organisations including that of serving on the councils of the Federation of Industries and the Malta Institute of Accountants. He was also a member of a number of boards including the Malta Stock Exchange.

2016 Financial Statements

Mark Portelli

Non-Executive Board Member

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.

Adrian Cutajar

Company Secretary

Appointed as the Bank's Company Secretary in June 2012. Dr Cutajar graduated Doctor of Laws from the University of Malta in 2003 and holds an MA in Financial Services from the University of Malta. Between 2004 and 2008 he held the position of Head of Legal and Compliance and Company Secretary with a financial services group listed on the Malta Stock Exchange. He is a member of the Chamber of Advocates, Malta and the Institute of Financial Services Practitioners. Dr Cutajar is currently Director of Artio Corporate Services Limited, focusing on the provision of compliance, governance and company secretarial services to licence holders authorised by the Malta Financial Services Authority.

Roderick Zammit Pace

Company Secretary

Appointed Company Secretary in October 2016. Dr. Roderick Zammit Pace is a partner at Refalo & Zammit Pace Advocates where he heads the firm's Corporate and Finance Law Practice Group. His areas of practice include banking, financial services and company and general commercial law. He has over 18 years' experience advising on corporate and financing transactions, regulatory matters and dispute resolution across the banking, insurance and asset management sectors.

He is a visiting lecturer within the Commercial Law Department of the Faculty of Laws at the University of Malta. He graduated Doctor of Laws from the University of Malta in 1997 and Master of Laws, as a British Chevening Scholar, from the University of London (London School of Economics and Political Science) in 1998.

General Information

DIRECTORS

The Directors who served throughout the year were as follows:

Michael Frendo	Non-Executive Chairman (resigned with effect from 4 October 2016 and re-appointed with effect from the same date)
Joaquim Francisco Da Silva Pinto	Chief Executive Officer (resigned with effect from 4 October 2016 and re-appointed with effect from the same date)
Kenneth Mizzi	Non-Executive Board Member (resigned with effect from 4 October 2016 and re-appointed with effect from the same date)
Mark Portelli	Non-Executive Board Member (resigned with effect from 4 October 2016 and re-appointed with effect from the same date)
Chev. Maurice Mizzi	Non-Executive Board Member (resigned with effect from 4 October 2016 and re-appointed with effect from the same date)
Sheikh Mohamed Feisal Q.F. Al-Thani	Non-Executive Board Member (appointed with effect from 4 October 2016) (Deputy Chairman)
Michael Anthony Collis	Non-Executive Board Member (appointed with effect from 4 October 2016)
Mohamed Ahmed Shafiek Mohamed Ahmed	Non-Executive Board Member (appointed with effect from 4 October 2016)
Mario P. Galea	Non-Executive Board Member (appointed with effect from 19 October 2016)
Maria Teresa Henriques Silva Moura Roque Dal Fabbro	Non-Executive Board Member (resigned with effect from 18 January 2016)
Adrian Coppini	Executive Board Member (resigned with effect from 4 October 2016)
Edward Cachia Caruana	Non-Executive Board Member (resigned with effect from 4 October 2016)
Luis Carlos Ferreira Avides Moreira	Executive Board Member (resigned with effect from 4 October 2016)
Paulo Eduardo Machado Fernandes	Executive Board Member (resigned with effect from 4 October 2016)

COMPANY SECRETARY

Roderick Zammit Pace (appointed with effect from 19 October 2016)
Adrian Cutajar (resigned with effect from 19 October 2016)

REGISTERED OFFICE

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

AUDITORS

PricewaterhouseCoopers
78, Mill Street
Qormi, QRM 3101
Malta

Directors' report

Directors' report

The Directors present their annual report together with the audited financial statements of the Bank for the year ended 31 December 2016.

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

PRINCIPAL ACTIVITIES

Banif Bank (Malta) 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 €70 million and €24.5 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 Feisal International for Investment Malta Limited, a subsidiary of Al Feisal for Investment Q.P.S.C. headquartered in Qatar.

The Bank provides a full range of commercial banking services to both residents and non-residents through a network of twelve branches, corporate and three business banking units.

In 2016, Banif Bank (Malta) plc concluded its ninth year of business activity in Malta. Within the context of a generally anaemic macroeconomic growth rate across the Eurozone and more favourable economic conditions locally, the Bank has maintained its position in the local market as a reliable financial services provider.

REVIEW OF BUSINESS DEVELOPMENT AND FINANCIAL POSITION

Business development

2016 was a particular year for the Bank, which was characterised by the sale of a 78.46% shareholding interest in the Bank by the former majority shareholder in favour of Al Feisal International for Investment Malta Limited. During the period under review the Bank also submitted itself satisfactorily to a voluntary asset quality review exercise undertaken by PricewaterhouseCoopers in connection with the share sale process.

Despite this challenging backdrop, the Bank maintained its positive momentum, reaching out to all its stakeholders and the wider community in which it conducts its business. In its ninth 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.

During the year under review, Banif Bank embarked on a prudent budget and structural programme. The measures implemented by the Bank included streamlining its operations, strengthening its retail and corporate business organisation, and maintaining the balance between deposit and loan portfolios - all the while maintaining a customer-centric approach to its business.

This approach has enabled the Bank to contribute to the economy without compromising its dedication to customers, stakeholders and the local community. The Bank's objectives and results were driven by its dedicated workforce which is committed to achieving the Bank's aims and goals while maintaining its high standards.

Al Feisal International for Investment Q.P.S.C.'s indirect shareholding in Banif Bank represents an important strategic investment for both the Al Feisal Group and the Bank. Al Feisal has a strong and globally-renowned track record in investment across a broad spectrum of activities including property, hospitality, trading, services, education and transportation in the GCC region and internationally. Banif Bank is ideally placed to leverage its majority shareholder's international experience and broad network of business relationships to achieve the Bank's focused diversification and expansion plans while strengthening its commitment to the local market.

Banif 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 team has fully embraced the Bank's new majority shareholder and the opportunities that the Al Feisal Group's strategic acquisition has opened up for the Bank.

Operating in the market

The performance of the Maltese economy remained robust in 2016, buoyed by positive labour market conditions as well as business and consumer confidence. This contributed to the country's financial stability in tandem with high projected economic growth in 2017.

International conditions continue to be challenging, with emerging countries experiencing a downturn in economic activity and geo-political events making economies unstable and markets volatile. While European economic growth has picked up, the uncertainty surrounding Brexit continues to impact financial markets.

Directors' report *(continued)*

Financial performance

During 2016, the Bank registered a profit after tax of €2.1 million (2015: €0.8 million).

In total, net operating income covered 117% of the operating expenses including net impairment provision (2015: 112%). The ratio increased from the 2015 level, mainly due to the gain on disposal of available-for-sale financial investments in 2016.

Total assets of the Bank amounted to €522.9 million at the end of 2016.

The Bank's efforts to maintain its asset and liability position substantially unchanged during the sale process relating to the Bank's shares, led to temporary prudent restraint of the Bank's business during that process which is now concluded. Thus the gross loans and advances to customers have decreased by €17.1 million, reaching €350.4 million by end of 2016, whilst deposits have increased by €8.7 million, reaching €483 million by end of 2016. The deposit transformation in loans´ ratio as at end of 2016 stood at 70.7%, which is lower than the level of 76% as at end of 2015, reflecting the general liquidity conditions of the Maltese market.

The Bank placed the excess of liquidity which was not transformed into loans, in Malta Sovereign Debt, with prime credit institutions and with the Central Bank of Malta.

The Bank generated a total operating income of €15.4 million, an increase of €1.5 million from the figure reported in the previous financial year mainly due to a gain on disposal of available-for-sale financial investments. The net interest income from business carried out with customers and banks amounted to €9.6 million (2015: €10.3 million). The reduction in the net interest income is the result of the decrease in the loan portfolio and due to the low interest rates´ environment. The Bank managed to off-set most of the low interest rate trend that persisted during 2016, as the decrease in interest receivable and similar income reduced 19%, and there was a greater decrease in interest payable of 32.6%.

Net fee and commission income amounted to €1.9 million (2015: €2.2 million). Net 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 €0.7 million (2015: €1.4 million) which consisted mainly of foreign exchange income. Given financial markets volatility and asset correlation, the Bank had no financial assets held-for-trading in its securities´ portfolios.

The Financial Risk Management note in the Financial Statements (Note 3), illustrates the process of how the Bank identifies and manages its risks and uncertainties. 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 the previous financial year has been concluded during the period under review. 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.

As at 31 December 2015, the Bank had increased the carrying amount of its €10 share in Visa Europe Limited by €2,461,000 thus reflecting the value envisaged to be emanating from the proposed transaction at that point in time. Following completion of the transaction in June 2016, the Bank increased the carrying amount of the cash component to the adjusted value of €2,623,000, with the impact of the disposal proceeds being reflected within current results for the period. The Bank also carried an amount of €482,000 for its interest in Visa Inc.'s preferred stock convertible into class 'A' common stock and the deferred cash consideration.

Total operating expenses excluding impairment increased by 2.5%, from €11 million in 2015 to €11.3 million in the year under review. Expenses relating to employee compensation and benefits including Directors amounted to €5.6 million, representing 50.1% (2015: 49.1%) of the total operating costs, general administrative expenses amounted to €4.7 million, 42% (2015: 43%), and amortisation and depreciation €0.9 million, 7.9% (2015: 8%).

Impairment

Since the start of its operations, the Bank was using market probability of defaults in view of the fact that history of credit losses was practically inexistent. During 2015, the Bank 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 2016, the effect of the collective impairment exercise together with the impairment resulting from the specific assessment in line with the Bank's provisioning policy, resulted in an increase in provisioning for impairment by a net amount of €1.9 million (2015: €1.4 million).

The gross increase in provision amounted to €4.2 million (2015: €4.7 million) whilst reversals of write-downs amounted to €2.3 million (2015: €3.3 million).

Directors' report *(continued)*

Total provision for impairment as a percentage of gross loans and advances to customers stood at 2.5% as at end of December 2016 (2015: 2%).

Credit facilities that were assessed individually for impairment decreased by €1 million, from €32.4 million as at 31 December 2015 to €31.4 million at 31 December 2016. The amount of specific provisions as a percentage of the non-performing loans stood at 21.5% as at end of 2016 (2015: 14.4%). Non-performing business credit facilities represented 76.2% of the total non-performing credit facilities (2015: 75.6%).

Tax

The Bank registered a profit before tax of €2.2 million (2015: €1.5 million). This attracted a tax charge of €0.1 million (2015: €0.6 million). As a result of the reversal in the fair value of available-for-sale financial investments and the tax exemption on a significant part of the gain on disposal of available-for-sale financial investments, the net deferred tax asset increased by €1 million and amounted to €4 million by end of December 2016 (2015: €3 million), mainly as a consequence of higher impairment provisions. Furthermore, the Bank still has unutilised tax losses carried forward and the Directors believe that the Bank will be registering further profits in the forthcoming years against which the unused tax losses can be utilised.

Financial and regulatory position

The Bank closed the year under review with a total asset base of €522.9 million (2015: €516.9 million). The largest component of assets was still represented by loans and advances to customers, which amounted to €350.4 million (2015: €367.5 million) gross of impairment allowances. The investment portfolio designated at inception as 'available-for-sale' more than doubled from €5.3 million as at end of 2015 to €17.8 million as at the end of the year under review. The portfolio includes an amount of €4.5 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 the same level of investment in property for the Bank's use and equipment and intangible assets. As at end of December 2016, the carrying amount of property and equipment amounted to €7.3 million (2015: €7.7 million), whilst that of intangible assets amounted to €1.3 million (2015: €0.8 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 in a position 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 and improve such ratios. The Bank is fully focused to raise and employ funds in the local retail and corporate business segments. At the same time, the Bank continues to invest in strengthening the operational capability and consolidating the investments made in previous years.

The Bank reorganised the asset composition such that the total asset base increased by €6 million during 2016 and the risk-weighted assets decreased by €13.5 million, from €244.5 million as at end of 2015 to €231 million by end of 2016. This had an impact on profitability, as placing funds in lower risk-weighted assets also entailed lower returns. The total Capital Adequacy Ratio stood at 10.9% as at end of December 2016, whilst Core Equity Tier 1 Capital Ratio stood at 10.4%. 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 position during 2016 remained strong, with the regulatory liquidity ratio under BR/05, standing at 56.9% as end of December 2016, compared to 54.8% in December 2015; and under the new regulatory liquidity coverage ratio, the ratio stood at 280.3% as end of December 2016.

On 4 October 2016, the Bank announced that following the non-objection of the European Central Bank Oitante S.A.'s 78.46% shareholding interest in the Bank was purchased by Al Feisal International for Investment Malta Limited, a subsidiary of Al Feisal International for Investment Q.P.S.C.

In December 2016, the Bank offset €7.9 million of its accumulated losses against its share capital and subsequently in January 2017 increased its issued share capital by €15 million, following a capital injection by Al Feisal international for Investment Malta Limited, the new controlling shareholder, in line with its pre-acquisition plans for Banif Bank.

Outlook moving forward

The Bank aims to meet its short to medium term goals while continuing to implement its long term vision. With its new financial strength position operating in a resilient economy as the Maltese, the Bank is very well placed to make most of the opportunities that exist.

During 2017 the Bank will continue investing in product propositions as well as in its branches, e-channels, and IT systems, with key customer benefits ranging from alternative solutions for savings, to reduced processing times, improved ease of access and convenience, and greater efficiency.

Directors' report *(continued)*

The Bank will also strengthen the control environment through changes to its organisational design, improvements in its internal controls and risk management, introducing more standardised processes across the Bank to speed up business as well as assess and monitor its risk appetite.

As part of the strategy, the Bank will also invest in its staff, creating appropriate and mandatory training to ensure they have the skills and knowledge necessary to enable them to deliver the necessary outstanding services for its customers.

Despite uncertainties with regards to the European political shape and economic outcome, as well as regulatory and competitive environment, in 2017 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, and supporting the Maltese economy.

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

During the year ended 31 December 2016, 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 Banif Bank (Malta) 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 8 March 2017 by:

JOAQUIM F. DA SILVA PINTO	**MICHAEL FRENDO**
Chief Executive Officer	Chairman

Statement of Compliance with the Principles of Good Corporate Governance

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

Banif Bank (Malta) 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, except where the business circumstances merit a different treatment.

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, the Compensation Committee and the Properties 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.

The Bank's strategy is set by the Board which has delegated the implementation thereof to the Executive Committee, which is in turn headed by the Chief Executive Officer, who is also a member of the Board of Directors.

PRINCIPLE 3 – COMPOSTION 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.

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

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

Dr Michael Frendo – Chairman
Sheikh Mohamed Feisal Q.F. Al-Thani[1] – Deputy Chairman
Mr Joaquim Da Silva Pinto
Mr Edward Cachia Caruana[2]
Mr Michael Anthony Collis[1]
Mr Adrian Coppini[2]
Mr Paulo Eduardo Machado Fernandes[2]
Mr Mario P. Calea[3]
Mr Kenneth Mizzi
Chev. Maurice Mizzi
Mr Luis Carlos Ferreira Avides Moreira[2]
Mr Mark Portelli
Ms Maria Teresa Henriques Silva Moura Roque Dal Fabbro[4]
Mr Mohamed Ahmed Shafiek Mohamed Ahmed[1]

1. Appointed with effect from 4 October 2016
2. Resigned with effect from 4 October 2016
3. Appointed with effect from 19 October 2016
4. Resigned with effect from 18 January 2016

SECTION 1 – COMPLIANCE WITH THE CODE (continued)

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), Mr Edward Cachia Caruana (resigned on 4 October 2016) and Mr Mario P. Calea (appointed on 19 October 2016).

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.

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 has delegated certain responsibilities to various committees, with specific responsibilities, as follows:

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

The Audit Committee

The Audit Committee monitors and reviews the effectiveness of the Bank's control functions, including internal audit and also 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 taking into account all types of risks.

The Compensation Committee

With effect from 4 October, this committee was redesignated from Remuneration Committee to Compensation Committee.

The overarching purpose of the Committee is to review the remuneration policy of the Bank and make any recommendations as it deems appropriate in light of 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; and
(c) report and provide assurance on the Bank's Remuneration Policy.

The Board has also appointed the Executive Committee as a management committee.

The Executive Committee

The Executive Committee meets on a weekly basis to oversee the overall management of the Bank. The Executive Committee is composed of five members, the Chief Executive Officer, the Chief Commercial Officer, the Chief Financial Markets and Investments Officer and the Chief Officer Corporate Services. Since October 2016, a non-executive Director is also a member of the Executive Committee, in order to enhance communication between the Board and the Executive Committee.

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

The Assets and Liabilities Committee

The Assets and Liabilities Committee (ALCO) meets on a quarterly 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 Internal Control Department, the Head of the Financial Management Department and the Head of the Commercial Department. The Head of the Risk Management Unit is also invited to attend the meetings of the ALCO.

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

The Properties Committee

This Committee meets in order to discuss and advise the Executive Committee on any proposals for the acquisition or the rental of properties to be utilised for the Bank's activities. At present, the members of this Committee are the Chief Officer Corporate Services and one non-executive Director.

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, Financial Management Department, Corporate Services Department, Operations and Systems Department and Internal Control 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 Chief Financial Markets and Investments Officer, the Chief Commercial Officer, the Head of Commercial Management Department and the Head of Business Development Unit.

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 and Communications Unit, Legal and Compliance Unit, Financial and Management Accounting Unit, Risk Management Unit, Information Technology Unit, Business Analysis Unit, Business Strategy Unit, General Operations Unit and the Treasury Unit.

The Global Risk Committee

The Global Risk Committee (GRC) deals with and reports to the Executive Committee 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.

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

SECTION 1 – COMPLIANCE WITH THE CODE *(continued)*

The Global Risk Committee (continued)

The GRC is composed of the Executive Committee members and the Heads of the Commercial Department, Financial Management Department, Corporate Services Department, Operations and Systems Department, Internal Control Department, and Risk Management Unit. The Committee meets on a quarterly basis.

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 2016 the Board of Directors met 12 times. Directors' attendance at Board Meetings during 2016 was as follows:

Members	Attended
Dr Michael Frendo – Chairman	10 out of 12
Sheikh Mohamed Feisal Q.F. Al-Thani – Deputy Chairman	1 out of 2
Mr Joaquim Da Silva Pinto	12 out of 12
Mr Edward Cachia Caruana	10 out of 10
Mr Adrian Coppini	10 out of 10
Mr Paulo Eduardo Machado Fernandes	10 out of 10
Mr Mario P. Galea	1 out of 1
Mr Kenneth Mizzi	11 out of 12
Chev. Maurice Mizzi	11 out of 12
Mr Luis Carlos Ferreira Avides Moreira	9 out of 10
Mr Mark Portelli	12 out of 12
Ms Maria Teresa Henriques Silva Moura Roque Dal Fabbro	Nil out of 2
Mr Mohamed Ahmed Shafiek Mohamed Ahmed	2 out of 2
Mr Michael Anthony Collis	2 out of 2

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

SECTION 1 – COMPLIANCE WITH THE CODE *(continued)*

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.

PRINCIPLE 7 – 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.

Main Principle – The Code

The Compensation 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 2016, the Compensation Committee met twice. The Committee was made up of two non-executive Directors till 4 October 2016, and three non-executive Directors from 19 October 2016 onwards. Their attendance at Committee's meetings during 2016 was as follows:

Members	Attended
Dr Michael Frendo – Chairman[1]	1 out of 1
Mr Michael Anthony Collis – Chairman[2]	1 out of 1
Mr Edward Cachia Caruana[1]	1 out of 1
Mr Mario P. Galea[3]	1 out of 1
Mr Kenneth Mizzi[2]	1 out of 1

[1]Resigned with effect from 4 October 2016
[2]Appointed with effect from 4 October 2016
[3]Appointed with effect from 19 October 2016

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.

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

SECTION 1 – COMPLIANCE WITH THE CODE *(continued)*

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

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

Banif'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 Banif 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.

Banif 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.

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

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 independent 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.

PRINCIPLE 8 (Code provision 8B)

Code provision 8B recommends that, *"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".*

Given the fact that the Directors are directly appointed by the Bank's shareholders, the Bank does not consider the need to develop a Nomination Committee. Notwithstanding this, the Bank is currently reviewing the matter in line with recently published regulations and the Board has already approved the setting up of a Compensation Committee. The Compensation Committee has been delegated the function to implement the Board Diversity Policy.

SECTION 3 – REMUNERATION POLICY

Banif Bank (Malta) 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 2016. The setting up of a Compensation Committee, which was approved by the Bank's Board of Directors in October 2016 took over the duties of the previous Remuneration Committee, which was set up in 2014. 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 is updated from time to time in line with operational requirements/realities. Nonetheless, such changes have not impacted the levels of compensation.

Banif Bank (Malta) 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, 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 levels of variable performance pay-outs to employees. On a yearly basis, the Bank's Board of Directors will approve a fund for bonuses and salary increases, which reflects the efforts and the results achieved by the Bank on its short and longer term goals. This is then distributed among employees in accordance with the Performance Appraisal Rules and Procedures and the Bank's Remuneration Policy.

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

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

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

Non-Executive Directors

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

The Bank paid non-executive directors compensation for the year 2016 as follows:

Michael Frendo (Chairman)	€ 41,300
Edward Cachia Caruana	€ 23,494
Kenneth Mizzi	€ 18,200
Chev. Maurice Mizzi	€ 18,580
Mark Portelli	€ 23,194
Mario P. Galea	€ 6,250
Sheikh Mohamed Bin Feisal Q.F. Al-Thani	€ 2,325
Mohamed Ahmed Shafiek Mohamed Ahmed	€ 4,075
Michael Anthony Collis	€ 4,950

Executive Directors

The Bank's Executive Committee was made up of four Executive Directors up to October and three Chief Officers and one Executive Director thereafter. Remuneration payable to these members for the year was:

Fixed Remuneration € 313,531 Variable remuneration € 10,268

Material Risk Takers (MRTs) Remuneration

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

	Senior Management	MRTs
Number of employees	4	22
Fixed	€ 313,531	€ 972,173
Variable	€ 10,268	€ 37,671

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

The four members of senior management constituting the Bank's Executive Committee, together with five Heads of Department enjoy non-cash benefits which include 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 2016.

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

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

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 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 Management Unit, which is entrusted with setting the risk-related policies, risk metrics and other risk mitigation procedures. Risk Management 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 Management 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 Management Unit. Credit Committee sittings at different authorisation 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 Management Unit) do not "go native" by becoming deal makers 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 and 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.

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

SECTION 5 – CORPORATE SOCIAL RESPONSIBILITY

Introduction

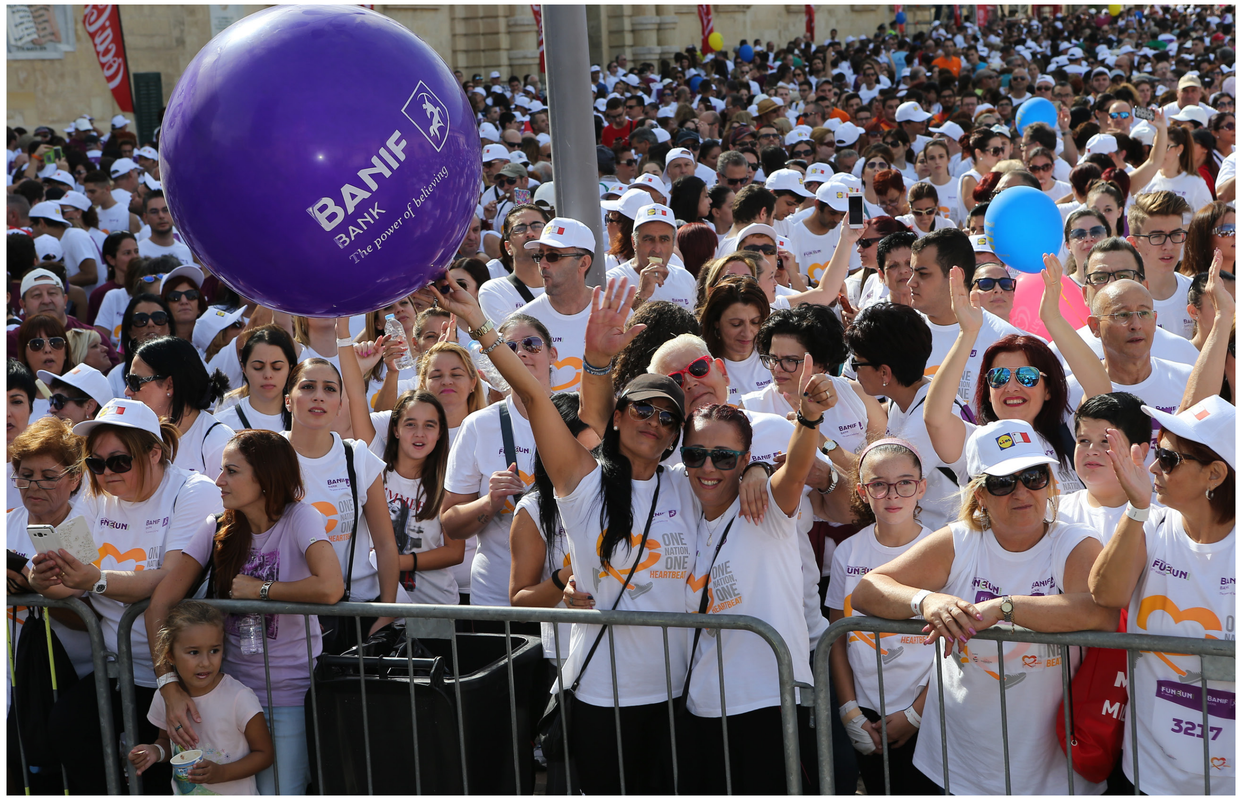
One of the mainstays of Banif Bank's philosophy is giving back to the community that it forms part of. Any business strategy, nowadays, is incomplete without considering engagement in the social fabric that customers are part and parcel of.

Philanthropy

In all CSR activities, Banif espouses its core values of innovation, ambition, effectiveness, confidence and humanism. Since it began operations in Malta, the Bank has focussed its commitment to contribute to key areas where it operates.

This is achieved through the implementation and maintenance of a multi-faceted CSR strategy that works in synergy with our business objectives. Throughout the year, we continued to foster our long-standing partnerships with influential NGOs and charities, in order to make a significant difference in the lives of others.

The President's Solidarity Fun Run has become a calendar event in Malta and the Bank is proud to have supported this initiative since the inaugural edition. Last year was another incredible feat of organisation and participation as thousands of people from all walks of life showed solidarity with the more vulnerable people in our society. Indeed, 'One Nation, One Heartbeat' has now permeated Malta's psyche.

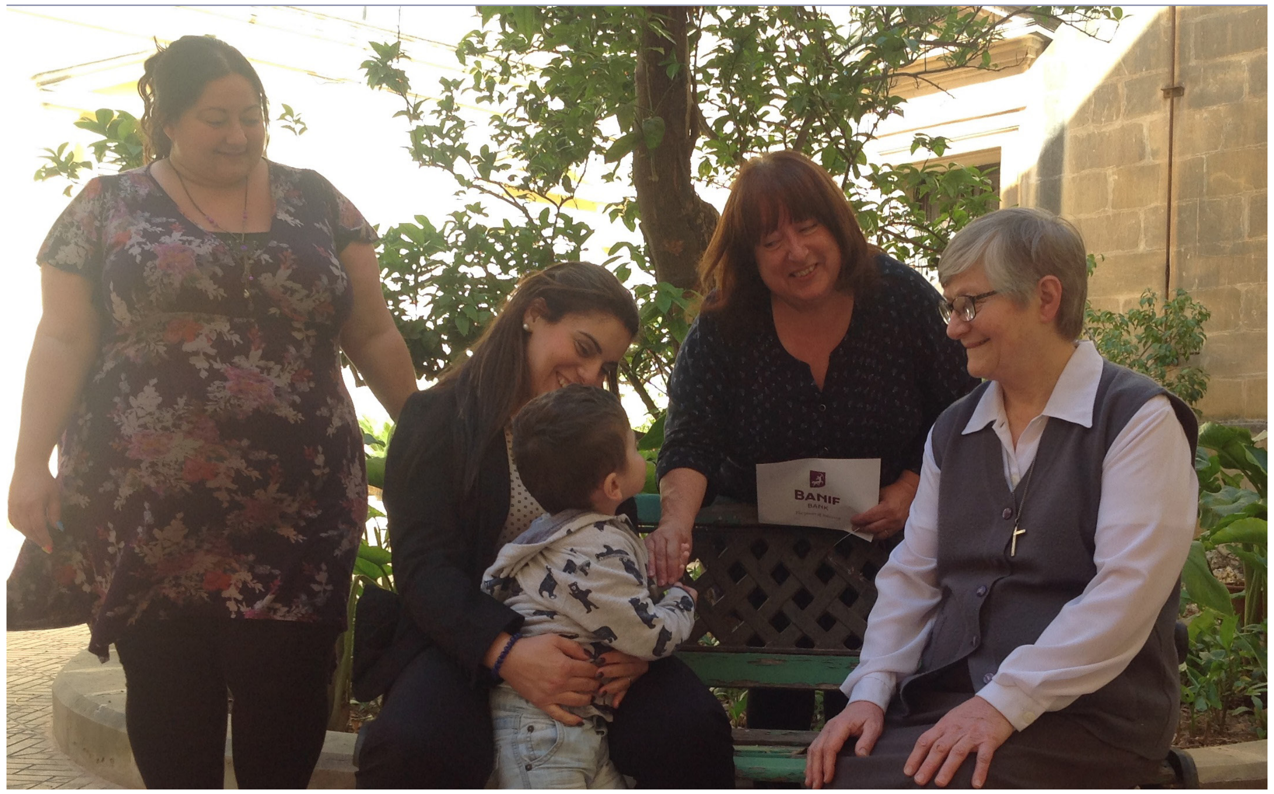


Last year, a mammoth €361,111 was raised during the Fun Run and the funds were passed on to the Malta Community Chest Foundation (MCCFF) during l-Istrina. Banif Bank also contributes to the MCCFF through its support of the annual Rockestra concert.

Charity and giving has no fixed value. Away from the razzmatazz of the big events, Banif 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.

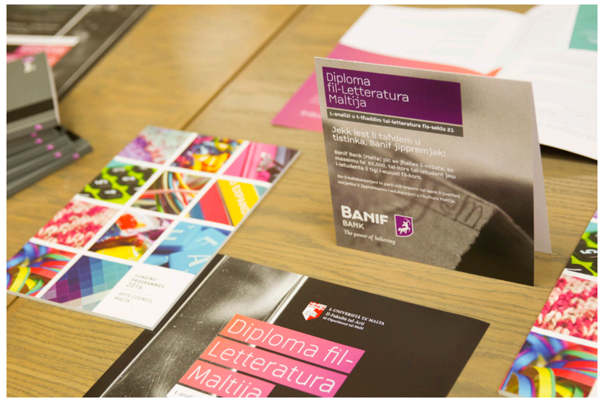
Statement of Compliance with the principles of Good Corporate Governance *(continued)*

SECTION 5 – CORPORATE SOCIAL RESPONSIBILITY *(continued)*



Through what has become an in-house tradition, Banif employees donated a significant sum by forfeiting €1 per month of their salaries. The Bank also supports the Hospice Midnight Walk through sponsorship and team participation. And who would have thought that asking employees to come to work in casual clothes once a month on a Friday would lead to a donation of €4,000? That is exactly what happened at Banif last year and the funds were then distributed amongst various NGOs that were picked by the staff themselves. Casual Friday is a bit of fun and it also helps work-life balance as employees are in their comfy clothes on Friday, just in time for the weekend.

Education



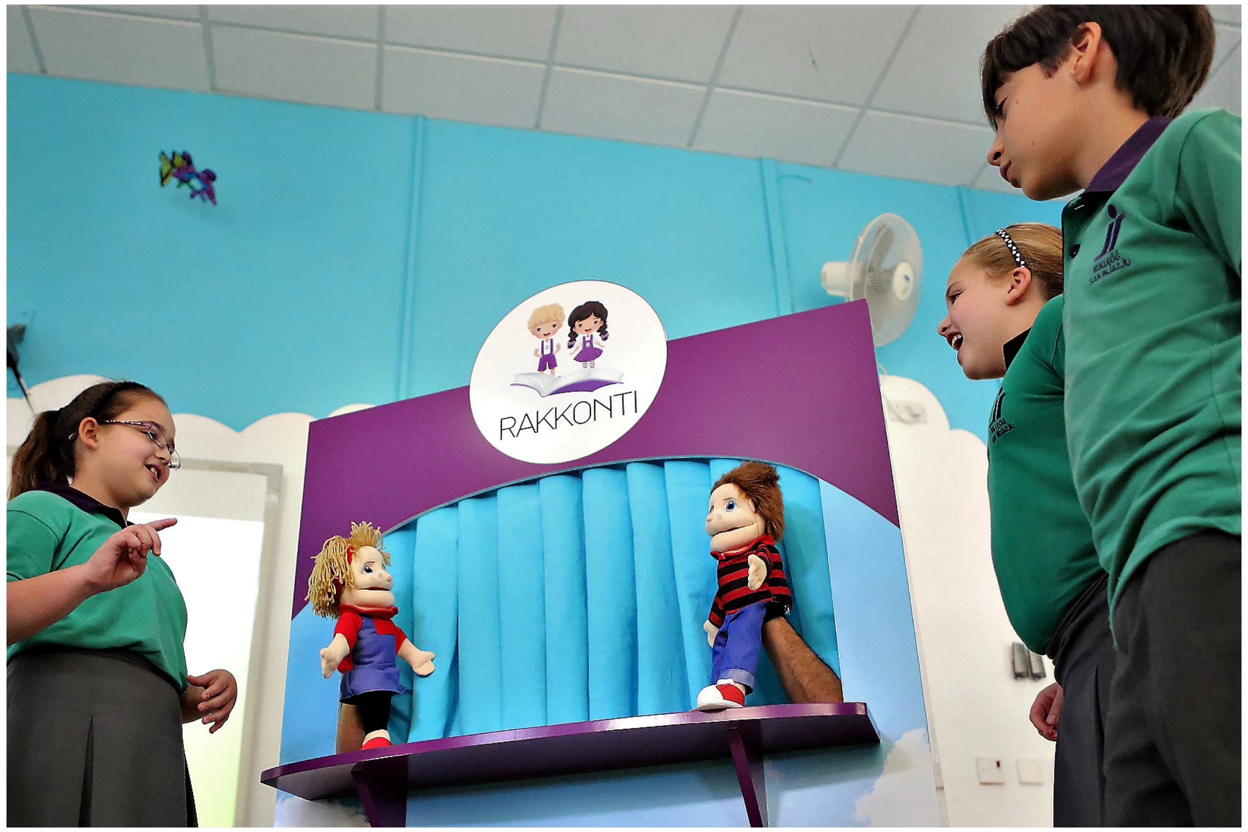
The Bank is supporting the University of Malta's new Diploma in Maltese Literature. To this end, the top placed student at the end of the course will be reimbursed for all fees. This part-time course is focusing on the critical analysis and application of Maltese literature in the 21st Century and will cover areas that are not covered by the Maltese BA programme.

A firm believer in starting early, Banif Bank is also supporting the National Literacy Agency of the Ministry for Education with Rakkonti, a literacy project for pre-school and primary school children.

Statement of Compliance with the principles of Good Corporate Governance *(continued)*

SECTION 5 – CORPORATE SOCIAL RESPONSIBILITY *(continued)*

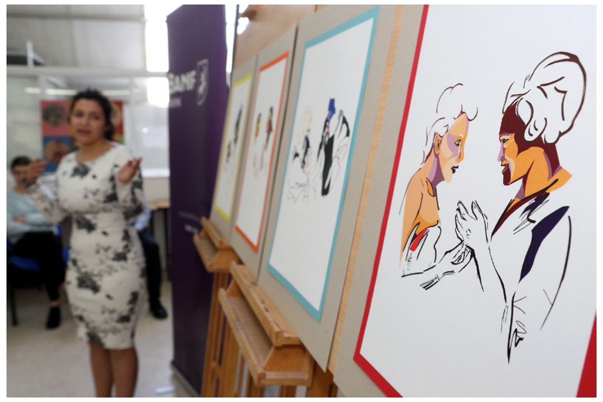
This is a three-year project aimed at boosting language and literacy skills related to reading, listening, speaking, writing and critical thinking through digital animation, song writing, fairy tales and puppet shows. With Trevor Zahra writing the tales, Dominic Calea composing the music and puppets to animate the stories, the children are in for some fun learning!



In 2016 Banif continued its partnership with the MCAST Institute of Creative Arts and its 'Life Case' projects. The project exposes Higher National Diploma in Fine Art students and BA Top-Up Photography students to the reality of being given a commission by a real client.

Working in line with certain specifications, brand guidelines and requirements, the Life Case allowed students to experience what it is really like to put ideas into a tangible result.

2016's project 'Meditgħid' highlighted the unifying aspects of Mediterranean culture, while also exploring themes of colours, patterns, fashion, cuisine, history and language. The artistic installation produced by the 10 students was well received by Banif and was displayed at the MCAST end of year exhibition.



Statement of Compliance with the principles of Good Corporate Governance *(continued)*

Heritage

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

In 2016, the Bank entered into a three-year sponsorship agreement with FWA which will see funds go into various projects lined up by the Organisation.

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

Environment

Annually 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 non-essential lights for one hour, from 8:30 to 9:30 p.m. towards the end of March, as a symbol for their commitment to the planet.

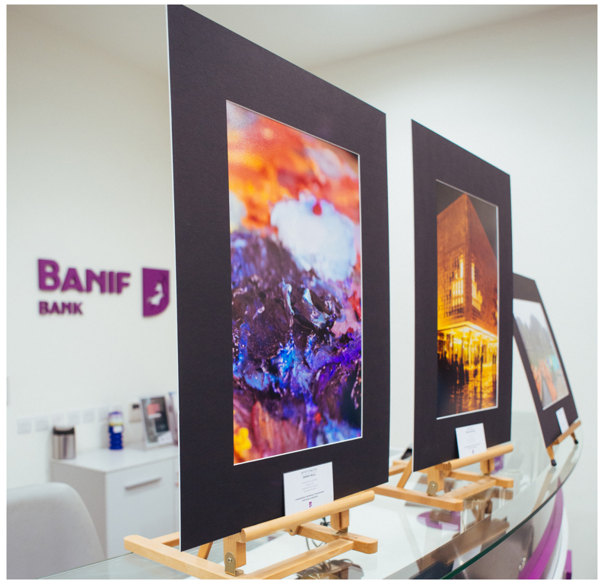
The Bank also organised a Car Free Day where many employees left their cars at home and walked, took the bus, ran, biked, or car pooled. This coincided with the EU Mobility Week intended to highlight the issues of pollution, reduction in emissions and air quality, by getting cars off the road.

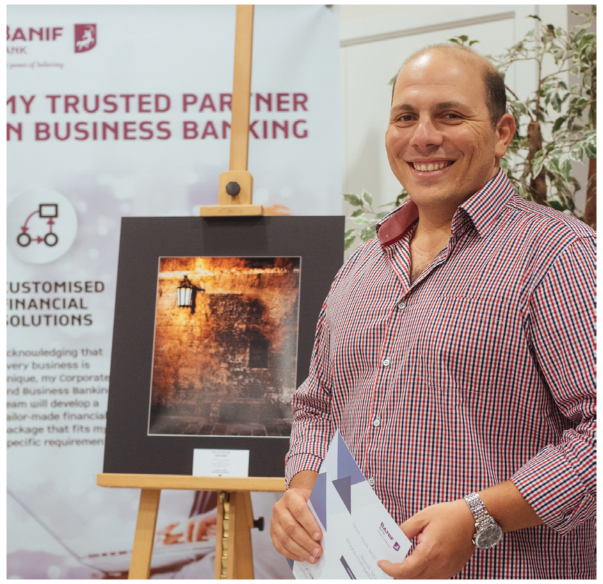
New battery banks also made their way to the Branches where the team and visiting customers were encouraged to make a different kind of deposit and bin used batteries for recycling.

Employee engagement

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

In 2016 Banif launched Get Up and Move - a series of internal activities promoting healthy living. Motivational events intended to make Banif Bank a great place to work bring the team together. These have included re-visiting old traditions like the Borża ta' San Martin, and tasting traditional Maltese food like bread and roasts, as well as having a go at the game of Tombla. The Bank's Sports and Social Committee also organises social events to bring team members together in an informal set up, with these including wine tasting and town heritage tours. There was also healthy participation in the Banif Photo Competition for staff. Employees were invited to take part in the competition which featured various categories. 130 photographs were received and judges then selected the best ones that were later used in an exhibition at the Bank. The same photos also featured in the annual Banif Agenda that was distributed to employees and customers.





Statement of Compliance with the principles of Good Corporate Governance *(continued)*

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

Banif encourages employees 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 quarter, 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 8 March 2017 by:

JOAQUIM F. DA SILVA PINTO Chief Executive Officer	**MICHAEL FRENDO** Chairman

Independent auditor's report
To the Shareholders of Banif Bank (Malta) p.l.c.

Report on the audit of the financial statements

Our opinion

In our opinion:
- Banif Bank (Malta) p.l.c.'s financial statements give a true and fair view of the Bank's financial position as at 31 December 2016, 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 Maltese Companies Act (Cap. 386).

What we have audited

Banif Bank (Malta) p.l.c.'s financial statements, set out on pages 40 to 122, comprise:
- the statement of financial position as at 31 December 2016;
- the 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.

Other information

The directors are responsible for the other information. The other information comprises the Directors' Report, Statement of Compliance with the Principles of Good Corporate Governance, the Additional Regulatory Disclosures, which we obtained prior to the date of this auditor's report. Other information 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).

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 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 has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the company'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.

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.

Independent auditor's report (continued)

Report on other legal and regulatory requirements

Opinion on other matters prescribed by the Banking Act, 1994

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 accordingly to the explanations given to us, the financial statement 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.

PricewaterhouseCoopers
78, Mill Street
Qormi
Malta

Fabio Axisa
Partner

8 March 2017

Statement of Financial Position
for the year ended 31 December 2016

	Notes	2016 €000	2015 €000
ASSETS			
Balances with Central Bank of Malta and cash	6	113,530	81,650
Cheques in course of collection		1,894	737
Financial investments classified as available-for-sale	7	17,758	5,291
Loans and advances to banks	8	29,695	50,185
Loans and advances to customers	9	341,595	360,254
Property and equipment	10	7,270	7,740
Intangible assets	11	1,298	820
Deferred tax assets	12	4,010	3,003
Derivative financial instruments	13	-	23
Prepayments and accrued income	14	1,595	1,704
Other assets	15	4,262	5,500
TOTAL ASSETS		522,907	516,907
EQUITY			
Share capital	16	24,544	32,500
Perpetual capital notes	17	5,000	-
Revaluation reserve	18	352	2,026
Reserve for General Banking Risks	18	992	844
Accumulated losses	18	(100)	(10,008)
TOTAL EQUITY		30,788	25,362
LIABILITIES			
Amounts owed to banks	19	71	3,577
Amounts owed to customers	20	482,964	474,294
Derivative financial instruments	13	-	448
Debt securities in issue	21	-	5,000
Other liabilities	22	5,220	3,952
Accruals and deferred income	23	3,864	4,274
TOTAL LIABILITIES		492,119	491,545
TOTAL EQUITY AND LIABILITIES		522,907	516,907
Memorandum items			
Contingent liabilities	24	8,331	10,842
Commitments	24	63,248	61,953

The accounting policies and explanatory notes on pages 46 to 122 form an integral part of the financial statements.The financial statements on pages 40 to 122 were approved and authorised for issue by the Board of Directors and signed on its behalf on 8 March 2017 by:

JOAQUIM F. DA SILVA PINTO
Chief Executive Officer

MICHAEL FRENDO
Chairman

Income Statement
For the year ended 31 December 2016

	Notes	2016 €000	2015 €000
Interest receivable and similar income			
- on loans and advances and balances with Central Bank of Malta and other instruments	25	15,926	19,693
- on debt and other fixed income instruments	25	103	93
Interest payable and similar expense	26	(6,403)	(9,499)
Net interest income		9,626	10,287
Fees and commission income	27	2,609	2,886
Fees and commission expense	27	(730)	(690)
Net fees and commission income		1,879	2,196
Net trading income	28	740	1,363
Gain on disposal of available-for-sale financial investments	7	3,105	-
Net operating income		15,350	13,846
Employee compensation and benefits	29	(5,642)	(5,395)
Other administrative expenses	30	(4,726)	(4,721)
Depreciation of property and equipment	10	(575)	(569)
Amortisation of intangible assets	11	(320)	(305)
Net impairment losses	31	(1,857)	(1,369)
Profit before tax		2,230	1,487
Income tax expense	32	(130)	(640)
Profit for the year		2,100	847
Earnings per share	33	6c5	2c6

The accounting policies and explanatory notes on pages 46 to 122 form an integral part of the financial statements.

Statement of Comprehensive Income
For the year ended 31 December 2016

	2016 €000	2015 €000
Profit for the year	2,100	847
Other comprehensive income		
Items that may be subsequently reclassified to profit or loss		
Available-for-sale investments:		
- Net changes in fair value, before tax	(114)	2,628
- Reclassification adjustments - net amounts reclassified to profit or loss, before tax	(2,461)	-
Income taxes	901	(919)
Other comprehensive income for the year, net of tax	(1,674)	1,709
Total comprehensive income for the year, net of tax	426	2,556

The accounting policies and explanatory notes on pages 46 to 122 form an integral part of the financial statements.

Statement of Changes in Equity
For the year ended 31 December 2016

	Notes	Share capital	Perpetual capital notes	Revaluation reserve	Reserve for General Banking Risks	Accumulated losses	Total
		€000	€000	€000	€000	€000	€000
At 1 January 2015		32,500	-	317	446	(10,457)	22,806
Comprehensive income							
Profit for the year		-	-	-	-	847	847
Other comprehensive income							
Fair valuation of available-for-sale financial assets							
- net changes in fair value arising during the year	7	-	-	1,709	-	-	1,709
Transfers and other movements		-	-	-	398	(398)	-
Total other comprehensive income for the year		-	-	1,709	398	(398)	1,709
Total comprehensive income for the year		-	-	1,709	398	449	2,556
At 31 December 2015		32,500	-	2,026	844	(10,008)	25,362
At 1 January 2016		**32,500**	**-**	**2,026**	**844**	**(10,008)**	**25,362**
Comprehensive income							
Profit for the year		**-**	**-**	**-**	**-**	**2,100**	**2,100**
Other comprehensive income							
Fair valuation of available-for-sale financial assets:							
- net changes in fair value arising during the year	7	**-**	**-**	**(75)**	**-**	**-**	**(75)**
- reclassifications - net amounts classified to profit or loss	7	**-**	**-**	**(1,599)**	**-**	**-**	**(1,599)**
Transfers and other movements		**-**	**-**	**-**	**148**	**(148)**	**-**
Total other comprehensive income for the year		**-**	**-**	**(1,674)**	**148**	**(148)**	**(1,674)**
Transactions with owners							
Reduction in share capital effected through offset of accumulated losses	16	**(7,956)**	**-**	**-**	**-**	**7,956**	**-**
Issue of perpetual additional Tier 1 Capital notes	17	**-**	**5,000**	**-**	**-**	**-**	**5,000**
Total transactions with owners		**(7,956)**	**5,000**	**-**	**-**	**7,956**	**5,000**
At 31 December 2016		**24,544**	**5,000**	**352**	**992**	**(100)**	**30,788**

Statement of Cash Flows
For the year ended 31 December 2016

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	Notes	2016 €000	2015 €000
Cash flows from operating activities			
Interest, fees and commission received		**18,882**	22,682
Interest, fees and commission paid		**(7,712)**	(11,936)
Proceeds from trading activities		**315**	1,668
Payments to employees and suppliers		**(10,539)**	(10,315)
Net interest on financial assets		**(29)**	91
Cash flows from operating profit before changes in operating assets and liabilities		**917**	2,190
Decrease/(increase) in operating assets:			
Balances with Central Bank of Malta		**1,770**	520
Loans and advances to customers		**17,140**	16,534
Other assets		**(25)**	(1,621)
Increase/(decrease) in operating liabilities:			
Amounts owed to customers		**8,670**	(104,909)
Other liabilities		**1,268**	(583)
Net cash flows generated from/(used in) operating activities before tax		**29,740**	(87,869)
Tax payable		**(234)**	-
Net cash flows generated from/(used in) operating activities		**29,506**	(87,869)
Cash flows from investing activities			
Purchase of property, equipment and intangible assets		**(903)**	(421)
Purchase of available-for-sale investments		**(20,099)**	(409)
Purchase of held-for-trading investments		**-**	(8,116)
Proceeds from sale of held-for-trading investments		**-**	30,053
Proceeds from disposal and redemption of available-for-sale investments		**8,162**	-
Net cash flows (used in)/generated from investing activities		**(12,840)**	21,107
Cash flows from financing activities			
Repayment of subordinated debt	17	**(5,000)**	-
Issue of perpetual capital notes	17	**5,000**	-
Net cash flows from financing activities		**-**	-
Net increase/(decrease) in cash and cash equivalents		**16,666**	(66,762)
Cash and cash equivalents at beginning of year		**123,460**	190,222
Cash and cash equivalents at end of year	34	**140,126**	123,460

The accounting policies and explanatory notes on pages 46 to 122 form an integral part of the financial statements.

1. STATUTORY INFORMATION

Banif Bank (Malta) 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.

On 20 December 2015, the Bank's majority shareholder at that date, Banif – Banco Internacional do Funchal, S.A., (Banif 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 non-objection of the European Central Bank by virtue of a decision dated 12 August 2016 made pursuant to Article 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 13 A of the Banking Act, 1994 (Cap. 371 of the Laws of Malta), the majority shareholding in the Bank held by Oitante S.A. was purchased by Al Feisal International for Investment Malta Limited, a subsidiary of Al Feisal International for Investment Company Q.P.S.C., headquartered in Qatar. As explained in Note 16, 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 postion.

The Bank as a stand alone 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 requirments 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 (Cap. 371 of the Laws of Malta), 1994 and the Companies Act, 1995 (Cap. 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).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.1 Basis of Preparation (continued)

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).

2.1.1 Appropriateness Of Going Concern Assumption

During the financial year ended 31 December 2016, the Bank continued to manage its business diligently taking cognisance of the regulatory capital constraints. The Bank placed itself in a position to withstand regulatory constraints by a constant margin, with the key objective of ensuring that the Bank's Total Capital Ratio constantly exceeds the regulatory minimum capital requirements. Throughout the period under review, the Bank's Total Capital Ratio consistently exceeded the regulatory minimum benchmark. This is particularly attributable to the profits registered by the Bank during the current financial year, amounting to €2.1 million.

The Bank continues to work on its strategy to move away from achieving regulatory ratios with tight margins, in order to achieve comfortable capital adequacy ratios which would enable the Bank to move to a financial position which is beyond the minimum set regulatory requirements and to enhance its financial profitability thus consolidating its position in the market. In this respect, the Bank has, during the period under review, continued to focus on the objective of increasing its Core Equity Tier 1. A new controlling shareholder that is committed to inject capital into the Bank to achieve the objectives referred to above has been located.

For this reason, the outgoing major shareholder had embarked on a competitive bidding process to invite all prospective investors that expressed interest in investing in the Bank to put forward their offers. The ultimate objective of this process led to a preferred bidder being selected as the new controlling shareholder. In this respect, a Share Purchase Agreement had been concluded between the Bank's previous parent and the new controlling shareholder in respect of the transfer of the Bank's major shareholding. As already highlighted, on 4 October 2016, Al Feisal International for Investment Malta Limited finalised the acquisition of the 78.46% shareholding previously owned by Oitante S.A., subsequent to regulatory approval. As outlined previously, during December 2016, the Bank resolved to offset €7.96 million of its accumulated losses against its share capital, thereby effecting a share capital reduction 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 plan to effect capital injections which would allow the Bank to execute the strategy mentioned previously, enhancing the business model currently undertaken by the Bank, with satisfactory buffers over and above the minimum regulatory capital requirements. Further details are included in Notes 3.6 – Capital Risk Management and 16 – Share Capital. The former note includes a Proforma Statement of Financial Position that illustrates the capital position of the Bank in a scenario where the increase of share capital had an effective date of 31 December 2016 rather than January 2017.

As outlined in Note 17 – Perpetual Capital Notes, on 4 October 2016, the Bank issued floating rate Perpetual Additional Tier 1 Capital Notes amounting to an aggregate amount of €5,000,000 to Al Feisal International for Investment Company Q.P.S.C. The notes are subject to interest at the rate of 10% until 31 December 2016 and at Euribor plus 10% thereafter, but all interest payments are cancellable at the discretion of the issuer.

The Notes constitute unsecured, undated and subordinated obligations of the Issuer; 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.1 Basis of Preparation (continued)

2.1.1 Appropriateness Of Going Concern Assumption *(continued)*

In view of the issue of new shares referred above, the Common Equity Tier 1 ('CET 1') capital amounting to €18,700,000 as at 31 December 2016 would have amounted to €33,700,000, had the increase in share capital occurred by 31 December 2016. The Total Own Funds would have increased from €24,787,000 at 31 December 2016, to €39,787,000. In any case, the Total Capital Ratio was 10.7% at 31 December 2016, which is in excess of the minimum regulatory prescribed ratio of 8%.

Until the capitalisation process was concluded, the Bank´s Management continued to focus on defined actions to manage the key components of its balance sheet, to ensure that the Bank's ability to realise its assets and to discharge its liabilities is not put in doubt during the period.

The main objective was to utilise the existing amount of capital in the most efficient manner without compromising the intended risk return relationship that the Bank has set. The Bank's Management continued managing the aggregate level, composition and credit quality of its financial assets, with impact on the level of risk weighted assets utilised for regulatory purposes. The Bank's Management also continued to monitor closely the liquidity management process taking into account the level and nature of the Bank's liquid assets, the terms of its time deposit liabilities and the extent of the maturity mismatches for the Bank's financial assets and liabilities reflected within the maturity ladder. These actions were complemented with reducing the cost of the Bank's funding and strengthening the monitoring of risks; with all measures intended to ensure sustainable improvement in the Bank's operating income.

As far as operating costs are concerned, the Bank's Management continued to exercise a disciplined control on costs, and a number of initiatives have been undertaken to generate synergies and to optimise the use of resources without compromising the quality level of service offered to clients.

Accordingly the Board of Directors firmly believes that no matters or developments indicate that a material uncertainty exists that may cast significant doubt about the Bank's ability to continue as a going concern.

2.2 Standards, interpretations and amendments to published standards effective in 2016

In 2016, the Bank adopted new standards, amendments and interpretations to existing standards that are mandatory for the Bank's accounting period beginning on 1 January 2016. 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 2016 have been published by the date of authorisation for issue of this financial information. The Bank's directors are of the opinion that, with the exception of the below, there are no requirements that will have a possible significant impact on the Bank's financial statements in the period of initial application.

IFRS 9 'Financial Instruments'

In July 2014, the IASB issued IFRS 9 'Financial Instruments', which is the comprehensive standard to replace IAS 39 'Financial Instruments: Recognition and Measurement', and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Standards, interpretations and amendments to published standards that are not yet adopted (continued)

Classification and measurement

The classification and measurement of financial assets will depend on how these are managed (the entity's business model) and their contractual cash flow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit or loss ('FVPL'). The combined effect of the application of the business model and the contractual cash flow characteristics tests may result in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39. However, based on an assessment of financial assets performed to date and expectations around changes to balance sheet composition, the Bank expects that the overall impact of any change will not be significant. For financial liabilities designated to be measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income.

Impairment

The impairment requirements apply to financial assets measured at amortised cost and FVOCI, and lease receivables 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 expected credit losses ('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 to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit impaired are in 'stage 3'.

The assessment of credit risk and the estimation of ECL are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.3 Standards, interpretations and amendments to published standards that are not yet adopted (continued)

Transition

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, but it is possible to apply the revised presentation for certain liabilities measured at fair value from an earlier date.

The Bank is assessing the impact that the impairment requirements will have on the financial statements. The Bank intends to quantify the potential impact of IFRS 9 once it is practicable to provide reliable estimates, which will be no later than in the Annual Report and Accounts 2017.

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.

Notes to Financial Statements
For the year ended 31 December 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.6 Financial assets (continued)

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 of their initial investment, other than because of credit deterioration.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.6 Financial assets (continued)

2.6.3 Loans and receivables (continued)

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.

Notes to Financial Statements
For the year ended 31 December 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.7 Impairment of financial assets (continued)

2.7.1 Assets carried at amortised cost (continued)

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e., on the basis of the 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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.7 Impairment of financial assets (continued)

2.7.1 Assets carried at amortised cost (continued)

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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.7 Impairment of financial assets (continued)

2.7.2 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 2.8.1.

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

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

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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

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	6 - 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 and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.11 Intangible assets (continued)

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 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.

Notes to Financial Statements
For the year ended 31 December 2016

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.14 Current and deferred income tax (continued)

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 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.18 Repurchase and reverse repurchase agreements (continued)

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.22 Interest income and expense (continued)

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

2.27 Financial guarantee contracts (continued)

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 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 (to which the Bank is not exposed).

- ***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

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Introduction (continued)

3.1.1 Preamble (continued)

- 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 proper control, which might involve internal operations, personnel, systems or external occurrences that in turn affect the income and capital funds of financial institutions. The Bank has adopted an operational risk management framework and procedures, which provide for the identification, assessment, management, monitoring and reporting of the Bank's operational risks.

The 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, approves policies covering specific areas, such as foreign exchange risk, interest rate risk and credit risk.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Introduction (continued)

3.1.2 Organisation (continued)

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 as well as a non-executive Director who is also a member of the Executive Committee, 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 Commitee. 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 and the Head of the Risk Management Unit.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.1 Introduction (continued)

3.1.2 Organisation (continued)

The Global Risk Committee is supported by all Bank Units but especially, from an internal control and risk governance perspective, the Internal Control Department, which performs a risk control and oversight function, with its main objective is 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 senior management consideration.

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. 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 2016, 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 mechanisms.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 Credit risk (continued)

3.2.2 Credit risk management (continued)

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 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, derivative financial instruments, 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 24 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 24. 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.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

3.2.3 Maximum exposure to credit risk *(continued)*

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.

	2016	2015
	€000	€000
Credit risk exposures relating to on-balance sheet assets:		
Loans and receivables		
Balances with Central Bank of Malta	108,798	78,372
Cheques in course of collection	1,894	737
Loans and advances to banks	29,695	50,185
Loans and advances to customers	341,595	360,254
Accrued income	903	1,119
Financial investments available-for-sale	17,417	5,291
Derivative financial instruments	-	23
	500,302	495,981
Credit risk exposures relating to off-balance sheet instruments:		
Contingent liabilities	8,331	10,842
Undrawn commitments to lend	63,116	60,526

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 government debt securities as shown in the following table:

	2016	2015
	€000	€000
Government debt securities	17,417	2,830

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

3.2.4 Credit concentration risk *(continued)*

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:

	2016	2015
	€000	€000
Manufacturing	7,282	7,467
Financial services	11,992	16,553
Households and individuals	252,045	248,404
Construction	9,123	15,287
Wholesale and retail	30,455	33,667
Other sectors	39,470	46,128
Gross loans and advances to customers	350,367	367,506

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 11.8% of the total loan portfolio as at end of 2016 (2015: 12.4%). 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 2016 amounted to €5,304,000 (2015: €5,385,000) 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.

Credit concentration risk by geographical region

The Bank also monitors credit concentration risk by geographical region. This concentration 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.

Notes to Financial Statements
For the year ended 31 December 2016

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

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 having an AAA to A-rating, based on Standard & Poor's (S&P) ratings. The debt securities held by the Bank are listed on the Malta Stock Exchange, a regulated market in Malta.

During 2015, the Bank disposed of securities issued by the Portuguese government. As outlined previously, through its daily operations, the Bank also transacts with various counterparty banks, with which the Bank places short-term funds and, until January 2016, the Bank entered into foreign exchange derivative transactions, subject to limits in place and subject to the respective institution's credit rating being within controlled parameters. 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 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 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
At 31 December 2016				
Loans and receivables				
Balances with the Central Bank of Malta	108,798	-	-	108,798
Loans and advances to banks	15,738	13,952	5	29,695
Available-for-sale financial assets	17,417	-	-	17,417
	141,953	13,952	5	155,910

	AAA to A-	BBB+ to BB	Unrated	Total
	€000	€000	€000	€000
At 31 December 2015				
Loans and receivables				
Balances with the Central Bank of Malta	78,372	-	-	78,372
Loans and advances to banks	20,405	29,775	5	50,185
Available-for-sale financial assets	2,830	-	-	2,830
	101,607	29,775	5	131,387

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. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

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 with 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.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

3.2.6 Information on credit quality of loans and advances to customers *(continued)*

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, 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:

	2016 €000	2015 €000
Manufacturing	**435**	382
Households and individuals	**6,570**	6,149
Construction	**132**	120
Wholesale and retail	**6,909**	6,357
Other	**2,170**	2,144
	16,216	15,152

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.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

3.2.6 Information on credit quality of loans and advances to customers *(continued)*

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.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

3.2.6 Information on credit quality of loans and advances to customers *(continued)*

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 2016.

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

	Forborne exposures 2016 €000	Forborne exposures 2015 €000
At 1 January	22,586	16,954
Loans to which forbearance measures have been extended during the year	1,610	9,366
Repayments	(2,162)	(1,227)
Retired from forborne	(2,839)	(2,507)
At 31 December	19,195	22,586

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

	2016 €000	2015 €000
Manufacturing	1,330	36
Financial services	2,941	2,990
Household and individuals	3,981	5,704
Construction	2,518	2,263
Wholesale and retail	5,090	6,051
Other sectors	3,335	5,542
	19,195	22,586

As at 31 December 2016 and 2015, 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.

Notes to Financial Statements
For the year ended 31 December 2016

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

3.2.6 Information on credit quality of loans and advances to customers *(continued)*

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

	Non-forborne exposures 2016 €000	Forborne exposures 2016 €000	Total 2016 €000	Non-forborne exposures 2015 €000	Forborne exposures 2015 €000	Total 2015 €000
Performing						
Neither past due nor impaired						
High grade	301,347	1,835	303,182	310,913	4,219	315,132
Standard	7,981	1,121	9,102	7,293	530	7,823
Substandard	379	20	399	1,459	801	2,260
	309,707	2,976	312,683	319,665	5,550	325,215
Past due loans by less than 90 days but not impaired						
Past due by less than 30 days	3,364	256	3,620	6,550	632	7,182
Past due by less than 60 days	1,738	838	2,576	2,430	-	2,430
Past due by less than 90 days	63	-	63	305	13	318
	5,165	1,094	6,259	9,285	645	9,930
Non-performing						
Past due loans by more than 90 days						
Specifically impaired, gross of specific impairment allowances	10,652	5,564	16,216	9,307	5,845	15,152
Past due by 90 days but not specifically impaired	4,363	6,474	10,837	4,440	4,612	9,052
	15,015	12,038	27,053	13,747	10,457	24,204
Other non-performing loans, but not specifically impaired	1,285	3,087	4,372	2,223	5,934	8,157
Gross loans and advances	331,172	19,195	350,367	344,920	22,586	367,506
Specific impairment allowances applied to specifically impaired exposures reflected above	(4,476)	(2,260)	(6,736)	(3,163)	(1,489)	(4,652)
Collective impairment allowances	(1,907)	(129)	(2,036)	(2,435)	(165)	(2,600)
Net loans and advances	324,789	16,806	341,595	339,322	20,932	360,254

Interest income recognised during the financial year ended 31 December 2016 in respect of forborne exposures amounted to €1,034,000 (2015: €1,317,000).

Notes to Financial Statements
For the year ended 31 December 2016

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

3.2.6 Information on credit quality of loans and advances to customers *(continued)*

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

Specific impairment allowance	Non-forborne €000	Forborne €000	Total €000
At 1 January 2015	2,943	640	3,583
Additions	1,902	1,138	3,040
Reversals	(1,682)	(289)	(1,971)
At 31 December 2015	3,163	1,489	4,652
At 1 January 2016	3,163	1,489	4,652
Additions	1,833	998	2,831
Reversals	(520)	(227)	(747)
At 31 December 2016	4,476	2,260	6,736

Collective impairment allowance	Non-forborne €000	Forborne €000	Total €000
At 1 January 2015	2,133	171	2,304
Additions	1,671	96	1,767
Reversals	(1,369)	(102)	(1,471)
At 31 December 2015	2,435	165	2,600
At 1 January 2016	2,435	165	2,600
Additions	901	51	952
Reversals	(1,429)	(87)	(1,516)
At 31 December 2016	1,907	129	2,036

Write-offs during the period under review were €45,000 (2015: €4,000).

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

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, and monitors the market value of collateral 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.

Term placements of €28.1 million at 31 December 2015 were attributable to reverse repurchase agreements with Banif S.A. which were secured by a pledge on sovereign debt securities. These securities had a market value of €35,125,000 as at 31 December 2015. The Bank could have sold or re-pledged such securities, but had an obligation to return the securities and the counterparty retained substantially all the risks and rewards of ownership. There were no reverse repurchase agreements outstanding as at 2016.

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.

Notes to Financial Statements
For the year ended 31 December 2016

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.2 *Credit risk* (continued)

3.2.7 Collateral *(continued)*

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 2016 €000	Forborne exposures 2016 €000	Non-forborne exposures 2015 €000	Forborne exposures 2015 €000
Performing				
Neither past due nor impaired				
Total maximum exposure	309,707	2,976	319,665	5,550
Extendible value of collateral:				
Secured by cash	(12,111)	(146)	(14,161)	(196)
Residential immovable property	(217,583)	(1,410)	(214,172)	(1,618)
Commercial immovable property	(36,407)	(1,116)	(46,926)	(2,156)
Other collateral	(768)	-	(117)	(1,055)
Total extendible value of collateral	(266,869)	(2,672)	(275,376)	(5,025)
Residual exposure	42,838	304	44,289	525
Past due by less than 90 days but not impaired				
Total maximum exposure	5,165	1,094	9,285	645
Extendible value of collateral:				
Secured by cash	(130)	(12)	(355)	(15)
Residential immovable property	(2,413)	(177)	(3,307)	-
Commercial immovable property	(1,443)	(843)	(1,222)	(508)
Other collateral	-	-	(6)	-
Total extendible value of collateral	(3,986)	(1,032)	(4,890)	(523)
Residual exposure	1,179	62	4,395	122
Non-performing				
Total maximum exposure	16,300	15,125	15,970	16,392
Extendible value of collateral:				
Secured by cash	(114)	(2)	(184)	(8)
Residential immovable property	(11,574)	(6,113)	(11,729)	(5,804)
Commercial immovable property	(1,364)	(7,228)	(1,340)	(8,599)
Total extendible value of collateral	(13,052)	(13,343)	(13,253)	(14,411)
Residual exposure	3,248	1,782	2,717	1,981

3. FINANCIAL RISK MANAGEMENT *(continued)*

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 control 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 government debt securities, for the purposes of mitigating exposures to fluctuations in interest rates. The Bank is accordingly in a position to manage the interest rate terms of its financial assets and simultaneously to effect changes to interest terms of liabilities reflecting the Bank's strategy together with market developments. The Bank's ALCO is primarily responsible for oversight over the Bank's interest rate risk management process and monitors actively the interest rate risk measures utilised by the Bank. Credit facilities and commitments to lend funds to customers are granted at prevailing market interest rates at drawdown date.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.3 Market risk (continued)

3.3.2 Interest rate risk *(continued)*

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

As at 31 December 2016	Carrying amount €000	Effective interest Rate %	Less than 3 months €000	Between 3 months and 1 year € 000	Between 1 year and 5 years €000	More than 5 years €000	Non-interest bearing €000
Financial assets							
Balances with Central Bank of Malta and cash	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	-	-	-
Total financial assets	502,237		479,816	11,301	2,695	3,688	4,737
Financial liabilities							
Amounts owed to banks	71	-	-	-	-	-	71
Amounts owed to customers	482,964	1.25%	278,904	89,392	114,668	-	-
Total financial liabilities	483,035		278,904	89,392	114,668	-	71
Interest repricing gap			200,912	(78,091)	(111,973)	3,688	5,007
Cumulative gap			200,912	122,821	10,848	14,536	

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.3 *Market risk* (continued)

3.3.2 Interest rate risk *(continued)*

As at 31 December 2015	Carrying amount €000	Effective interest Rate %	Less than 3 months €000	Between 3 months and 1 year € 000	Between 1 year and 5 years €000	More than 5 years €000	Non-interest bearing €000
Financial assets							
Balances with Central Bank of Malta and cash	81,650	-0.03%	78,372	-	-	-	3,278
Financial investments available-for-sale	2,830	3.75%	-	-	-	2,830	-
Loans and advances to banks	50,185	0.01%	50,180	-	-	-	5
Loans and advances to customers	360,254	4.82%	359,993	261	-	-	-
Total financial assets	494,919		488,545	261	-	2,830	3,283
Financial liabilities							
Amounts owed to banks	3,577	0.10%	3,577	-	-	-	-
Amounts owed to customers	474,294	1.67%	249,489	96,594	128,211	-	-
Debt securities in issue	5,000	10.25%	-	-	5,000	-	-
Total financial liabilities	482,871		253,066	96,594	133,211	-	-
Interest repricing gap			235,479	(96,333)	(133,211)	2,830	5,744
Cumulative gap			235,479	139,146	5,935	8,765	

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.3 *Market risk* (continued)

3.3.2 Interest rate risk *(continued)*

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.

	2016 Fixed €000	Variable €000	2015 Fixed €000	Variable €000
Interest-earning assets				
Financial investments available-for-sale	**17,417**	**-**	2,830	-
Balances with Central Bank of Malta	**-**	**108,798**	-	78,372
Loans and advances to banks	**6,649**	**23,041**	46,970	3,210
Loans and advances to customers	**2,519**	**339,076**	648	359,606
	26,585	**470,915**	50,448	441,188
Interest-bearing liabilities				
Amounts owed to banks	**-**	**-**	2,746	831
Amounts owed to customers	**244,070**	**238,894**	268,373	205,921
Debt securities in issue	**-**	**-**	5,000	-
	244,070	**238,894**	276,119	206,752

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, amounts owed to customers and to banks and debt securities in issue 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 and carrying amount of the investments, a sensitivity analysis disclosing how equity would have been affected by changes in interest rates that were reasonably possible at the end of the reporting period is not deemed necessary.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.3 *Market risk* (continued)

3.3.2 Interest rate risk *(continued)*

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 €1,508,000 (2015: €1,477,000). 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 €1,508,000 (2015: €1,477,000).

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 forward contracts.

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3. FINANCIAL RISK MANAGEMENT *(continued)*

3.3 *Market risk* (continued)

3.3.3 Currency risk *(continued)*

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
As at 31 December 2016					
Financial assets					
Balances with Central Bank of Malta and cash	113,530	113,410	48	58	14
Financial investments available-for-sale	17,417	17,417	-	-	-
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
Total financial assets	507,524	480,691	9,059	16,178	1,596
Financial liabilities					
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
Total financial liabilities	492,119	467,029	9,215	14,491	1,384
Net on balance sheet position			(156)	1,687	212

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.3 *Market risk* (continued)

3.3.3 Currency risk *(continued)*

	Total €000	EUR €000	GBP €000	USD €000	Other €000
As at 31 December 2015					
Financial assets					
Balances with Central Bank of Malta and cash	81,650	81,485	83	58	24
Financial investments available-for-sale	5,291	5,291	-	-	-
Loans and advances to banks	50,185	28,007	10,840	9,877	1,461
Loans and advances to customers	360,254	357,979	-	2,275	-
Other assets	7,038	5,303	2	1,683	50
Total financial assets	504,418	478,065	10,925	13,893	1,535
Financial liabilities					
Amounts owed to banks	3,577	2,090	-	1,486	1
Amounts owed to customers	474,294	439,558	9,946	23,307	1,483
Subordinated debt	5,000	5,000	-	-	-
Other liabilities	8,226	7,720	443	60	3
Total financial liabilities	491,097	454,368	10,389	24,853	1,487
Net on balance sheet position			536	(10,960)	48
Off-balance sheet net notional position			532	10,821	-
Net currency exposure			4	(139)	48

The notional amounts of the derivative contracts at the end of the reporting periods substantially match the carrying amount of the net foreign currency exposure. Accordingly, a sensitivity analysis for foreign exchange risk disclosing how profit or loss and equity would have been affected by changes in foreign exchange rates were reasonably possible at the end of the reporting periods would not reflect significant impacts (after hedging transactions).

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.3 *Market risk* (continued)

3.3.3 Currency risk *(continued)*

Under the scenario that the euro appreciates by 20% against all currencies the effect would be a loss of €1,000 (2015: a loss of €226,000) 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 €1,000 (2015: a gain of €226,000) 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 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 70.7% (2015: 76.0%) 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 2016 is 56.9% (2015: 54.2%), which is significantly higher than the prudential parameters set by the MFSA.

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

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.3 *Liquidity risk* (continued)

(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 2016 was 280.34% (2015: 313%)

As at 31 December 2016 and 2015 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 2016 was 182.08%. (2015: 171.7%)

As at 31 December 2016 and 2015 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.

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.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.4 *Liquidity risk* (continued)

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

At 31 December 2016	Total €000	Within 3 months €000	Less than 1 year €000	Over 1 but less than 5 years €000	Over 5 years €000	No maturity date €000
Financial assets						
Balances with Central Bank of Malta and cash	113,530	113,530	-	-	-	-
Financial investments 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
Total financial assets	507,865	176,777	25,408	34,661	266,986	4,033
Financial liabilities						
Amounts owed to banks	71	71	-	-	-	-
Amounts owed to customers	482,964	279,373	88,943	114,648	-	-
Other liabilities	9,084	-	-	-	-	9,084
Total financial liabilities	492,119	279,444	88,943	114,648	-	9,084
Maturity gap		(102,667)	(63,535)	(79,987)	266,986	
Cumulative gap		(102,667)	(166,202)	(246,189)	(20,797)	

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.4 *Liquidity risk* (continued)

At 31 December 2015	Total €000	Within 3 months €000	Less than 1 year €000	Over 1 but less than 5 years €000	Over 5 years €000	No maturity date €000
Financial assets						
Balance with Central Bank of Malta and cash	81,650	-	-	-	-	81,650
Financial investments available-for-sale	5,291	-	-	-	2,830	2,461
Loans and advances to banks	50,185	50,185	-	-	-	-
Loans and advances to customers	360,254	43,541	9,602	43,565	263,546	-
Other assets	7,038	1,704	-	-	-	5,334
Total financial assets	504,418	177,080	9,602	43,565	266,376	7,795
Financial liabilities						
Amounts owed to banks	3,577	3,577	-	-	-	-
Amounts owed to customers	474,294	250,259	95,824	128,211	-	-
Debt securities in issue	5,000	-	-	5,000	-	-
Other liabilities	8,226	169	-	-	-	8,057
Total financial liabilities	491,097	254,005	95,824	133,211	-	8,057
Maturity gap		(76,925)	(86,222)	(89,646)	266,376	
Cumulative gap		(76,925)	(163,147)	(252,793)	13,583	

A balance with the Central Bank of Malta of €1,404,000, which at 31 December 2015 was pledged in favour of the Depositor Compensation Scheme in compliance with the Depositor Compensation Scheme Regulations, was released and is no longer pledged for Depositor Compensation Scheme's purposes. An amount of €4,515,000 (2015: €2,830,000) comprising financial investments available-for-sale have been pledged in favour of the said Depositor Compensation Scheme.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.4 *Liquidity risk* (continued)

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

	Total €000	Within 3 months €000	Less than 1 year €000	Over 1 but less than 5 years €000	Over 5 years €000
At 31 December 2016					
Financial liabilities					
Amounts owed to banks	71	71	-	-	-
Amounts owed to customers	482,964	279,373	88,943	114,648	-
Total financial liabilities	483,035	279,444	88,943	114,648	-
At 31 December 2015					
Financial liabilities					
Amounts owed to banks	3,577	3,577	-	-	-
Amounts owed to customers	474,294	250,259	95,824	128,211	-
Total financial liabilities	477,871	253,836	95,824	128,211	-

The Bank's currency derivatives are all settled on a gross basis. The following table analyses the Bank's derivative financial instruments into relevant maturity groupings based on the remaining period at the end of the reporting period to the contractual maturity date. The Bank does not have outstanding derivative contracts at 31 December 2016.

Contracted undiscounted cash flows

At 31 December 2015				
Inflows	14,842	13,877	965	-
Outflows	(15,266)	(14,318)	(948)	-
	(424)	(441)	17	-

As from 2015, the Bank reinforced the control of liquidity risk by conducting, for the first time an Internal Liquidity Adequacy Assessment Process (ILAAP) in line with the authoritative methodology. 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, 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.

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, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through its control framework and by monitoring and responding to potential risks, such risks may be prudently managed and mitigated. Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.5 *Operational risk* (continued)

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 must be appointed by each respective Unit within the Bank. The Risk Management Unit within the Internal Control Department 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 Management 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 Management 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 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 presently applies the Basic Indicator Approach ('BIA') under the CRR in order to arrive at the 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 €1,994,000 (2015: €1,840,000).

In the 2016 Internal Capital Adequacy Assessment Process ('ICAAP'), the actual level of operational risk materialisation recorded on the Bank's database was compared to the regulatory and economic capital quantification under the above mentioned 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 a lower level of operational risk than calculated under the BIA (Pillar 1); however the latter figure was retained by way of capital allocation taking a prudent and conservative approach and in full compliance with applicable regulation.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.5 *Operational risk* (continued)

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.

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 Regulations ('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 I and the additional requirement identified under Pillar II represents the total capital actually required under the CRR.

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.6 *Capital risk management* (continued)

The following is an analysis of the Bank's capital base in accordance with the CRR's requirements applicable at 31 December 2016:

	2016 €000	2015 €000
Common Equity Tier 1 (CET1) capital		
Share capital	24,544	32,500
Retained earnings	(100)	(10,008)
Reserve for general banking risks	992	844
Revaluation reserve	352	2,026
Adjustments:		
Depositor Compensation Scheme Reserve	(4,079)	(3,783)
Intangible assets	(1,298)	(820)
Removal of Unrealised gains to Tier 2	(141)	(1,216)
Deferred tax assets	(1,570)	(698)
	18,700	18,845
Additional Tier 1 Perpetual Capital Notes	5,000	-
Tier 2 capital		
Subordinated loan capital	-	1,667
Transitional adjustments	946	1,103
Revaluation reserve (unrealised gains)	141	1,216
	1,087	3,986
Total own funds	24,787	22,831

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.6 *Capital risk management* (continued)

The tables below summarise the regulatory capital requirements and ratios of the Bank as at the end of the reporting periods.

As at 31 December 2016	Carrying amount €000	Weighted amount €000	Capital requirement €000
On-balance sheet assets			
Balances with Central Bank of Malta and cash	113,530	-	-
Cheques in course of collection	1,894	379	30
Financial investments available-for sale	17,758	341	27
Loans and advances to banks	29,695	5,938	475
Loans and advances to customers	341,595	174,728	13,978
Property, plant and equipment	7,270	7,270	582
Intangible assets	1,298	-	-
Deferred tax asset	4,010	5,067	405
Prepayments and accrued income	1,595	1,595	128
Others assets	4,262	4,022	322
	522,907	199,340	15,947
Off-balance sheet instruments			
Contingent liabilities and commitments	71,447	6,108	489
Credit risk	594,354	205,448	16,436
Foreign exchange risk		578	46
Operational risk		24,930	1,994
		230,956	18,476
Own funds			
Common Equity Tier 1 ('CET1') capital			18,700
Additional Tier 1 Capital – Perpetual Capital Notes			5,000
Tier 2 Capital			1,087
Total own funds			24,787
Total capital ratio			10.7%

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.6 *Capital risk management* (continued)

As at 31 December 2015	Carrying amount €000	Weighted amount €000	Capital requirement €000
On-balance sheet assets			
Balances with Central Bank of Malta and cash	81,650	-	-
Cheques in course of collection	737	147	12
Financial investments available-for sale	5,291	2,461	197
Loans and advances to banks	50,185	564	45
Loans and advances to customers	360,254	194,230	15,538
Property, plant and equipment	7,740	7,740	619
Intangible assets	820	-	-
Deferred tax asset	3,003	2,998	240
Derivative financial instruments	23	18	1
Prepayments and accrued income	1,704	1,704	136
Other assets	5,500	5,492	439
	516,907	215,354	17,227
Off-balance sheet instruments			
Contingent liabilities and commitments	71,368	6,108	1,179
Credit risk	588,275	221,462	18,406
Foreign exchange risk		21	2
Operational risk		22,995	1,840
		244,478	20,248
Own funds			
Common Equity Tier 1 ('CET1') capital			18,845
Tier 2 Capital			3,986
Total own funds			22,831
Total capital ratio			9.3%

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For the year ended 31 December 2016

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.6 *Capital risk management* (continued)

The Bank aims to, over the near and medium terms, avoid a situation of regulatory marginality inter alia by consolidating its capital adequacy ratios position with a reasonable cushion in excess of the regulatory floors and also, enhance profitability and return on capital employed.

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 Feisal International for Investment Malta Limited, a subsisdiary of Al Feisal for Investment Company Q.P.S.C. headquartered in Qatar.

On the same date as explained in Note 17, the Bank issued floating rate Perpetual Additional Tier 1 Capital Notes amounting to an aggregate amount of €5,000,000 to Al Feisal 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.

The Bank's subordinated unsecured debt securities amounting to €5 million held by Oitante S.A., which were outstanding at 31 December 2015, have been repaid at par on 4 October 2016.

As explained in Note 1 - Basis of Preparation, 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, increased the issued share capital by €15 million, following a capital injection by the new controlling shareholder.

The table below illustrates the Proforma Statement of Financial Position of the Bank in a hypothetical scenario where the increase in the issued share capital by €15 million occurred and had an effective date of 31 December 2016, rather than January 2017.

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For the year ended 31 December 2016

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.6 *Capital risk management* (continued)

In this scenario, as illustrated in the Proforma Statement of Financial Position, the Bank's total equity amount to €45.788 million as compared to the equity reflected in the audited Statement of Financial Position, amounting to €30.788 million.

	Proforma 2016 (unaudited) €000	Audited 2016 €000
ASSETS		
Balances with Central Bank of Malta and cash	113,530	113,530
Cheques in course of collection	1,894	1,894
Financial investments classified as available-for-sale	17,758	17,758
Loans and advances to banks	29,695	29,695
Funds made available by the principal shareholder	15,000	-
Loans and advances to customers	341,595	341,595
Property and equipment	7,270	7,270
Intangible assets	1,298	1,298
Deferred tax assets	4,010	4,010
Derivative financial instruments	-	-
Prepayments and accrued income	1,595	1,595
Other assets	4,262	4,262
TOTAL ASSETS	537,907	522,907
EQUITY		
Share capital	39,544	24,544
Perpetual capital notes	5,000	5,000
Revaluation reserve	352	352
Reserve for General Banking Risks	992	992
Accumulated losses	(100)	(100)
TOTAL EQUITY	45,788	30,788
LIABILITIES		
Amounts owed to banks	71	71
Amounts owed to customers	482,964	482,964
Other liabilities	5,220	5,220
Accruals and deferred income	3,864	3,864
TOTAL LIABILITIES	492,119	492,119
TOTAL EQUITY AND LIABILITIES	537,907	522,907
Memorandum items		
Contingent liabilities	8,331	8,331
Commitments	63,248	63,248

Notes to Financial Statements
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3. FINANCIAL RISK MANAGEMENT *(continued)*

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 available-for-sale and derivative financial instruments (Notes 7 and 13). The Bank is required to disclose fair value measurements by level of the following fair value measurement hierarchy for financial instruments that are measured in the statement of financial position at fair value:

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

The IFRS 13 hierarchy of valuation techniques is based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions.

The following tables reflect an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

At 31 December 2016	**Level 1 €000**	**Level 3 €000**	**Total €000**
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

At 31 December 2015	**Level 1 €000**	**Level 2 €000**	**Total €000**
Financial assets			
Held for trading instruments			
Derivative financial instruments	-	23	23
	-	23	23
Financial investments available-for-sale			
Government debt, fixed income instruments	2,830	-	2,830
Other equities	-	2,461	2,461
	2,830	2,461	5,291
Total financial assets	2,830	2,484	5,314
Financial liabilities			
Held for trading instruments			
Derivative financial instruments	-	448	448
Total financial liabilities	-	448	448

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

3. FINANCIAL RISK MANAGEMENT *(continued)*

3.7 Fair values of financial assets and liabilities (continued)

3.7.1 Financial instruments measured at fair value ***(continued)***

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, composed of government debt issued by the Government of Malta, which is listed on the Malta Stock Exchange.

Financial instruments in Level 2

Fair values for the Bank's derivative contracts are 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 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 date 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 shares.

Financial instruments not measured at fair value

Loans and advances to banks and customers and amounts owed to banks and customers are carried at amortised cost in the statement of financial position. The Board considers the carrying amounts of loans and advances to banks and customers to be a reasonable estimate of their fair value principally in view of the relatively short periods to repricing or maturity from the end of the reporting periods. The fair values of fixed interest deposits and amounts owed to banks are not deemed to be significantly different from their carrying amounts, based on discounted cash flows at current market interest rates, particularly due to the relatively short periods to maturity.

4. ACCOUNTING ESTIMATES AND JUDGEMENTS

4.1 *Critical accounting estimates and judgements in applying the Bank's accounting policies*

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

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

4.2 *Impairment losses on loans and advances*

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 2.8, 9 and 31).

5. SEGMENTAL INFROMATION

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.

5. SEGMENTAL INFROMATION *(continued)*

The following tables present income, profit and certain asset and liability information regarding the Bank's business segments for the years ended 31 December 2016 and 2015:

	2016			
	Retail banking	Corporate banking	Other	Total
	€000	€000	€000	€000
Net operating income				
Net interest income	7,462	5,536	(3,372)	9,626
Net fees and commission income	802	1,058	19	1,879
Net trading income	-	-	740	740
Gain on disposal of available-for-sale financial investments	-	-	3,105	3,105
Total operating income	8,264	6,594	492	15,350
Net impairment losses	221	(2,078)	-	(1,857)
Net operating income	8,485	4,516	492	13,493
Employee compensation and benefits	(1,828)	(500)	(3,314)	(5,642)
Other administrative expenses	(1,539)	(1,080)	(2,107)	(4,726)
Depreciation of property and equipment and amortisation of intangible assets	(392)	(22)	(481)	(895)
Profit before tax				2,230
Income tax expense				(130)
Profit for the year				2,100
Assets and liabilities				
Segment assets	238,951	117,480	158,755	515,186
Unallocated assets				7,721
Total assets				522,907
Segment liabilities	142,111	96,784	8,297	247,192
Unallocated liabilities				244,927
Total liabilities				492,119

5. SEGMENTAL INFROMATION *(continued)*

	2015 Retail banking €000	Corporate banking €000	Other €000	Total €000
Net operating income				
Net interest income	4,669	7,306	(1,688)	10,287
Net fees and commission income	1,070	1,163	(37)	2,196
Net trading income	-	-	1,363	1,363
Total operating income	5,739	8,469	(362)	13,846
Net impairment losses	(428)	(941)	-	(1,369)
Net operating income	5,311	7,528	(362)	12,477
Employee compensation and benefits	(1,867)	(454)	(3,074)	(5,395)
Other administrative expenses	(1,514)	(1,147)	(2,060)	(4,721)
Depreciation of property and equipment and amortisation of intangible assets	(378)	(21)	(475)	(874)
Profit before tax	1,552	5,906	(5,971)	1,487
Income tax expense				(640)
Profit for the year				847
Assets and liabilities				
Segment assets	265,453	108,821	74,270	448,544
Unallocated assets				68,363
Total assets				516,907
Segment liabilities	113,114	84,911	16,921	214,946
Unallocated liabilities				276,599
Total liabilities				491,545

6. BALANCES WITH CENTRAL BANK OF MALTA AND CASH

	2016 €000	2015 €000
Current		
Balances with Central Bank of Malta	108,798	78,372
Cash	4,732	3,278
	113,530	81,650

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 €3,028,000 (2015: €3,394,000).

The balance of €1,404,000 which at 31 December 2015 was pledged in favour of the Depositor Compensation Scheme in compliance with the Depositor Compensation Scheme Regulations was released during the current financial year.

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7. FINANCIAL INVESTMENTS CLASSIFIED AS AVAILABLE-FOR-SALE

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

	2016 €000	2015 €000
Equities	341	2,461
Government debt securities		
Local and listed on the Malta Stock Exchange	17,417	2,830
At 31 December	17,758	5,291

	2016 €000	2015 €000
Non-current		
Debt and other fixed income instruments	17,417	2,830

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

	2016 €000	2015 €000
At 1 January	5,291	2,254
Acquisitions	20,304	409
Redemptions/maturities	(4,000)	-
Disposals	(922)	-
Amortisation	(340)	-
Fair value movements	(2,575)	2,628
At 31 December	17,758	5,291

Government debt securities of €4,515,000 (2015: €2,830,000) 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 are 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 closing of the transaction.

7. FINANCIAL INVESTMENTS CLASSIFIED AS AVAILABLE-FOR-SALE *(continued)*

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 €482,025 (with the latter element recognised within other assets), reflecting the fair value upon completion and unchanged as at 31 December 2016.

As at 31 December 2016, 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.

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

	2016 €000	2015 €000
Current		
Repayable on call and at short notice	23,046	3,215
Term placements	6,649	46,970
	29,695	50,185

Term placements of €28.1 million at 31 December 2015 were attributable to reverse repurchase agreements with Banif which were secured by a pledge on sovereign debt securities. These securities had a market value of €35,125,000 as at 31 December 2015. The Bank may sell or re-pledge such securities, but has an obligation to return the securities and the counterparty retains substantially all the risks and rewards of ownership. There were no reverse repurchase agreements outstanding as at 31 December 2016.

9. LOANS AND ADVANCES TO CUSTOMERS

	2016 €000	2015 €000
Repayable on call and at short notice	50,241	66,013
Term loans and advances	300,126	301,493
Gross loans and advances to customers	350,367	367,506
Less allowances for impairment losses	(8,772)	(7,252)
Net loans and advances to customers	341,595	360,254
Impairment allowances		
Specific impairment allowances	6,736	4,652
Collective impairment allowances	2,036	2,600
	8,772	7,252
Current	72,229	84,960
Non-current	278,138	282,546
Gross loans and advances to customers	350,367	367,506

The aggregate gross amount of impaired loans and advances to customers as at 31 December 2016 amounted to €16,216,000 (2015: €15,152,000). Specific impairment allowances at the end of the reporting period include €479,000 (2015: €464,000), reflected in the table above, in respect of interest in suspense.

10. PROPERTY AND EQUIPMENT

	Land and buildings €000	Computer equipment €000	Other equipment €000	Total €000
At 1 January 2015				
Cost	8,452	1,614	1,359	11,425
Accumulated depreciation	(1,406)	(1,142)	(815)	(3,363)
Net book amount	7,046	472	544	8,062
Year ended 31 December 2015				
At 1 January 2015	7,046	472	544	8,062
Acquisitions	75	140	79	294
Disposals	(37)	-	(10)	(47)
Depreciation charge for the year	(281)	(73)	(215)	(569)
At 31 December 2015	6,803	539	398	7,740
At 31 December 2015				
Cost	8,490	1,754	1,428	11,672
Accumulated depreciation	(1,687)	(1,215)	(1,030)	(3,932)
Net book amount	6,803	539	398	7,740
Year ended 31 December 2016				
At 1 January 2016	6,803	539	398	7,740
Acquisitions	4	82	27	113
Disposals	(8)	-	-	(8)
Depreciation charge for the year	(287)	(65)	(223)	(575)
At 31 December 2016	**6,512**	**556**	**202**	**7,270**
At 31 December 2016				
Cost	8,486	1,836	1,455	11,777
Accumulated depreciation	(1,974)	(1,280)	(1,253)	(4,507)
Net book amount	**6,512**	**556**	**202**	**7,270**

Future capital expenditure which was authorised by the Board, but has to date not yet been contracted for, amounted to €132,000 (2015: €1,410,000). Additionally, at 31 December 2015, an amount of €17,000 had been contracted for but not provided for in the financial statements (Note 24). Property and equipment includes assets amounting to €58,000 (2015: €152,000) which are still not put to use at year end.

11. INTANGIBLE ASSETS

	Computer software & royalties €000	Other intangibles €000	Total €000
At 1 January 2015			
Cost	2,243	146	2,389
Accumulated depreciation	(1,318)	-	(1,318)
Net book amount	925	146	1,071
Year ended 31 December 2015			
At 1 January 2015	925	146	1,071
Acquisitions	66	-	66
Disposals	(12)	-	(12)
Amortisation for the year	(305)	-	(305)
At 31 December 2015	674	146	820
At 31 December 2015			
Cost	2,297	146	2,443
Accumulated amortisation	(1,623)	-	(1,623)
Net book amount	674	146	820
Year ended 31 December 2016			
At 1 January 2016	674	146	820
Acquisitions	805	-	805
Disposals	(7)	-	(7)
Amortisation for the year	(320)	-	(320)
At 31 December 2016	**1,152**	**146**	**1,298**
At 31 December 2016			
Cost	3,095	146	3,241
Accumulated amortisation	(1,943)	-	(1,943)
Net book amount	**1,152**	**146**	**1,298**

At 31 December 2016, computer software included assets amounting to €386,000 (2015: Nil) which were still not put to use at year end.

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12. DEFERRED TAX ASSETS

Deferred tax assets and liabilities are attributable to the following:

	Assets 2016 €000	Liabilities 2016 €000	Net 2016 €000	Assets 2015 €000	Liabilities 2015 €000	Net 2015 €000
Differences between depreciation and capital allowances	-	(275)	(275)	-	(186)	(186)
Loan impairment allowances	3,472	-	3,472	2,538	-	2,538
Fair value movements on investments	-	(184)	(184)	-	(1,085)	(1,085)
Unused tax losses	997	-	997	1,736	-	1,736
	4,469	(459)	4,010	4,274	(1,271)	3,003

Movement in temporary differences related to:

	At 1 January 2015	Recognised in profit or loss €000	Recognised in other comprehensive income €000	At 31 December 2015 €000	Recognised in profit or loss €000	Recognised in other comprehensive Income €000	At 31 December 2016 €000
Differences between depreciation and capital allowances	(209)	23	-	(186)	(89)	-	(275)
Loan impairment allowances	2,060	478	-	2,538	934	-	3,472
Fair value movements on investments	(166)	-	(919)	(1,085)	-	901	(184)
Unused tax losses	2,876	(1,140)	-	1,736	(739)	-	997
	4,561	(639)	(919)	3,003	106	901	4,010

The recognised deferred tax assets and liabilities are expected to be recovered or settled principally after more than twelve months from the end of the reporting period. The deferred tax liabilities reflected in other comprehensive income relate to the 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.

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13. DERIVATIVE FINANCIAL INSTRUMENTS

During the year end 31 Decmber 2015, the Bank entered into a number of forward foreign exchange contracts with clients and an equivalent number of back-to-back arrangements with Banif S.A.

The forward contracts entered into are contractual agreements to buy or sell a currency at a specified rate and date in the future. On the other hand, under the cross-currency swaps entered into, the Bank carries out a spot transaction exchanging a specified amount in one currency with a specific amount in another currency and agrees to re-exchange at a specified rate and date in the future. During 2016 the existing contracts expired with no outstanding contracts at 31 December 2016.

The table below shows the fair values of derivative financial instruments held by the Bank at 31 December 2015.

	Assets 2015 €000	Liabilities 2015 €000
Current		
Derivatives held for trading		
Forward foreign exchange	23	-
Cross-currency swaps	-	448
	23 -	448

The derivative financial instruments at 31 December 2015 principally related to the forward purchase of US$13,660,000 against euro maturing within one year from the end of the reporting period at an average contractual rate of 1.05812, and the forward purchase of £658,000 against euro maturing within one year from the end of the reporting period at the average contractual rates of 0.705035.

14. PREPAYMENTS AND ACCRUED INCOME

	2016 €000	2015 €000
Current		
Prepayments	692	585
Accrued income	903	1,119
	1,595	1,704

15. OTHER ASSETS

	2016 €000	2015 €000
Other financial assets	3,039	4,881
Other assets	1,223	619
	4,262	5,500
Current	3,692	5,334
Non-current	570	166
	4,262	5,500

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

16. SHARE CAPITAL

	2016 No. of shares	2016 €	2015 No. of shares	2015 €
Authorised				
Ordinary shares of €1 each	-	-	50,000,000	50,000,000
Ordinary shares of €0.7552 each	92,690,678	70,000,000	-	-
Issued and fully paid up				
Ordinary shares of €1 each	-	-	32,500,000	32,500,000
Ordinary shares of €0.7552 each	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 of 9 December 2016, the Board resolved to offset €7,956,000 of its 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 €24,584,000 (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.

On 20 January 2017, the board increased its issued share capital by €15,000,000 divided into 19,862,289 Ordinary 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 Ordinary Shares of a nominal value of €0.7552 each).

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

17. PERPETUAL CAPITAL NOTES

On 4 October 2016, the Bank issued floating rate Perpetual Additional Tier 1 Capital Notes amounting to an aggregate amount of €5,000,000 to Al Feisal 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.

The Bank's subordinated unsecured debt securities amounting to €5 million held by Oitante S.A., which were outstanding at 31 December 2015, have been repaid at par on 4 October 2016.

18. RESERVES

A. Accumulated losses

Accumulated losses represent 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.

Accumulated losses include an amount of €4,079,000 (2015: €3,783,000) 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 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 the year ended 2016 the methodology for calculating this reserve was updated in line with the requirements BR/09/2016 issued by the Malta Financial Services Authority.

19. AMOUNTS OWED TO BANKS

	2016 €000	2015 €000
Current		
Term loans and advances	-	2,745
Repayable on demand	71	832
	71	3,577
Amounts include:		
Due to banks	-	2,745
Other	71	832
	71	3,577

20. AMOUNTS OWED TO CUSTOMERS

	2016 €000	2015 €000
Term deposits	244,069	268,373
Repayable on demand	238,895	205,921
	482,964	474,294
Current	368,296	346,083
Non-current	114,668	128,211
	482,964	474,294

Included in 'Amounts owed to customers' are deposits of €29,391,000 (2015: €31,000,000) held as collateral for loan commitments and irrevocable commitments under guarantees and import letters of credit.

21. DEBT SECURITIES IN ISSUE

	2016 €000	2015 €000
10% subordinated unsecured debt	-	5,000

The Bank's subordinated unsecured and unlisted debt securities bearing interest at 10% per annum and amounting to €5 million held by Oitante S.A. and which were outstanding at 31 December 2015, have been repaid at par on 4 October 2016.

22. OTHER LIABILITIES

	2016 €000	2015 €000
Bills payable	2,695	2,170
Accounts payable and sundry creditors	1,350	890
Obligations under guarantees and other documentary credits	1,175	892
	5,220	3,952

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

	2016 €000	2015 €000
At 1 January	892	1,086
Arising during the year	2,677	2,456
Utilised	(292)	(36)
Unused amounts reversed	(2,102)	(2,614)
	1,175	892

23. ACCRUALS AND DEFERRED INCOME

	2016 €000	2015 €000
Accrued interest	2,797	3,375
Accrued operating expenditure	843	662
Accrued capital expenditure	224	237
	3,864	4,274

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

24. CONTINGENT LIABILITIES AND COMMITMENTS

As part of its business activities, the Bank enters into various irrevocable commitments and contingent liabilities. Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods.

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed expiry dates, or other termination clauses. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements. The potential credit loss is less than the total unused commitments since most commitments to extend credit are contingent upon customers meeting specific conditions. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments. Even though these obligations are not recognised on the Statement of Financial Position, they do contain credit risk and are therefore part of the overall risk of the Bank.

The total outstanding commitments and contingent liabilities are as follows:

	2016 €000	2015 €000
Contingent liabilities		
Guarantees	8,153	10,357
Documentary credits	178	485
	8,331	10,842
Commitments		
Undrawn commitments to lend	63,116	60,526
Capital commitments (note 10)		
Authorised but not contracted for	132	1,410
Contracted for	-	17
	132	1,427
Total commitments	63,248	61,953

24. CONTINGENT LIABILITIES AND COMMITMENTS (*continued*)

- *Operating lease commitments – Bank as lessee*

During 2016, the Bank did not enter into any new contracts of commercial lease for immovable property.

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

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

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

	2016 €000	2015 €000
Within one year	238	329
After one year but not more than five years	-	171
	238	500

- *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 standing. At year end, there were no significant unresolved legal claims.

25. INTEREST RECEIVABLE AND SIMILAR INCOME

	2016 €000	2015 €000
On loans and advances to banks	30	1,669
On loans and advances to customers	16,210	18,021
On balances with Central Bank of Malta	(314)	3
	15,926	19,693
On debt and other fixed income instruments	450	97
Net amortisation of discounts and premiums	(347)	(4)
	103	93
Total interest and similar income	16,029	19,786

The income earned from loans and advances to banks during the financial year ended 31 December 2015 was almost entirely made up of interest earned on balances and placements held with banks which until 19 December 2015 formed part of Banif Group.

Interest income on loans and advances to customers includes income generated from impaired financial assets which amounted to €2,135,000 (2015: €2,202,000).

26. INTEREST PAYABLE AND SIMILAR EXPENSE

	2016 €000	2015 €000
On amounts owed to banks	7	25
On amounts owed to customers	5,888	8,967
On debt securities in issue	381	507
On perpetual capital notes	127	-
	6,403	9,499

27. NET FEES AND COMMISION INCOME

	2016 €000	2015 €000
Fees and commission income		
Credit related fees and commissions	696	823
Other fees	1,913	2,063
	2,609	2,886
Fees and commission expense		
Other fees	(730)	(690)
Net fees and commission income	1,879	2,196

28. NET TRADING INCOME

	2016 €000	2015 €000
Debt securities		
Net interest income	-	245
Realised gains on sale	-	473
	-	718
Foreign exchange activities		
From derivatives	425	(483)
From commercial business activities	315	1,128
	740	645
Net trading income	740	1,363

29. EMPLOYEE COMPENSATION AND BENEFITS

	2016 €000	2015 €000
Directors' remuneration	481	370
Wages and salaries		
Executive officers and senior managerial	354	323
Other managerial, supervisory and clerical	4,426	4,341
Others	39	34
Social security costs		
Executive officers and senior managerial	11	7
Other managerial, supervisory and clerical	328	317
Others	3	3
	5,161	5,025
Total employee compensation and benefits	5,642	5,395

The total fees payable to non-executive directors amounted to €137,400 (2015: €78,466)

The average number of persons employed by the Bank during the years 2016 and 2015 was as follows:

	2016	2015
Executive officers and senior managerial	6	5
Other managerial, supervisory and clerical	153	151
Others	2	2
	161	158

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30. OTHER ADMINISTRATIVE EXPENSES

	2016 €000	2015 €000
Auditors' remuneration	50	45
Information system and communications	1,203	982
Business development	421	623
Corporate services	1,285	1,251
Regulatory expenses	556	344
Other	1,211	1,476
	4,726	4,721

Other remuneration payable to the auditors include assurance related services of €20,000 (2015: €101,000), payable to the Bank's auditors. Non-audit services provided during 2015 amounted to €12,600 (2015: €1,000).

Corporate services include operating lease payments amounting to €339,000 (2015: €313,000).

In total, from incorporation up to 31 December 2016, the Bank has contributed €1,396,000 in variable contributions to the Depositor Compensation Scheme. This represents 0.4% (2015: 0.2%) of the eligible deposits at end of December 2016. The cash contribution paid during 2016 amounted to €451,000 and is included under Regulatory expenses.

31. NET IMPAIRMENT LOSSES

	2016 €000	2015 €000
Write-downs		
Loans and advances to customers		
- specific allowances	2,939	2,827
- collective allowances	1,221	1,879
- bad debts written off	45	4
	4,205	4,710
Reversals of write-downs		
Loans and advances to customers		
- specific allowances	(854)	(1,758)
- collective allowances	(1,494)	(1,583)
	(2,348)	(3,341)
Net impairment losses	1,857	1,369

32. INCOME TAX EXPENSE

The components of income tax for the years ended 31 December 2016 and 2015 are:

	2016 €000	2015 €000
Income statement:		
Current income tax	(236)	(1)
Deferred income tax	106	(639)
	(130)	(640)

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

	2016 €000	2015 €000
Profit before tax	2,230	1,487
Tax at the applicable rate of 35%	781	520
Tax effect of:		
Non-deductible expenses	191	73
Other differences	11	47
Income not subject to tax	(853)	-
	130	640

33. EARNINGS PER SHARE

Earnings per share is calculated by dividing net profit attributable to the shareholders of the Bank as shown in the income statement divided by the weighted average number of Ordinary Shares outstanding during the year.

	2016	2015
Net profit attributable to shareholders (€000)	2,100	847
Weighted average number of ordinary shares in issue	32,500,000	32,500,000
Earnings per share (€ cents)	6c5	2c6

34. CASH AND CASH EQUIVALENTS

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

	2016 €000	2015 €000
Cash (Note 6)	4,732	3,278
Balances with Central Bank of Malta (excluding reserve deposit and Depositor Compensation Scheme pledged)	105,770	73,574
Loans and advances to banks (Note 8)	29,695	50,185
Amounts owed to banks (Note 19)	(71)	(3,577)
Cash and cash equivalents	140,126	123,460
Adjustment to reflect balances with contractual maturity of more than three months	3,028	4,798
	143,154	128,258
As per statement of financial position:		
Balances with Central Bank of Malta and cash	113,530	81,650
Loans and advances to banks	29,695	50,185
Amounts owed to banks	(71)	(3,577)
	143,154	128,258
Balances with contractual maturity of more than 3 months	(3,028)	(4,798)
Cash and cash equivalents	140,126	123,460

35. RELATED PARTIES

35.1 Identification of related parties

On 20 December 2015, the Bank's majority shareholder, Banif – Banco Internacional do Funchal, S.A., (Banif 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 are duly effective in accordance with the legislation of that Member State throughout the European Union without future formalities.

As part of this regulatory re-structuring process, shares previously held by Banif S.A. were taken over by Oitante S.A., effectively becoming the parent company of the Bank between 20 December 2015 and 4 October 2016. The Bank did not transact with Oitante S.A. during this period.

On 4 October 2016, it was announced that following the conclusion of regulatory approval, the Bank's majority shareholding was purchased by Al Feisal International for Investment Limited, a subsidiary of Al Feisal International for Investment Q.P.S.C. headquartered in Qatar.

35. RELATED PARTIES *(continued)*

35.1 Identification of related parties (continued)

Prior to the resolution measures described above, Banif S.A. was the immediate and ultimate controlling parent. Entities forming part of the Banif Group, the Bank's directors ('key management personnel') and with related parties, primarily entities controlled by key management personnel were considered to be related parties. The Bank's related party transactions mainly comprise transactions with the former parent company and other entities controlled by the parent. These transactions principally include placements with banks, derivative contracts and issuance of Bank debt securities. Although in 2015 interest income from these placements accounted for a significant percentage of the Bank's interest income, 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.

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

35.2 Transaction arrangements and agreements involving key management personnel

During the year under review, the following banking transactions were carried out with key management personnel, and auditor's controlled by others:

	2016 €000	2015 €000
Income statement		
Interest and similar income	216	-
Interest and similar expense	2	6

	2016 €000	2015 €000
Statement of financial position		
Loans and advances to customers	1,315	14
Amounts owed to customers	2,054	859
Accruals and deferred income	-	1

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.

35.3 Entities controlled by non-executive directors

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

	2016 €000	2015 €000
Income statement		
Interest and similar income	9	25
Interest and similar expense	-	4
Other administrative expenses	233	185

35. RELATED PARTIES *(continued)*

35.3 Entities controlled by non-executive directors (continued)

Year end balances arising principally from the transactions referred to previously, are disclosed:

	2016 €000	2015 €000
Statement of financial position		
Loans and advances to customers	47	532
Prepayments and accrued income	52	53
Amounts owed to customers	1,517	2,816
Accruals and deferred income	16	11

35.4 Etities ultimately controlled by former parent company, Banif – Banco Internacional do Funchal,S.A., (Banif S.A.)

	€000
Income statement for the period ended 19 December 2015	
Interest and similar income	102
Net fees and commissions	159

35.5 Compensation to key management personnel

Directors' remuneration and salaries to executive officers are separately disclosed in Note 29.

35.6 Transaction with other related parties

*35.6.1 **Parent company up until 19 December 2015 - Banif – Banco Internacional do Funchal, S.A., (Banif S.A.)***

	€000
Income statement for the period ended 19 December 2015	
Interest and similar income	1,669
Interest and similar expense	1,530
Net trading losses	(1,346)

35.6.2 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 during that period, Oitante S.A.

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

	€000
Statement of financial position as at 31 December 2016	
Loans and advances to parent company	3
Amounts owed to parent company	222

35. RELATED PARTIES *(continued)*

35.6 Transaction with other related parties (continued)

35.6.3 Parent company as from 4 October 2016 – Al Faisal International for Investment Limited (continued)

As explained in Note 17, on 4 October 2016 the Bank issued floating rate Perpetual Additional Tier 1 Capital Notes amounting to an aggregate of €5,000,000 to Al Feisal International for Investment Company Q.P.S.C.

Morevoer, transactions affecting the Bank's Share Capital are disclosed in Note 16.

36. STATUTORY INFORMATION

Banif Bank (Malta) p.l.c. is a limited liability company domiciled and resident in Malta.

The immediate parent company of Banif Bank (Malta) 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 Banif Bank (Malta) 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 Al Gharafa Premises, P.O. Box 22121, Doha, Qatar.

The ultimate controlling party of Banif Bank (Malta) p.l.c. is H.E, Sheikh Mohamed Feisal Q.F Al-Thani.

Additional Regulatory disclosures for the year ended 31 December 2016

Additional Regulatory Disclosures
For the year ended 31 December 2016

1. OVERVIEW

These Additional Regulatory Disclosures ('ARDs') are aimed at providing the Bank's stakeholders further insight to 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 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.

The Bank fully implements the Three Lines of Defence Principle whereby all internal entities/stakeholders are involved in the risk **Capital** management framework which is:

- First line: **"The Frontline"** – This involves the internal entities which own, and manage risk and control activities i.e. frontline operating units. Such is composed mainly of the Commercial Department, Operations and Systems Department and the Treasury Unit.
- 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 Management Unit, and the Legal and Compliance Unit and the specialised function tasked with objectively analysing credit requests and participating actively in Credit Committees, mainly the Credit Analysis Unit.
- 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 to the Internal Audit Unit.

The Internal Control Department (ICD) plays a pivotal role in the risk management framework. The Head, ICD is an independent first-level official and who 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 Management Unit, the Legal and Compliance Unit and the Credit Analysis Unit. The Bank's Internal Audit Unit responds directly to the Audit Committee.

2. RISK MANAGEMENT FRAMEWORK (*continued*)

As implied by its name, Risk Management 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.

The Bank is still in a relatively early stage of its organisational lifecycle and, for the time being, it was not deemed expedient to augment the risk function structure by branching out in additional formally-delineated internal entities. As such, at the present time, Risk Management Unit is hierarchically a unified internal entity within the Bank's macro structure and this ensures maximum flexibility in the deployment, allocation and focus of the risk-tasked headcount. Nevertheless, officials within the risk function do specialise in different risk fields in line with the Unit's main responsibilities as briefly listed hereunder:

- Credit risk: various risk metrics are defined and regularly updated. These include, inter alia, probability of default ('PD') values, stress testing exercises on the loan portfolio within the banking book. The institution, and regular updating of, risk-related models such as credit scoring systems for unsecured personal lending and home loans;

- Concentration risk: concentration is analysed from different dimensions which are single-name risk, sectoral risk, product concentration and collateral;

- Operational risk: 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 Unit is the owner of the Key Performance Indicators and Key Risk Indicator metrics used in the operational risk management toolkit;

- Solvency risk: Pillar II economic capital quantification through the regular updating of the Bank Internal Capital Adequacy Assessment Process ('ICAAP');

- Liquidity risk: regular updating of the Bank's Internal Liquidity Adequacy Assessment Process ('ILAAP');

- Interest rate risk: covered through ICAAP and ILAAP; and

- Residual risks: various other risks not mentioned separately above also fall within the Unit's remit. For instance reputational risk, customer complaints investigation, enterprise risk management, market risk oversight etc.

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 which are:

- the Global Risk Committee; and
- the Assets and Liabilities Committee.

During the year under review, the Bank further boosted its internal governance architecture through the formal separation of the remit of the existing Audit Committee from that of the newly formed Risk Committee.

2. RISK MANAGEMENT FRAMEWORK (*continued*)

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, 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 Unit and others. Any exceedance of the threshold must be authorised 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 Management Unit on the level of provisioning on the loan book should a downgrade in sectoral risk rating take place due to say, exogenous factors such as economic downturn in one or more macroeconomic sectors.

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 Management Unit, provides a simple guide as to how this is practised in the Bank; to this might be added other risks 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 Unit);

- risk aggregation: this involves reducing overall institutional risk through diversification. For instance, the Risk Management 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 of provisions and bad debts) should one or more sectors experience a downturn. Similarly, the Risk Management 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:

	2016	
	No. of shares	€000
Authorised		
Ordinary shares of €0.7552 each	92,690,678	70,000
Issued		
Ordinary shares of €0.7552 each	32,500,000	24,544

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.

3. CAPITAL MANAGEMENT (*continued*)

3.1 *Own funds* (continued)

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 form part of Own Funds only if those profits have been verified by the Bank's independent external auditor.

Retained earnings include an amount of €4,079,000 (2015: €3,783,000) pledged in favour of the Depositor Compensation Scheme as at 31 December 2016, that are 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 time 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 Banif 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 Feisal 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.

3. CAPITAL MANAGEMENT (*continued*)

3.1 *Own funds* (continued)

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.

	As at 31 December 2016 €000
Common Equity Tier 1 (CET1) capital	
Common Equity Tier 1 (CET1) capital: instruments and reserves	
Capital instruments and the related share premium accounts	24,544
Retained earnings	(4,180)
Funds for general banking risk	992
Revaluation reserve	212
CET1 capital before regulatory adjustments	21,568
Common Equity Tier 1 (CET1) capital: regulatory adjustments	
Intangible assets	(1,298)
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)	(1,570)
Total regulatory adjustments to CET1	(2,868)
CET1 capital	18,700
Additional Tier 1 capital	5,000
Tier 1 capital	23,700
Tier 2 capital	
Tier 2 capital before regulatory adjustments	
Capital instruments and subordinated loans	-
Transitional adjustments to Tier 2 capital	1,087
Tier 2 capital: regulatory adjustments	
Regulatory adjustments relating to unrealised gains pursuant to Article 481	-
Total Tier 2 capital	1,087
Total risk weighted assets	230,956
Capital ratios	
CET1 capital	8.1%
Tier 1 capital	10.3%
Total capital	10.7%

3. CAPITAL MANAGEMENT (*continued*)

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 in 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.

3. CAPITAL MANAGEMENT (*continued*)

3.2 Capital Requirements (continued)

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

At 31 December 2016	Exposure value €000	Risk weighted assets €000	Capital required €000
Central governments or Central banks	126,216	-	-
Institutions	29,809	5,962	477
Corporates	13,677	10,092	807
Retail	88,978	55,885	4,471
Secured by mortgages on immovable property	222,256	83,561	6,685
Items associated with particularly high risk	5,000	7,500	600
Exposures in default	22,486	23,775	1,902
Equity	341	341	27
Other items	21,784	18,332	1,467
Credit risk	530,547	205,448	16,436
Operational risk		24,930	1,994
Foreign exchange risk		578	46
Total capital required		230,956	18,476
Own funds			
Common Equity Tier 1			18,700
Additional Tier 1			5,000
Tier 2			1,087
Total own funds			24,787
Total capital ratio			10.7%

The Bank´s Management continuously undertakes initiatives and actions to ensure that the Bank's ability to realise its assets and to discharge its liabilities is not put in doubt until the capitalisation process is concluded.

3. CAPITAL MANAGEMENT (*continued*)

3.2 Capital Requirements (continued)

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 determine 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 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 light of the risk management techniques in place and the availability of relevant information. The following risk types were considered material:

i. credit risk;
ii. liquidity risk;
iii. interest rate risk;
iv. position risk on the Bank's trading book;
v. operational risk;
vi. 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% 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 2016 ICAAP, the top three of the eleven risk types identified above were credit risk, interest rate risk and stategy/business risk; in aggregate these three risks constituted 74.8% (2015: 68.3%) of the overall economic capital allocation of the Bank. In line with expectations, credit risk consumed the highest share of economic capital given that since January 2008, the Bank has strived to develop a sound loan book through organic growth. During the three years ended in 2015, 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. In the 2016 ICAAP review exercise, Business/Strategy Risk displaced Liquidity Risk as the third-most capital intensive risk. Needless to say, the need to optimise capital consumption and revenue generation is in tandem with the strategic thrust adopted following the entry of the new majority shareholder.

3. CAPITAL MANAGEMENT (*continued*)

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

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 Management Unit.

The ICAAP process and the final document has been independently followed and evaluated by the Internal Control Department – Internal Audit Unit of the Bank.

As from early 2017, the Bank has embarked on an exercise of further enhancing its 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).

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 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 is 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 Feisal International for Investment Limited, a subsidiary of Al Feisal International for Investment Q.P.S.C. headquartered in Qatar and the increase of issued share capital by €15,000,000, as authorised by the Malta Financial Services Authority, effective on 20 January 2017, this will increase the Bank's core equity Tier 1 capital, thus enhancing the Bank's leverage ratio.

4. LEVERAGE (*continued*)

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

	2016 €000
Total assets as per published financial statements	522,907
Adjustment for off-balance sheet items	14,547
Other adjustments	
Deduction for intangible assets	(1,298)
Other	751
Leverage ratio exposure	**536,907**
Tier 1 capital	**23,700**
Leverage Ratio	**4.4%**

5. CREDIT RISK

5.1 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 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 four 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 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 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.

5. CREDIT RISK (*continued*)

5.2 Credit risk management (continued)

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 2016, 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 of 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:

	2016	2016
	Average exposure	Year end exposure value
	€000	€000
Central Government or central banks	112,231	126,216
Public sector entities	109	-
Institutions	30,129	29,809
Corporates	11,625	13,677
Retail exposures	91,703	88,978
Secured by mortgages on immovable property	220,875	222,256
Items associated with particular high risk	10,139	5,000
Exposures in default	24,300	22,486
Equity	871	341
Other items	20,842	21,784
Total	522,824	530,547

As at 31 December 2016	Year end exposure value
	€000
On-balance sheet exposures	522,907
Less deductions for assets that are not risk-weighted	(1,246)
On Balance Sheet exposures after deductions	521,661
Off-balance sheet exposures before credit conversion factor (CCF)	71,447
Less deductions through CCF	(62,561)
On Balance Sheet exposures after deductions	8,886
Total Exposure	**530,547**

5. CREDIT RISK (*continued*)

5.2 Credit risk management (continued)

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

At 31 December 2016	Total	Less than 1 year	Over 1 but less than 5 years	Over 5 years	No maturity
	€000	€000	€000	€000	€000
Central Government or central banks	126,216	11,034	2,695	3,688	108,799
Institutions	29,809	29,809	-	-	-
Corporates	13,677	7,924	2,389	3,364	-
Retail exposures	88,978	23,674	20,602	44,702	-
Secured by mortgages on immovable property	222,256	7,993	7,136	207,127	-
Items associated with particular high risk	22,486	8,229	3,340	10,917	-
Exposures in default	5,000	3,303	1,407	290	-
Equity exposures	341	-	-	-	341
Other items	21,784	7,756	2,027	7,270	4,731
Total	530,547	99,722	39,596	277,358	113,871

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 Banif 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 11.8% of the total loan portfolio as at end of 2016 (2015: 12.4%). 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 2016 amounted to €5,304,000 (2015: €5,385,000) 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. CREDIT RISK (*continued*)

5.3 *Credit concentration risk* (continued)

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:

At 31 December 2016

	Total	Manufacturing	Financial services	Households and individuals	Construction	Wholesale and retail	Other sectors
	€000	€000	€000	€000	€000	€000	€000
Central Government or central banks	126,216	-	-	-	-	-	126,216
Institutions	29,809	-	29,809	-	-	-	-
Corporates	13,677	2,667	380	-	12	3,262	7,356
Retail exposures	88,978	1,621	7,592	40,020	5,649	14,179	19,917
of which: SME	45,845	1,438	7,410	1	5,635	13,204	18,157
Secured by mortgages on immovable property	222,256	2,027	2,401	203,893	2,873	4,189	6,873
of which: SME	13,780	1,756	1,794	-	2,813	3,523	3,894
Items associated with particular high risk	5,000	200	-	680	3,995	-	125
of which: SME	4,120	-	-	-	3,995	-	125
Exposures in default	22,486	631	2,068	7,862	426	6,267	5,232
Equity	341	-	-	-	-	-	341
Other items	21,784	-	21,784	-	-	-	-
Total	**530,547**	**7,146**	**64,034**	**252,455**	**12,955**	**27,897**	**166,060**

5. CREDIT RISK (*continued*)

5.3 *Credit concentration risk* (continued)

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.

At 31 December 2016	Total	Malta	Portugal	Other
	€000	€000	€000	€000
Central Government or central banks	126,216	126,216	-	-
Institutions	29,809	6,698	7,254	15,857
Corporates	13,677	13,677	-	-
Retail exposures	88,978	88,921	-	57
Secured by mortgages on immovable property	222,256	220,195	-	2,061
Items associated with particular high risk	5,000	5,000	-	-
Exposures in default	22,486	22,486	-	-
Equity	341	-	-	341
Other items	21,784	21,784	-	-
Total	530,547	504,977	7,254	18,316

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.

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. CREDIT RISK (*continued*)

5.4 Credit quality (continued)

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.

Additional Regulatory Disclosures
For the year ended 31 December 2016

5. CREDIT RISK (*continued*)

5.4 Credit quality (continued)

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

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

	2016 €000
Gross loans and advances	
High Grade	306,802
Standard	11,678
Substandard	462
Doubtful	31,425
	350,367

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.

5. CREDIT RISK (*continued*)

5.4 Credit quality (continued)

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

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

Specific impairment allowances	Total	Manufacturing	Households and individuals	Construction	Wholesale and retail	Other
	€000	€000	€000	€000	€000	€000
At 1 January 2016						
At beginning of year	4,652	202	1,778	137	1,775	760
Additions	2,832	53	853	21	1,752	153
Reversals	(747)	-	(409)	(1)	(199)	(138)
At 31 December 2016	6,737	255	2,222	157	3,328	775

Collective impairment allowances	Total	Manufacturing	Households and individuals	Construction	Wholesale and retail	Other
	€000	€000	€000	€000	€000	€000
At 1 January 2016						
At beginning of year	2,600	100	848	179	547	926
Additions	952	48	114	45	577	168
Reversals	(1,516)	(79)	(773)	(59)	(178)	(427)
At 31 December 2016	2,036	69	189	165	946	667

5. CREDIT RISK (*continued*)

5.4 Credit quality (continued)

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

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:

	2016
	€000
Gross loans and advances to customers	
Impaired	16,216
Past due but not impaired	17,095
Neither past due nor impaired	317,056
	350,367

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
Gross loans and advances by industry		
Manufacturing	435	808
Households and individuals	6,570	5,278
Construction	132	2,125
Wholesale and retail	6,909	2,679
Other sectors	2,170	6,205
	16,216	17,095

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 Standardised Approach for credit risk to calculate Pillar 1 minimum capital requirements in line with the CRR.

5. CREDIT RISK (*continued*)

5.4 Credit quality (continued)

5.4.3 Use of External Credit Assessment Institutions (ECAIs) *(continued)*

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 collateralised by pledged ECAI-rated financial assets.

Ratings	Credit quality steps	Loans and advances to banks
		€000
AAA to AA-	1	92
A+ to A-	2	15,646
BBB+ to BBB-	3	13,952
Unrated		5
Total		29,695

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 2016.

5. CREDIT RISK (*continued*)

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 following table 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 collateralising 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.

5. CREDIT RISK (*continued*)

5.6 *Collateral and other credit enhancements* (continued)

At 31 December 2016	Total exposure value	Immovable property		Other eligible collateral	Residual value
		Residential immovable property	Commercial immovable property		
	€000	€000	€000	€000	€000
Central governments or Central banks	126,216	-	-	-	126,216
Institutions	29,809	-	-	-	29,809
Corporates	13,677	1,924	661	2,713	8,379
Retail exposures	88,978	-	44,183	11,855	32,940
Secured by mortgages on immovable property	222,256	221,590	666	-	-
Items associated with particularly high risk	22,486	14,533	7,828	102	23
Exposures in default	5,000	3,672	1,314	14	-
Equity exposures	341	-	-	-	341
Other items	21,784	-	-	-	21,784
Total	530,547	241,719	54,652	14,684	219,492

6. LIQUIDITY RISK – ASSET ENCUMBRANCE

Further to Sec. 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.

At 31 December 2016	Carrying amount of encumbered assets	Carrying amount of unencumbered assets	Total carrying amount	Risk weighted encumbered assets	Risk weighted unencumbered assets	Total risk weighted amount
	€000	€000	€000	€000	€000	€000
Central governments or Central banks made up of:	7,542	118,673	126,216	-	-	-
Reserve deposit	3,028	-	-	-	-	-
Securities pledged for DCS	4,515	-	-	-	-	-
Public sector entities						
Institutions	-	29,809	29,809	-	5,962	5,962
Corporates	-	13,677	13,677	-	10,092	10,092
Retail	-	88,978	88,978	-	55,885	55,885
Secured by mortgages on immovable property	-	222,256	222,256	-	83,561	83,561
Items associated with particularly high risk	-	5,000	5,000	-	7,500	7,500
Exposures in default	-	22,486	22,486	-	23,775	23,775
Equity	-	341	341	-	341	341
Other items made up of:	3,039	18,745	21,784	-	18,331	18,331
Visa collateral	3,039	-	-	3,039	-	3,039
Collateral pledged for SEPA payments	-	-	-	-	-	-
Total credit risk	10,581	519,965	530,547	3,039	205,447	208,486

7. MARKET RISK

7.1 Trading Book

At the present time, the trading book held by the Bank is relatively modest in magnitude.

In fact, as at balance sheet date, the trading book was marked to market at €17,064,000. On this basis, in terms of CRR Article 94, the Bank enjoyed a derogation from the requirement to set aside Pillar I capital in respect of position risk on the trading book.

In terms of CRR Article 92(3)(c), the Bank has allocated Pillar I regulatory capital in respect of foreign-exchange risk amounting to €72,290.

In the eventuality that a greater level of trading-book activity is resorted to at some future date, the Bank has established clearly defined Treasury Unit thresholds and limits beyond which top management authorisation to proceed would be required.

7.2 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 ensured a gain of €3,105,000 as part of the process of acquisition by Visa Inc. of Visa Europe Ltd. During the current financial year, Visa Inc. announced its proposed acquisition of Visa Europe Limited, subject to regulatory approval. The Bank is a member of Visa Europe Limited and holds one ordinary share of €10, although only limited value was attached to the share. Voting and any economic rights relating to the shares are broadly based on the sales volumes of the particular member. As set out in the announcement by Visa Inc., there is 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 may also be receivable following the fourth anniversary of closing of the transaction subject to an earn-out mechanism. The preferred stock and earn-out elements of the consideration are contingent upon certain factors. As at 31 December 2016, 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. which transaction is expected to be completed during 2016. Prior to the announcement of the proposed transaction, the Directors believe 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 2016, the Bank recognised the membership share at its nominal value.

7.3 Securitisation Position

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

7.4 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:

- That the local banking scenario is effectively not tied to the prevailing Euribor rates applicable on the European mainland;

7. MARKET RISK (*continued*)

7.4 Interest Rate Risk (IRR) (continued)

- Instead, local credit interest rates are set at a higher level of interest and lending base rate hover around 2.5% p.a.; and
- That market pressure to reduce interest rates could be experienced at banking industry level.

Accordingly, the following interest rate falls were simulated:

- Base: reduction of 1%;
- Stress testing magnitude 1: reduction of 1.25%;
- Stress testing magnitude 2: reduction of 1.50%.

Additionally, an interest rate rise of 1% was also considered but was not stressed in view that any such increase (as unlikely as it might be within the prevailing local context), would have a beneficial, not detrimental effect on earnings.

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.

7.5 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 is 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 metric are deduced at a stringent confidence level of 99%. 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) and was a low level of actual withdrawal. The said 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.

7.6 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 is practicable. This mechanism is reflected in the figures reported in the tables on the following page which present this matching process.

7. MARKET RISK (*continued*)

7.6 *Currency risk* (continued)

	Total	EUR	GBP	USD	Other
	€000	€000	€000	€000	€000
As at 31 December 2016					
Total financial assets	**507,865**	**481,032**	**9,059**	**16,178**	**1,596**
Total financial liabilities	**492,119**	467,029	9,215	14,491	1,384
Net on balance sheet position			(156)	1,687	212
Off-balance sheet net notional position			-	(1,746)	-
Net currency exposure			(156)	(59)	212

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, Standardised Approach (SA).

As at balance sheet date, the following comparative figures applied:

Operational Risk Capital Charge	
	€000
Standardised Approach (simulation)	1,705
Basic Indicator Approach (actual)	1,994
Difference	**289**

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 for inclusion in the operational risk database.

The level of sophistication of operational risk activity is being enhanced on an ongoing basis; in 2016 the Key Performance Indicator and Key Risk Indicator tools were included in the operational risk management toolkit.

9. REMUNERATION POLICY

During 2016 the Bank has established a Remuneration Committee, 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 2016 amounted to €142,368 which are analysed as follows:

	€
Michael Frendo - Chairman	41,300
Edward Cachia Caruana	23,494
Kenneth Mizzi	18,200
Chev. Maurice Mizzi	18,580
Mark Portelli	23,194
Michael Anthony Collis	4,950
Mario P. Galea	6,250
Sheikh Mohamed Bin Feisal Al-Thani	2,325
Mohamed Ahmed Shafiek Mohamed Ahmed	4,075
Total Directors' fees	**142,368**

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 a contract of employment. 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, and the Executive Committee members' contracts of employment do not contain provisions for termination payments and/or other payments linked to early termination, other than 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 2016 amounted to €232,800, split as follows:

Fixed remuneration	**Variable remuneration**
€313,532	€10,268

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. 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	2 ED + 4 NED
Sheikh Mohamed Feisal Q.F. Al-Thani	3 NED
Mr Joaquim Silva Pinto	1 ED
Mr Michael Anthony Collis	2 ED + 1 NED
Mr Mario P Galea	5 NED
Mr Kenneth Mizzi	3 ED + 2 NED
Chev. Maurice Mizzi	4 ED + 2 NED
Mr Mark Portelli	1 ED + 8 NED
Mr Mohamed Ahmed Shafiek Mohamed Ahmed	2 ED + 1 NED

FIVE YEAR SUMMARY

Statements of Financial Position
As at 31 December

	2016	2015	2014	2013	2012
	€000	€000	€000	€000	€000
ASSETS					
Balances with Central Bank of Malta and cash	**113,530**	81,650	29,008	93,898	7,119
Cheques in course of collection	**1,894**	737	2,097	1,642	3,386
Financial investments held-for-trading	**-**	-	21,464	16,254	22,405
Financial assets at fair value through profit or loss	**-**	-	-	-	500
Financial investments available-for-sale	**17,758**	5,291	2,254	1,900	1,132
Loans and advances to banks	**29,695**	50,185	166,745	121,645	107,622
Loans and advances to customers	**341,595**	360,254	378,154	342,341	320,048
Property and equipment	**7,270**	7,740	8,062	7,587	6,369
Intangible assets	**1,298**	820	1,071	899	664
Deferred tax asset	**4,010**	3,003	4,561	5,230	5,386
Derivative financial instruments	**-**	23	899	625	3
Prepayments and accrued income	**1,595**	1,704	2,091	1,954	1,934
Other assets	**4,262**	5,500	2,663	2,305	2,128
TOTAL ASSETS	**522,907**	516,907	619,069	596,280	478,696
EQUITY					
Share capital	**24,544**	32,500	32,500	32,500	32,500
Perpetual Capital Note	**5,000**	-	-	-	-
Retained earnings	**(100)**	(10,008)	(10,457)	(11,059)	(10,993)
Revaluation reserve	**352**	2,026	317	87	38
Reserve for General Banking Risks	**992**	844	446	190	-
TOTAL EQUITY	**30,788**	25,362	22,806	21,718	21,545
LIABILITIES					
Amounts owed to banks	**71**	3,577	214	5,999	13,844
Amounts owed to customers	**482,964**	474,294	579,203	554,007	430,996
Derivative financial instruments	**-**	448	840	192	51
Debt securities in issue	**-**	5,000	5,000	5,000	5,000
Other liabilities	**5,220**	3,952	4,722	2,686	2,388
Accruals and deferred income	**3,864**	4,274	6,284	6,678	4,872
TOTAL LIABILITIES	**492,119**	491,545	596,263	574,562	457,151
TOTAL EQUITY AND LIABILITIES	**522,907**	516,907	619,069	596,280	478,696
Memorandum items					
Contingent liabilities	**8,331**	10,842	11,536	8,101	8,101
Commitments	**63,248**	61,953	62,279	72,958	63,647

FIVE YEAR SUMMARY (*continued*)

Income Statements
For the year ended 31 December

	2016 €000	2015 €000	2014 €000	2013 €000	2012 €000
Interest receivable and similar income					
- on loans and advances and balances with the Central Bank of Malta	**15,926**	19,693	22,899	20,291	16,384
- on debt securities classified as loans and receivables	**-**	-	-	256	328
- on debt and other fixed income instruments	**103**	93	102	3,060	283
Interest payable and similar expense	**(6,403)**	(9,499)	(14,260)	(15,480)	(10,196)
Net interest income	**9,626**	10,287	8,741	8,127	6,799
Fees and commission income	**2,609**	2,886	2,704	2,204	1,781
Fees and commission expense	**(730)**	(690)	(588)	(510)	(433)
Net fees and commission income	**1,879**	2,196	2,116	1,694	1,348
Net trading income and other income	**740**	1,363	3,071	2,102	2,604
Net gain on sale of investment securities	**-**	-	-	161	-
Other operating income	**-**	-	-	29	-
Gain on disposal of available-for-sale financial investments	**3,105**	-	-	-	-
Net operating income	**15,350**	13,846	13,928	12,113	10,751
Employee compensation and benefits	**(5,642)**	(5,395)	(5,287)	(5,162)	(4,735)
Other administrative expenses	**(4,726)**	(4,721)	(4,538)	(4,650)	(4,197)
Depreciation of property and equipment	**(575)**	(569)	(540)	(471)	(461)
Amortisation of intangible assets	**(320)**	(305)	(341)	(258)	(206)
Net impairment losses	**(1,857)**	(1,369)	(1,820)	(1,319)	(902)
Profit before tax	**2,230**	1,487	1,402	253	250
Income tax (expense)/credit	**(130)**	(640)	(544)	(129)	(77)
Profit/(loss) for the year	**2,100**	847	858	124	173
Earnings per share	**6c5**	2c6	2c6	0c4	0c6

FIVE YEAR SUMMARY *(continued)*

Statements of cash flows
For the year ended 31 December

	2016 €000	2015 €000	2014 €000	2013 €000	2012 €000
Cash flows from operating activities					
Interest, fees and commission received	**18,882**	22,682	25,548	22,586	18,289
Interest, fees and commission paid	**(7,712)**	(11,936)	(15,494)	(14,277)	(8,722)
Proceeds/cash losses from trading activities	**315**	1,668	1,824	1,776	3,791
Payments to employees and suppliers	**(10,539)**	(10,315)	(9,836)	(9,812)	(8,855)
Cash flows from operating profit before changes in operating assets and liabilities	**946**	2,099	2,042	273	4,503
(Increase)/decrease in operating assets:					
Reserve deposit with Central Bank of Malta	**1,770**	520	(356)	(836)	417
Loans and advances to banks	**-**	-	80,000	(80,000)	1
Loans and advances to customers	**17,140**	16,534	(40,965)	(26,584)	(65,578)
Other loans and receivables	**-**	-	3,333	3,123	3,808
Other assets	**(25)**	(1,621)	(1,145)	1,069	995
(Decrease)/increase in operating liabilities:					
Amounts owed to banks	**-**	-	(5,000)	(7,800)	(26,467)
Amounts owed to customers	**8,670**	(104,909)	25,196	123,011	169,123
Other liabilities	**1,268**	(583)	2,210	366	(650)
	29,769	(87,960)	65,315	12,622	86,152
Income tax paid	**(234)**	-	-	-	(2)
Net cash flows from operating activities	**29,535**	(87,960)	65,315	12,622	86,150
Cash flows from investing activities					
Property, plant and equipment and intangible assets	**(903)**	(421)	(1,447)	(2,122)	(388)
Financial investments available-for-sale	**(20,099)**	(409)	-	(528)	21,240
Proceeds on disposal and redemption of available-for sale investments	**8,162**	-	-	-	-
Financial investments held-for-trading	**-**	21,937	(14,732)	6,061	9,552
Financial assets at fair value through profit or loss	**-**	-	-	500	(500)
Proceeds from sale of held-for-trading investments	**-**	-	11,093	-	-
Interest received on available-for-sale investments	**(29)**	91	104	3,067	355
Net cash flows used in investing activities	**(12,869)**	21,198	(4,982)	6,978	30,259
Cash flows from financing activities					
Proceeds from issue of preference shares	**-**	-	-	-	-
Proceeds from issue of debt securities	**-**	-	-	-	5,000
Issue of perpetual capital notes	**5,000**	-	-	-	-
Repayment of subordinated debt	**(5,000)**	-	-	-	-
Net cash flows used in financing activities	**-**	-	-	-	5,000
Net increase in cash and cash equivalents	**16,666**	(66,762)	60,333	19,600	121,409
Cash and cash equivalents at beginning of year	**123,460**	190,222	129,889	110,289	(11,120)
Cash and cash equivalents at end of year	**140,126**	123,460	190,222	129,889	110,289

FIVE YEAR SUMMARY *(continued)*

Accounting ratios

	2016	2015	2014	2013	2012
	%	%	%	%	%
Net interest income and other operating income to total assets	**2.94**	2.68	2.25	2.03	2.25
Operating expenses to total assets	**2.15**	2.13	1.73	1.77	2.01
Cost to income ratio	**73.38**	79.37	76.87	87.02	89.28
Profit/(loss) before tax to total assets	**0.43**	0.29	0.22	0.04	0.05
Profit/(loss) before tax to equity	**7.24**	5.86	6.14	1.16	1.16
Profit/(loss) after tax to equity	**6.82**	3.34	3.76	0.57	0.80
Shares in issue (millions)	**32.5**	32.5	32.5	32.5	32.5
Net assets per share (€0 cents)	**95**	78	70	66	66
Profit/(loss) per share (€0 cents)	**6.46**	2.61	2.64	0.38	0.63

SUPPLEMENTARY FINANCIAL INFORMATION

SHAREHOLDING INFORMATION

The issued share capital stood at €24,584,000 made up of 32,500,000 fully paid up ordinary shares of €0.7552 each as at 31 December 2016 (2015: €32,500,000 made up of 32,500,000 fully paid up ordinary shares of €1 each).

The ordinary shares are held as follows:

	No. of shares
Al Feisal International for Investment Malta Limited (C 74331)	25,500,0000
PG Holdings Ltd (C 8569)	1,750,000
Virtu Investments Ltd (C 42860)	1,750,000
Mizzi Holdings Ltd (C 813)	1,750,000
SAK Ltd (C 3240)	1,750,000
	32,500,000

The percentage holdings stand as follows:

	%
Al Feisal International for Investment Malta Limited (C 74331)	78.46
PG Holdings Ltd (C 8569)	5.385
Virtu Investments Ltd (C 42860)	5.385
Mizzi Holdings Ltd (C 813)	5.385
SAK Ltd (C 3240)	5.385
	100.00

Each ordinary share entitles the shareholder to one voting right. The directors are appointed by ordinary resolution of the Company in general meeting in line with article 139(4) of the Companies Act, 1995 (Cap. 386 of the laws of Malta).