

Annual Report and
Financial Statements

2018



izola Bank



izola Bank

Annual Report
2018

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Chairperson's Statement

For the Year Ended 31 December 2018

I am pleased to present the Bank's results for the year ended 31 December 2018.

Review of performance

During the year ended 31 December 2018, the Bank generated a profit before tax of €2,442,498 down 31% on 2017. Profit after tax was €1,508,179, down 33% over the previous year. The main contributor to the reduction in profits was the year on year reduction in other income, which is mainly composed of investment gains. In fact, operating income, excluding other revenue registered a 11% increase year on year.

Net interest income increased by €932,068 (21%) whilst net fee and commission income registered a decrease of €397,946 compared to the previous year. This is a result of strong growth in factoring activities. These were complemented by a 85% reduction in other operating income. As a result, total operating income decreased by 18% over 2017.

Personnel expenses and other administrative expenses increased by 5% in the year under review. This increase was mainly due to increases in regulatory and compliance costs and partially offset by reduced marketing spend. The Bank's Cost-to-Income ratio rose to close the year at 57.9% (2017: 49.9%) driven mainly by the reduction in investment gains.

Review of financial position

Total assets increased by 15% to €237,153,602 whereas total liabilities rose from €177,157,964 to €205,068,875 – an increase of 16%. Shareholders' equity amounted to €32,084,727 compared with €29,471,840 of a year earlier.

As at 31 December 2018, the Capital Adequacy Ratio stood at a healthy 24% and liquidity ratios were significantly above European banking sector norms.

The combination of the current credit approval and monitoring structures and the high level of credit insurance cover have helped to ensure very good credit quality of factoring debtors with minimal losses. In fact, out of a total amount of €181,266,340 of net factoring turnover in 2018, the Bank has only incurred bad debts of €141,992 during the year.

Looking ahead

The Bank is committed to continue seeking further growth in its factoring operations in Belgium, mainly through its online factoring services named Izola Factor launched in mid-2017, together with growth in domestic loans and advances to customers through niche lending.

Conclusion

On behalf of the Board, I would like to thank our customers for their loyalty and support. Finally, I would like to express my thanks to the management team and staff members for their continuing hard work and commitment to the Bank.



Ms. Magdalena De Roeck
Chairperson/Director
Izola Bank p.l.c.

4 April 2019

The directors have prepared this report for Izola Bank p.l.c (“the Bank”) in accordance with Article 177 of the Companies Act 1995 (Chapter 386, Laws of Malta) (“the Act”) including the further provisions as set out in the sixth schedule of the Act, together with the financial statements of the Bank for the year ended 31 December 2018.

Board of directors

Ms. Magdalena De Roeck (Chairperson)

Ms. Caroline Van Marcke

Mr. Joseph C. Caruana (i)

Mr. Francis Gouder (i)

Mr. Charles Hertogs (i)

Mr. Guido Mizzi (i)

Mr. Patrick H. Van Leynseele (i)

(i) independent directors

Company secretary

Mr. Calvin Bartolo

Principal activities

Izola Bank p.l.c. is registered in Malta as a public limited liability company under the Companies Act, 1995 (Chapter 386, Laws of Malta). The Bank is licensed by the Malta Financial Services Authority to carry out the business of banking in terms of the Banking Act, 1994 (Chapter 371, Laws of Malta).

The Bank is principally engaged in providing corporate banking and factoring services to resident and non-resident customers including to related parties with simple and easy to use savings products for both local and foreign individuals and businesses.

Review of business developments, financial performance and future developments

During the accounting period under review, the Bank continued growing and diversifying its retail customer depositor base, raising funding from Malta, Belgium and Germany and continued building its factoring business both in Belgium and in Malta. Furthermore, the Bank also carried on developing niche commercial lending services both in Malta and abroad and intends to continue strengthening this in the years ahead.

The Bank reported a profit after tax of €1,508,179 for the year under review. Total assets stood at €237,153,602 as at year end. Other results may be referred to in the Statement of Financial Position and Statement of Profit or Loss and Other Comprehensive Income on pages 1 and 2 respectively.

Principal risks and uncertainties

The main risks that the Bank has identified are credit risk arising from changes in credit quality and the recoverability of loans and amounts due from Belgian and Maltese counterparties, concentration risk arising from an uneven distribution of counterparties mainly drawn from the Belgian property, building and construction and related services sector, the Bank's exposure to the retail sector in Malta, and liquidity and interest rate risks which are inherent in the nature of the business of banking. Other risks which are closely monitored by management include foreign exchange risk and investment price risk, reputational risk, operational risk as well as cyber-security and business continuity risks.

Directors' Report

For the Year Ended 31 December 2018

Risk management policies have been established to identify and analyse the risks faced by the Bank, to set out appropriate risk limits and controls, and to monitor risks and adherence to limits. A detailed overview of these risks, together with the respective financial metrics are outlined in note 4 of the Financial Statements.

Directors' responsibilities

The Companies Act, 1995 (Chapter 386, Laws of Malta) (the 'Act') requires the directors of Izola Bank p.l.c. to prepare financial statements for each financial period 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 period in accordance with the requirements of International Financial Reporting Standards as adopted by the EU.

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 Act and the Banking Act, 1994 (Chapter 371, 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 oversight of management, are responsible to ensure that the Bank establishes and maintains internal control to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Management is responsible, with oversight by 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.

Events occurring after reporting date

No significant events have taken place since the financial reporting date that would have otherwise required adjustment to and/or disclosure in this annual report.

Dividends and reserves

The directors have proposed a final dividend of €1,750,000 in respect of 2018, representing a dividend per share of €4.375.

Information pursuant to Listing Rule 5.64

The Bank does not have any listed securities carrying voting rights.

Information pursuant to Listing Rule 5.70.1

The Bank provides a range of banking services to the Van Marcke Group, of which the Bank itself is a member. Ms. Magdalena de Roeck, Ms. Caroline Van Marcke, Mr. Charles Hertogs and Mr. Patrick Van Leynseele are indirectly interested in this business relationship by virtue of their directorships of various companies within the Van Marcke Group.

Further details can be found within note 31 of the Financial Statements.

Going concern

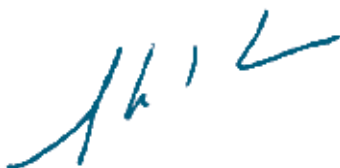
As required by Listing Rule 5.62, upon due consideration of the Bank's profitability, financial position, capital adequacy and solvency, the directors confirm the Bank's ability to continue operating as a going concern for the foreseeable future.

It is hereby declared that during the reporting period, there were no breaches of Standard Licence Conditions or other regulatory requirements.

Auditors

KPMG have expressed their willingness to continue in office. A resolution proposing the re-appointment of KPMG as auditors of the Bank will be submitted at the forthcoming Annual General Meeting.

Approved by the Board of Directors on 4 April 2019 and signed on its behalf by:



Ms. Magdalena De Roeck
Chairperson/Director



Mr. Guido Mizzi
Director

Registered Address

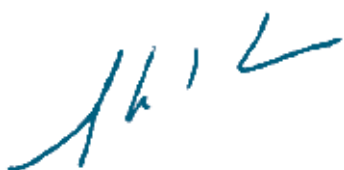
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Statement by the Directors

on the Financial Statements included in the Annual Report

Pursuant to Listing Rule 5.68, we, the undersigned, declare that to the best of our knowledge, the financial statements included in the Annual Report, and prepared in accordance with the requirements of International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank, and that the Directors' Report includes a fair review of the development and performance of the business and position of the Bank, together with a description of the principal risks and uncertainties that it faces.

Signed on behalf of the Board of Directors on 4 April 2019 by:



Ms. Magdalena De Roeck
Chairperson/Director



Mr. Guido Mizzi
Director

Pursuant to Listing Rule 5.97 as issued by the Listing Authority, Izola Bank p.l.c. (the 'Bank') hereby includes a Statement of Compliance reporting on the extent to which the Bank has adopted the Code of Principles of Good Corporate Governance appended as Appendix 5.1 to the said Listing Rules (the 'Principles') and the effective measures that the Bank has taken to ensure compliance with these Principles during the period under review.

Introduction

The adoption of the Principles is not mandatory, however the Board of Directors (the 'Board') of Izola Bank p.l.c. believes that the adoption of these Principles is in the best interest of the Bank and its shareholders.

The Bank applies all the provisions of the code of Principles of Good Corporate Governance (the "Code"), save where there exist particular circumstances that warrant non-adherence thereto, as outlined in Part Two to this Statement. During the year under review, the Bank did not apply any corporate governance practices beyond the provisions under national law.

PART ONE - Compliance with the Code

Principle 1: The Board

The Bank is headed by an effective Board and all directors exercise prudent controls which enable risk to be assessed and managed. All directors are responsible for determining the Bank's strategic aims and its organisational structure. The directors regularly review management performance and ensure that the Bank has the appropriate mix of financial and human resources to meet its objectives. Every director is conversant with the statutory and regulatory requirements connected to the business of the Bank and regularly attends meetings of the Board. Directors are appointed by the shareholders during the Bank's Annual General Meeting for a period of one year.

The Board delegates specific responsibilities to the Audit and Risk Committee, the Remuneration and Nomination Committee, the Credit Committee, and the Asset and Liability Committee. Each Committee has its own terms of reference which are in turn approved by the Board.

Principle 2: Chairperson and Chief Executive

The Bank's current organisational structure ensures a clear division of responsibilities between the Chairperson who is responsible for leading the Board, and the Chief Executive Officer who is responsible for leading the senior management in executing agreed strategy and managing the business.

Principle 3: Composition of the Board

The Board considers that it is of sufficient size for the requirements of the business and its members possess the required diversity of knowledge and experience to properly execute their duties as directors.

The Board is composed exclusively of non-executive directors. The Chief Executive Officer attends all board meetings in order to provide the Board with all necessary management and operational information. At the same time, through his attendance he is able to gain a better understanding of the Board's strategic thinking and direction. He does not have a right to vote at meetings.

During the period under review, the Board consisted of five independent directors and two non-independent directors, including the Chairperson (as set out in the Directors' Report). In determining the independence of its directors, the Board has referred to the principles relating to independence contained in the Code. Each independent non-executive director has made a declaration in writing to that effect.

Directors' Statement of Compliance

with the Code of Principles of Good Corporate Governance

Principle 4: Responsibilities of the Board

The Board's role and responsibility is to execute the four basic roles of corporate governance namely: accountability, monitoring, strategy formation and policy development.

The Board regularly reviews and evaluates corporate strategy, major operational and financial plans, risk policy and performance objectives, and monitors implementation and corporate performance within the parameters of all relevant laws, regulations and codes of best business practice. The Board has ensured that policies and procedures are in place to maintain the highest standards of corporate conduct, including compliance with laws, regulations, business and ethical standards of the Company and its employees.

The Board delegates specific responsibilities to the following Committees and requires management to monitor performance and report to its satisfaction, at least on a quarterly basis, a number of key performance indicators.

BOARD COMMITTEES

Audit and Risk Committee

The Audit and Risk Committee's primary purpose is to protect the interests of the Bank's shareholders and assist the directors in conducting their role effectively so that the Bank's decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times. The Audit and Risk Committee's terms of reference reflect the provisions of the relative Listing Rules, except that the vetting and approving of Related Party Transactions is a matter dealt with by the Board.

In terms of Listing Rules 5.117, 5.118 and 5.118A, the Audit and Risk Committee is composed of three non-executive directors. All three non-executive directors are considered as independent since they are free from any business, family or other relationship with the Bank or its management that may create a conflict of interest such as to impair their judgement. The Chairman of the Audit and Risk Committee is appointed by the Board of Directors.

In terms of Listing Rule 5.118A, Mr Guido Mizzi is the director whom the Board considers as independent of the Bank and competent in accounting, given his extensive experience as a former managing partner of a local accountancy firm. Mr. Hertogs was for many years a business consultant with a major German multinational group, whilst Mr. Van Leynseele is a partner in a Brussels law firm and a member of the Bar in both Brussels and New York.

All three directors have experience serving on various other boards and are considered as competent to be a member of the Audit and Risk Committee of the Bank. The Board thus considers that the committee members as a whole have the competence relevant to the banking sector.

	Meetings held: 4
Members	Attended
Mr. Guido Mizzi (Chairman)	4
Mr. Charles Hertogs	3
Mr. Patrick H. Van Leynseele	4

Other Board members have a right to attend the meetings. The Audit and Risk Committee has direct access and reporting channels to the Head of Finance and Treasury, who is responsible for the preparation and integrity of financial statements, and the Risk and Compliance manager, who is responsible for ensuring proper execution of the risk management and control framework. The Head of IT, who is responsible for the maintenance of internal controls in relation to ICT, attends meetings when ICT-related topics are discussed. Both the internal and external auditors are also invited to attend meetings on an ad-hoc basis.

The Company Secretary acts as Secretary to the Committee. As from May 2018, the Audit Committee was renamed Audit and Risk Committee to formally include the oversight of risk.

Principle 4: Responsibilities of the Board (Continued)

Remuneration and Nomination Committee

The Remuneration and Nomination Committee is composed of three directors and meets at least once a year. The Remuneration and Nomination Committee is tasked with delving into the detail of oversight of remuneration, making proposals to the Board on the remuneration policy for directors and senior management and with leading the process for Board appointments and the assessment of the size, composition, performance and individual and collective suitability of directors. The terms of reference of this Committee are in line with Code Provisions of 8.A.2 - 8.A.6 and 8.B.2 - 8.B.8. Further information on the Bank's remuneration practices are included within the Remuneration Report immediately following this section.

	Meetings held: 1
Members	Attended
Mr. Francis Gouder (Chairperson)	1
Ms. Caroline Van Marcke	1
Mr. Patrick H. Van Leynseele	1

The Company Secretary acts as Secretary to the Committee.

Credit Committee

The Credit Committee is composed of two independent non-executive directors and the CEO and operates within a Board-approved credit sanctioning limit. Proposals falling outside the Committee's limits are referred together with the Committee's recommendations to the Board for consideration and determination.

	Meetings held: 4
Members	Attended
Mr. Joseph C. Caruana (Chairman)	4
Mr. Francis Gouder	4
Mr. Andrew Mifsud	4

The Company Secretary acts as Secretary to the Committee. The Head of Credit regularly attends the meetings.

Management Committee

Asset and Liability Management Committee (ALCO)

The ALCO meets quarterly to monitor the Bank's financial performance, and review and manage financial risks in accordance with Bank policies, namely: interest rate, liquidity and funding risk, solvency, market sector and country risk and counterparty and foreign exchange risk. The ALCO reports to the Board on a quarterly basis.

Until April 2018, the ALCO was composed of one independent non-executive director, the CEO, the Head of Finance and Treasury and a Finance Assistant Manager. From May 2018, the Board confirmed that the ALCO operates as a management committee.

	Meetings held: 4
Members	Attended
Mr. Andrew Mifsud (Chairman)	4
Mr. Francis Gouder – resigned from committee 17.05.2018	1
Mr. Calvin Bartolo	4
Mr. Karl Cachia	2

The Company Secretary acts as Secretary to the Committee.

Directors' Statement of Compliance

with the Code of Principles of Good Corporate Governance

Principle 5: Board Meetings

During the financial year 2018 the Board met four times. Notice of the dates of forthcoming meetings together with all board papers were circulated well in advance to the directors so that they had ample opportunity to consider the information and prepare for the next scheduled board meeting. After each board meeting and before the next meeting, minutes that faithfully record attendance and decisions were prepared and circulated to all directors.

Attendance of the Board members during the said year was as follows:

<i>Members</i>	<i>Attended</i>
Ms. Magdalena De Roeck (Chairperson)	4
Ms. Caroline Van Marcke	4
Mr. Joseph C. Caruana	3
Mr. Charles Hertogs	2
Mr. Francis Gouder	4
Mr. Guido Mizzi	3
Mr. Patrick H. Van Leynseele	4

Principle 6: Information and Professional Development

All new directors are briefed in detail by the CEO and Company Secretary on the Bank's organisation and activities and their responsibilities as directors.

When they judge it necessary, all directors can access independent professional advice at the Bank's expense in order to discharge their responsibilities as directors. All directors also have access to the services of the Company Secretary for advice on all governance matters.

Throughout the year, directors have the opportunity to attend relevant conferences and seminars in order to keep abreast with the latest developments in banking.

The Bank is committed to provide for the development and training of management and employees. The Board is updated at least annually with the latest staff development programme. In accordance with Code Provision 6, the Board is responsible for the appointment of the CEO whilst, in line with Code Provision 6.5, the CEO is responsible for the recruitment and appointment of senior management.

Principle 7: Evaluation of the Board's Performance

The Board has set up the Remuneration and Nomination Committee to periodically review and monitor the effectiveness of the Bank's suitability policy and to guide the execution of suitability assessments of directors and key function holders.

Principle 8: Committees

During the initial months of 2018, as is permitted in terms of provision 8.A.2 of the Code, the Board carried out the tasks normally delegated to a Remuneration Committee since the remuneration of directors is not performance-related. As from May 2018, the Board established a Remuneration and Nomination Committee to oversee matters of remuneration and nomination in line with best practice. More detailed information regarding remuneration is presented in the Remuneration Statement following this Statement of Compliance with the Code of Principles of Good Corporate Governance.

Principle 9 and 10: Relations with Shareholders and with the Market and Institutional Shareholders

The Bank provides the market with regular, timely, accurate and detailed information in accordance with the requirements of the Listing Rules by way of company announcements.

The Bank communicates with its shareholders through the Bank's Annual General Meeting as well as by way of the Annual Report and Financial Statements.

The Bank has an Internal Code of Dealing Policy to give guidance to the Bank's directors and employees on procedures to be followed when dealing in the Bank's securities and on the treatment of Inside Information in line with the provisions of the Prevention of Financial Markets Act and any related subsidiary legislation and regulations.

Principle 11: Conflicts of Interest

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

Each director has declared to the Bank, where applicable, his or her indirect beneficial interest in the share capital of the Bank. The Board has put in place a Conflict of Interest Policy that governs what actions directors need take in instances where a conflict of interest arises.

Principle 12: Corporate Social Responsibility

The Board seeks to adhere to accepted principles of corporate social responsibility in implementing day-to-day management practices of the Bank. The Bank seeks to act as a good corporate citizen in the local community and work closely with customers, employees, suppliers and public authorities.

Directors' Statement of Compliance

with the Code of Principles of Good Corporate Governance

PART TWO – Non-Compliance with the Code

Principle 2 – Code Provision 2.3

The Chairperson of the Bank cannot be considered independent in accordance with the principles relating to independence contained in the Code.

Principle 3 – Composition of the Board

The Board is composed entirely of non-executive directors. By invitation of the Board, the Chief Executive Officer attends all board meetings in order to provide the Board with all necessary management and operational information.

Principle 4 – Code Provision 4.2.7

The Code Provision recommends that the Board should develop a succession policy for the future composition of the Board and particularly the executive component thereof, for which the Chairman should hold key responsibility. The Board does not have a succession policy in place for the future composition of the Board of Directors. This approach may be revised in the future in line with changes to the Bank's size and/or organisational structure.

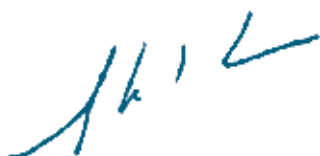
Principle 6 – Code Provision 6.4.4

Code Provision 6.4.4 recommends the CEO to establish a succession plan for senior management. The Board does not have a succession policy in place for senior management. This approach may be revised in the future in line with changes to the Bank's size and/or organisational structure.

Listing Rule 5.97.4

The information required by this Listing Rule is found in the Directors' Report, within the Directors' Responsibilities section.

Approved by the Board of Directors on 4 April 2019 and signed on its behalf by:



Ms. Magdalena De Roeck
Chairperson/Director



Mr. Guido Mizzi
Director

Remuneration Report

For the Year Ended 31 December 2018

For the Year Ended 31 December 2018

As is permitted in terms of provision 8.A.2 of the Code, until May 2018, the Board carried out the tasks normally delegated to a Remuneration Committee. Thereafter, the Bank established a Remuneration and Nomination Committee to oversee remuneration and nomination matters.

Remuneration Policy

The aim of the Bank's Remuneration Policy is to increase transparency in remuneration matters, to support the business goals of the Bank by efficient remuneration structures, and to create common basic values and guidelines for the Bank when offering remuneration and benefits to the senior management team of the Bank.

Remuneration Statement

Executive Management

Reference to senior management shall mean the CEO, the Head of Finance and Treasury, the Head of Operations, the Head of Credit and the Head of IT. The Board is of the opinion that the remuneration packages for senior management are in line with local market expectations and are at an appropriate level to attract and retain executives with the appropriate skills, qualities and experience to ensure the effective management of the Bank.

The terms and conditions of employment of senior management are set out in the respective indefinite contracts of employment. Senior management are not entitled to share options or profit sharing. There are no supplementary pension or early retirement schemes in place and notice periods are as established by law. Senior management are eligible for an annual salary increase and discretionary performance bonus in line with the Bank's internal policies.

Non-cash benefits to which senior management are entitled are the use of a company car. Other benefits afforded to all staff member, including senior management are personal accident, life and health insurance cover.

Loans amounting to €270,000 were advanced to key management personnel as disclosed in note 29.3 to the Financial Statements.

There have been no significant changes in the Bank's remuneration policy for senior management during the year under review. During the course of 2018, the Bank started offering all staff members, including senior management, subsidies on home loan interest rates and intends to start contributing to a personal pension scheme during the course of 2019.

Total emoluments of senior management for the year ended 31 December 2018 are as follows:

Fixed Remuneration	Variable Remuneration	Share Options	Others
€309,436	€107,250	None	Non-cash benefits referred to immediately above.

Directors

As at 31 December 2018, the Board was composed of 7 non-executive directors.

The maximum annual aggregate emoluments that may be paid to the directors are approved by the shareholders in a General Meeting. This amount was fixed at an aggregate sum of €60,000 at the Annual General Meeting held on 22 March 2018.

None of the directors had service contracts with the Bank as at the end of the financial year.

Furthermore, none of the directors, in their capacity as a director of the Bank, is entitled to profit sharing, share options, pension benefits or any other remuneration.

Total emoluments of directors from the Bank for the year ended 31 December 2018 are as follows.

Fixed Remuneration	Variable Remuneration	Share Options	Others
€42,000	None	None	None



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Marina Street
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Malta
(+356) 2563 1000

Independent Auditors' Report

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

Report required by Listing Rule 5.98 issued by the Listing Authority in Malta

We are required, pursuant to Listing Rule 5.98, to express an opinion to the shareholders of Izola Bank p.l.c (the "Bank") on specific disclosures in the Annual Report which relate to the directors' corporate governance statement (the "Disclosures") for the year ended 31 December 2018.

Specifically, with respect to the following matters noted in Listing Rule 5.100 (as applicable to issuers of non-equity securities that do not carry voting rights), we report whether:

- (a) we have identified material misstatements with respect to the disclosures referred to in Listing Rule 5.97.4. Where any material misstatements are identified, we are required to provide an indication of the nature of such misstatements; and
- (b) the disclosures required by Listing Rule 5.97.7 has been provided.

Responsibilities of the Directors

Pursuant to Listing Rule 5.97, the directors are responsible for preparing the Disclosures that are free from material misstatement in accordance with the requirements of the Listing Rules.

Auditors' responsibilities

Our responsibility is to examine the Disclosures and to report thereon in the form of a reasonable assurance conclusion based on our work. We conducted our engagement in accordance with International Standard on Assurance Engagements 3000, *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*.

We apply International Standard on Quality Control 1 and, accordingly, we maintain a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

KPMG, a Maltese Civil Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

The firm is registered as a partnership of Certified Public Accountants in terms of the Accountancy Profession Act.

A list of partners and directors of the firm is available at Portico Building, Marina Street, Pietà, PTA 9044, Malta.



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Independent Auditors' Report (continued)

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

Auditors' responsibilities (continued)

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

We are not required to, and we do not, consider whether the directors' statements on internal control and risk management systems cover all the risks and controls in relation to the financial reporting process or form an opinion on the effectiveness of the Bank's corporate governance procedures or its risks and control procedures, nor on the ability of the Bank to continue in operational existence. Our opinion in relation to the disclosures pursuant to Listing Rule 5.97.4 is based solely on our knowledge and understanding of the Bank and its environment obtained in forming our opinion on the audit of the financial statements. We have not performed any procedures by way of audit, verification or review on the underlying information from which the disclosures required by Listing Rule 5.97.7 is derived.

We also read the other information included in the Annual Report in order to identify any material inconsistencies with the Disclosures.

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Independent Auditors' Report (*continued*)

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

Conclusion

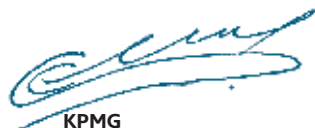
Our conclusion has been formed on the basis of, and is subject to, the matters outlined in this report.

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

In our opinion:

- (a) in light of the knowledge and understanding of the Bank and its environment obtained during the course of our audit of the financial statements, we have not identified material misstatements with respect to disclosures referred to in Listing Rule 5.97.4, included in the Directors' Report, as this relates to the Bank's internal control and risk management systems in relation to the financial reporting process; and
- (b) the disclosure required by Listing Rule 5.97.7 with respect to the composition and operation of the board of directors, of the audit committee and of the other committees established by the board, has been included in the Directors' Statement of Compliance with the Code of Principles of Good Corporate Governance.

The Principal authorised to sign on behalf of KPMG on the work resulting in this assurance report is Claude Ellul.



KPMG

Registered Auditors

4 April 2019

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Statement of Financial Position

As at 31 December 2018

		2018	2017
ASSETS	Note	€	€
Cash and items in transit	29	816	2,587
Balances with Central Bank of Malta	29	2,512,597	1,948,344
Investment securities	13	42,111,712	57,213,412
Loans and advances to banks	14	18,788,220	20,079,499
Factored receivables	15	86,260,140	48,583,631
Other loans and advances to customers	16	74,286,614	65,524,805
Property and equipment	17	10,264,853	10,343,320
Intangible assets	18	1,653,214	1,634,529
Other assets	19	1,275,436	1,299,677
Total assets		237,153,602	206,629,804
LIABILITIES			
Balance owed to Central Bank of Malta	20	13,000,000	16,300,000
Deposits from banks	21	250,068	-
Deposits from customers	22	177,157,086	145,767,422
Debt securities issued	23	11,888,899	11,871,811
Deferred tax liabilities	24	560,484	724,009
Current tax payable		802,074	1,154,671
Accruals	25	1,410,264	1,340,051
Total liabilities		205,068,875	177,157,964
EQUITY			
Share capital	26	10,000,000	10,000,000
Capital contribution	26	16,032,675	12,532,675
Property revaluation reserve	26	2,629,651	2,657,412
Fair value reserve	26	627,781	876,876
Depositor compensation scheme reserve	26	409,640	354,523
Reserve for general banking risk	26	6,470	36
Retained earnings	26	2,378,510	3,050,318
Total equity attributable to equity holders of the Bank		32,084,727	29,471,840
Total liabilities and equity		237,153,602	206,629,804
Memorandum items			
Commitments	27	88,918,753	60,202,304

The accompanying notes are an integral part of these financial statements.

The financial statements on pages 1 to 88 were approved by the Board of Directors on 4 April 2019 and signed on its behalf by:



Ms. Magdalena De Roeck
Director



Mr. Guido Mizzi
Director

Statement of Profit or Loss and Other Comprehensive Income

For the Year Ended 31 December 2018

	Note	2018 €	2017 €
Interest income calculated using the effective interest method	5	8,081,029	7,065,787
Interest expense	5	(2,627,953)	(2,544,779)
Net interest income		5,453,076	4,521,008
Fee and commission income	6	107,713	493,089
Fee and commission expense	6	(74,055)	(61,485)
Net fee and commission income		33,658	431,604
Other revenue	7	318,151	2,149,619
Operating income		5,804,885	7,102,231
Depreciation and amortisation	17 & 18	(619,313)	(453,578)
Impairment reversals / (losses) on financial instruments	8	134,698	(349,741)
Personnel expenses	9.2	(1,327,505)	(1,151,639)
Other expenses	9.4	(1,550,267)	(1,590,342)
Profit before tax	9	2,442,498	3,556,931
Income tax expense	10	(934,319)	(1,295,527)
Profit for the year		1,508,179	2,261,404
Other comprehensive income			
Items that will not be reclassified to profit or loss			
Transfer of depreciation on revaluation surplus net of deferred tax			
- retained earnings		31,564	(13,503)
- revaluation reserve		(31,564)	13,503
Property revaluation		-	1,806,050
Deferred tax adjustment on property revaluation		3,803	(123,609)
		3,803	1,682,441
Items that are or may be reclassified subsequently to profit or loss			
Movement in fair value reserve (FVOCI debt instruments):			
- net change in fair value		(408,919)	-
- reclassified to profit or loss		14,733	-
Movement in fair value reserve (available-for-sale financial assets):			
- net change in fair value		-	(916,279)
- reclassified to profit or loss		-	(1,826,840)
Related tax		145,091	956,402
		(249,095)	1,786,717
Other comprehensive income for the year, net of income tax		(245,292)	(104,276)
Total comprehensive income for the year		1,262,887	2,157,128
Earnings per share	11	3.77	5.65

The accompanying notes are an integral part of these financial statements.

Statement of Changes in Equity

For the Year Ended 31 December 2018

	Share Capital €	Property revaluation reserve €	Fair value reserve €	Depositor compensation scheme reserve €	Capital contribution €	Reserve for general banking risk €	Retained earnings €	Total €
Balance at 1 January 2018	10,000,000	2,657,412	876,876	354,523	12,532,675	36	3,050,318	29,471,840
Total comprehensive income	-	-	-	-	-	-	1,508,179	1,508,179
Profit for the year	-	-	-	-	-	-	1,508,179	1,508,179
Other comprehensive income, net of tax	-	-	-	55,117	-	6,434	(61,551)	-
Transfer from retained earnings	-	-	-	55,117	-	6,434	(61,551)	-
Transfer of depreciation on revaluation surplus	-	(31,564)	-	-	-	-	31,564	-
Fair value reserve:	-	-	(408,919)	-	-	-	-	(408,919)
- net change in fair value	-	-	(408,919)	-	-	-	-	(408,919)
- reclassified to profit or loss	-	-	14,733	-	-	-	-	14,733
Tax on other comprehensive income	-	3,803	145,091	-	-	-	-	148,894
Total other comprehensive income	-	(27,761)	(249,095)	55,117	-	6,434	(29,987)	(245,292)
Total comprehensive income for the year	-	(27,761)	(249,095)	55,117	-	6,434	1,478,192	1,262,887
Transactions with equity holders	-	-	-	-	-	-	-	-
Contributions by and distributions	-	-	-	-	-	-	(2,150,000)	(2,150,000)
Dividends to equity holders (note 26.8)	-	-	-	-	-	-	(2,150,000)	(2,150,000)
Contributions paid by equity holders	-	-	-	-	3,500,000	-	-	3,500,000
Total contributions by and distribution to equity holders	-	-	-	-	3,500,000	-	(2,150,000)	1,350,000
Balance at 31 December 2018	10,000,000	2,629,651	627,781	409,640	16,032,675	6,470	2,378,510	32,084,727

Statement of Changes in Equity

For the Year Ended 31 December 2018

	Share Capital €	Property revaluation reserve €	Fair value reserve €	Depositor compensation scheme reserve €	Capital contribution €	Reserve for general banking risk €	Retained earnings €	Total €
Balance at 1 January 2017	10,000,000	961,468	2,663,593	238,387	11,436,521	217	3,168,372	28,468,558
Total comprehensive income	-	-	-	-	-	-	2,261,404	2,261,404
Profit for the year	-	-	-	-	-	-	2,261,404	2,261,404
Other comprehensive income, net of tax	-	13,503	-	116,136	-	(181)	(129,458)	-
Transfer from retained earnings	-	13,503	-	116,136	-	(181)	(129,458)	-
Revaluation surplus	-	1,806,050	-	-	-	-	-	1,806,050
Movement in fair value reserve (available-for-sale financial assets):	-	-	(916,279)	-	-	-	-	(916,279)
- net change in fair value	-	-	(916,279)	-	-	-	-	(916,279)
- reclassified to profit or loss	-	-	(1,826,840)	-	-	-	-	(1,826,840)
Tax on other comprehensive income	-	(123,609)	956,402	-	-	-	-	832,793
Total other comprehensive income	-	1,695,944	(1,786,717)	116,136	-	(181)	(129,458)	(104,276)
Total comprehensive income for the year	-	1,695,944	(1,786,717)	116,136	-	(181)	2,131,946	2,157,128
Transactions with equity holders								
Contributions by and distributions								
Dividends to equity holders (note 26.8)	-	-	-	-	-	-	(2,250,000)	(2,250,000)
Contributions paid by equity holders	-	-	-	-	1,096,154	-	-	1,096,154
Total contributions by and distribution to equity holders	-	-	-	-	1,096,154	-	(2,250,000)	(1,153,846)
Balance at 31 December 2017	10,000,000	2,657,412	876,876	354,523	12,532,675	36	3,050,318	29,471,840

The accompanying notes are an integral part of these financial statements.

Statement of Cash Flows

For the Year Ended 31 December 2018

	Note	2018 €	2017 €
Cash flows from operating activities			
Interest and commission receipts		7,385,966	8,669,021
Interest and commission payments		(2,031,436)	(2,196,268)
Payments to employees and suppliers		(2,759,166)	(1,906,617)
Cash from operations before changes in operating assets/liabilities		2,595,364	4,566,136
Increase/(decrease) in operating assets:			
- other loans and advances to customers		(8,485,121)	(1,268,188)
- factored receivables		(37,992,738)	(28,578,468)
- other receivables		-	(2,934,587)
Increase/(decrease) in operating liabilities:			
- deposits from customers		31,389,664	10,747,328
- balance owed to Central Bank of Malta		(3,300,000)	(5,000,000)
Net cash generated from operating activities before income tax	28	(15,792,831)	(22,467,779)
Income tax paid		(1,301,489)	(712,816)
Net cash (used in)/from operating activities		(17,094,320)	(23,180,595)
Cash flows from investing activities			
Payments to acquire property, equipment and intangible assets		(559,531)	(5,839,157)
Proceeds from disposals of investment securities		24,129,036	21,170,143
Payments to acquire investment securities		(9,412,713)	(12,604,899)
Interest received from investment securities		949,252	1,524,330
Dividend received		199,411	262,536
Net cash from investing activities		15,305,455	4,512,953
Cash flow from financing activities			
Dividends paid to shareholders		(2,150,000)	(2,000,000)
Capital contributed by shareholders		3,500,000	1,096,154
Interest paid on debt securities		(540,000)	(540,000)
Net cash from/(used in) financing activities		810,000	(1,443,846)
Net decrease in cash and cash equivalents		(978,865)	(20,111,488)
Cash and cash equivalents at beginning of year		22,030,430	42,141,918
Cash and cash equivalents at end of year	29	21,051,565	22,030,430

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

For the Year Ended 31 December 2018

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izola Bank

Notes to the Financial Statements

For the Year Ended 31 December 2018

1 Reporting entity

Izola Bank p.l.c. (the “Bank”) is a public limited liability company domiciled and incorporated in Malta. The Bank is primarily involved in corporate and retail banking.

2 Basis of preparation

2.1 Statement of compliance

These financial statements have been drawn up in accordance with International Financial Reporting Standards as adopted by the EU (“IFRS”). All references in these financial statements to IAS, IFRS or SIC/IFRIC interpretation refer to those adopted by the EU.

These financial statements have also been prepared and presented in accordance with the provisions of the Companies Act, 1995 (Chapter 386, Laws of Malta) and the Banking Act, 1994 (Chapter 371, Laws of Malta).

This is the first set of the Bank’s annual financial statements in which IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* have been applied. Changes to significant accounting policies are described in Note 2.5.

2.2 Basis of measurement

The financial statements have been prepared on a historical cost basis, except for the following material items:

Items	Measurement basis
Financial assets at FVOCI (from 1 January 2018)	Fair value
Available-for-sale financial assets (before 1 January 2018)	Fair value
Premises and improvements	Revalued amount.

2.3 Functional and presentation currency

These financial statements are presented in Euro (€), which is the Bank’s functional currency.

2.4 Use of estimates and judgements

In preparing these financial statements, management has made judgements, estimates and assumptions that affect the application of the Bank’s accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

Management’s approach in making such judgements in applying accounting policies, assumptions and estimation uncertainties has been aligned with the requirements of IFRS 9: *Financial Instruments*. This change in approach, although not deemed to involve significant judgements and estimates, is as follows:

2 Basis of preparation (continued)

2.4 Use of estimates and judgements (continued)

Applicable for 2018 only

Classification of financial assets

Assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are sole payment of principle and interest ("SPPI") on the principal amount outstanding.

Impairment of financial instruments

Determining inputs into the expected credit loss ("ECL") measurement model, including incorporation of forward-looking information.

In the opinion of the directors, the accounting estimates and judgements made in the course of preparing these financial statements are not difficult, subjective or complex to a degree which would warrant their descriptions as significant and critical in terms of the requirements of IAS1: *Presentation of Financial Statements*.

2.5 Changes in significant accounting policies

The Bank has initially adopted IFRS 9 Financial Instruments ("IFRS 9") (Note 2.5.A) and IFRS 15 *Revenue from Contracts with Customers* ("IFRS 15") (Note 2.5.B) from 1 January 2018.

A number of other new standards are also effective from 1 January 2018 but they do not have a material effect on the Bank's financial statements.

Due to the transition method chosen by the Bank in applying IFRS 9, comparative information throughout these financial statements has not generally been restated to reflect its requirements.

The adoption of IFRS 15 did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Bank. Accordingly, the impact on the comparative information is limited to new disclosure requirements.

The effect of initially applying these standards is mainly attributed to the following:

- impairment losses, not of a material nature, recognised on financial assets;
- additional disclosures related to IFRS 9; and
- additional disclosures related to IFRS 15.

2.5.A IFRS 9 Financial instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39"). The requirements of IFRS 9 represent a significant change from IAS 39. The new standard brings fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

The Bank has adopted consequential amendments to IFRS 7 *Financial Instruments: Disclosures* that are applied to disclosures relating to the year ended 31 December 2018, but have not been applied to the comparative information.

The key changes to the Bank's accounting policies resulting from its adoption of IFRS 9 are summarised below.

Notes to the Financial Statements

For the Year Ended 31 December 2018

2 Basis of preparation (continued)

2.5 Changes in significant accounting policies (continued)

2.5.A IFRS 9 Financial instruments (continued)

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the previous IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- the remaining amount of change in the fair value is presented in profit or loss.

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments. Under IFRS 9, credit losses are recognised earlier than under IAS 39.

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below.

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 were not deemed to result in a material change on retained earnings and have been reflected in the current period financial results. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.
- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.
 - The determination of the business model within which a financial asset is held.
 - The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
 - The designation of certain investments in equity instruments not held for trading as at FVOCI.
- If a debt security had low credit risk at the date of initial application of IFRS 9, then the Bank has assumed that credit risk on the asset had not increased significantly since its initial recognition.

2 Basis of preparation (continued)

2.5 Changes in significant accounting policies (continued)

2.5.B IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced IAS 18 *Revenue*, IAS 11 *Construction Contracts* and related interpretations.

The Bank initially applied IFRS 15 on 1 January 2018 retrospectively in accordance with IAS 8 without any practical expedients. The timing or amount of the Bank's fee and commission income from contracts with customers was not impacted by the adoption of IFRS 15. The impact of IFRS 15 was limited to the new disclosure requirements.

3 Significant accounting policies

Except for the changes explained in Note 2.5, the Bank has consistently applied the following accounting policies to all periods presented in these consolidated financial statements.

3.1 Financial assets and financial liabilities

Policy applicable from 1 January 2018

3.1.1 Recognition and initial measurement

The Bank initially recognises factoring receivables and other loans and advances, deposits by customers and banks and debt securities issued on the date on which they are originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

3.1.2 Classification

3.1.2.1 Financial assets

On initial recognition, a financial asset is classified as measured at: amortised cost, FVOCI or FVTPL.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are SPPI.

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.2 Classification (continued)

3.1.2.1 Financial assets (continued)

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

All other financial assets are classified as measured at FVTPL.

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Business model assessment

The Bank makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

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

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Assessment of whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.2 Classification (continued)

3.1.2.1 Financial assets (continued)

Assessment of whether contractual cash flows are solely payments of principal and interest

In assessing whether the contractual cash flows are SPPI, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Bank considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets; and
- features that modify consideration of the time value of money.

Non-recourse loans

In some cases, loans made by the Bank that are secured by collateral of the borrower limit the Bank's claim to cash flows of the underlying collateral (non-recourse loans). The Bank applies judgment in assessing whether the non-recourse loans meet the SPPI criterion.

The Bank typically considers the following information when making this judgement:

- whether the contractual arrangement specifically defines the amounts and dates of the cash payments of the loan;
- the fair value of the collateral relative to the amount of the secured financial asset;
- the ability and willingness of the borrower to make contractual payments, notwithstanding a decline in the value of collateral;
- whether the borrower is an individual or a substantive operating entity or is a special-purpose entity;
- the Bank's risk of loss on the asset relative to a full-recourse loan;
- the extent to which the collateral represents all or a substantial portion of the borrower's assets; and
- whether the Bank will benefit from any upside from the underlying assets.

Reclassifications

Financial assets are not reclassified subsequent to their initial recognition, except in the period after the Bank changes its business model for managing financial assets.

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

Financial liabilities

The Bank classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost.

3.1.3 Derecognition

3.1.3.1 Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

From 1 January 2018 any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability.

3.1.3.2 Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

3.1.4 Modifications of financial assets and financial liabilities

3.1.4.1 Financial assets

If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different.

If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised (Note 3.1.3) and a new financial asset is recognised at fair value plus any eligible transaction costs. Any fees received as part of the modification are accounted for as follows:

- fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- other fees are included in profit or loss as part of the gain or loss on derecognition.

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.4 Modifications of financial assets and financial liabilities (continued)

3.1.4.1 Financial assets (continued)

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place. This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases.

If the modification of a financial asset measured at amortised cost or FVOCI does not result in derecognition of the financial asset, then the Bank first recalculates the gross carrying amount of the financial asset using the original effective interest rate of the asset and recognises the resulting adjustment as a modification gain or loss in profit or loss. For floating-rate financial assets, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs or fees incurred and fees received as part of the modification the gross carrying amount of the modified financial asset is adjusted and amortised over the remaining term of the modified financial asset. If such a modification is carried out because of financial difficulties of the borrower then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income calculated using the effective interest rate method.

3.1.4.2 Financial liabilities

The Bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability derecognised and consideration paid is recognised in profit or loss. Consideration paid includes non-financial assets transferred, if any, and the assumption of liabilities, including the new modified financial liability.

If the modification of a financial liability is not accounted for as derecognition, then the amortised cost of the liability is recalculated by discounting the modified cash flows at the original effective interest rate and the resulting gain or loss is recognised in profit or loss. For floating-rate financial liabilities, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of the modification. Any costs and fees incurred are recognised as an adjustment to the carrying amount of the liability and amortised over the remaining term of the modified financial liability by re-computing the effective interest rate on the instrument.

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.5 Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

3.1.6 Fair value measurement

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When one is available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as 'active' if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument on initial recognition is normally the transaction price - i.e. the fair value of the consideration given or received. If the Bank determines that the fair value on initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique for which any unobservable inputs are judged to be insignificant in relation to the measurement, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value on initial recognition and the transaction price.

Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, then the Bank measures assets and long positions at a bid price and liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for the particular risk exposure. Portfolio-level adjustments - e.g. bid-ask adjustment or credit risk adjustments that reflect the measurement on the basis of the net exposure - are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

The fair value of a financial liability with a demand feature (e.g. a demand deposit) is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.7 Impairment

The Bank recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;
- factored receivables;
- loans and advances to banks; and
- other loans and advances to customers.

No impairment loss is recognised on equity investments.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

- debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments on which credit risk has not increased significantly since their initial recognition.

The Bank considers a debt investment security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Bank does not apply this low credit risk exemption to any other financial instruments.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Financial instruments for which a 12-month ECL is recognised are referred to as 'Stage 1 financial instruments'.

Life-time ECL are the ECL that result from all possible default events over the expected life of the financial instrument. Financial instruments for which a lifetime ECL is recognised but which are not credit-impaired are referred to as 'Stage 2 financial instruments'.

Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Bank expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive; and
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

Restructured financial assets

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised and ECL are measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the expected cash flows arising from the modified financial asset are included in calculating the cash shortfalls from the existing asset.

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.7 Impairment (continued)

Restructured financial assets (continued)

- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is included in calculating the cash shortfalls from the existing financial asset that are discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired (referred to as 'Stage 3 financial assets'). A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a loan that is overdue for 90 days or more is considered credit-impaired even when the regulatory definition of default is different.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness, if any.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows:

- financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- loan commitments and financial guarantee contracts: generally, as a provision;
- where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.7 Impairment (continued)

Presentation of allowance for ECL in the statement of financial position (continued)

- debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value.

Write-off

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are included in 'impairment losses on financial instruments' in the statement of profit or loss and OCI.

Financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

3.1.8 Non-derivative financial assets and financial liabilities

Non-derivative financial assets and financial liabilities comprise investments in equity and debt securities, cash and cash equivalents, loans and receivables, deposits and debt securities issued. These are recognised initially on the date on which they originated.

Non-derivative financial assets and financial liabilities are recognised initially at fair value plus, for an item not at fair value through profit or loss, any transaction costs directly attributable to its acquisition or issue. Subsequent to initial recognition, non-derivative financial assets and financial liabilities are measured as described below.

Financial assets

The Bank classifies its financial assets into one of the following categories:

3.1.8.1 Held-to-maturity investments

Held-to-maturity investments are non-derivative assets with fixed or determinable payments with a fixed maturity. Such investments are classified as held-to-maturity when the bank has the positive intent and ability to hold to maturity, and which are not designated as at fair value through profit or loss or as available-for-sale.

Held-to-maturity investments are carried at amortised cost using the effective interest method, less any impairment losses (see note 3.1.13). A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available-for-sale, and would prevent the Bank from classifying investment securities as held to maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.8 Non-derivative financial assets and financial liabilities (continued)

3.1.8.1 Held-to-maturity investments (continued)

- sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- sales or reclassifications after the Bank has collected substantially all of the asset's original principal; and
- sales or reclassifications attributable to non-recurring isolated events beyond the Bank's control that could not have been reasonably anticipated.

3.1.8.2 Available-for-sale financial assets

Available-for-sale investments are non-derivative investments that are designated as available for sale or are not classified within another category of financial assets. Available-for-sale investments comprise equity securities and debt securities. Unquoted equity securities whose fair value cannot reliably be measured are carried at cost. All other available-for-sale investments are measured at fair value after initial recognition.

Interest income is recognised in profit or loss using the effective interest method. Dividend income is recognised in profit or loss when the Bank becomes entitled to the dividend. Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss. Impairment losses are recognised in profit or loss (see note 3.1.13).

Other fair value changes, other than impairment losses, are recognised in other comprehensive income and presented as part of the fair value reserve in equity until the investment is sold, whereupon the cumulative gains and losses previously recognised in other comprehensive income are reclassified to profit or loss.

Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss. Impairment losses are recognised in profit or loss.

A non-derivative financial asset may be reclassified from the available-for-sale category to the loans and receivables category if it otherwise would have met the definition of loans and receivables and if the Bank has the intention and ability to hold that financial asset for the foreseeable future or until maturity.

3.1.8.3 Loans and receivables (including factored receivables)

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term. These include loans and advances to banks and to customers that are recognised on the day the cash is advanced to these borrowers, and factoring receivables. These loans and receivables are initially measured at fair value plus transaction costs that are directly attributable to the acquisition of the financial assets. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less impairment losses (see note 3.1.13).

3.1.8.4 Financial liabilities

The Bank classifies financial liabilities as measured at amortised cost (see note 3.8).

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.9 Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognised as a separate asset or liability in the statement of financial position. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in other comprehensive income, is recognised in profit or loss.

Assets, designated by the Bank as available-for-sale, that are sold, are derecognised and corresponding receivables from the buyer for the payment are recognised as at the date the Bank commits to sell the assets.

Held-to-maturity instruments and loans and receivables are derecognised on the day these are transferred by the Bank.

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

3.1.10 Offsetting

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when, and only when, the Bank has a current legally enforceable right to set off the recognised amounts and there is an intention either to settle them on a net basis, or to realise the asset and settle the liability simultaneously.

3.1.11 Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

3.1.12 Fair value measurement

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using the quoted prices in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.12 Fair value measurement (continued)

The best evidence of the fair value of a financial instrument at the initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Bank determines the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price.

Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or liability measured at fair value has a bid price and an ask price, then the Bank measures assets and long positions at a bid price and liabilities and short positions at an ask price.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Bank recognises transfer between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

3.1.13 Identification and measurement of impairment

At each reporting date, the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets (including equity instruments) are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

The Bank considers evidence of impairment for loans and receivables, held-to-maturity investment securities and available-for-sale debt securities at both a specific asset and collective level. All individually significant loans and receivables, held-to-maturity investment securities and available-for-sale debt securities are assessed for specific impairment. All individually significant loans and receivables, held-to-maturity investment securities and available-for-sale debt securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and receivables, held-to-maturity investment securities and available-for-sale debt securities that are not individually significant are collectively assessed for impairment by grouping together loans and receivables, held-to-maturity investment securities and available-for-sale debt securities with similar risk characteristics.

3 Significant accounting policies (continued)

3.1 Financial assets and financial liabilities (continued)

3.1.13 Identification and measurement of impairment (continued)

In assessing collective impairment, the Bank uses historical trends of the probability of default, the timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends. Default rates, loss rates and the expected timing of future recoveries are regularly reviewed by the Bank's Credit Committee to ensure that they remain appropriate.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised. If the cash flows of the renegotiated asset are substantially different, then the contractual rights to cashflows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and the new financial asset is recognised at fair value. The impairment loss before an expected restructuring is measured as follows.

- If the expected restructuring will not result in derecognition of the existing asset, then the estimated cash flows arising from the modified financial asset are included in the measurement of the existing asset based on their expected timing and amounts discounted at the original effective rate of the existing financial asset.
- If the expected restructuring will result in derecognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its derecognition. This amount is discounted from the expected date of derecognition to the reporting date using the original effective interest rate of the existing financial asset.

Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and receivables or held-to-maturity investment securities. Interest on impaired assets continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit and loss.

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in the fair value reserve in equity to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to the effective interest method are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, then the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

The Bank writes off certain loans and receivables and investment securities when they are determined to be uncollectible.

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Significant accounting policies (continued)

3.2 Cash and cash equivalents

Cash and cash equivalents comprise notes and coins in hand, unrestricted balances held with the Central Bank of Malta and highly liquid financial assets with original maturities of three months or less from the date of acquisition that are subject to an insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

3.3 Loans and advances

Policy applicable from 1 January 2018

Factored receivables and other loans and advances captions in the statement of financial position include factoring receivables and other loans and advances measured at amortised cost; they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

Factored receivables and loans and advances' were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market and that the Bank did not intend to sell immediately or in the near term.

Loans and advances to banks were classified as loans and receivables. Loans and advances to customers included those classified as factoring receivables and other loans and receivables.

Loans and advances were initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

3.4 Investment securities

Policy applicable from 1 January 2018

The 'investment securities' caption in the statement of financial position includes:

- equity investment securities mandatorily measured at FVTPL. These are at fair value with changes recognised immediately in profit or loss;
- debt securities measured at FVOCI; and
- equity investment securities designated as at FVOCI.

For debt securities measured at FVOCI, gains and losses are recognised in OCI, except for the following, which are recognised in profit or loss in the same manner as for financial assets measured at amortised cost:

- interest revenue using the effective interest method;
- ECL and reversals; and
- foreign exchange gains and losses.

When debt security measured at FVOCI is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss. The Bank elects to present in OCI changes in the fair value of certain investments in equity instruments that are not held for trading. The election is made on an instrument-by-instrument basis on initial recognition and is irrevocable.

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised in profit or loss. Dividends are recognised in profit or loss unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of an investment.

3 Significant accounting policies (continued)

Policy applicable before 1 January 2018

Investment securities were initially measured at fair value plus, in the case of investment securities not at FVTPL, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held-to-maturity, FVTPL or available-for-sale. The Bank held only investment securities classified as available-for-sale.

Available-for-sale

Available-for-sale investments are non-derivative investments that are designated as available-for-sale or are not classified as another category of financial assets. Available-for-sale investments comprise equity securities and debt securities. Unquoted equity securities whose fair value cannot be measured reliably are carried at cost. All other available-for-sale investments are measured at fair value after initial recognition.

Interest income is recognised in profit or loss using the effective interest method. Dividend income is recognised in profit or loss when the Bank becomes entitled to the dividend. Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss. Impairment losses are recognised in profit or loss.

Other fair value changes, other than impairment losses, are recognised in OCI and presented in the fair value reserve within equity. When the investment is sold, the gain or loss accumulated in equity is reclassified to profit or loss. A non-derivative financial asset may be reclassified from the available-for-sale category to the loans and receivables category if it would otherwise have met the definition of loans and receivables and if the Bank has the intention and ability to hold that financial asset for the foreseeable future or until maturity.

3.5 Property and equipment

3.5.1 Recognition and measurement

Items of property and equipment are measured at cost or revalued amount less accumulated depreciation and any accumulated impairment losses.

Freehold property is shown at open market value based on periodic valuations by the directors in consideration of a fair value determined by an external independent valuer less subsequent depreciation. A revaluation is carried out if the fair value of the property would otherwise differ materially from the carrying amount as at the reporting date. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset.

3.5.2 Revaluation surplus or deficit

Increases in the carrying amount arising on revaluation of property are credited to the revaluation reserve in the statement of changes in equity. Decreases that offset previous increases of the same individual asset are charged against revaluation reserve directly in equity; all other decreases are expensed in the statement of profit or loss and other comprehensive income. Any subsequent increases are credited to the statement of profit or loss and other comprehensive income up to the amount previously debited, and then to the revaluation reserve. Upon disposal of premises, the relevant portion of the revaluation reserve realised is released and transferred from revaluation reserve to retained earnings.

Where parts of an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Significant accounting policies (continued)

3.5 Property and equipment (continued)

3.5.3 Subsequent costs

The cost of replacing a component of an item of property and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits emanating from such component will flow to the Bank and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property and equipment are recognised in profit or loss as incurred.

3.5.4 Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment from the date they are available for use.

Land is not depreciated. Upon revaluation of property, accumulated depreciation is eliminated against the gross carrying amount of the asset.

The estimated useful lives for the current and comparative years are as follows:

Premises and improvements	20 – 100 years
Computer hardware	5 years
Other equipment	5 – 15 years
Motor vehicles	5 years.

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

3.6 Intangible assets – software

Software acquired by the Bank is stated at cost less accumulated amortization and any accumulated impairment losses.

Subsequent expenditure on software assets is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Software is amortised on a straight-line basis in profit or loss over its estimated useful life, from the date on which it is available for use. The estimated useful life of software for the current and comparative periods is three to fifteen years.

Amortisation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

3.7 Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets.

3 Significant accounting policies (continued)

3.7 Impairment of non-financial assets (continued)

An impairment loss is recognised if the carrying amount of an asset or cash-generating unit (CGU) exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

3.8 Deposits and debt securities issued

Deposits and debt securities issued are the Bank's sources of debt funding. These are initially measured at fair value less incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. The Bank did not designate any liabilities at fair value through profit or loss.

3.9 Interest

Policy applicable from 1 January 2018

Effective interest rate

Interest income and expense are recognised in profit or loss using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

When calculating the effective interest rate for financial instruments other than purchased or originated credit-impaired assets, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not ECL. For purchased or originated credit-impaired financial assets, a credit-adjusted effective interest rate is calculated using estimated future cash flows including ECL.

The calculation of the effective interest rate includes transaction costs and fees paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

Amortised cost and gross carrying amount

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

The 'gross carrying amount of a financial asset' is the amortised cost of a financial asset before adjusting for any expected credit loss allowance

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Significant accounting policies (continued)

3.9 Investment securities (continued)

Calculation of interest income and expense

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

Presentation

Interest income calculated using the effective interest method presented in the statement of profit or loss and OCI includes:

- interest on financial assets and financial liabilities measured at amortised cost; and
- interest on debt instruments measured at FVOCI.

Interest expense presented in the statement of profit or loss and OCI includes:

- financial liabilities measured at amortised cost.

Interest income and expense on other financial assets and financial liabilities carried at FVTPL were presented in other income under the category net income from other financial instruments at FVTPL.

Policy applicable before 1 January 2018

Effective interest rate

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The calculation of the effective interest rate includes all transaction costs, and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or liability.

Presentation

Interest income and expense presented in the statement of profit or loss and other comprehensive income include interest on financial assets and liabilities measured at amortised cost calculated on an effective interest basis and interest on available-for-sale investment securities calculated on an effective interest basis.

3 Significant accounting policies (continued)

3.10 Fees and commission

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, credit administration charges and similar fees, are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, the related loan commitment fees are recognised on a straight-line basis over the commitment period.

A contract with a customer that results in a recognised financial instrument in the Bank's financial statements may be partially in the scope of IFRS 9 and partially in the scope of IFRS 15. If this is the case, then the Bank first applies IFRS 9 to separate and measure the part of the contract that is in the scope of IFRS 9 and then applies IFRS 15 to the residual.

Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

3.11 Dividend income

Dividend income is recognised when the right to receive income is established. Usually, this is the ex-dividend date for quoted equity securities. Dividends are presented in net trading income, net income from other financial instruments at FVTPL or other revenue based on the underlying classification of the equity investment.

From 1 January 2018, dividends on equity instruments designated as at FVOCI that clearly represent a recovery of part of the cost of the investment are presented in OCI.

3.12 Foreign currency transactions

Transactions in foreign currencies are translated into the functional currency of the Bank at the spot exchange rates at the date of the transactions.

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the spot exchange rate at the reporting date. The foreign currency gain or loss on monetary items is the difference between the amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in the foreign currency translated at the spot exchange rate at the end of the year.

Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into the functional currency at the spot exchange rate at the date on which the fair value is determined. Non-monetary items that are measured based on historical cost in a foreign currency are translated using the spot exchange rate at the date of the transaction.

Foreign currency differences arising on translation are generally recognised in profit or loss. However, foreign currency differences arising from the translation of available-for-sale equity instruments (before 1 January 2018) or equity investments in respect of which an election has been made to present subsequent changes in fair value in OCI (from 1 January 2018).

Notes to the Financial Statements

For the Year Ended 31 December 2018

3 Significant accounting policies (continued)

3.13 Operating lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

3.14 Employee benefits

The Bank contributes towards the State pension defined contribution plan in accordance with local legislation and to which it has no commitment beyond the payment of fixed contributions. Obligations for contributions to the defined contribution plan are recognised as an expense in profit or loss as they fall due.

3.15 Income tax

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognised in profit or loss except to the extent that it relates to items recognised directly in equity, or in other comprehensive income.

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to the tax payable or receivable in respect of previous years. The amount of current tax payable or receivable is the best estimate of the tax amount expected to be paid or received that reflects uncertainty related to income taxes, if any. It is measured using tax rates enacted or substantively enacted at the reporting date. Current tax also includes any tax arising from dividends. Current tax assets and liabilities are offset only if certain criteria are met.

Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Future taxable profits are determined based on the reversal of relevant taxable temporary differences. If the amount of taxable temporary differences is insufficient to recognise a deferred tax asset in full, then future taxable profits, adjusted for reversals of existing temporary differences, are considered, based on business plans. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised; such reductions are reversed when the probability of future taxable profits improves.

Unrecognised deferred tax assets are reassessed at each reporting date and recognised to the extent that it has become probable that future taxable profits will be available against which they can be used. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date. Deferred tax assets and liabilities are offset only if certain criteria are met.

3.16 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognised as a deduction from the equity net of any tax effects. The Bank presents basic earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period.

3.17 Financial guarantees and loan commitments

'Financial guarantees' are contracts that require the Bank to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. 'Loan commitments' are firm commitments to provide credit under pre-specified terms and conditions.

3 Significant accounting policies (continued)

3.17 Financial guarantees and loan commitments (continued)

Financial guarantees issued or commitments to provide a loan at a below-market interest rate are initially measured at fair value. Subsequently, they are measured as follows:

- from 1 January 2018: at the higher of the loss allowance determined in accordance with IFRS 9 and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15; and
- before 1 January 2018: at the higher of the amount representing the initial fair value amortised over the life of the guarantee or the commitment and the present value of any expected payment to settle the liability when a payment under the contract has become probable. The Bank has issued no loan commitments that are measured at FVTPL.

For other loan commitments:

- from 1 January 2018: the Bank recognises a loss allowance;
- before 1 January 2018: the Bank recognised a provision in accordance with IAS 37 if the contract was considered to be onerous.

Liabilities arising from financial guarantees and loan commitments are included within provisions.

3.18 Segment reporting

An operating segment is a component of the Bank that engages in business activities from which it may earn revenues and incur expenses, including revenue and expenses that relate to transactions with any of the Bank's other components, whose operating results are reviewed regularly by the Bank's Board of Directors (being the chief operating decision maker), to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

3.19 New standards and interpretations endorsed by the EU but not yet effective

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2018 and earlier application is permitted; however the Bank has not early adopted them in preparing these financial statements.

3.19.1 IFRS 16 Leases

IFRS 16 specifies how an IFRS reporter will recognise, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. This standard is effective as from 1 January 2019. The Bank is assessing the potential impact on its financial statements resulting from the application of IFRS 16.

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review

4.1 Organisation

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Audit and Risk Committee and the Credit Committee with the responsibility for monitoring risk in their specified areas. Non-executive directors sit on these Committees whereas the Chief Executive Officer also attends meetings of the Board and Credit Committees. The Committees report regularly to the Board of Directors on their activities. The Board has also established an Asset and Liability Management Committee (ALCO) which is a management committee that reports to the Board of Directors on a quarterly basis.

Risk management policies have been established to identify and analyse the risks faced by the Bank, to set out appropriate risk limits and controls, and to monitor risks and adherence to limits. The risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank has developed appropriate risk management training for the needs of the relevant staff members.

4.2 Risk exposure

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

The main categories of risk are:

- *Credit risk;*
- *Market risk;*
- *Liquidity risk; and*
- *Operational risk.*

4.3 Capital base

The Bank is a licensed financial services provider and must therefore comply with the laws and regulations on capital requirements. The Bank has adopted the Standardised Approach to calculate its capital requirements.

4.3.1 Capital management

The Bank must have sufficient capital to comply with regulatory capital requirements. The purpose of the Bank's capital management is to ensure an efficient use of capital in relation to risk appetite as well as business development.

The Bank's regulatory capital is analysed into two tiers:

- Tier 1 capital, which includes ordinary share capital, capital contribution, retained earnings and accumulated other comprehensive income.
- Tier 2 capital consisting of any general loan-loss reserves and other reserves.

Banking operations are categorised as banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and to exposures not recognised in the statement of financial position.

The Bank has complied with all capital requirements directives and rules throughout the year.

There have been no material changes in the Bank's management of capital during the year.

4. Financial risk management and review (continued)

4.3 Capital base (continued)

4.3.2 Calculation of minimum capital requirement and risk-weighted assets

The minimum capital requirements are calculated for the credit, market and operational risk. The capital ratio is calculated using the definition of regulatory capital and risk-weighted assets. The total capital ratio must not be lower than 8%.

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

Below is the Bank's capital requirements and capital adequacy ratio computation.

	2018	2017
	€	€
Tier 1 capital		
Ordinary share capital	10,000,000	10,000,000
Capital contribution	16,032,675	12,532,675
Retained earnings	2,378,510	3,050,318
Property revaluation reserve	2,629,651	2,657,412
Fair value movement reserve	627,781	876,876
Deductions related to intangible assets	(1,653,214)	(1,634,529)
Transitional provisions (unrealised gains)	-	(706,858)
	30,015,403	26,775,894
Tier 2 capital		
General Banking Risk Reserve	6,470	640,825
	6,470	640,825
Total regulatory capital	30,021,873	27,416,719

Further information on the Bank's capital adequacy ratios may be found in sections 3 and 4 of Appendix 1 – Pillar 3 disclosures as at 31 December 2018, which are subject to internal review by the Bank.

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.4 Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's factored receivables, other loans and advances to customers and banks, and investment debt securities. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk). The Bank's credit risk policies and procedures are reviewed through internal audit.

The Bank follows standards, policies and procedures established by the Bank's Board of Directors for the control and monitoring of all risks. The Board of Directors has delegated the responsibility for the management of credit risk to the Credit Committee within a Board-approved credit sanctioning limit. The Bank's management is responsible for the oversight of the Bank's credit risk. The Bank's management, reporting to the Credit Committee and the Board of Directors, is responsible for managing the Bank's credit risk, including the following.

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorisation structure for the approval and renewal of credit facilities. Authorisation limits are allocated to the CEO, the Head of Finance and Treasury, the Credit Committee or the Board of Directors, as appropriate.
- Reviewing and assessing credit risk: the Bank's Credit department assesses all credit exposures in excess of designated limits, before facilities are committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.
- Limiting concentrations of exposure to counterparties, geographies and industries (for loans and advances and similar exposures) and by issuer, credit rating band, market liquidity and country (for investment securities).
- Developing and maintaining the Bank's risk gradings to categorise exposures according to the degree of risk of default. The current risk grading framework consists of 6 grades reflecting varying degrees of risk of default. The responsibility for setting risk grades lies with the final approving executive or committee, as appropriate. Risk grades are subject to regular reviews by senior management.
- Developing and maintaining the Bank's processes for measuring ECL: This includes processes for:
 - initial approval, regular validation and back-testing of the models used;
 - determining and monitoring significant increase in credit risk; and
 - incorporation of forward-looking information.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports on the credit quality of local portfolios are provided to the Credit Committee, which may require appropriate corrective action to be taken. These include reports containing estimates of ECL allowances.
- Providing advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.

4.4.1 Maximum exposure to credit risk

The Bank's maximum credit risk exposure to on and off-balance sheet financial instruments, before taking account of any collateral held or other credit enhancements can be classified in the following categories:

- Financial assets recognised in the statement of financial position comprise balances with Central Bank of Malta, financial investments, factored receivables, and other loans and advances. The maximum exposure to credit risk of these financial assets equals their carrying amount.
- Commitments for factored receivables, overdrafts and credit cards - the maximum exposure to credit risk is the full amount of the committed facilities (note 27).

4. Financial risk management and review (continued)

4.4 Credit risk (continued)

4.4.2 Credit quality analysis

The following table sets out information about the credit quality of financial assets measured at amortised cost, FVOCI debt investments (2018) and available-for-sale debt assets (2017). Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

	2018					2017
	Stage 1	Stage 2	Stage 3	POCI	Total	Total
Loans and advances to banks at amortised cost						
Grade 1: Low risk	18,788,220	-	-	-	18,788,220	20,079,499
Grade 2: Fair risk	-	-	-	-	-	-
Grade 3: Substandard	-	-	-	-	-	-
Grade 4: Doubtful	-	-	-	-	-	-
Grade 5: Loss	-	-	-	-	-	-
Loss allowance	-	-	-	-	-	-
Carrying amount	18,788,220	-	-	-	18,788,220	20,079,499
Factored receivables						
Grade 1: Low risk	84,849,585	-	-	-	84,849,585	47,168,371
Grade 2: Fair risk	1,400,109	-	-	-	1,400,109	1,943,345
Grade 3: Substandard	-	-	302,901	-	302,901	-
Grade 4: Doubtful	-	-	514,689	-	514,689	506,878
Grade 5: Loss	-	-	-	-	-	-
Loss allowance	(246,898)	-	(560,246)	-	(807,144)	(1,034,963)
Carrying amount	86,002,796	-	257,344	-	86,260,140	48,583,631
Other loans and advances to banks at amortised cost						
Grade 1: Low risk	74,240,685	-	-	-	74,240,685	65,610,902
Grade 2: Fair risk	31,291	-	-	-	31,291	6,305
Grade 3: Substandard	41,550	-	-	-	41,550	20,338
Grade 4: Doubtful	-	-	180,103	-	180,103	143,146
Grade 5: Loss	-	-	-	-	-	-
Loss allowance	(26,912)	-	(180,103)	-	(207,015)	(255,886)
Carrying amount	74,286,614	-	-	-	74,286,614	65,524,805

Loan commitments subject to credit loss provision (included with other loans and advances to customers) are rated as Grade 1 – Low risk and are classified within Stage 1.

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.4 Credit risk (continued)

4.4.2 Credit quality analysis (continued)

The following table sets out information about the overdue status of loans and advances to customers in Stages 1, 2 and 3.

	2018				2017
	Stage 1	Stage 2	Stage 3	Total	Total
Factored receivables					
Current	78,783,469	-	-	78,783,469	46,879,486
Overdue < 30 days	6,600,509	-	-	6,600,509	648,111
Overdue > 30 days	1,123,060	-	560,246	1,683,306	1,056,034
Total	86,507,038	-	560,246	87,067,284	48,583,631
Other loans and advances to customers					
Current	74,240,685	-	-	74,240,685	65,379,228
Overdue < 30 days	31,291	-	-	31,291	2,431
Overdue > 30 days	41,550	-	180,103	221,653	143,146
Total	74,313,526	-	180,103	74,493,629	65,524,805
Debt investment securities at FVOCI (2017: available-for-sale)					
Grade 1: Low risk	35,142,667	-	-	35,142,667	40,461,681
Grade 2: Fair risk	-	-	-	-	-
Grade 3: Substandard	-	-	-	-	-
Grade 4: Doubtful	-	-	-	-	-
Grade 5: Loss	-	-	-	-	-
Total gross carrying amount	35,142,667	-	-	35,142,667	40,461,681
Loss allowance (OCI)	(16,606)	-	-	(16,606)	-
Carrying amount – fair value	35,126,061	-	-	35,126,061	40,461,681

4.4.3 Analysis of collateral

The Bank holds collateral against loans and advances to customers in the form of pledges over deposits held with the Bank, collateralised by receivables or by real estate. Factored receivables are without recourse but are covered by credit insurance or asset backed. No collateral is held against investment and loans and advances to banks.

At the reporting date, 64% (2017: 73%) of other loans and advances to customers were secured by cash amounting to €47,431,963 (2017: €48,186,659), 18% (2017: 5%) of other loans and advances to customers were secured against property, whilst 9% (2017: 2%) of other loans and advances to customers were secured against receivables and shares.

4. Financial risk management and review (continued)

4.4 Credit risk (continued)

4.4.3 Analysis of collateral (continued)

The collateralised loans are as follows:

	Carrying amounts	
	2018	2017
	€	€
Loans and advances to customers		
<i>Type of collateral</i>		
Deposits held with the Bank	47,431,963	48,186,659
Bills of exchange	5,077,908	5,083,381
Real estate	13,203,308	3,143,852
Unlisted shares	930,098	854,724
Assignment of receivables	474,633	-
Factored receivables		
	2018	2017
	€	€
<i>Type of collateral</i>		
Motor vehicles	53,878,924	22,388,627

4.4.4 Amounts arising from Expected Credit Losses

Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and expert credit assessment and including forward-looking information.

The objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

- the remaining lifetime probability of default (PD) as at the reporting date; with
- the remaining lifetime PD for this point in time that was estimated at the time of initial recognition of the exposure (adjusted where relevant for changes in prepayment expectations).

The Bank uses three criteria for determining whether there has been a significant increase in credit risk:

- quantitative test based on movement in PD;
- qualitative indicators; and
- a backstop of 30 days past due (excluding factored receivables).

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.4 Credit risk (continued)

4.4.4 Amounts arising from Expected Credit Losses (continued)

Credit risk grades

The Bank allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement.

Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower.

Credit risk grades are defined and calibrated such that the risk of default occurring increases exponentially as the credit risk deteriorates so, for example, the difference in risk of default between credit risk grades 1 and 2 is smaller than the difference between credit risk grades 2 and 3.

Each exposure is allocated to a credit risk grade on initial recognition based on available information about the borrower. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade.

Generating the term structure of PD

Credit risk grades are a primary input into the determination of the term structure of PD for exposures.

The Bank collects performance and default information about its credit risk exposures analysed by jurisdiction or region and by type of product and borrower as well as by credit risk grading. For some portfolios, information purchased from external credit reference agencies is also used.

The Bank employs statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposures and how these are expected to change as a result of the passage of time.

Modified financial assets

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognised and the renegotiated loan recognised as a new loan at fair value. When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

- its remaining lifetime PD at the reporting date based on the modified terms; with
- the remaining lifetime PD estimated based on data on initial recognition and the original contractual terms.

When modification results in derecognition, a new loan is recognised and allocated to Stage 1 (assuming it is not credit-impaired at that time).

The Bank renegotiates loans to customers in financial difficulties (referred to as 'forbearance activities') to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis if the debtor is currently in default on its debt or if there is a high risk of default, there is evidence that the debtor made all reasonable efforts to pay under the original contractual terms and the debtor is expected to be able to meet the revised terms.

4. Financial risk management and review (continued)

4.4 Credit risk (continued)

4.4.4 Amounts arising from Expected Credit Losses (continued)

Modified financial assets (continued)

The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. The Bank Credit Committee regularly reviews reports on forbearance activities.

For financial assets modified as part of the Bank's forbearance policy, the estimate of PD reflects whether the modification has improved or restored the Bank's ability to collect interest and principal and the Bank's previous experience of similar forbearance action. As part of this process, the Bank evaluates the borrower's payment performance against the modified contractual terms and considers various behavioural indicators.

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired. A customer needs to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be credit-impaired/in default or the PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to Stage 1.

Measurement of ECL

The key inputs into the measurement of ECL are the term structure of the following variables:

- probability of default (PD);
- loss given default (LGD); and
- exposure at default (EAD).

ECL for exposures in Stage 1 is calculated by multiplying the 12-month PD by LGD and EAD.

Lifetime ECL is calculated by multiplying the lifetime PD by LGD and EAD.

LGD is the magnitude of the likely loss if there is a default. The Bank estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For loans secured by retail property, LTV ratios are a key parameter in determining LGD. LGD estimates are recalibrated for different economic scenarios and, for real estate lending, to reflect possible changes in property prices.

They are calculated on a discounted cash flow basis using the effective interest rate as the discounting factor.

EAD represents the expected exposure in the event of a default. The Bank derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EADs are potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts. For some financial assets, EAD is determined by modelling the range of possible exposure outcomes at various points in time using scenario and statistical techniques.

As described above, and subject to using a maximum of a 12-month PD for Stage 1 financial assets, the Bank measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for credit risk management purposes, the Bank considers a longer period. The maximum contractual period extends to the date at which the Bank has the right to require repayment of an advance or terminate a loan commitment or guarantee.

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.4 Credit risk (continued)

4.4.4 Amounts arising from Expected Credit Losses (continued)

Measurement of ECL (continued)

However, for retail overdrafts and credit card facilities that include both a loan and an undrawn commitment component, the Bank measures ECL over a period longer than the maximum contractual period if the Bank's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Bank's exposure to credit losses to the contractual notice period.

These facilities do not have a fixed term or repayment structure and are managed on a collective basis. The Bank can cancel them with immediate effect but this contractual right is not enforced in the normal day-to-day management, but only when the Bank becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Bank expects to take, and that serve to mitigate ECL. These include a reduction in limits, cancellation of the facility and/or turning the outstanding balance into a loan with fixed repayment terms.

Loss allowance

The following table summarises the loss allowance by class of financial instrument. Comparative amounts for 2017 represent the allowance account for credit losses and reflect the measurement basis under IAS 39.

	Gross carrying amount	Stage 1	Stage 2	Stage 3	Net amount as per SOFP	Comparative 2017 IAS39
	€	€	€	€	€	€
Loans and advances to customers at amortised cost	74,493,629	(26,912)	-	(180,103)	74,286,614	(255,886)
Factored receivables at amortised cost	87,067,284	(246,898)	-	(560,246)	86,260,140	(1,034,963)
Investment securities at FVOCI – Debt instruments	35,142,667	(16,606)	-	-	35,126,061	-
Loss allowance per stage		290,416	-	(740,349)		-
Total loss allowance			(1,030,765)			(1,290,849)

The provision for credit losses on Balances with Central Bank, Loans and advances to banks and Loan commitments is insignificant.

4. Financial risk management and review (continued)

4.4 Credit risk (continued)

4.4.5 Neither past due nor impaired loans and securities

	2017
	€
Factored receivables	37,895,232
Loans and advances to customers	57,185,841
Loans and advances to banks	20,079,499
Investment securities	57,213,412
	172,373,984

4.4.6 Past due but not impaired

These are receivables for the comparative period where contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security/collateral available and/or the stage of collection of amounts owed to the Bank.

4.4.7 Loans with renegotiated terms and forbearance

The Bank has adopted the additional accounting policies, in note 3.1.7, as requested by the European Securities and Markets Authority (ESMA) Public Statement on the Treatment of Forbearance Practices in IFRS Financial Statements of Financial Institutions.

Loans with renegotiated terms are loans that have been restructured due to changing market conditions, deterioration in the borrower's financial position and other factors not related to the current or potential credit deterioration of a customer. Under certain circumstances, the Bank may renegotiate the terms and conditions of a loan in response to actual or perceived financial difficulties of a customer. This practice of renegotiation for credit purposes is known as loan forbearance.

During 2018 and 2017, there were no instances where the terms and conditions of a loan had to be renegotiated in response to perceived financial difficulties of a customer. Consequently, the Bank did not apply forbearance measures during the current and comparative year.

As at 31 December 2018, the Bank did not renegotiate any loans (2017: five loans with a carrying amount of €164,514 and on which interest of €495 was recognised). The renegotiated loans were repaid in 2018.

	Total
	€
At 1 January 2017	12,902
Recognised impairment	-
Loans repaid	(12,902)
Renegotiated loans	164,514
At 31 December 2017	164,514
At 1 January 2018	164,514
Recognised impairment	-
Loans repaid	(164,514)
Renegotiated loans	-
At 31 December 2018	-

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.4 Credit risk (continued)

4.4.8 Write-off policy

The Bank writes off a loan, security and/or factored receivable balance (and any related expected credit loss) when management determines that the loan, security and/or factored receivable is uncollectible. This determination is reached after considering information such as occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. During the current year, amounts receivable of €141,992 (2017: €89,020) were written off by the Bank.

4.4.9 Settlement risk

'Settlement risk' is the risk of loss due to the failure of an entity to honour its obligations to deliver cash, securities or other assets as contractually agreed. The Bank's activities does not expose it to significant settlement risk.

4.4.10 Industry concentration

The following industry concentrations relating to loans and advances to customers are considered significant:

	2018		2017	
	€	%	€	%
Other sectors	5,179,722	7	8,594,354	13
Wholesale and retail trade	26,732,119	36	20,172,377	31
Real estate, renting and business activities	42,374,773	57	36,758,074	56
	74,286,614	100	65,524,805	100

4.4.11 Concentration risk

In addition to the industry concentration mentioned in note 4.4.10, the Bank monitors concentration of credit risk by sector and by geographic location. An analysis of concentrations of credit risk (net of loss allowances) is shown on the next page.

Notes to the Financial Statements

For the Year Ended 31 December 2018

4 Financial risk management (continued)

4.4 Credit risk (continued)

4.4.11 Concentration risk (continued)

	Loans and advances to customers		Factored receivables		Loans and advances to banks		Investment securities	
	2018	2017	2018	2017	2018	2017	2018	2017
	€	€	€	€	€	€	€	€
Carrying amount	74,286,614	65,524,805	86,260,140	48,583,631	18,788,220	20,079,499	42,111,712	57,213,412
Concentration by sector								
Corporate	73,141,574	64,445,135	32,381,216	26,222,590	-	-	13,154,388	12,879,052
Private individuals	1,145,040	1,079,670	53,878,924	22,361,041	-	-	-	-
Banks	-	-	-	-	18,788,220	20,079,499	100,050	810,751
Sovereign	-	-	-	-	-	-	21,871,623	26,771,878
Equity	-	-	-	-	-	-	6,985,651	16,751,731
	74,286,614	65,524,805	86,260,140	48,583,631	18,788,220	20,079,499	42,111,712	57,213,412
Concentration by location								
Europe	73,078,713	64,332,536	86,260,140	48,583,631	18,788,220	20,079,499	42,111,712	57,213,412
USA	1,207,901	1,192,269	-	-	-	-	-	-

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.4 Credit risk (continued)

4.4.11 Concentration risk (continued)

Concentration by location for loans and advances to customers and banks and investment securities is measured based on the location of the borrower or issuer of the security.

4.5 Market risk

Market risk comprises the risk of losses in value caused by unexpected changes in market prices (interest rates, equity prices, foreign exchange rates and credit spreads) before the affected positions can be closed out or hedged.

Market risk for the Bank consists of three elements:

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

4.5.1 Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or re-price at different times or at different amounts. The Bank accepts deposits from customers at both fixed and floating rates and for varying maturity periods. This risk is managed through the matching of the interest resetting dates on assets and liabilities. However, the Bank seeks to maximise the spread over the cost of capital by investing funds in a portfolio of securities and loans and receivables with a longer tenure than the liabilities (therefore carrying a negative maturity gap position) through the efficient management of shorter-term liabilities over the medium to longer term. The table on the next page summarises re-pricing mismatches at reporting date together with the effective interest rates where applicable.

Notes to the Financial Statements

For the Year Ended 31 December 2018

4 Financial risk management (continued)

4.5 Market risk (continued)

4.5.1 Interest rate risk (continued)

2018	Effective interest rate %	Carrying amount €	Less than three months €	Between three months and one year €	Between one year and five years €	More than five years €	Others €
Assets							
Cash	-	816	-	-	-	-	816
Balances receivable from Central Bank of Malta	- 0.4%	2,512,597	2,512,597	-	-	-	-
Investments:							
- Available-for-sale debt securities	3.7%	35,126,061	1,002,100	2,657,250	21,524,473	9,942,238	-
- Available-for-sale equities	-	6,985,651	-	-	-	-	6,985,651
Loans and advances to banks	- 0.3%	18,788,220	18,788,220	-	-	-	-
Other loans and advances to customers	3.3%	74,286,614	16,200,620	20,928,377	7,450,472	29,707,145	-
Factored receivables	-	86,260,140	-	-	-	-	86,260,140
Other assets	-	13,193,503	-	-	-	-	13,193,503
Total assets		237,153,602	38,503,537	23,585,627	28,974,945	39,649,383	106,440,110
Liabilities							
Balance owed to Central Bank of Malta	0%	13,000,000	-	-	13,000,000	-	-
Deposits from banks	0.1%	250,068	250,068	-	-	-	-
Deposits from customers	2.0%	177,157,086	87,904,790	44,850,846	35,175,448	9,226,002	-
Debt securities issued	4.6%	11,888,899	-	-	-	11,888,899	-
Current tax payable	-	802,074	-	802,074	-	-	-
Other liabilities	-	1,970,748	-	-	-	-	1,970,748
		205,068,875	88,154,858	45,652,920	48,175,448	21,114,901	1,970,748
Equity							
Issued capital		10,000,000	-	-	-	-	10,000,000
Property revaluation reserve		2,629,651	-	-	-	-	2,629,651
Depositors' compensation scheme reserve		409,640	-	-	-	-	409,640
Fair value reserve		627,781	-	-	-	-	627,781
Retained earnings		2,378,510	-	-	-	-	2,378,510
Reserve for general banking risk		6,470	-	-	-	-	6,470
Capital contribution		16,032,675	-	-	-	-	16,032,675
		32,084,727	-	-	-	-	32,084,727
Total liabilities and equity		237,153,602	88,154,858	45,652,920	48,175,448	21,114,901	34,055,475
Gap			(49,651,321)	(22,067,293)	(19,200,503)	18,534,482	72,384,635
Cumulative gap			(49,651,321)	(71,718,614)	(90,919,117)	(72,384,635)	-

Notes to the Financial Statements

For the Year Ended 31 December 2018

4 Financial risk management (continued)

4.5 Market risk (continued)

4.5.1 Interest rate risk (continued)

2017	Carrying amount €	Effective interest rate %	Less than three months €	Between three months and one year €	Between one year and five years €	More than five years €	Others €
Assets							
Cash	2,587	-	-	-	-	-	2,587
Balances receivable from Central Bank of Malta	1,948,344	-0.4%	1,948,344	-	-	-	-
Investments:							
- Available-for-sale debt securities	40,461,681	3.5%	-	707,000	23,294,450	16,460,231	-
- Available-for-sale equities	16,751,731	-	-	-	-	-	16,751,731
Loans and advances to banks	20,079,499	-0.2%	20,079,499	-	-	-	-
Other loans and advances to customers	65,524,805	3.9%	21,787,435	5,759,335	7,043,649	30,934,386	-
Factored receivables	48,583,631	-	-	-	-	-	48,583,631
Other assets	13,277,526	-	-	-	-	-	13,277,526
Total assets	206,629,804		43,815,278	6,466,335	30,338,099	47,394,617	78,615,475
Liabilities							
Balance owed to Central Bank of Malta	16,300,000	0%	-	3,300,000	13,000,000	-	-
Deposits from customers	145,767,422	1.3%	82,198,758	17,174,812	41,938,745	4,455,107	-
Debt securities issued	11,871,811	4.6%	-	-	-	11,871,811	-
Current tax payable	1,154,671	-	-	1,154,671	-	-	-
Other liabilities	2,064,060	-	-	-	-	-	2,064,060
	177,157,964		82,198,758	21,629,483	54,938,745	16,326,918	2,064,060
Equity							
Issued capital	10,000,000	-	-	-	-	-	10,000,000
Property revaluation reserve	2,657,412	-	-	-	-	-	2,657,412
Depositors' compensation scheme reserve	354,523	-	-	-	-	-	354,523
Fair value reserve	876,876	-	-	-	-	-	876,876
Retained earnings	3,050,318	-	-	-	-	-	3,050,318
Reserve for general banking risk	36	-	-	-	-	-	36
Capital contribution	12,532,675	-	-	-	-	-	12,532,675
	29,471,840		-	-	-	-	29,471,840
Total liabilities and equity	206,629,804		82,198,758	21,629,483	54,938,745	16,326,918	31,535,900
Gap			(38,383,480)	(15,163,148)	(24,600,646)	31,067,699	47,079,575
Cumulative gap			(38,383,480)	(53,546,628)	(78,147,274)	(47,079,575)	-

4. Financial risk management and review (continued)

4.5 Market risk (continued)

4.5.1 Interest rate risk (continued)

4.5.1.1 Interest rate profile

At the reporting date, the interest rate profile of the Bank's interest bearing financial instruments was:

	2018	2017
	€	€
Fixed rate instruments		
Investments – Debt securities	33,612,753	38,942,631
Loans and advances to banks	-	2,687,579
Loans and advances to customers	53,427,914	52,679,248
Balance owed to Central Bank of Malta	(13,000,000)	(16,300,000)
Debt securities in issue	(11,888,899)	(11,871,811)
Amounts owed to customers	(110,238,815)	(81,552,465)
	(48,087,047)	(15,414,818)
Variable rate instruments		
Investments – Debt securities	1,513,308	1,519,050
Loans and advances to customers	20,858,700	12,845,557
Balance receivable from Central Bank of Malta	2,512,597	1,948,344
Loans and advances to banks	18,788,220	17,391,920
Deposits from banks	(250,068)	-
Deposits from customers	(66,918,271)	(64,214,957)
	(23,495,514)	(30,510,086)

4.5.1.2 Fair value sensitivity analysis for fixed rate instruments

The Bank does not account for any fixed rate financial assets and liabilities at fair value through profit or loss. Therefore, a change in interest rates at the reporting date would not affect profit or loss.

A sudden increase of 50 basis points in the yield to maturity of the benchmark 10-year Malta Government Stock would lead to a decrease in value of investments available for sale amounting to €264,637. Such a decrease would be recognised in other comprehensive income and in equity. A decrease of 50 basis points in interest rates would have an equal but opposite effect on other comprehensive income and equity.

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.5 Market risk (continued)

4.5.1 Interest rate risk (continued)

4.5.1.3 Cash flow sensitivity analysis for variable rate instruments

The sensitivity of the interest rate gaps to various interest rate scenarios is also monitored by management. Standard scenarios that are considered on a quarterly basis include a 50 basis point (bp) parallel rise or fall in all the yield curves. An analysis of the Bank's sensitivity to an increase or decrease in market interest rates is as presented below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

	Impact on	
	Profit or Loss	Equity
	€	€
2018		
+ 50 basis points	(117,478)	(117,478)
- 50 basis points	117,478	117,478
2017		
+ 50 basis points	(151,697)	(151,697)
- 50 basis points	151,697	151,697

4.5.2 Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to the changes in foreign exchange rates. The Bank holds and deals in foreign currency with the aim to service the foreign exchange buying and selling activity by its clients. The Bank does not speculate on its foreign exchange holdings. The Bank's foreign exchange exposure is mainly limited to the United States Dollar and Swiss Francs originating from the Bank's corporate banking business. The Bank manages this risk by ensuring that its foreign currency denominated liabilities are matched to corresponding assets in the same currency.

Exposure to foreign currencies is maintained at minimum levels and within the prescribed limits set by the Bank's Board of Directors. In the scenario whereby all foreign currencies fluctuate up or down by 20% against the Euro, the carrying amounts of financial assets and liabilities would fluctuate, up or down by €373,047 and €248,698 (2017: €26,849) respectively.

4. Financial risk management and review (continued)

4.5 Market risk (continued)

4.5.2 Currency risk (continued)

The following table provides an analysis of the financial assets and liabilities of the Bank into relevant currency groupings:

	Euro €	2018 Other currencies €	Total €	Euro €	2017 Other currencies €	Total €
Financial assets						
Cash	816	-	816	2,587	-	2,587
Investment securities:						
- Debt securities	35,126,061	-	35,126,061	40,461,681	-	40,461,681
- Equities securities	6,985,651	-	6,985,651	16,751,732	-	16,751,732
Loans and advances to banks and balances receivable from Central Bank of Malta	20,178,375	1,122,441	21,300,816	21,449,042	578,801	22,027,843
Loans and advances to customers	73,078,714	1,207,900	74,286,614	64,332,536	1,192,269	65,524,805
Factored receivables	86,260,140	-	86,260,140	48,583,631	-	48,583,631
	221,629,757	2,330,341	223,960,098	191,581,209	1,771,070	193,352,279
Financial liabilities						
Balance owed to Central Bank of Malta	13,000,000	-	13,000,000	16,300,000	-	16,300,000
Debt securities issued	11,888,899	-	11,888,899	11,871,811	-	11,871,811
Deposits from banks	250,068	-	250,068	-	-	-
Deposits from customers	176,318,933	838,153	177,157,086	144,335,268	1,432,154	145,767,422
	201,457,900	838,153	202,296,053	172,507,079	1,432,154	173,939,233

At the reporting date, the Bank was not exposed to any significant off-balance sheet currency risk.

4.5.3 Investment price risk

The exposure of the Bank to this risk is not significant. Frequent management reviews are carried out to ensure high quality of the portfolio.

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.5 Market risk (continued)

4.5.4 Fair values of financial instruments

The fair values of financial assets that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Bank determines fair values using other valuation techniques.

(a) Valuation models

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

- Level 1: inputs that are quoted market prices (unadjusted) in active markets for identical instruments.
- Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3: inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs that are not observable 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.

Valuation techniques include net present value and discounted cash flow models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates.

Fair values reflect the credit risk of the instrument and include adjustments to take account the credit risk of the counterparty as appropriate.

The objective of valuation techniques is to arrive at a fair value measurement that reflects the price that would be received to sell the asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date.

(b) Valuation framework

The Bank's only assets which are measured at fair value are the investments in Malta Government Stocks, corporate bonds which are listed on the Malta Stock Exchange and collective investment schemes. Malta Government Stocks and corporate bonds are classified as investment securities at FVOCI, whilst investment securities include equity securities representing units in investment funds that, under IAS 39 were designated at FVOCI. However, under IFRS 9, only instruments meeting the definition of 'equity instrument' under IAS 32 can be classified as FVOCI. In view of the fact that these instruments do not meet this definition, these assets have been classified as mandatorily measured at FVTPL under IFRS 9. The Head of Finance and Treasury has overall responsibility for independently verifying the results of all fair value measurements.

4. Financial risk management and review (continued)

4.5 Market risk (continued)

4.5.4 Fair values of financial instruments (continued)

(c) Financial instruments measured at fair value – Fair value hierarchy

The table below analyses financial instruments measured at fair value at the reporting date by the level in fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the value recognised in the statement of financial position.

	Level 1 €	Level 2 €	Level 3 €	Total €
31-Dec-18				
Investment securities:				
- Debt instruments	35,126,061	-	-	35,126,061
- Equity instruments	6,985,651	-	-	6,985,651
	42,111,712	-	-	42,111,712
31-Dec-17				
Investment securities:				
- Debt instruments	40,461,681	-	-	40,461,681
- Equity instruments	16,751,731	-	-	16,751,731
	57,213,412	-	-	57,213,412

Investment securities – Debt instruments

This category of assets is carried at fair value. The instrument included in this category is quoted and its fair value has been determined by reference to the market price as at 31 December 2018.

Investment securities – Equity instruments

The Bank has an interest in an open-ended investment fund as disclosed in note 13.4. This asset is carried at fair value and its fair value has been determined by reference to the net asset value of this security as at 31 December 2018.

The Bank does not have a material exposure to unquoted equity investments.

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.5 Market risk (continued)

4.5.4 Fair values of financial instruments (continued)

(d) Financial instruments not measured at fair value

The fair value of the debt securities issued as at 31 December 2018 amounted to €12,720,000 (2017: €12,690,000) whilst its carrying amount was €11,888,899 (2017: €11,871,811). The carrying amount of all the other financial instruments not measured at fair value approximates their fair value for the following reasons:

Loans and advances to banks and factored receivables

This category of assets is reported net of allowances for expected credit losses to reflect the estimated recoverable amounts. Loans and advances to banks are re-priceable within 3 months whilst factored receivables are measured at amortised cost. The carrying amounts of these financial assets therefore approximate their fair values.

Loans and advances to customers

32% (2017: 33%) of loans and advances to customers mature within 3 months and hence, the carrying amounts of these financial assets approximate their fair values. 23% (2017: 20%) mature after more than three months and within five years. The other 45% (2017: 47%) mature after more than five years. A large portion of these instruments are cash secured by deposits from customers held by the Bank. There were no significant changes in the market interest rates during the term of these advances. The fair values of these instruments therefore approximate their respective carrying amount.

Balance owed to Central Bank of Malta

The loans contracted by the Bank during the current and comparative year with Central Bank of Malta under the Program 'Eurosysteem Monetary Policy Operations - Central Bank of Malta Directive No.8' are carried at amortised cost. Part of the Malta Government Stocks held by the Bank were pledged in favour of Central Bank of Malta as disclosed in note 13.2. The fair values of these loans approximate their respective carrying amount.

Deposits from customers

This category of liabilities is carried at amortised cost and amounts to €177,157,086 (2017: €145,767,422). 50% (2017: 47%) of the Bank's deposits from customers have a contractual repricing term of three months or less. The carrying value of these amounts approximates their fair values. In respect of other longer-term fixed-maturity deposits, which are re-priceable upon their contractual maturity date, given the insignificant changes in market interest rates, the fair values of these liabilities approximate their respective carrying amount.

Deposits from banks

This category of liabilities is carried at amortised cost and amounts to €250,068 (2017: €Nil). These are short term and the carrying value of these amounts approximates their fair values.

Debt securities issued

This category of liabilities is carried at amortised cost. The instrument included in this category is quoted and its fair value has been determined by reference to the market price as at 31 December 2018.

4. Financial risk management and review (continued)

4.6 Liquidity risk

Liquidity risk is the risk that the Bank's obligations to repay liabilities or fund new loans exceeds the Bank's ability to raise funds from either the liquidation of assets or the acceptance of new deposits. Liquidity risk arises because a bank does not exactly match the maturity of assets with the maturity of liabilities but must always be able to meet its liabilities as they fall due. Liquidity risk may also be affected by the depth of the market in which the Bank has its assets and liabilities.

Liquidity risk is divided into two categories:

- Market (product) liquidity risk: risk of losses arising from difficulty in accessing a product or market at the required time, price and volume.
- Funding liquidity risk: risk of losses arising from a timing mismatch between investing, placements and funds arising from activities resulting in obligations missing the settlement date or satisfied at higher than normal rates.

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation. The key elements of the Bank's liquidity strategy are as follows.

- Maintaining a diversified funding base consisting of customer deposits (both retail and corporate) and wholesale market deposits and maintaining contingency facilities.
- Carrying a portfolio of highly liquid assets, diversified by currency and maturity.
- Monitoring maturity mismatches, behavioural characteristics of the Bank's financial assets and financial liabilities, and the extent to which the Bank's assets are encumbered and so not available as potential collateral for obtaining funding.
- Stress testing of the Bank's liquidity position against various exposures and global, country-specific and Bank-specific events.

Liquidity policies and procedures are reviewed by internal audit. All liquidity policies are subject to the review by the Asset and Liability Management Committee and the approval of the Board of Directors.

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.6 Liquidity Risk (continued)

The following table provides an analysis of the financial assets and liabilities of the Bank into relevant remaining maturity groupings based on the ability of recovery or repayment:

At 31 December 2018	Less than one month	Between one and three months	Between three months and one year	Between one and five years	More than five years	Total
	€	€	€	€	€	€
Financial assets						
Cash	816	-	-	-	-	816
Investment securities:						
- Equity securities	6,965,498	-	-	-	20,153	6,985,651
- Debt securities	35,126,061	-	-	-	-	35,126,061
Loans and advances to banks and balances receivable from Central Bank of Malta	21,300,816	-	-	-	-	21,300,816
Loans and advances to customers	23,938,606	66,976	6,530,042	10,893,594	32,857,396	74,286,614
Factored receivables	18,699,663	17,844,266	11,915,609	36,469,168	1,331,434	86,260,140
	106,031,460	17,911,242	18,445,651	47,362,762	34,208,983	223,960,098
Financial liabilities						
Balance owed to Central Bank of Malta	-	-	-	13,000,000	-	13,000,000
Deposits from banks	250,068	-	-	-	-	250,068
Deposits from customers	79,616,940	8,287,848	44,850,848	35,175,448	9,226,002	177,157,086
Debt securities issued	-	-	-	-	11,888,899	11,888,899
	79,867,008	8,287,848	44,850,848	48,175,448	21,114,901	202,296,053

4. Financial risk management and review (continued)

4.6 Liquidity Risk (continued)

At 31 December 2017	Less than one month	Between one and three months	Between three months and one year	Between one and five years	More than five years	Total
	€	€	€	€	€	€
Financial assets						
Cash	2,587	-	-	-	-	2,587
Investment securities:						
- Equity securities	16,731,578	-	-	-	20,153	16,751,731
- Debt securities	40,461,681	-	-	-	-	40,461,681
Loans and advances to banks and balances receivable from Central Bank of Malta	22,027,843	-	-	-	-	22,027,843
Loans and advances to customers	21,743,312	44,123	5,759,335	7,043,649	30,934,386	65,524,805
Factored receivables	15,078,797	12,044,527	6,169,433	14,975,084	315,790	48,583,631
	<u>116,045,798</u>	<u>12,088,650</u>	<u>11,928,768</u>	<u>22,018,733</u>	<u>31,270,329</u>	<u>193,352,278</u>
Financial liabilities						
Balance owed to Central Bank of Malta	-	-	3,300,000	13,000,000	-	16,300,000
Deposits from customers	75,813,453	6,385,305	17,174,812	38,938,745	7,455,107	145,767,422
Debt securities issued	-	-	-	-	11,871,811	11,871,811
	<u>75,813,453</u>	<u>6,385,305</u>	<u>20,474,812</u>	<u>51,938,745</u>	<u>19,326,918</u>	<u>173,939,233</u>

Notes to the Financial Statements

For the Year Ended 31 December 2018

4. Financial risk management and review (continued)

4.6 Liquidity Risk (continued)

4.6.1 Exposure to liquidity risk

The key measure used by the Bank for managing liquidity risk is the ratio of net liquid assets to customer deposits. For this purpose, net liquid assets are considered as comprising cash and cash equivalents less any deposits from banks and other borrowings and commitments maturing within the next month. This calculation is used to measure the Bank's compliance with the liquidity limit established by the Malta Financial Services Authority. Details of the Bank's ratio of net liquid assets to deposits at the reporting date and during the reported period are as follows:

	2018	2017
As at 31 December	97%	70%
Average for the year	82%	85%
Maximum for the year	97%	104%
Minimum for the year	65%	70%

4.6.2 Residual contractual maturities of financial liabilities

The table below shows a maturity analysis for financial liabilities by remaining contractual maturities of undiscounted cash flows:

	Carrying amount	Gross nominal outflow	Repayable on demand	Between one and three months	Between three months and one year	Between one and five years	After more than five years
				€	€	€	€
At 31 December 2018							
Debt securities issued	11,888,899	(15,780,000)	-	-	(540,000)	(2,160,000)	(13,080,000)
Balance owed to Central Bank of Malta	13,000,000	(13,000,000)	-	-	-	(13,000,000)	-
Deposits from banks	250,068	(250,068)	(250,068)	-	-	-	-
Deposits from customers	177,157,086	(182,396,096)	(67,123,570)	(20,781,220)	(45,403,197)	(37,670,403)	(11,417,706)
	202,296,053	(211,426,164)	(67,373,638)	(20,781,220)	(45,943,197)	(52,830,403)	(24,497,706)
At 31 December 2017							
Debt securities issued	11,871,811	(16,320,000)	-	-	(540,000)	(2,160,000)	(13,620,000)
Balance owed to Central Bank of Malta	16,300,000	(16,300,000)	-	-	(3,300,000)	(13,000,000)	-
Deposits from customers	145,767,422	(150,075,888)	(75,840,429)	(6,485,002)	(18,311,665)	(40,668,866)	(8,769,926)
	173,939,233	(182,695,888)	(75,840,429)	(6,485,002)	(22,151,665)	(55,828,866)	(22,389,926)

4. Financial risk management and review (continued)

4.7 Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Bank's operations.

Management of operational risk

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness. To manage this risk in an appropriate manner the following policies have been adopted:

- To adopt policies, processes and procedures to control and/or mitigate material operational risks.
- To identify and assess the operational risk inherent in all material products, activities, processes and systems. Before new products, activities, processes and systems are introduced or undertaken, the operational risk inherent in them is subject to adequate assessment.
- To monitor all potential operational risks and material exposures to losses.
- To monitor whether there is motive, means and opportunity, within the overall control environment to commit fraudulent acts.
- To adopt contingency and business continuity plans to ensure ability to operate on an ongoing basis and limit losses in the event of severe business disruption.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management. Periodic operational risk reports are submitted to the Bank's Audit and Risk Committee.

A financial measurement of this risk is arrived at by the Bank for the purpose of allocating risk capital using the Basic Indicator Approach under the Capital Requirements Directive rules. The capital requirement for operational risk under this method was calculated at €974,543 as at 31 December 2018 (2017: €964,387).

Notes to the Financial Statements

For the Year Ended 31 December 2018

5 Net interest income

	Note	2018 €	2017 €
Interest income			
Loans and advances to banks		4,164	7,849
Loans and advances to customers		2,224,182	2,825,933
Factored receivables		4,865,892	2,739,731
Financial assets measured at FVOCI (2017: available-for-sale)		986,791	1,492,274
		8,081,029	7,065,787
Interest expense			
Deposits from banks		-	3,933
Loans and advances to banks		56,178	113,282
Deposits from customers		2,014,687	1,870,474
Debts securities issued		540,000	540,000
Amortisation of debt issuance costs	21	17,088	17,090
Total interest expense		2,627,953	2,544,779
Net interest income		5,453,076	4,521,008

Income from factored receivables has been reclassified from Net fee and commission income (note 6) to Net interest income to conform to the current year presentation.

The amounts reported above include interest income and expense, calculated using the effective interest method, that relate to the following financial assets and financial liabilities.

	2018 €	2017 €
Interest income		
Financial assets measured at amortised cost	7,094,238	5,573,513
Financial assets measured at FVOCI (2017: available-for-sale)	986,791	1,492,274
Total	8,081,029	7,065,787
Financial liabilities measured at amortised cost		
	2,627,953	2,544,779

6 Net fee and commission income

	2018	2017
	€	€
Account maintenance and other bank charges	107,713	493,089
Fee and commission income	107,713	493,089
SWIFT and bank charges	(74,055)	(61,485)
Fee and commission expense	(74,055)	(61,485)
Net fee and commission income	33,658	431,604

Performance obligations and revenue recognition policies

Fee and commission income from contracts with customers is measured based on the consideration specified in a contract with a customer. The Bank recognises revenue when it transfers control over a service to a customer.

The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers, including significant payment terms, and the related revenue recognition policies.

Type of service	Nature and timing of satisfaction of performance obligations, including significant payment terms	Revenue recognition under IFRS 15 (applicable from 1 January 2018)
Retail and corporate banking service	<p>The Bank provides banking services to corporate customers, including the provision of credit facilities, foreign currency transactions, account maintenance and servicing fees.</p> <p>Transaction-based fees for foreign currency transactions and credit facilities are charged to the customer's account when the transaction takes place.</p> <p>Servicing fees are charged on a periodical basis and are based on fixed rates reviewed annually by the Bank.</p> <p>No fees are charged to the Bank's retail customer base.</p>	<p>Revenue from account service and servicing fees is recognised over time as the services are provided.</p> <p>Revenue related to transactions is recognised at the point in time when the transaction takes place.</p>

Notes to the Financial Statements

For the Year Ended 31 December 2018

7 Other revenue

	2018	2017
	€	€
Net gain on sale of available-for-sale securities	-	1,826,840
Dividends on available-for-sale equity securities	-	262,536
Net loss from other financial instruments at FVTPL	(449,079)	-
Net gain on sale of debt investment securities measured at FVOCI	450,896	-
Dividends on equity securities measured at FVTPL	199,411	-
Net gain from foreign exchange	52,545	14,615
Other income	64,378	45,628
	318,151	2,149,619

8 Impairment allowances

	2018	2017
	€	€
Write-offs		
Factored receivables	(141,992)	(89,020)
	(141,992)	(89,020)
Loss allowance		
Factored receivables		
- Reversal of prior year provisions	1,034,963	-
- Stage 1 and 2	(246,898)	-
- Stage 3	(560,246)	-
Credit cards, overdrafts and other advances		
- Reversal of prior year provisions	255,886	-
- Stage 1 and 2	(26,912)	-
- Stage 3	(180,103)	-
	276,690	-
Provisions for credit losses		
Factored receivables		
- collective allowance	-	(304,856)
- specific allowance	-	72,819
Credit cards, overdrafts and other advances		
- collective allowance	-	(49,574)
- specific allowance	-	20,890
	-	(260,721)
Total Impairments	134,698	(349,741)

9 Profit before tax

9.1 Profit before income tax is stated after charging fees payable, exclusive of VAT, to the Bank's auditors during 2018 for:

	€
Auditors' remuneration	37,480
Other assurance services	4,348
Other non-audit services	44,488
	86,316

9.2 Personnel expenses incurred by the Bank during the year are analysed as follows:

	2018	2017
	€	€
Directors' fees	42,000	46,000
Staff costs:		
- wages, salaries and allowances	1,214,832	1,046,515
- defined contribution social security costs	70,673	59,124
	1,327,505	1,151,639

9.3 The weekly average number of persons employed by the Bank during the year was as follows:

	2018	2017
	No.	No.
Managerial	5	5
Supervisory and clerical	25	23
	30	28

9.4 Other expenses incurred by the Bank during the year are analysed as follows:

	2018	2017
	€	€
IT hardware and software maintenance costs	306,056	417,384
Marketing expenses	158,076	248,692
Amortisation of premium on investment securities	185,963	230,248
Other	900,172	694,018
	1,550,267	1,590,342

Notes to the Financial Statements

For the Year Ended 31 December 2018

10 Income tax expense

10.1 Total income tax expense

	Note	2018 €	2017 €
Current tax expense			
Current year		(948,950)	(1,318,361)
Deferred tax			
Origination and reversal of temporary differences	24	14,631	22,834
Total income tax expense		(934,319)	(1,295,527)

10.2 The income tax expense for the year and the result of the accounting profit multiplied by the tax rate applicable in Malta, the Bank's country of incorporation, are reconciled as follows:

	2018 €	2017 €
Profit before income tax	2,442,498	3,556,931
Income tax at the applicable tax rate of 35%	(854,874)	(1,244,926)
Income tax effect of:		
Depreciation charges not deductible by way of capital allowances	(21,622)	(11,023)
Non-taxable income	181	346
Non-allowable expenses	(58,004)	(39,924)
Tax expense	(934,319)	(1,295,527)

11 Earnings per share

Earnings per share is calculated on the profit attributable to ordinary shareholders of the Bank for the year ended 31 December 2018 amounting to €1,508,179 (2017: €2,261,404) divided by 400,000 (2017: 400,000), being the equivalent number of ordinary shares in issue and ranking equally for dividend during the year.

12 Financial assets and financial liabilities

12.1 Classification of financial assets and financial liabilities

The following table provides a reconciliation between line items in the statement of financial position and categories of financial instruments.

2018	Note	Mandatory at FVTPL	FVOCI – debt instruments	FVOCI – equity instruments	Amortised cost	Total carrying amount
Cash and items in transit	29	-	-	-	816	816
Balances with Central Bank of Malta	29	-	-	-	2,512,597	2,512,597
Investment securities	13	6,965,498	35,126,061	20,153	-	42,111,712
Loans and advances to banks	14	-	-	-	18,788,220	18,788,220
Factored receivables	15	-	-	-	86,260,140	86,260,140
Other loans and advances to customers	16	-	-	-	74,286,614	74,286,614
Other assets	19	-	-	-	1,275,436	1,275,436
Total financial assets		6,965,498	35,126,061	20,153	183,123,823	225,235,535
Balance owed to Central Bank of Malta	20	-	-	-	13,000,000	13,000,000
Deposits from banks	21	-	-	-	250,068	250,068
Deposits from customers	22	-	-	-	177,157,086	177,157,086
Debt securities issued	23	-	-	-	11,888,899	11,888,899
Accruals	25	-	-	-	1,410,264	1,410,264
Total financial liabilities		-	-	-	203,706,317	203,706,317

2017	Note	Available-for-sale	Amortised cost	Total carrying amount
Cash and items in transit	29	-	2,587	2,587
Balances with Central Bank of Malta	29	-	1,948,344	1,948,344
Investment securities	13	57,213,412	-	57,213,412
Loans and advances to banks	14	-	20,079,499	20,079,499
Factored receivables	15	-	48,583,631	48,583,631
Other loans and advances to customers	16	-	65,524,805	65,524,805
Other assets	19	-	1,299,677	1,299,677
Total financial assets		57,213,412	137,438,543	194,651,955
Balance owed to Central Bank of Malta	20	-	16,300,000	16,300,000
Deposits from customers	22	-	145,767,422	145,767,422
Debt securities issued	23	-	11,871,811	11,871,811
Accruals	25	-	1,340,051	1,340,051
Total financial liabilities		-	175,279,284	175,279,284

Notes to the Financial Statements

For the Year Ended 31 December 2018

12 Financial assets and financial liabilities (continued)

12.2 Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

The following table shows the original measurement categories in accordance with IAS 39 and the new measurement categories under IFRS 9 for the Bank's financial assets and financial liabilities as at 1 January 2018.

	Note	Original classification under IAS39	New classification under IFRS 9	Original carrying amount under IAS39	New carrying amount under IFRS9
Cash and items in transit	29	Loans and receivables	Amortised cost	2,587	2,587
Balances with Central Bank of Malta	29	Loans and receivables	Amortised cost	1,948,344	1,948,344
Investment securities	13	Available-for-sale	FVOCI	40,481,834	40,481,834
Investment securities	13	Available-for-sale	FVTPL (mandatory)	16,731,578	16,731,578
Loans and advances to banks	14	Loans and receivables	Amortised cost	20,079,499	20,079,499
Factored receivables	15	Loans and receivables	Amortised cost	48,583,631	48,583,631
Other loans and advances to customers	16	Loans and receivables	Amortised cost	65,524,805	65,524,805
Other assets	19	Loans and receivables	Amortised cost	1,299,677	1,299,677
Total financial assets				194,651,955	194,651,955
Balance owed to Central Bank of Malta	20	Loans and receivables	Amortised cost	16,300,000	16,300,000
Deposits from customers	22	Amortised cost	Amortised cost	145,767,422	145,767,422
Debt securities issued	23	Amortised cost	Amortised cost	11,871,811	11,871,811
Accruals	25	Amortised cost	Amortised cost	1,340,051	1,340,051
Total financial liabilities				175,279,284	175,279,284

The Bank's accounting policies on the classification of financial instruments under IFRS 9 are set out in Note 3. The following table reconciles the carrying amounts of investment securities under IAS 39 to the carrying amounts under IFRS 9 on transition to IFRS 9 on 1 January 2018.

12 Financial assets and financial liabilities (continued)

12.2 Classification of financial assets and financial liabilities on the date of initial application of IFRS 9 (continued)

	IAS39 carrying amount 31 December 2017	Reclassification	Remeasurement	IFRS9 carrying amount 1 January 2018
Available-for-sale				
Investment securities:				
Opening balance	57,213,412			
To FVTPL		(20,153)		
To FVOCI - equity		(16,731,578)		
To FVOCI - debt		(40,461,681)		
Closing balance				-
FVOCI – equity				
Investment securities:				
Opening balance				
From available-for-sale		20,153	-	
Closing balance				20,153
FVOCI – debt				
Investment securities:				
Opening balance				
From available-for-sale		40,461,681	-	
Closing balance				40,461,681
Total FVOCI				40,481,834
FVTPL – equity				
Investment securities:				
Opening balance				
From available-for-sale		16,731,578	-	
Closing balance				16,731,578
Total FVTPL				16,731,578

Amortised cost financial instruments under IAS 39 have not been materially affected on classification and measurement on transition to IFRS 9 on 1 January 2018.

Notes to the Financial Statements

For the Year Ended 31 December 2018

13 Investment securities

13.1

	2018	2017
	€	€
Investment securities measured at FVOCI - debt instruments	35,126,061	-
Investment securities designated		
as at FVOCI - equity investments	20,153	-
as at FVTPL - equity investments	6,965,498	-
Available-for-sale debt securities	-	40,461,681
Available-for-sale equity instruments	-	16,751,731
	42,111,712	57,213,412

13.2 Investment securities measured at FVOCI - debt instruments comprise:

	2018
	€
Malta Government Stocks	21,871,623
Local corporate bonds	13,254,438
	35,126,061

As at 31 December 2018, part of the Malta Government Stocks held by the Bank were pledged in favour of the Central Bank of Malta to cover the Bank's participation in the Euro-system financing operations, €13,000,000 at that date.

13.3 Investment securities designated as at FVOCI - equity investments comprise:

	2018
	€
Unquoted equity holding	20,153

13.4 Investment securities mandatory measured at FVTPL - equity investments comprise:

	2018
	€
Collective investment schemes	6,965,498

13 Investment securities (continued)

13.5 Available-for-sale debt securities comprise:

	2017
	€
Malta Government Stocks	26,771,878
Local corporate bonds	13,689,803
	<u>40,461,681</u>

13.6 Available-for-sale equity instruments comprise:

	2017
	€
Unquoted equity holding	20,153
Collective investment schemes	16,731,578
	<u>16,751,731</u>

As at 31 December 2017, part of the Malta Government Stocks held by the Bank were pledged in favour of the Central Bank of Malta to cover the Bank's participation in the Euro-system financing operations, €16,300,000 at that date.

13.7 The movement in investment securities may be summarised as follows:

	€
At 1 January 2017	66,925,325
Acquisitions	12,604,899
Disposals	(21,400,533)
Net fair value movement	(916,279)
At 31 December 2017	<u>57,213,412</u>
At 1 January 2018	57,213,412
Acquisitions	9,542,978
Disposals	(24,129,036)
Net fair value movement	(515,642)
At 31 December 2018	<u>42,111,712</u>

Notes to the Financial Statements

For the Year Ended 31 December 2018

14 Loans and advances to banks

	2018	2017
	€	€
Repayable on call and at short notice	18,788,220	17,391,920
Term loans and advances	-	2,687,579
	18,788,220	20,079,499

15 Factored receivables

	2018	2017
	€	€
Receivables factored without recourse		
- Invoice factoring	33,188,360	27,229,967
- Bills of Exchange factoring	53,878,924	22,388,627
	87,067,284	49,618,594
Less Impairment loss allowance	(807,144)	(1,034,963)
	86,260,140	48,583,631

16 Other loans and advances to customers

16.1 Loans and advances to customers at amortised cost

	Note	2018	2017
		€	€
Term loans and advances to third parties		9,421,124	3,670,462
Term loans and advances to related parties	31.3	52,531,963	53,515,379
Credit cards and overdrafts		12,540,542	8,594,850
Less Impairment loss allowance		(207,015)	(255,886)
		74,286,614	65,524,805

17 Property and equipment

17.1

	Cost / Revalued amount		Cost		
	Total €	Premises and improvements €	Computer hardware €	Other equipment €	Motor vehicles €
Cost/revalued amount					
At 1 January 2017	4,314,503	3,059,825	544,107	603,947	106,624
Acquisitions	5,473,905	5,416,799	29,787	27,319	-
Premises revaluation	1,806,050	1,806,050	-	-	-
At 31 December 2017	11,594,458	10,282,674	573,894	631,266	106,624
At 1 January 2018	11,594,458	10,282,674	573,894	631,266	106,624
Acquisitions	215,972	166,246	35,334	14,392	-
At 31 December 2018	11,810,430	10,448,920	609,228	645,658	106,624
Depreciation					
At 1 January 2017	1,088,477	195,427	426,907	450,746	15,397
Charge for year	162,661	70,253	37,923	35,393	19,092
At 31 December 2017	1,251,138	265,680	464,830	486,139	34,489
At 1 January 2018	1,251,138	265,680	464,830	486,139	34,489
Charge for year	294,439	197,320	40,841	37,185	19,093
At 31 December 2018	1,545,577	463,000	505,671	523,324	53,582
Carrying amount					
At 1 January 2017	3,226,026	2,864,398	117,200	153,201	91,227
At 31 December 2017	10,343,320	10,016,994	109,064	145,127	72,135
At 1 January 2018	10,343,320	10,016,994	109,064	145,127	72,135
At 31 December 2018	10,264,853	9,985,920	103,557	122,334	53,042

17.2 The carrying amount of premises and improvements that would have been included in the financial statements had these assets not been revalued (see note 3.5) and had been carried at cost less depreciation is €7,258,389 (2017: €7,009,072).

17.3 As at 31 December 2018, capital expenditure authorised but not contracted for amounted to €2,571,449 (2017: €234,500) and capital expenditure authorised and contracted for amounted to €Nil (2017: nil). The bulk of this expenditure will be directed toward construction and refurbishment works at what will eventually become the Bank's main premises at Castille Square.

Notes to the Financial Statements

For the Year Ended 31 December 2018

17 Property and equipment (continued)

17.4 Revaluation of premises

The Bank's premises are measured at the revalued amount less accumulated depreciation. The revaluation amount is determined on the basis of open market values provided periodically, at least every five years, by independent valuers. The Bank occupies almost the full complement of two adjacent and prestigious houses – Nos. 53 and 58 in East Street, Valletta, close to the 'Lower Barrakka' Gardens and with views of the Grand Harbour and the three cities. The buildings date to the eighteenth century and are structurally sound and complete of finishes of a very high standard. In 2017, the Bank acquired new premises at 4, Castille Place and as at 31 December 2018 was in the process of commencing extensive improvements and refurbishment to the building.

The value of the new premises acquired during 2017 approximates its acquisition price, whilst the valuations of the other properties held since prior years were revalued by an independent professionally qualified architect during 2017 in accordance with accounting policy 3.5.1. The valuation was principally done using the "investment income approach" whereby market value is derived by capitalising at an appropriate yield rate, the annual income produced, should the property be leased out to third parties. The income is arrived at by analysing a number of rental rates taking cognisance of the location of the property, its size, layout, and planning and energy performance considerations. Significant unobservable inputs used in the valuation of these properties is the rental income applied in the region of €33 per square metre per month for commercial premises, and the percentage capitalisation rate of 7% which indicates the multiplier relationship between Net Rental Income and Property Value.

The valuation is deemed to reflect a level 3 in the fair value hierarchy.

18 Intangible assets

	Computer software €
Cost	
At 1 January 2017	2,865,128
Acquisitions	365,252
At 31 December 2017	3,230,380
At 1 January 2018	3,230,380
Acquisitions	343,559
At 31 December 2018	3,573,939
Depreciation	
At 1 January 2017	1,304,936
Charge for year	290,915
At 31 December 2017	1,595,851
At 1 January 2018	1,595,851
Charge for the year	324,874
At 31 December 2018	1,920,725
Carrying amount	
At 1 January 2017	1,560,192
At 31 December 2017	1,634,529
At 1 January 2018	1,634,529
At 31 December 2018	1,653,214

As at 31 December 2018, capital expenditure authorised but not contracted for amounted to €675,279 (2017: €648,703) and capital expenditure authorised and contracted for amounted to €89,503 (2017: €43,750).

Notes to the Financial Statements

For the Year Ended 31 December 2018

19 Other assets

	2018	2017
	€	€
Accrued income	1,131,526	1,213,623
Accounts receivable and prepayments	143,910	86,054
	1,275,436	1,299,677

20 Balance owed to Central Bank of Malta

20.1 The Bank participates in the Euro-system financing operations. In this respect, part of the Malta Government Stocks held by the Bank (see note 13) were pledged in favour of the Central Bank of Malta to cover the Bank's participation.

21 Deposits from banks

	2018	2017
	€	€
Other deposits from banks	250,068	-
	250,068	-

22 Deposits from customers

	2018	2017
	€	€
Term deposits	110,238,815	77,847,511
Current deposits	66,918,271	67,919,911
	177,157,086	145,767,422

Notes to the Financial Statements

For the Year Ended 31 December 2018

23 Debt securities issued

	2018	2017
	€	€
Debt securities issued at amortised cost	11,888,899	11,871,811
At 1 January	11,871,811	11,854,721
Amortisation of debt issuance costs during the year	17,088	17,090
At 31 December	11,888,899	11,871,811

In 2015, the Bank issued unsecured debt securities amounting €12,000,000 at 4.5% maturing in 2025. The debt securities issued as at 30 June 2015 constitute the general, direct, unconditional and unsecured obligations of the Bank and shall at all times rank pari passu, without any priority or preference among themselves and with other unsecured debt.

The Bank has not had any breaches with respect to debt securities neither this year nor in the comparative year.

24 Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets	Liabilities	Net	Assets	Liabilities	Net
	2018	2018	2018	2017	2017	2017
	€	€	€	€	€	€
Property and equipment, and intangible assets carried at cost	-	(390,756)	(390,756)	-	(350,455)	(350,455)
Property carried at revalued amount	-	(357,342)	(357,342)	-	(361,145)	(361,145)
Investment securities - FVOCI	-	(324,519)	(324,519)	-	(469,610)	(469,610)
Investment securities - FVTPL	-	157,178	157,178	-	-	-
Impairment allowance	354,955	-	354,955	457,201	-	457,201
	354,955	(915,439)	(560,484)	457,201	(1,181,210)	(724,009)

24 Deferred tax assets and liabilities (continued)

Movement in temporary differences relates to:

	At 1 January 2018	Recognised in profit or loss	Recognised in equity	At 31 December 2018
	€	€	€	€
Property and equipment, and intangible assets carried at cost	(350,455)	(40,301)	-	(390,756)
Property carried at revalued amount	(361,145)	-	3,803	(357,342)
Investment securities - FVOCI	(469,610)	-	145,091	(324,519)
Investment securities - FVTPL	-	157,178	-	157,178
Allowance for expected credit losses	457,201	(102,246)	-	354,955
	(724,009)	14,631	148,894	(560,484)

	At 1 January 2017	Recognised in profit or loss	Recognised in equity	At 31 December 2017
	€	€	€	€
Property and equipment, and intangible assets carried at cost	(276,633)	(73,822)	-	(350,455)
Property carried at revalued amount	(237,536)	-	(123,609)	(361,145)
Investment securities - FVOCI	(1,426,012)	-	956,402	(469,610)
Allowance for loan losses	360,545	96,656	-	457,201
	(1,579,636)	22,834	832,793	(724,009)

25 Accruals

	2018	2017
	€	€
Accrued interest payable	962,354	831,783
Other accrued expenses	447,910	508,268
	1,410,264	1,340,051

Notes to the Financial Statements

For the Year Ended 31 December 2018

26 Share capital and reserves

26.1 Share capital

	Ordinary shares	
	2018	2017
	No.	No.
On issue at 1 January:		
Issued for cash	54,762	54,762
Issued in lieu of dividend payment	345,238	345,238
On issue at 31 December – fully paid	400,000	400,000

At 31 December 2018, the authorised and issued share capital comprised 400,000 ordinary shares (2017: 400,000) of €25 each. At 31 December 2018, IBL I Limited and IBL T Limited, which are 100% indirect subsidiaries of VMKG PLLC (the ultimate parent), held 1% and 99% of the Bank's issued ordinary shares respectively.

All shares in issue, both Class 'A' and Class 'B' shares are fully paid up and enjoy exactly the same rights in all respects.

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 shareholders' meetings of the Bank.

26.2 Capital contribution

These amounts represent irrevocable and unconditional contributions by the shareholders and are interest free.

26.3 Property revaluation reserve

The property revaluation reserve represents the surplus arising on the revaluation of the Bank's premises and improvements, net of related deferred tax effects, and net of that part of the surplus realised through use of the revalued property. This reserve is not distributable except on realisation of the assets through sale.

26.4 Fair value reserve

The fair value reserve comprises:

- the cumulative net change in the fair value of equity securities measured at FVOCI (2017: available-for-sale financial assets) net of deferred tax effect; and
- the cumulative net change in the fair value of debt securities measured at FVOCI (2017: available-for-sale financial assets) net of deferred tax effect until the assets are derecognised or reclassified. This amount is increased by the amount of loss allowance.

26.5 Depositor compensation scheme reserve

The depositor compensation scheme reserve represents amounts set aside by the Bank from its retained earnings. As at 31 December 2018, a total amount of €409,640, (2017: €354,523) was placed with Central Bank of Malta by the Bank and pledged in favour of the Depositor Compensation Scheme.

26 Share capital and reserves (continued)

26.6 Reserve for general banking risk

Banking Rule 09 (BR09) requires the Bank to hold a Reserve for General Banking Risk, calculated as a percentage of non-performing loans. This reserve is required to be funded from planned dividends. In this respect, the Bank has taken a reserve at the end of this year amounting to €6,470 (2017: €36).

26.7 Availability of reserves for distribution

	2018	2017
	€	€
Distributable	18,411,185	15,582,993
Non-distributable	3,673,542	3,888,847
	22,084,727	19,471,840

26.8 Dividends

During the current year the Bank declared and paid a dividend amounting to €5.375 (2017: €5.625) per ordinary share that amounted to €2,150,000 (2017: €2,250,000).

After 31 December 2018, the directors proposed a dividend of €4.375 per ordinary share in respect of 2018 amounting to €1,750,000. The dividends have not been recognised as liabilities.

27 Commitments

	2018	2017
	€	€
Unutilised factoring, overdraft facilities and credit card commitments	88,918,753	60,202,304

The Bank may unconditionally cancel factoring commitments at its discretion, other than amounts being currently utilised by customers.

Notes to the Financial Statements

For the Year Ended 31 December 2018

28 Net cash generated from operating activities

	2018	2017
	€	€
Profit for the year	1,508,179	2,261,404
Adjustments for:		
Depreciation and amortisation	619,313	453,578
Income tax expense	934,319	1,295,527
Impairment reversals / (losses) on financial instruments	(134,698)	260,721
Interest receivable on investment securities	(986,791)	(1,492,274)
Interest expense on debt securities issued	540,000	540,000
Net loss from other financial instruments at FVTPL	449,079	-
Realised gains on disposal of investment securities	(450,896)	(1,826,840)
Amortisation of premiums and discounts on available-for-sale securities	-	230,248
Amortisation of premiums and discounts on debt investment securities	185,965	-
Amortisation of debt issuance costs	17,088	17,090
Dividend income	(199,411)	(262,536)
	2,482,147	1,476,918
Changes in loans and advances to customers and other receivables	(8,485,121)	(4,202,775)
Changes in factored receivables	(37,821,665)	(28,578,468)
Changes in deposits from banks, from customers and to Central Bank of Malta	28,089,664	8,430,399
Changes in accruals	(57,856)	406,147
	(15,792,831)	(22,467,779)

29 Cash and cash equivalents

	2018	2017
	€	€
Cash and items in transit	816	2,587
Balances with Central Bank of Malta	2,512,597	1,948,344
Loans and advances to banks with contractual maturity of three months or less	18,788,220	20,079,499
Deposits from banks	(250,068)	-
	21,051,565	22,030,430

Balances with Central Bank of Malta amounting to €409,640 (2017: €354,523) are pledged in favour of the Depositor Compensation Scheme.

30 Operating leases

The Bank had no operating lease agreements in force during the year ended 31 December 2018 (2017: nil).

31 Related parties

31.1 Identity of related parties, and parent and ultimate controlling party

Related parties are related by virtue of having common directors.

The Bank's immediate parent is IBL T Limited, the registered office of which is 53-58, East Street, Valletta VLT 1251, Malta.

The Bank's ultimate parent is VMKG PLLC, company number 0447.152.677. The financial results and assets and liabilities of the Bank are included in the consolidated financial statements of VMKG PLLC, the registered office of which is Paepsemlaan, 28-30, 1070 Brussels, Belgium.

Magdalena De Roeck and Caroline Van Marcke have an indirect beneficial interest in the shareholding of the Bank and have significant control in the ultimate parent.

31.2 Related party transactions

Interest, fees and other income/charges in respect of related parties in the statement of comprehensive income comprise:

	2018	2017
	€	€
Interest receivable and similar income	3,506,881	4,172,735
Fees and commissions receivable	91,000	478,160
Other operating income	64,378	45,628
Interest expense	516,420	542,070

Notes to the Financial Statements

For the Year Ended 31 December 2018

31 Related parties (continued)

31.3 Related party transactions

The statement of financial position includes outstanding transactions and balances in respect of related parties as follows:

	2018	2017
	€	€
Loans and advances to customers	52,531,963	53,515,379
Prepayments and accrued income	547,255	687,800
Deposits from customers	41,199,813	52,976,668
Debt securities issued to directors	290,000	290,000
Accruals	126,181	106,026

Loans and advances to customers include two loans amounting to €250,000 and €20,000 advanced to key management personnel in 2015 and 2017 respectively. €250,000 is secured against property in Malta, bears interest at 1.75% per annum and is repayable after more than five years from the reporting date. €20,000 is unsecured, bears interest at 1% per annum and is repayable after more than five years.

31.4 Transactions with key management personnel

	2018	2017
	€	€
Directors' fees	42,000	46,000
Compensation to key management personnel – salaries	416,686	345,059
Loans advanced to key management personnel	-	20,000

32 Operating segments

32.1 The Bank has identified one reportable operating segment, being corporate banking services, which is its only strategic business unit. Revenues earned and expenses incurred are the result of corporate banking services provided to its clients. Management does not use any other internal report for decision making which is significantly different from information disclosed in the statement of profit or loss and other comprehensive income.

32 Operating segments (continued)

32.2 Geographical information

The Bank provides all its services from Malta. In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets are based on the geographical location of the assets.

	2018	2017
	€	€
Revenue		
Malta	3,712,443	2,194,720
Belgium	4,476,299	5,364,156
	8,188,742	7,558,876
Non-current assets		
Malta – property, equipment and intangible assets	11,918,067	11,977,849

The Bank's major customer is the Group of which it forms part. Belgium is the country of domicile of this Group.

Information about revenues, costs and balances as a result of transactions with this Group is set out in note 31.



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Independent Auditors' Report

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

1. Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Izola Bank p.l.c. (the "Bank" or the "Company"), which comprise the statement of financial position as at 31 December 2018, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements:

- (a) give a true and fair view of the financial position of the Bank as at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU; and
- (b) have been properly prepared in accordance with the provisions of the Companies Act, 1995 (Chapter 386, Laws of Malta) (the "Act") and the Banking Act, 1994 (Chapter 371, Laws of Malta) (the "Banking Act").

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 Auditors' responsibilities for the audit of the financial statements section of our report. During the course of our audit, we maintained our independence from the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants, together with the ethical requirements that are relevant to our audit of the financial statements in accordance with the Accountancy Profession (Code of Ethics for Warrant Holders) Directive issued in terms of the Accountancy Profession Act (Chapter 281, Laws of Malta) ("APA"), and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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Independent Auditors' Report (continued)

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period (selected from those communicated to the audit committee), and include a description of the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We summarise below the key audit matter, together with our response by way of the audit procedures we performed to address that matter in our audit, and key observations arising with respect to such risks of material misstatement.

Our audit approach to the 'expected credit loss' on financial exposures

Accounting policy note 2.5.A, 3.1, 3.3, 3.4 and 3.17 to the financial statements and note 4.4, 12, 13, 14, 15, 16 and 27.

Expected credit loss ("ECL") allowance, amounting to €1,030,765, on:

- financial assets carried at fair value through other comprehensive income ("FVOCI"), net of ECL
Debt securities within 'Investment securities' €35,126,061.
- financial exposures carried at amortised cost, net of ECL and related commitments
'Factored receivables' €86,260,140,
'Other loans and advances to customers' €74,286,614,
'Loans and advances to banks' €18,788,220, and
Commitments to lend included in 'Commitments' €88,918,753.

With effect from 1 January 2018, the Company implemented IFRS 9 Financial Instruments. This new financial reporting standard requires the Company to adopt the ECL model in the determination of impairment on assets carried at amortised cost and on debt securities at FVOCI, and of provisions on related commitments to lend.

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Independent Auditors' Report

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

Key Audit Matters (continued)

We do not consider the measurement of ECL to be subject to a high risk of material misstatement resulting from judgement. Nonetheless, the calculation of the ECL is considered of most significance in our audit of the financial statements for the current period, being the period of initial application, due to the audit effort involved, particularly in relation to the Probability of Default ("PD").

Our response

Specifically in relation to factored receivables, loans and advances to customers and commitments to lend, as part of our procedures:

- we assessed the design and implementation as well as the operating effectiveness of certain controls relevant to the ECL process, namely (a) the sanctioning of facilities in line with the established authorisation limits as per the Company's credit policy; and (b) the Credit Committee review of ECL movements.
- specifically in relation to receivables related to bills of exchange factoring, we also assessed the design and implementation as well as the operating effectiveness of the controls which monitor receipts from debtors in accordance with the applicable repayment terms.
- we evaluated the Company's credit risk grading methodology used in determining the PD for these exposures. As part of our testing on that methodology:
 - specifically in relation to loans and advances which are cash secured, we evaluated whether the balance securing the exposure was in excess of the respective exposure amount outstanding;
 - we performed credit reviews on a sample of non-cash secured loans and advances, focusing on the borrowers' ability to repay from normal operations, the performance history and receipts after the financial reporting date, using relevant internal and external information on those exposures. We evaluated those reviews in the light of the Company's internal credit risk assessment on those exposures;
 - specifically for factored receivables with overdue exposures at the reporting date, we evaluated the timeliness of receipts, considering the number of days overdue, against the contractual repayment dates, to assess possible indicators of any unidentified non-performing factored receivables;

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Independent Auditors' Report (*continued*)

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

Key Audit Matters (*continued*)

- specifically in relation to overdue factoring exposures and for the sample of non-cash secured loans and advances (noted above), we also:
 - assessed whether a significant increase in credit risk was appropriately identified by the Company, if any; and
 - evaluated whether these exposures were graded in line with the Company's credit policy.

Specifically in relation to debt securities and loans and advances to banks, as part of our procedures:

- we evaluated credit risk for each counterparty by reference to the respective counterparty's external credit rating, or to relevant market information (in relation to unrated exposures), in assessing the appropriateness of the Bank's credit risk ratings used in determining the PD; and
- we evaluated the appropriateness of the Company's ECL by evaluating the sensitivity of PDs to reasonably possible changes in credit risk grading and, in the case of debt securities, by also comparing the fair value at initial recognition to the quoted prices in an active market at the financial reporting date and evaluating whether those differences represent a deterioration in credit risk

We have no key observations to report, specific to this matter.

Other Information

The directors are responsible for the other information which comprises:

- the 'Chairperson's Statement';
- the 'Directors' Report';
- the 'Statement by the Directors on the Financial Statements included in the Annual Report';
- the 'Directors' Statement of Compliance with the Code of Principles of Good Corporate Governance';
- the 'Remuneration Report'; and
- the appendices to the annual report ('Appendix I – Pillar 3 Disclosures', 'Appendix II – Five-Year Summary' and 'Appendix III – Supplementary Financial Information'),

but does not include the financial statements and our auditors' report thereon.

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Independent Auditors' Report

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

Other Information (continued)

Our opinion on the financial statements does not cover the other information and, other than in the case of the directors' report on which we report separately below in our 'Opinion on the Directors' Report', we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information, 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. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors for the financial statements

The directors are responsible for the preparation of financial statements that (a) give a true and fair view in accordance with IFRS as adopted by the EU, and (b) are properly prepared in accordance with the provisions of the Act and the Banking Act, 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 Company'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 Company or to cease operations, or have no realistic alternative but to do so.

The directors are also responsible for overseeing the financial reporting process

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Independent Auditors' Report (continued)

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

Auditors' 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 auditors' 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.
- Consider the extent of compliance with those laws and regulations that directly affect the financial statements, as part of our procedures on the related financial statement items. For the remaining laws and regulations, we make enquiries of directors and other management, and inspect correspondence with the regulatory authority, as well as legal correspondence. As with fraud, there remains a higher risk of non-detection of other irregularities (whether or not these relate to an area of law directly related to the financial statements), as these may likewise involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

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Independent Auditors' Report

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

Auditors' Responsibilities for the Audit of the Financial Statements (continued)

- 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 Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' 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 auditors' report. However, future events or conditions may cause the Company 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 the audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

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

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Independent Auditors' Report (continued)

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

2. Opinion on the Directors' Report

The directors are responsible for preparing a directors' report in accordance with the provisions of article 177 of the Act and other applicable legal requirements, and is to include a statement that the Company is a going concern with supporting assumptions or qualifications as necessary, as required by Listing Rule 5.62 issued by the Listing Authority in Malta.

We are required to consider whether the information given in the directors' report for the accounting period for which the financial statements are prepared is consistent with those financial statements; and, if we are of the opinion that it is not, we shall state that fact in our report. We have nothing to report in this regard.

Pursuant to article 179(3) of the Act, we are also required to:

- express an opinion on whether the directors' report has been prepared in accordance with the applicable legal requirements; and
- state whether, in the light of the knowledge and understanding of the entity and its environment obtained in the course of our audit of the financial statements, we have identified material misstatements in the directors' report, giving an indication of the nature of any such misstatements.

Pursuant to Listing Rule 5.62 of the Listing Rules issued by the Listing Authority in Malta, we are required to review the directors' statement in relation to going concern.

In such regards:

- in our opinion, the directors' report has been prepared in accordance with the applicable legal requirements;
- we have not identified material misstatements in the directors' report; and
- we have nothing to report in relation to the statement on going concern

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Independent Auditors' Report

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

3. Report on Other Legal and Regulatory Requirements

Matters on which we are required to report by the Act, specific to public-interest entities

Pursuant to article 179B(1) of the Act, we report as under matters not already reported upon in our 'Report on the Audit of the Financial Statements':

- we were first appointed as auditors on 8 June 1994 by the board of directors, and subsequently reappointed by the shareholders at the Company's general meetings for each financial year thereafter. Excluding the initial appointment period following the set-up of the Company, the period of total uninterrupted engagement is twenty-four years;
- our opinion on our audit of the financial statements is consistent with the additional report to the audit committee required to be issued by the Audit Regulation (as referred to in the Act); and
- we have not provided any of the prohibited services as set out in the APA

Matters on which we are required to report by the Banking Act and by exception by the Act

Pursuant to article 31(3)(a), (b) and (c) of the Banking Act, 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 thereof; and
- the Bank's financial statements are in agreement with the books of account.

KPMG, a Maltese Civil Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

The firm is registered as a partnership of Certified Public Accountants in terms of the Accountancy Profession Act.

A list of partners and directors of the firm is available at Portico Building, Marina Street, Pietà, PTA 9044, Malta.



KPMG
Portico Building
Marina Street
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Malta
(+356) 2563 1000

Independent Auditors' Report (continued)

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

3. Report on Other Legal and Regulatory Requirements (continued)

Matters on which we are required to report by the Banking Act and by exception by the Act (continued)

Furthermore, we have nothing to report in respect of the above matters, where the Act requires us to report to you by exception pursuant to articles 179(10) and 179(11).

Pursuant to article 31(3)(d) of the Banking Act, in our opinion and to the best of our knowledge and belief and, on the basis of the explanations given to us, the financial statements give the information required by law in force in the manner so required.

The Principal authorised to sign on behalf of KPMG on the audit resulting in this independent auditors' report is Claude Ellul.

KPMG
Registered Auditors

4 April 2019

KPMG, a Maltese Civil Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

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INTRODUCTION

Background to Pillar 3 disclosures

The objective of Basel II Pillar 3 is to improve market discipline through effective public disclosure and to complement requirements under Pillar 1 and Pillar 2. To that end, Pillar 3 introduces substantial new public disclosure requirements, and represents a significant increase in the amount of information made publicly available by banks and investment firms regarding capital structure, capital adequacy, risk management and risk measurement.

Nature of Disclosures

This document serves as the Basel II Pillar 3 disclosures of Izola Bank p.l.c. in accordance with the Malta Financial Services Authority ('MFSA') Banking Rule 7 (BR07).

The Annual Report of Izola Bank p.l.c. has been filed with the MFSA Registry of Companies and the MFSA Banking Unit. These Pillar 3 disclosures refer to the financial year ended 31st December 2018 and have been included in the Annual Report for 2018.

The Bank has in place a formal policy to comply with the disclosure requirements laid down in Banking Rule BR/07/2018. The Directors, after due consideration of the size and complexity of the Bank, do not feel it necessary to produce Pillar 3 disclosures more frequently than annually.

Banking Rule BR/07 requirements are incorporated in this document if they are deemed relevant for the Bank. The Bank's management is responsible for the verification of these Pillar 3 disclosures. They are also subject to review and verification by the Bank's Audit Committee.

1 RISK MANAGEMENT OBJECTIVES AND POLICIES

The principal risks to which Izola Bank p.l.c. is exposed are business, credit concentration, operational and interest rate risk in the non-trading book. Counterparty risk is also recognised as important.

Business risk

Business risk is the risk that the Bank may not be able to carry out its business plan or its desired strategy and could therefore suffer losses if its income falls.

This is a risk that every business faces. Business risk mainly results from the Bank's dependence on the Group for its ongoing business. There are no specific mitigating factors though it is to be noted that the Group is itself diversified and has a large number of clients and suppliers which in turn helps to diversify the underlying risk.

Concentration risk

Concentration risk arises as a result of the concentration of exposures within the same category, whether it is geographical location, product type, industry sector or counterparty type. These risks are managed through adherence to Board approved lending criteria.

The Bank recognizes that credit concentration risk is present in the Bank's factoring business in view of the fact that factored debtors are mainly active in the property, building and construction sector in Belgium and the retail sector in Malta. Credit concentration risk is mitigated by a comprehensive credit insurance policy covering credit risks arising from the Bank's factoring exposure in Belgium and by the Group's experience in the property, building and construction sector combined with in depth knowledge of the customer base in Belgium. The credit risk concentration to the factored receivables in Malta is mitigated through the dispersion of debtors combined with security over the underlying asset.

Operational risk

Operational risk is associated with the Bank's internal processes and systems and the potential for these not to function properly. Through implementing a robust internal control system, the Bank is able to mitigate many of the identified risks. The Bank also maintains third party insurance to cover certain risk events such as computer fraud. Regular reporting on operational risk is made to the Audit Committee.

Interest rate risk in the non-trading book

Market risk incorporates the loss of income which in the Bank's case would be as a result of changes to interest rates. Izola Bank p.l.c. limits this exposure to movements in interest rates by matching as much as possible its advances to deposits in the same maturity bands.

2 BOARD AND COMMITTEES STRUCTURE

The Bank's Board of Directors comprises seven non-executive directors and meets quarterly throughout the year. In addition the Board delegates specific responsibilities to the Remuneration and Nomination Committee, the Audit and Risk Committee, the Credit Committee and the Asset and Liability Management Committee (ALCO).

Remuneration and Nomination Committee

Composition: The Remuneration and Nomination Committee comprises three non-executive directors.

Main Functions: The Remuneration and Nomination Committee is tasked with delving into the detail of oversight of performance, remuneration and nomination practices.

Frequency: This Committee meets at least once a year.

Credit Committee

Composition: The Credit Committee is made up of two non-executive independent directors and the Chief Executive Officer.

Main Functions: The Credit Committee considers credit applications and keeps credit limits under review.

Frequency: The Committee meets at least four times a year.

Audit and Risk Committee

Composition: The Audit and Risk Committee comprises three non-executive independent directors.

Main Functions: The primary purpose of the Audit and Risk Committee is to protect the interests of the Bank's shareholders and assist the Directors in conducting their role effectively so that the Bank's decision making capability, the accuracy of its reporting and financial results and the Bank's risk management processes are maintained at a high level at all times.

The Committee provides independent review, monitoring and assessment of:

- the integrity of the annual financial statements
- the effectiveness of management's system of internal control
- the effectiveness of the Bank's risk management processes
- the Bank's compliance with applicable laws and regulations
- the Bank's ethical and business standards.

Frequency: The Committee meets at least four times a year.

2 BOARD AND COMMITTEES STRUCTURE (continued)

Asset and Liability Management Committee (ALCO)

Composition: This Committee is made up of the Chief Executive Officer, the Head of Finance and Treasury and Compliance and a Finance Assistant Manager.

Main Functions: The ALCO:

- monitors the Bank's financial performance, and reviews and manages financial risks in accordance with Bank policies;
- manages the Bank's balance sheet in respect of the adequate matching of assets and liabilities, asset mix, liabilities and balance sheet growth;
- formulates a forward looking strategy for the Bank in terms of the mix of assets and liabilities, given its expectations of the future and the potential consequences of interest rate movements, liquidity constraints, foreign exchange exposure and capital adequacy.

Frequency: The Committee meets at least four times a year.

3 OWN FUNDS

During the year ended 31 December 2018, the Bank complied with all of the externally imposed capital requirements to which it was subject. The following table summarises the composition of the Bank's regulatory capital as reported to the MFSA as at 31 December 2018.

	2018 €
Common Equity Tier 1 (CET1) Capital: instruments and reserves	
Paid up capital instruments	26,032,675
Retained Earnings	2,378,510
Accumulated other comprehensive income (and other reserves)	3,257,432
	<hr/>
CET1 Capital before regulatory adjustments	31,668,617
	<hr/>
Common Equity Tier 2 (CET2) Capital: instruments and reserves	
Reserve for General Banking Risk	6,470
	<hr/>
	6,470
	<hr/>
Regulatory deductions and adjustments	
Deductions related to intangible assets	(1,653,214)
	<hr/>
Total Own Funds	30,021,873
	<hr/>

3 OWN FUNDS (continued)

Composition of Own Funds

- i. Ordinary Shares: At 31 December 2018, the authorised share capital comprised 400,000 ordinary shares of €25 each. All shares in issue are fully paid up. 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 shareholders' meetings of the Bank.
- ii. Retained Profits: this includes the balance available for distribution to the shareholders.
- iii. Capital Contribution: this represents a contribution by the shareholders to the distributable reserves of the Bank.
- iv. Collective Provisioning: this represents a general provision against the Bank's unsecured lending.
- v. Available-for-sale Financial Assets (AFS): this represents fair value movements on AFS assets, net of tax.
- vi. Revaluation Reserve: this represents reserves arising from the revaluation of tangible fixed assets, net of tax.

4 CAPITAL ADEQUACY

4.1 Internal Capital Adequacy Assessment Process (ICAAP)

ICAAP Methodology

The Bank's latest ICAAP report is based on 31st December 2017 figures.

The Bank has chosen to base its ICAAP on the results of the Pillar 1 calculation with additional Pillar 2 risks – business risk, credit concentration and interest rate risk in the banking book – assessed separately through stress testing and added to Pillar 1. The Bank has also further analysed its operational risk exposure through stress testing in order to determine whether an additional Pillar 2 charge for operational risk may be necessary.

The Bank's ICAAP also contains three year projections as well as the capital plan, and the Board monitors that there are adequate capital resources to support the corporate goals contained within the plan.

In order to produce a capital plan, the Bank's ICAAP contains calculations of the capital resources requirement (effectively the minimum capital required) for each of the three years using the standardised approach for credit risk and the basic indicator approach for operational risk.

Under the standardised approach for credit risk, the Bank applies a risk weighted asset value to each of its exposure classes and provides 8% of that risk weighted asset value as the minimum capital requirement for credit risk.

Under the basic indicator approach for operational risk, the Bank calculates its average net income over the previous three years and provides 15% of that average net income as the minimum capital requirement for operational risk.

4 CAPITAL ADEQUACY (continued)**4.2 Credit Risk Capital Requirements by Standardised Approach Exposure Class**

Table 4.1 Capital Requirement by exposure class as at 31 December 2018

	Capital Requirement
	€ 000s
Central Government or Central Banks	725
Corporates	4,522
Institutions	309
Retail	2,579
Other	923
Total	9,058

4.3 Market Risk Capital Requirement

The market risk capital requirement of the Bank is not significant, comprising a foreign exchange risk charge of €119,375.

4.4 Operational Risk Capital Requirement

The gross income registered by the Bank in 2018, 2017 and 2016 amounted to €5,804,885, €7,102,231 and €6,134,668 respectively. The operational risk capital requirement for 2018 amounted to €974,543.

4 CAPITAL ADEQUACY (continued)

4.5 Calculation of minimum capital requirement and risk-weighted assets

	Statement of financial position value 2018	Risk weighted exposure 2018	Capital requirement 2018	Statement of financial position value 2017	Risk weighted exposure 2017	Capital requirement 2017
	€	€	€	€	€	€
On balance sheet assets						
Cash and items in transit	816	611	49	2,587	517	41
Balance with Central Bank of Malta	2,512,597	-	-	1,948,344	-	-
Investments	42,111,712	10,577,691	846,215	57,213,412	21,421,906	1,713,752
Loans and advances to banks	18,788,220	3,757,644	300,612	20,079,499	4,015,900	321,272
Factored receivables	86,260,140	67,338,562	5,387,085	48,583,631	39,937,418	3,194,993
Other loans and advances to customers	74,286,614	20,012,802	1,601,024	65,524,805	14,835,857	1,186,869
Property and equipment	10,264,853	10,264,853	821,188	10,343,320	10,343,320	827,466
Intangible assets	1,653,214	-	-	1,634,529	1,634,529	130,762
Prepayments and accrued income	1,275,436	1,275,436	102,035	1,299,677	1,299,677	103,974
	237,153,602	113,227,599	9,058,208	206,629,804	93,489,124	7,479,129
Off balance sheet items						
Commitments	88,918,753			60,202,304		
Credit risk capital requirement		113,227,599	9,058,208		93,489,124	7,479,129
Foreign exchange risk capital requirement		1,492,188	119,375		181,584	14,527
Operational risk capital requirement		12,181,788	974,543		12,053,113	964,249
Total capital requirement		126,901,575			105,732,821	
Total own funds	30,021,873			27,416,719		
Capital adequacy ratio			24%			26%

5 CREDIT RISK

5.1 Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to the financial instrument fails to meet its contractual obligations. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

The Bank follows standards, policies and procedures established by the Board of Directors for the control and monitoring of all risks. The Board of Directors has delegated the responsibility for the management of credit risk to the Credit Committee. The Bank's management is responsible for the oversight of the Bank's credit risk. The Bank's credit risk policies and procedures are reviewed regularly through internal audit.

5.2 Definition of 'past due' and 'impaired' for accounting purposes

Impaired factored receivables

These comprise factored receivables for which the Bank determines an expected credit loss based on the probability that it will be unable to collect all principal and interest due according to the contractual terms of the factored receivables agreements.

Table 5.1 Allowance for impairment on factored receivables

	2018	2017
	€	€
Factored receivables – gross	87,067,284	49,618,594
Collectively determined	86,507,038	49,111,716
Collective allowance for impairment	246,898	528,085
Specific allowance for impairment	560,246	506,878

Past due but not impaired

Receivables where contractual interest or principal payments are past due but the Bank believes that impairment is not appropriate on the basis of the level of security / collateral available and / or the stage of collection of amounts owed to the Bank.

As at 31 December 2018, 9.5% (2017: 22%) of the Bank's factored receivables were past due but not impaired. 60% of these became due during the last week of December 2018. A substantial amount of these past due receivables have been paid by the date of issue of these financial statements.

5 CREDIT RISK (Continued)

5.2 Definition of 'past due' and 'impaired' for accounting purposes (continued)

Table 5.2 Neither past due nor impaired loans and securities

	2018	2017
	€	€
Loans and advances to customers	74,311,766	57,185,841
Loans and advances to banks	18,788,220	20,079,499
Investment securities	42,111,712	57,213,412
	135,211,698	134,478,752

5.3 Description of approaches and methods adopted for determining value adjustments and provisions

Allowances for impairment

The Bank establishes an allowance for expected credit losses that represents its estimate of expected losses in its factored receivables portfolio. The main components of this allowance are outlined in note 4.4 of the financial statements.

	2018	2017
	€	€
Allowance for impairment on factored receivables	807,144	1,034,963

Table 5.3 Total period end and average exposures after individual impairment and prior to credit risk mitigation by exposure class.

	Exposure as at 31/12/2018	Average Exposure for period to 31/12/2018
	€ 000s	€ 000s
Central Government or Central Banks	37,539	21,375
Corporates	124,544	139,312
Institutions	18,889	22,057
Retail	42,988	28,056
Other	13,194	5,281
Total	237,154	216,081

5 CREDIT RISK (Continued)

5.3 Description of approaches and methods adopted for determining value adjustments and provisions (continued)

Table 5.4 Geographic distribution of exposure classes

	Malta	Europe	Rest of the World	Total
	€ 000s	€ 000s	€ 000s	€ 000s
Central Government or Central Banks	37,539	-	-	37,539
Corporates	30,085	93,231	1,228	124,544
Institutions	1,772	17,117	-	18,889
Retail	42,458	531	-	42,988
Other	12,100	1,093	-	13,193
Total	123,954	111,972	1,228	237,154

Table 5.5 Distribution of the exposures by industry/counterparty type

	Central Government or Central Banks	Corporates	Institutions	Retail	Other	Total
	€ 000s	€ 000s	€ 000s	€ 000s	€ 000s	€ 000s
Monetary Financial Institutions	6,844	35,797	18,888	-	-	61,529
Sovereigns	21,872	-	-	-	-	21,872
Manufacturing	-	2,548	-	-	-	2,548
Wholesale and retail trade	250	40,918	-	14,937	-	56,105
Real estate, renting and business activities	2,880	8,877	-	-	-	11,757
Construction	3,800	31,795	-	-	-	35,595
Households	-	-	-	28,052	-	28,052
Other	1,893	4,610	1	-	13,194	19,698
Total	37,539	124,545	18,889	42,989	13,194	237,156

Table 5.6 Residual Maturity Breakdown of the exposures

	< 1 year	1 – 5 years	> 5 years	Total
	€ 000s	€ 000s	€ 000s	€ 000s
Central Government or Central Banks	8,205	19,972	9,361	37,538
Corporates	70,872	9,490	44,182	124,544
Institutions	18,889	-	-	18,889
Retail	-	29,569	13,420	42,989
Other	1,298	1,413	10,485	13,196
Total	99,264	60,444	77,448	237,156

5 CREDIT RISK (Continued)

5.4 Past Due Exposures and Impaired Assets

Table 5.7 Impaired, past due exposures and provisions by industry sector

Standardised exposure classes	Individual & collective provision	Charged to income statement in the year ended 31 December 2018
	€ 000s	€ 000s
Central Government or Central Banks	-	-
Corporates	1,031	260
Institutions	-	-
Other	-	-
Total	1,031	260

Table 5.8 Impaired, past due exposures and provisions by geographic area

Standardised exposure classes	Individual & collective provision	Charged to income statement in the year ended 31 December 2018
	€ 000s	€ 000s
Malta	29	(29)
Europe	1,002	289
Rest of the World	-	-
Total	1,031	260

Table 5.9 Movement in allowances for impaired and past due exposures and provisions

	Individual & collective provisions
	€ 000s
Opening balance	1,291
Impairment increase	(260)
Closing balance	1,031
Amounts written off	142

6 STANDARDISED APPROACH TO CREDIT RISK

6.1 Exposure to Institutions

Fitch Rating Agency is the External Credit Assessment Institution (ECAI) used to rate exposures to institutions. The external ratings are mapped to the prescribed credit quality assessment scale that in turn produces standard risk weightings in line with Article 119 of the Credit Requirements Regulations (CRR).

The following table shows the exposure values before and after Credit Risk Mitigation associated with the credit quality step under the Standardised Approach.

Table 6.1 Institutions

Credit Quality Step	Risk Weight	Ratings	Exposure	Exposure After CRM
			€ 000s	€ 000s
1	20%	Fitch AAA to A	18,788	2,758
3	50%	Fitch BBB	100	50

6.2 Exposure to Central Government and Central Bank

Exposures to central government and central bank denominated and funded in the domestic currency of the central government and central bank are assigned a risk weight of 0% in line with Article 114(4) of the CRR.

Table 6.2 Central Government and Central Bank

Credit Quality Step	Risk Weight	Banking Regulation	Exposure	Exposure After CRM
			€ 000s	€ 000s
1	0%	Art. 114(4)	2,593	-
2	0%	Art. 114(4)	21,872	-

6.3 Exposure to Corporates

A large part of corporate exposures have a 0% risk weighting as they are cash secured. A number of corporate exposures are secured by real estate and are allocated a 50% risk weighting. The rest are allocated a 75% or 100% risk weighting as they are unsecured.

Table 6.3 Corporates

Credit Quality Step	Risk Weight	Banking Regulation	Exposure	Exposure After CRM
			€ 000s	€ 000s
1	0%	Art. 400(1)g	47,432	-
3	50%	Art. 124(2) / Art. 126(1)	21,133	10,567
4	75%	Art. 123 (a) to (c)	22,123	16,592
5	100%	Art. 122(2)	27,989	27,989

7 REMUNERATION POLICY

The Board carries out the tasks normally delegated to a Remuneration Committee since the remuneration of directors is not performance related. The Board has established a Remuneration Policy the aim of which is to increase transparency when offering remuneration and benefits to the Bank's senior management team.

8 CREDIT RISK MITIGATION

8.1 Collateral

Analysis of collateral is disclosed in Note 4.4.3 of the Annual Report 2018.

Table 8.1 Exposure value covered by eligible financial collateral

	€ 000s
Central Government or Central Banks	-
Corporates	78,964
Institutions	-
Retail	47,452
Total	126,416

9. CONCLUSION

This disclosure document has been prepared in accordance with the requirements of Banking Rule 7 issued by the Malta Financial Services Authority (MFSA).

Statement of Profit or Loss and Other Comprehensive Income

	2018	2017	2016	2015	2014
	€	€	€	€	€
Interest receivable and similar income	8,081,029	7,065,787	4,292,747	4,665,066	4,168,187
Interest payable and similar charge	(2,627,953)	(2,544,779)	(2,314,406)	(2,273,514)	(2,162,773)
Net interest income	5,453,076	4,521,008	1,978,341	2,391,552	2,005,414
Fee and commission income	33,658	431,604	2,438,376	2,775,879	2,734,690
Other operating income	318,151	2,149,619	1,717,951	880,645	412,045
Other operating charges	(3,497,085)	(3,195,559)	(2,391,099)	(1,983,298)	(1,562,888)
Net impairment gain/(losses)	134,698	(349,741)	(28,431)	(481,736)	(61,860)
Profit before tax	2,442,498	3,556,931	3,715,138	3,583,042	3,527,401
Income tax expense	(934,319)	(1,295,527)	(1,448,751)	(1,197,022)	(1,229,201)
Profit for the year	1,508,179	2,261,404	2,266,387	2,386,020	2,298,200
Other comprehensive income for the year, net of income tax	(245,292)	(117,779)	(431,410)	974,495	1,716,034
Total comprehensive income for the year	1,262,887	2,143,625	1,834,977	3,360,515	4,014,234
Earnings per share	3.77	5.65	5.67	5.97	5.75

Statement of Financial Position

	2018	2017	2016	2015	2014
	€	€	€	€	€
ASSETS					
Cash and items in transit	816	2,587	2,084	1,656,731	29,825
Balances with Central Bank of Malta	2,512,597	1,948,344	10,351,518	989,261	976,517
Investments	42,111,712	57,213,412	66,925,325	52,537,656	71,079,589
Loans and advances to banks	18,788,220	20,079,499	31,788,316	32,471,446	16,976,777
Factored receivables	86,260,140	48,583,631	20,237,200	19,639,543	21,292,678
Other loans and advances to customers	74,286,614	65,424,805	61,350,109	58,439,875	33,016,654
Property and equipment	10,264,853	10,343,320	3,226,026	3,150,034	2,495,321
Intangible assets	1,653,214	1,634,529	1,560,192	1,100,934	864,951
Other assets	1,275,436	1,299,677	1,979,181	1,414,231	1,638,357
Total assets	237,153,602	206,629,804	197,419,951	171,399,711	148,370,669
LIABILITIES					
Balance owed to Central Bank of Malta	13,000,000	16,300,000	21,300,000	21,700,000	20,000,000
Deposits from banks	250,068	-	-	-	-
Deposits from customers	177,157,086	145,767,422	132,337,023	107,261,236	90,853,295
Debt securities in issue	11,888,899	11,871,811	11,854,721	11,837,631	8,969,458
Deferred tax liabilities	560,484	724,009	1,579,636	1,515,335	1,321,717
Current tax payable	802,074	1,154,671	549,126	286,575	766,297
Accruals	1,410,264	1,340,051	1,330,887	1,118,970	1,519,459
Total liabilities	205,068,875	177,157,964	168,951,393	143,719,747	123,430,226
EQUITY					
Called up share capital	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
Property revaluation reserve	2,629,651	2,657,412	961,468	1,048,190	955,479
Fair value reserve	627,781	876,876	2,663,593	3,020,434	2,150,803
Depositor compensation scheme reserve	409,640	354,523	238,387	238,387	160,508
Reserve for general banking risk	6,470	36	217	217	8,544
Capital contribution	16,032,675	12,532,675	11,436,521	10,482,904	8,853,898
Retained earnings	2,378,510	3,050,318	3,168,372	2,889,832	2,811,211
Total equity attributable to equity holders of the Bank	32,084,727	29,471,840	28,468,558	27,679,964	24,940,443
Total liabilities and equity	237,153,602	206,629,804	197,419,951	171,399,711	148,370,669
Memorandum items					
Commitments	88,918,753	60,202,304	42,580,312	33,128,620	34,989,271

Statement of Cash Flows

	2018	2017	2016	2015	2014
	€	€	€	€	€
Net cash from operating activities	(17,094,320)	(23,180,595)	21,140,824	19,126,796	10,956,398
Cash flows from investing activities					
Payments to acquire property, equipment and intangible assets	(559,531)	(5,839,157)	(852,138)	(1,134,576)	(437,520)
Payments to acquire investments	(9,412,713)	(12,604,899)	(20,884,368)	(16,403,055)	(23,039,901)
Proceeds from disposals of investments	24,129,036	21,170,143	7,353,517	10,464,323	8,240,386
Interest received from investments	949,252	1,524,330	1,625,087	3,159,361	2,364,716
Dividend received	199,411	262,536	227,943	194,820	-
Net cash used in investing activities	15,305,456	4,512,953	(12,529,959)	(3,719,127)	(12,872,319)
Cash flows from financing activities					
Dividends paid to shareholders	(2,150,000)	(2,000,000)	(2,000,000)	(2,250,000)	(2,000,000)
Net capital contribution received	3,500,000	1,096,154	953,617	1,629,006	1,446,952
Issue of debt securities net of transaction costs	-	-	-	3,498,144	-
Redemption of debt securities	-	-	-	(669,000)	-
Interest paid on debt securities	(540,000)	(540,000)	(540,000)	(481,500)	(481,500)
Net cash from / (used in) financing activities	810,000	(1,443,846)	(1,586,383)	1,726,650	(1,034,548)
Increase / (decrease) in cash and cash equivalents	(978,865)	(20,111,488)	7,024,482	17,134,319	(2,950,469)

Accounting Ratios

	2018	2017	2016	2015	2014
	%	%	%	%	%
Net interest income and other operating income to total asset	2.45	3.44	3.11	3.53	3.47
Operating expenses to total assets	1.42	1.72	1.23	1.44	1.10
Profit before tax to total assets	1.03	1.72	1.88	2.09	2.38
Pre-tax return on capital employed	8.60	13.90	15.10	15.33	16.29
Profit after tax to equity	4.70	7.67	7.96	8.62	9.21

Directors' interest in the share capital of the Bank or in any related company as at 31 December 2018

No director has a direct beneficial or non-beneficial interest in the share capital of the Bank.

Magdalena De Roeck and Caroline Van Marcke have an indirect beneficial interest in the shareholding of the Bank through their indirect shareholding in VMKG PLLC, a company registered in Belgium with registration number 0447.152.677. VMKG PLLC is the ultimate holding company of the Group to which the Bank belongs.

Furthermore, Magdalena De Roeck and Caroline Van Marcke are also directors of IBL I Limited and IBL T Limited and other companies forming part of the Group. VMT S.A and IVM S.A are the trading and industrial holding companies of the Van Marcke Group respectively.

	Type & class of shares	Issued shares	Percentage paid up	Nominal value per share
IBL I Limited C 16321				
VMT S.A	Ordinary	24,999	100	€24.79
IVM S.A	Ordinary	1	100	€24.79
IBL T Limited C 16322				
VMT S.A	Ordinary	24,999	100	€24.79
IVM S.A	Ordinary	1	100	€24.79
Shareholders holding 5% or more of the Share Capital as at 31st December 2018				
IBL I Limited	Ordinary "A"	1	100	€25.00
IBL T Limited	Ordinary "B"	399,999	100	€25.00

Number of Shareholders

Class	Number of Shares	Number of Holders
Class A	1	1
Class B	399,999	1
Range	Class "A"	Class "B"
1 – 5,000	1	-
5,001 & over	-	1

As at date of publication of the annual report, no changes were effected to the shareholding structure.



izola Bank

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