



**ANNUAL REPORT & FINANCIAL STATEMENTS**  
**2011**

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### DIRECTORS' AND OTHER STATUTORY REPORTS

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I am pleased to present the Bank's results for the year ended 31 December 2011.

## **Review of performance**

During the year ended 31 December 2011, the Bank generated a profit before tax of €2,298,379, up 21.3% on 2010. Profit after tax was €1,536,943, an increase of 33.6% over the previous year.

Net interest income increased by 32.2% whilst net fee and commission income registered a 15.9% increase over the previous year.

Administrative expenses increased by 61% in the year under review due to the Bank's participation in a one-time major marketing event. The Bank's Cost-to-Income ratio stood at a healthy 37.7% (2010: 36.57%).

## **Review of financial position**

Total assets increased by 13.8% to €89,690,939 whereas total liabilities rose from €64,065,479 to €72,516,902 – an increase of 13.2%. Shareholders' equity amounted to €17,174,037 compared with €14,754,289 of a year earlier.

As at 31 December 2011 the Capital Adequacy Ratio of 58% and Liquidity Ratio of 137% were both well above the European and US banking sector norms.

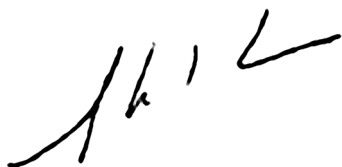
There was no sign of deterioration in asset quality in 2011. The current credit approval and monitoring structures have helped to ensure very good credit quality of factoring debtors and minimised losses. In fact out of a total amount of €75,995,395 of invoices factored in 2011, the Bank has only taken a specific provision on €40,160 worth of invoices or 0.05% of the total factored invoices during the year.

## **Looking ahead**

The Bank is committed to seek further growth in its internet banking operations in 2012 and will devote considerable marketing resources to attract new customers.

## **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.



Mrs. Magdalena De Roeck  
Chairperson  
Izola Bank plc

23 March 2012

# Directors' Report

For the Year Ended 31 December 2011

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The directors present their report together with the financial statements of Izola Bank plc ("the Bank") for the year ended 31 December 2011.

## Board of directors

Mrs. Magdalena De Roeck (Chairperson)

Countess Alexis d'Oultremont

Mr. Peter Van Marcke

Mr. Frederick E. Amato-Gauci \*(i)

Mr. Joseph Caruana (i)

Mr. Anthony Camilleri \*\* (i)

Mr. Charles Hertogs (i)

Mr. Patrick Van Leynseele (i)

Mr. Guido Mizzi (i)

Mr. Herbert Zammit Laferla + (i)

\* resigned on 16 May 2011

\*\* appointed on 1 February 2011 and resigned on 30 November 2011

+ appointed on 1 December 2011

(i) independent

## Company secretary

Mr. Stefan Farrugia

## Results for the year

The Bank reported a profit after tax of €1,536,943 for the year under review. Further information on the results is provided in the Chairperson's Statement which immediately precedes this Directors' Report.

## Principal activities

Izola Bank plc 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 services to non-resident customers.

## Review of financial performance and future developments

A review of the Bank's financial performance for the year ended 31 December 2011 and a summary of likely future developments are given in the Chairperson's Statement which immediately precedes this Directors' Report.

## Events occurring after reporting date

No events to report.

## Dividends and reserves

The directors have proposed a final dividend of €1,500,000 in respect of 2011, representing a dividend per share of €5.36.


## Going concern

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

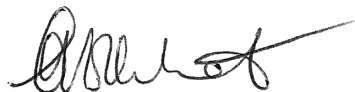
## Auditors

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 23 March 2012 and signed on its behalf by:



Mr. Peter Van Marcke  
Director



Countess Alexis d'Oultremont  
Director

## Registered Address

53-58 East Street  
Valletta  
Malta

## Statement by the Directors

On the Financial Statements included in the Annual Report

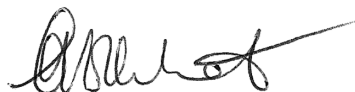
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Pursuant to Listing Rule 5.68, we, the undersigned, declare that to the best of our knowledge, the financial statements included in the Annual Report, and prepared in accordance with the requirements of International Financial Reporting Standards as 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 this 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 23 March 2012 by:



Mr. Peter Van Marcke  
Director



Countess Alexis d'Oultremont  
Director

# Directors' Statement of Compliance

With the Code of Principles of Good Corporate Governance

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, 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 requirements 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.

The Board delegates specific responsibilities to the Board Committee, the Audit Committee and the Credit 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 three non-independent directors (including the Chairperson). 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 in terms of Code Provision 3.4.

### 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 delegates specific responsibilities to the following Committees:

# Directors' Statement of Compliance

With the Code of Principles of Good Corporate Governance

## Principle 4: Responsibilities of the Board (*continued*)

### BOARD COMMITTEES

#### *Board Committee*

The Board Committee meets on an ad hoc basis and acts in an advisory capacity to the Board.

Members	Meetings held: 3 Attended
Magdalena De Roeck (Chairperson)	3
Peter Van Marcke	3
Countess Alexis d'Oultremont	3
Andrew Mifsud +	0

+ appointed to the Committee on 17 November 2011

#### *Audit Committee*

The Audit 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 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. The three non-executive directors who sit on this Committee are considered independent in accordance with the principles relating to independence contained in the Code.

In terms of Listing Rule 5.118, Mr Guido Mizzi is the director whom the Board considers is independent and competent in accounting, given his extensive experience as a former managing partner of a local accountancy firm.

Members	Meetings held: 4 Attended
Frederick E. Amato-Gauci (Chairman) *	1
Joseph Caruana	4
Guido Mizzi (Chairman) +	4
Anthony Camilleri **	1
Herbert Zammit Laferla ++	1

\* resigned on 16 May 2011

+ appointed Chairman of the Committee on 27 July 2011

\*\* resigned on 30 November 2011

++ appointed on 1 December 2011

Other Board members have a right to attend the meetings. The Financial Controller is responsible for the maintenance of internal controls and attends all meetings. The ICT & Operations Manager, who is responsible for the maintenance of internal controls in relation to ICT, attends meetings when ICT-related topics are discussed.

The CEO acts as Secretary to the Committee. The Secretary circulates information and makes available the minutes of meetings of the Committee to all members of the Board.

#### *Credit Committee*

The Credit Committee is composed of two non-executive independent 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.

Members	Meetings held: 4 Attended
Joseph Caruana (Chairman)	4
Frederick E. Amato-Gauci*	1
Anthony Camilleri**	1
Herbert Zammit Laferla+	1
Andrew Mifsud++	1

\*resigned on 16 May 2011

\*\* resigned on 30 November 2011

+ appointed on 1 December 2011

+ appointed to the Committee on 17 November 2011

The Financial Controller attends meetings of the Credit Committee and the Finance Officer acts as Secretary to the Committee.



## MANAGEMENT COMMITTEE

### *Asset and Liability Management Committee (ALCO)*

The ALCO meets once a month 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.

The ALCO is chaired by the CEO and has as members the Financial Controller and Finance Officer.

### **Principle 5: Board Meetings**

During the calendar year 2011 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:

<b>Members</b>	<b>Attended</b>
Magdalena de Roeck	4
Countess Alexis d'Oultremont	4
Peter Van Marcke	4
Frederick E Amato-Gauci *	1
Anthony Camilleri**	4
Joseph Caruana	4
Charles Hertogs	3
Guido Mizzi	3
Patrick H Van Leynseele	4
Herbert Zammit Laferla +	0

\* resigned on 16 May 2011

\*\* resigned on 30 November 2011

+ appointed on 1 December 2011

### **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.

### **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.

# Directors' Statement of Compliance

With the Code of Principles of Good Corporate Governance

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## 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.

## 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.

## PART TWO – Non-Compliance with the Code

### Principle 2 – Code Provision 2.3

The Chairperson 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.

### 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.

### Principle 4 – Code Provision 4.3

The Board does not organise formal information sessions for its directors but information on the day-to-day running of the Bank is provided by the CEO who attends Board meetings. Through his attendance, the CEO keeps the Board informed on their statutory and fiduciary duties and the Bank's operations and prospects.

### Principle 6 – Information and Professional Development

The Code Provision (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.

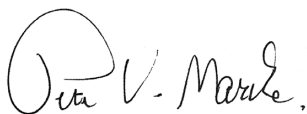
### Principle 7 – Evaluation of the Board's Performance

The Board does not consider it necessary to appoint a Committee to carry out an annual evaluation of its own performance and that of its Committees.

### Principle 8.B.1 - Nomination Committee

The Board has not established a Nomination Committee for the appointment of new directors to the Board. All potential new directors are informally assessed by the Board based on an evaluation of the skills, knowledge and experience already present and those needed.

Approved by the Board of Directors on 23 March 2012 and signed on its behalf by:



Mr. Peter Van Marcke  
Director



Countess Alexis d'Oultremont  
Director

## Directors' Responsibilities

For the Financial Statements

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.

Signed on behalf of the Board of Directors on 23 March 2012 by:



Mr. Peter Van Marcke  
Director



Countess Alexis d'Oultremont  
Director

# Remuneration Report

For the Year Ended 31 December 2011

The Board carries out the tasks normally delegated to a Remuneration Committee since the remuneration of directors is not performance-related.

## 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 Financial Controller and the ICT & Operations Manager. 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. Senior management are eligible for an annual salary increase and performance bonus. The said annual salary increases and bonuses are not directly performance related.

Non-cash benefits to which senior management are entitled are the use of a company car and personal accident and health insurance.

There have been no significant changes in the Bank's remuneration policy for senior management during the year under review and no significant changes are expected for 2012.

Total emoluments of senior management for the year ended 31 December 2011 are as follows:

Fixed Remuneration	Variable Remuneration	Share Options	Others
€148,728	€11,985	None	Non-cash benefits referred to immediately above.

### *Directors*

As at 31 December 2011, the Board was composed of non-executive directors.

The maximum annual aggregate emoluments that may be paid to the directors is approved by the shareholders in a General Meeting. This amount was fixed at an aggregate sum of €35,000 at the Annual General Meeting held on 15 April 2011.

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 for the year ended 31 December 2011 are as follows:

Fixed Remuneration	Variable Remuneration	Share Options	Others
€29,309	None	None	None



**FINANCIAL STATEMENTS**  
**2011**

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# Statement of Financial Position

As at 31 December 2011

	Note	2011 €	2010 €
<b>ASSETS</b>			
Cash		1,104	1,218
Balances receivable from Central Bank of Malta		5,288,371	885,071
Investments	13	38,757,542	30,790,237
Loans and advances to banks	14	6,337,124	11,052,866
Factored receivables	15	15,787,107	16,404,996
Other loans and advances to customers	16	19,281,374	16,219,498
Property and equipment	17	2,102,956	2,037,316
Intangible assets	18	186,787	294,186
Other assets	19	1,948,574	1,134,380
<b>Total assets</b>		<b>89,690,939</b>	<b>78,819,768</b>
<b>LIABILITIES</b>			
Balance owed to Central Bank of Malta	13.3	7,000,000	-
Amounts owed to customers	20	54,634,490	52,718,805
Debt securities issued	21	8,792,718	8,733,363
Deferred tax liabilities	22	345,201	343,777
Current tax payable		804,831	942,899
Accruals and deferred income	23	939,662	1,326,635
<b>Total liabilities</b>		<b>72,516,902</b>	<b>64,065,479</b>
<b>EQUITY</b>			
Called up share capital	24	7,000,000	4,000,000
Capital contribution	24	7,206,170	7,449,182
Property revaluation reserve	24	626,059	633,271
Fair value reserve	24	128,024	6,091
Depositor compensation scheme reserve	24	37,425	37,425
Retained earnings	24	2,176,359	2,628,320
<b>Total equity attributable to equity holders of the Bank</b>		<b>17,174,037</b>	<b>14,754,289</b>
<b>Total liabilities and equity</b>		<b>89,690,939</b>	<b>78,819,768</b>
<b>Memorandum items</b>			
Commitments	25	21,984,511	21,709,573

The notes on pages 6 to 47 are an integral part of these financial statements.

The financial statements on pages 2 to 47 were approved by the Board of Directors on 23 March 2012 and signed on its behalf by:



Mr. Peter Van Marcke  
Director



Countess Alexis d'Oultremont  
Director

## Statement of Comprehensive Income

For the Year Ended 31 December 2011

	Note	2011 €	2010 €
Interest receivable and similar income			
- on loans and advances	5	1,678,439	1,544,278
- on debt securities		1,780,770	1,261,998
Interest expense and similar charges	6	(1,699,157)	(1,474,670)
<b>Net interest income</b>		<b>1,760,052</b>	<b>1,331,606</b>
Fee and commission income		1,926,055	1,668,449
Fee and commission expense		(38,227)	(38,921)
<b>Net fee and commission income</b>	7	<b>1,887,828</b>	<b>1,629,528</b>
Net trading gains	8	14,595	22,464
Other operating income		26,821	4,193
<b>Operating income</b>		<b>3,689,296</b>	<b>2,987,791</b>
Administrative expenses		(1,096,295)	(679,222)
Depreciation		(258,861)	(267,472)
Impairment allowances	9	(35,761)	(145,951)
<b>Profit before income tax</b>	10	<b>2,298,379</b>	<b>1,895,146</b>
Income tax expense	11	(761,436)	(745,009)
<b>Profit for the year</b>		<b>1,536,943</b>	<b>1,150,137</b>
Other comprehensive income, net of income tax			
Transfer of depreciation on revaluation surplus net of deferred tax			
- retained earnings		11,096	11,096
- revaluation reserve		(7,212)	(7,212)
Change in fair value of available-for-sale financial assets, net of deferred tax		121,933	6,091
<b>Other comprehensive income for the year, net of income tax</b>		<b>125,817</b>	<b>9,975</b>
<b>Total comprehensive income for the year</b>		<b>1,662,760</b>	<b>1,160,112</b>
<b>Earnings per share</b>	12	<b>5.94</b>	<b>4.14</b>

The notes on pages 6 to 47 are an integral part of these financial statements.

# Statement of Changes in Equity

For the Year Ended 31 December 2011

	Share capital €	Property revaluation reserve €	Fair value reserve €	Depositor compensation scheme reserve €	Capital contribution €	Retained earnings €	Total €
<b>Balance at 1 January 2011</b>	<b>4,000,000</b>	<b>633,271</b>	<b>6,091</b>	<b>37,425</b>	<b>7,449,182</b>	<b>2,628,320</b>	<b>14,754,289</b>
<b>Total comprehensive income for the year</b>							
Profit	-	-	-	-	-	1,536,943	1,536,943
<b>Other comprehensive income, net of tax</b>							
Transfer of depreciation on revaluation surplus	-	(11,096)	-	-	-	11,096	-
Deferred tax thereon	-	3,884	-	-	-	-	3,884
Change in fair value of available-for-sale financial assets, net of deferred tax	-	-	121,933	-	-	-	121,933
Total other comprehensive income, net of tax	-	(7,212)	121,933	-	-	11,096	125,817
Total comprehensive income for the year	-	(7,212)	121,933	-	-	1,548,039	1,662,760
<b>Transactions with equity holders, recognised directly in Equity</b>							
<b>Contributions by and distributions to equity holders</b>							
Capitalisation of capital contribution	3,000,000	-	-	-	(3,000,000)	-	-
Dividends to equity holders	-	-	-	-	-	(2,000,000)	(2,000,000)
Contributions paid by equity holders	-	-	-	-	2,756,988	-	2,756,988
Total contributions by and distributions to equity holders	3,000,000	-	-	-	(243,012)	(2,000,000)	756,988
<b>Balance at 31 December 2011</b>	<b>7,000,000</b>	<b>626,059</b>	<b>128,024</b>	<b>37,425</b>	<b>7,206,170</b>	<b>2,176,359</b>	<b>17,174,037</b>
Balance at 1 January 2010	4,000,000	640,483	-	51,417	7,449,182	1,453,095	13,594,177
<b>Total comprehensive income for the year</b>							
Profit	-	-	-	-	-	1,150,137	1,150,137
<b>Other comprehensive income, net of tax</b>							
Transfer of depreciation on revaluation surplus	-	(11,096)	-	-	-	11,096	-
Deferred tax thereon	-	3,884	-	-	-	-	3,884
Change in fair value of available-for-sale financial assets, net of deferred tax	-	-	6,091	-	-	-	6,091
Transfer to retained earnings	-	-	-	(13,992)	-	13,992	-
Total other comprehensive income, net of tax	-	(7,212)	6,091	(13,992)	-	25,088	9,975
Total comprehensive income for the year	-	(7,212)	6,091	(13,992)	-	1,175,225	1,160,112
<b>Balance at 31 December 2010</b>	<b>4,000,000</b>	<b>633,271</b>	<b>6,091</b>	<b>37,425</b>	<b>7,449,182</b>	<b>2,628,320</b>	<b>14,754,289</b>

The notes on pages 6 to 47 are an integral part of these financial statements.



## Statement of Cash Flows

For the Year Ended 31 December 2011

	Note	2011 €	2010 €
<b>Cash flows from operating activities</b>			
Interest and commission receipts		2,936,306	3,239,384
Interest and commission payments		(1,553,888)	(1,126,629)
Payments to employees and suppliers		(1,085,049)	(843,552)
Operating profit before changes in operating assets/liabilities		297,369	1,269,203
Changes in operating assets:			
- loans and advances to customers		(3,066,183)	4,920,763
- factored receivables		585,751	(11,113,486)
- other receivables		-	130,875
Changes in operating liabilities:			
- amounts owed to customers		1,915,685	(1,196,454)
- amounts owed to banks		7,000,000	(1,500,000)
Net cash generated from/(absorbed by) operating activities before income tax	26	6,732,622	(7,489,099)
Income tax paid		(958,088)	(34,999)
<b>Net cash from/(used in) operating activities</b>		5,774,534	(7,524,098)
<b>Cash flows from investing activities</b>			
Payments to acquire property, equipment and intangible assets		(217,100)	(582,290)
Proceeds from disposals of investments		6,638,366	-
Payments to acquire investments		(14,391,288)	(1,834,914)
Interest received from investments		1,615,774	1,452,518
<b>Net cash used in investing activities</b>		(6,354,248)	(964,686)
<b>Cash flow from financing activities</b>			
Dividends paid to shareholders		(2,000,000)	-
Capital contributed by shareholders		2,756,988	-
Issue of debt securities		-	9,000,000
Capitalised costs related to the issue of debt securities		-	(297,005)
Interest paid on debt securities		(489,830)	-
<b>Net cash from financing activities</b>		267,158	8,702,995
<b>Net (decrease)/increase in cash and cash equivalents</b>		(312,556)	214,211
Cash and cash equivalents at beginning of year		11,939,155	11,724,944
<b>Cash and cash equivalents at end of year</b>	27	11,626,599	11,939,155

The notes on pages 6 to 47 are an integral part of these financial statements.

# Notes to the Financial Statements

For the Year Ended 31 December 2011

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## 1 Reporting entity

Izola Bank p.l.c. (the “Bank”) is a public limited liability company domiciled and incorporated in Malta.

## 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 (the “applicable framework”). 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), to the extent that such provisions do not conflict with the applicable framework.

### 2.2 Basis of measurement

Assets and liabilities are measured at historical cost except for available-for-sale financial assets that are measured at fair value.

### 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

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of 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 accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in note 31.

## 3 Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

### 3.1 Financial assets and financial liabilities

#### 3.1.1 *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.

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.

## 3 Significant accounting policies (*continued*)

### 3.1 Financial assets and financial liabilities (*continued*)

#### 3.1.1 *Non-derivative financial assets and financial liabilities (continued)*

##### 3.1.1.1 *Held-to-maturity investments*

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that 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. 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:

- 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.

##### 3.1.1.2 *Available-for-sale financial assets*

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

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.

Other fair value changes are recognised in other comprehensive income until the investment is sold or impaired, whereupon the cumulative gains and losses previously recognised in other comprehensive income are reclassified to profit or loss as a reclassification adjustment.

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.

##### 3.1.1.3 *Loans and advances*

Loans and advances 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 which are recognised on the day the cash is advanced to these borrowers, and factoring receivables. These loans and advances are classified as loans and receivables and 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.

# Notes to the Financial Statements

For the Year Ended 31 December 2011

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## 3 Significant accounting policies (*continued*)

### 3.1 Financial assets and financial liabilities (*continued*)

#### 3.1.2 *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 financial asset 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 assets 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.

#### 3.1.3 *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 legally enforceable right to set off the recognised amounts and there is an intention either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

#### 3.1.4 *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.

#### 3.1.5 *Fair value measurement*

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Bank establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

## 3 Significant accounting policies *(continued)*

### 3.1 Financial assets and financial liabilities *(continued)*

#### 3.1.5 Fair value measurement *(continued)*

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

Assets and long positions are measured at a bid price; liabilities and short positions are measured at an asking price. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Bank and the counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Bank believes a third-party market participant would take them into account in pricing a transaction.

#### 3.1.6 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 securities) 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 advances and held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and advances and held-to-maturity investment securities are assessed for specific impairment. All individually significant loans and advances and held-to-maturity investment securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics.

In assessing collective impairment the Bank uses historical trends of the probability of default, 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 data. 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.

# Notes to the Financial Statements

For the Year Ended 31 December 2011

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## 3 Significant accounting policies *(continued)*

### 3.1 Financial assets and financial liabilities *(continued)*

#### 3.1.6 Identification and measurement of impairment *(continued)*

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. Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and advances. 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 or loss.

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income 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 time value 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 in profit or loss, 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 advances and investment securities when they are determined to be uncollectible.

### 3.2 Cash and cash equivalents

Cash and cash equivalents comprise notes and coins in hand, unrestricted balances held with Central Bank of Malta and deposits with contractual maturity of less than three months. Subsequent to initial recognition, cash and cash equivalents are carried at amortised cost.

### 3.3 Property and equipment

#### 3.3.1 Recognition and measurement

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

Freehold property is revalued to fair value on the basis of its existing use every five years or earlier, whenever its fair value differs materially from its carrying amount. Revaluations are performed by a professionally qualified architect. Any surpluses arising on such revaluation are credited to a revaluation reserve. Any deficiencies resulting from decreases in value are deducted from this reserve to the extent that it is sufficient to absorb them, with any excess charged to profit or loss thereafter.

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

#### 3.3.2 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 embodied within the part 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 Significant accounting policies (*continued*)

### 3.3 Property and equipment (*continued*)

#### 3.3.3 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.

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 – 10 years
Motor vehicles	5 years

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

### 3.4 Intangible assets - software

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

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

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful life of the software, from the date that it is available for use since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. The estimated useful life of software is three to five years.

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

### 3.5 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 indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash generating unit ("CGU") 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 or CGU.

The Bank's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

An impairment loss is recognised if the carrying amount of an asset or a CGU exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

# Notes to the Financial Statements

For the Year Ended 31 December 2011

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## 3 Significant accounting policies (*continued*)

### 3.5 Impairment of non-financial assets (*continued*)

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.

### 3.6 Deposits and debt securities issued

Deposits and debt securities issued are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method. The Bank did not choose to carry any liabilities at fair value through profit or loss.

### 3.7 Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

### 3.8 Interest

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 effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

The calculation of the effective interest rate includes all transaction costs, and discounts or premiums 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.

Interest income and expense presented in the statement of 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.

### 3.9 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, investment management fees, sales commission, placement fees and syndication 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.

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



### 3 Significant accounting policies (*continued*)

#### 3.10 Trading gains/losses

Trading gains/losses comprise all realised and unrealised foreign exchange differences.

##### *Foreign currency transactions*

Transactions in foreign currencies are translated in the functional currency of the Bank at the foreign exchange rate prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in profit or loss. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into the functional currency at foreign exchange rates ruling at the dates the fair values were determined. Foreign currency differences arising in retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, which are recognised in other comprehensive income.

#### 3.11 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.

#### 3.12 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.

#### 3.13 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 is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities against current tax assets, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities against current tax assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised for temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. 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.

#### 3.14 Earnings per share

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.

# Notes to the Financial Statements

For the Year Ended 31 December 2011

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## 3 Significant accounting policies (*continued*)

### 3.15 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.

### 3.16 New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2011, and have not been applied in preparing these financial statements. None of these are expected to have a significant effect on the financial statements of the Bank, except for IFRS 9 Financial Instruments, which becomes mandatory for the Bank's 2015 financial statements and could change the classification and measurement of financial assets. The Bank does not plan to adopt this standard early and the extent of the impact has not been determined.

## 4 Financial risk management

### 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 Board Committee, the Audit Committee and the Credit Committee, which are responsible for the monitoring of risk in their specified areas. Non-executive directors sit on these Committees with the Chief Executive Officer also sitting on 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 Committee (ALCO) which is a management committee that reports to the Board 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: Risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. It arises from the lending, treasury, factoring of receivables and investment activities undertaken by the Bank.
- Market risk: Risk of losses arising from unfavourable changes in the level and volatility of interest rates, foreign exchange rates or investment prices.
- Liquidity risk: Liquidity risk 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.
- Operational risk: 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 and are faced by all business entities.

## 4 Financial risk management (*continued*)

### 4.3 Capital base

The Bank is a licensed financial services provider and must therefore comply with the capital requirements under the relevant capital requirements laws and regulations. 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 and retained earnings and excludes intangibles assets.
- Tier 2 capital, which includes property revaluation reserve, collective impairment allowances and fair value reserve.

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.

#### 4.3.2 *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.

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 4 Financial risk management (continued)

### 4.3 Capital base (continued)

#### 4.3.2 Calculation of minimum capital requirement and risk-weighted assets (continued)

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.

	2011 €	2010 €
Tier 1 capital		
Ordinary share capital	7,000,000	4,000,000
Capital contribution	7,206,170	7,449,182
Retained earnings	2,176,359	2,628,320
Intangible assets	(186,787)	(294,186)
	<u>16,195,742</u>	<u>13,783,316</u>
Tier 2 capital		
Property revaluation reserve	626,059	633,271
Collective impairment allowance	170,334	174,733
Fair value reserve	128,024	6,091
	<u>924,417</u>	<u>814,095</u>
Total regulatory capital	<u>17,120,159</u>	<u>14,597,411</u>

## Notes to the Financial Statements

For the Year Ended 31 December 2011

### 4 Financial risk management (continued)

#### 4.3 Capital base (continued)

##### 4.3.2 Calculation of minimum capital requirement and risk-weighted assets (continued)

	Statement of financial position 2011	Risk weighted exposure 2011	Capital requirement 2011	Statement of financial position 2010	Risk weighted exposure 2010	Capital requirement 2010
<b>On balance sheet assets</b>						
Cash	1,104	-	-	1,218	-	-
Balances with Central Bank of Malta	5,288,371	-	-	885,071	-	-
Investments	38,757,542	364,153	29,132	30,790,237	3,653	292
Loans and advances to banks	6,337,124	1,267,425	101,394	11,052,866	2,210,573	176,846
Factored receivables	15,787,107	15,787,107	1,262,969	16,404,996	16,404,996	1,312,400
Other loans and advances to customers	19,281,374	4,026,374	322,110	16,219,498	295,498	23,640
Property and equipment	2,102,956	2,102,956	168,236	2,037,316	2,037,316	162,985
Intangible assets	186,787	186,787	14,943	294,186	294,186	23,535
Prepayments and accrued income	1,948,574	974,287	77,943	1,134,380	567,190	45,375
	<b>89,690,939</b>	<b>24,709,089</b>	<b>1,976,727</b>	<b>78,819,768</b>	<b>21,813,412</b>	<b>1,745,073</b>
<b>Off balance sheet items</b>						
Commitments	21,984,511	-	-	21,709,573	-	-
Credit risk capital requirement		24,709,089	1,976,727		21,813,412	1,745,073
Foreign exchange risk capital requirement		26,801	2,144		45,802	3,660
Operational risk capital requirement		4,888,975	391,118		4,378,878	350,310
<b>Total capital requirement</b>		<b>29,624,865</b>			<b>26,238,092</b>	
<b>Own funds</b>						
Original own funds	16,195,742			13,783,316		
Additional own funds	924,417			814,095		
<b>Total own funds</b>	<b>17,120,159</b>			<b>14,597,411</b>		
<b>Capital adequacy ratio at 31 December</b>			<b>58%</b>			<b>56%</b>

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 4 Financial risk management (*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 loans and advances to customers and other banks, and other investment 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 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 credit risk policies and procedures are reviewed regularly through internal audit.

At the reporting date, 76% (2010: 98%) of other loans and advances to customers and 73% (2010: 92%) of investments were cash secured, whilst 3% (2010: Nil%) were secured against shares in a local company.

#### 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, loans and advances and acceptances and endorsements. 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 25).

#### 4.4.2 *Industry concentration*

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

	2011		2010	
	€	%	€	%
Manufacturing	2,835,614	15	3,639,430	22
Wholesale and retail trade	4,710,652	24	1,376,996	9
Real estate, renting and business activities	11,735,108	61	11,203,072	69
	<b>19,281,374</b>	<b>100</b>	<b>16,219,498</b>	<b>100</b>

## 4 Financial risk management (*continued*)

### 4.4 Credit risk (*continued*)

#### 4.4.3 Analysis of collateral

The Bank holds collateral against loans and advances to customers and investment securities in the form of pledges over deposits held with the Bank. Factored receivables are unsecured and collateral generally is not held over loans and advances to banks.

The fair value of collateral held as security is as follows:

#### Carrying amounts of neither past due nor impaired

	Loans and advances to customers		Investment in debt securities	
	2011	2010	2011	2010
	€	€	€	€
Type of collateral				
Deposits held with the Bank	14,655,000	15,924,000	28,186,574	28,186,574
Shares held by directors	600,000	-	-	-

#### 4.4.4 Impaired factored receivables

These comprise factored receivables for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the factored receivables agreements.

	2011	2010
	€	€
Factored receivables - gross	16,018,298	16,605,593
Collectively determined	16,018,298	16,605,593
Collective allowance for impairment	165,167	174,733
Specific allowance for impairment	66,024	25,864

#### 4.4.5 Neither past due nor impaired loans and securities

	2011	2010
	€	€
Loans and advances to customers	19,281,374	16,219,498
Loans and advances to banks	6,337,124	11,052,866
Investment securities	38,757,542	30,790,237
	64,376,040	58,062,601

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 4 Financial risk management (*continued*)

### 4.4 Credit risk (*continued*)

#### 4.4.6 *Past due but not impaired*

These are 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 2011, 6% (2010: 22%) of the Bank's factored receivables were past due but not impaired.

#### 4.4.7 *Loans with renegotiated terms*

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Once the loan is restructured, it remains in this category independent of satisfactory performance after restructuring.

The Bank does not have loans with renegotiated terms.

#### 4.4.8 *Allowances for impairment*

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its factored receivables portfolio. The main components of this allowance are a specific loss component that relates to individually impaired receivables, and a collective loss allowance established for groups of factored receivables in respect of losses that have been incurred but have not been identified and subject to individual assessment for impairment.

	2011	2010
	€	€
<i>Factored receivables</i>		
Collective allowance for impairment	165,167	174,733
Specific allowance for impairment	66,024	25,864

#### 4.4.9 *Write-off policy*

The Bank writes off a loan, security and / or factored receivable balance (and any related allowance for impairment losses) 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.



## 4 Financial risk management (continued)

### 4.4 Credit risk (continued)

#### 4.4.10 Concentration risk

The Bank monitors concentration of credit risk by sector and by geographic location. An analysis of concentrations of credit risk is shown hereunder.

	Loans and advances to customers		Factored receivables		Loans and advances to banks		Investment securities	
	2011 €	2010 €	2011 €	2010 €	2011 €	2010 €	2011 €	2010 €
Carrying amount	<b>19,281,374</b>	16,219,498	<b>15,787,107</b>	16,404,996	<b>6,337,124</b>	11,052,866	<b>38,757,542</b>	30,790,237
<b>Concentration by sector</b>								
Corporate	<b>19,281,374</b>	16,219,498	<b>15,787,107</b>	16,404,996	-	-	<b>28,186,574</b>	28,186,574
Banks	-	-	-	-	<b>6,337,124</b>	11,052,866	<b>721,000</b>	-
Sovereign	-	-	-	-	-	-	<b>9,846,315</b>	2,600,010
Equity	-	-	-	-	-	-	<b>3,653</b>	3,653
	<b>19,281,374</b>	16,219,498	<b>15,787,107</b>	16,404,996	<b>6,337,124</b>	11,052,866	<b>38,757,542</b>	30,790,237
<b>Concentration by location</b>								
Europe	<b>19,281,374</b>	16,219,498	<b>15,787,107</b>	16,404,996	<b>6,337,124</b>	11,052,866	<b>38,757,542</b>	30,790,237

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.

# Notes to the Financial Statements

For the Year Ended 31 December 2011

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## 4 Financial risk management (*continued*)

### 4.5 Market risk (*continued*)

#### 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 page 23 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 2011

### 4 Financial risk management (continued)

#### 4.5 Market risk (continued)

##### 4.5.1 Interest rate risk (continued)

2011	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 €
<b>Assets</b>							
Cash	1,104	-	-	-	-	-	1,104
Balances receivable from Central Bank of Malta	5,288,371	0.9	5,288,371	-	-	-	-
Investments:							
- Held-to-maturity debt securities	29,186,574	5.5	1,000,000	28,186,574	-	-	-
- Available-for-sale debt securities	9,567,315	4.5	-	-	-	9,567,315	-
- Equities available-for-sale	3,653	-	-	-	-	-	3,653
Loans and advances to banks	6,337,124	0.7	6,337,124	-	-	-	-
Loans and advances to customers	19,281,374	4.3	8,981,374	-	9,700,000	600,000	-
Factored receivables	15,787,107	-	-	-	-	-	15,787,107
Other assets	4,238,317	-	-	-	-	-	4,238,317
<b>Total assets</b>	<b>89,690,939</b>		<b>21,606,869</b>	<b>28,186,574</b>	<b>9,700,000</b>	<b>10,167,315</b>	<b>20,030,181</b>
<b>Liabilities</b>							
Balance owed to Central Bank of Malta	7,000,000	1.0	3,000,000	-	4,000,000	-	-
Amounts owed to customers	54,634,490	1.6	29,753,954	1,590,197	23,290,339	-	-
Debt securities issued	8,792,718	5.4	-	-	8,792,718	-	-
Current tax payable	804,831	-	-	-	-	-	804,831
Other liabilities	1,284,863	-	-	-	-	-	1,284,863
	<b>72,516,902</b>		<b>32,753,954</b>	<b>1,590,197</b>	<b>36,083,057</b>	<b>-</b>	<b>2,089,694</b>
<b>Equity</b>							
Issued capital	7,000,000	-	-	-	-	-	7,000,000
Property revaluation reserve	626,059	-	-	-	-	-	626,059
Depositors' compensation scheme reserve	37,425	-	-	-	-	-	37,425
Fair value reserve	128,024	-	-	-	-	-	128,024
Retained earnings	2,176,359	-	-	-	-	-	2,176,359
Capital contribution	7,206,170	-	-	-	-	-	7,206,170
	<b>17,174,037</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>17,174,037</b>
<b>Total liabilities and equity</b>	<b>89,690,939</b>		<b>32,753,954</b>	<b>1,590,197</b>	<b>36,083,057</b>	<b>-</b>	<b>19,263,731</b>
<b>Gap</b>			<b>(11,147,085)</b>	<b>26,596,377</b>	<b>(26,383,057)</b>	<b>10,167,315</b>	<b>766,450</b>
<b>Cumulative gap</b>			<b>(11,147,085)</b>	<b>15,449,292</b>	<b>(10,933,765)</b>	<b>(766,450)</b>	<b>-</b>

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 4 Financial risk management (continued)

### 4.5 Market risk (continued)

#### 4.5.1 Interest rate risk (continued)

2010	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 €
<b>Assets</b>							
Cash	1,218	-	-	-	-	-	1,218
Balances receivable from Central Bank of Malta	885,071	1.0	885,071	-	-	-	-
Investments:							
- Held-to-maturity debt securities	29,786,574	5.2	3,235,000	26,551,574	-	-	-
- Available-for-sale debt securities	1,000,010	-	-	-	-	1,000,010	-
- Equities available-for-sale	3,653	-	-	-	-	-	3,653
Loans and advances to banks	11,052,866	0.6	11,052,866	-	-	-	-
Loans and advances to customers	16,219,498	3.8	6,519,498	-	9,700,000	-	-
Factored receivables	16,404,996	-	-	-	-	-	16,404,996
Other assets	3,465,882	-	-	-	-	-	3,465,882
<b>Total assets</b>	<b>78,819,768</b>		<b>21,692,435</b>	<b>26,551,574</b>	<b>9,700,000</b>	<b>1,000,010</b>	<b>19,875,749</b>
<b>Liabilities</b>							
Balance owed to Central Bank of Malta	-	-	-	-	-	-	-
Amounts owed to customers	52,718,805	1.7	45,653,430	710,036	6,355,339	-	-
Debt securities issued	8,733,363	5.4	-	-	-	8,733,363	-
Current tax payable	942,899	-	-	-	-	-	942,899
Other liabilities	1,670,412	-	-	-	-	-	1,670,412
	<b>64,065,479</b>		<b>45,653,430</b>	<b>710,036</b>	<b>6,355,339</b>	<b>8,733,363</b>	<b>2,613,311</b>
<b>Equity</b>							
Issued capital	4,000,000	-	-	-	-	-	4,000,000
Property revaluation reserve	633,271	-	-	-	-	-	633,271
Depositors' compensation scheme reserve	37,425	-	-	-	-	-	37,425
Fair value reserve	6,091	-	-	-	-	-	6,091
Retained earnings	2,628,320	-	-	-	-	-	2,628,320
Capital contribution	7,449,182	-	-	-	-	-	7,449,182
	<b>14,754,289</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>14,754,289</b>
<b>Total liabilities and equity</b>	<b>78,819,768</b>		<b>45,653,430</b>	<b>710,036</b>	<b>6,355,339</b>	<b>8,733,363</b>	<b>17,367,600</b>
<b>Gap</b>			<b>(23,960,995)</b>	<b>25,841,538</b>	<b>3,344,661</b>	<b>(7,733,353)</b>	<b>2,508,149</b>
<b>Cumulative gap</b>			<b>(23,960,995)</b>	<b>1,880,543</b>	<b>5,225,204</b>	<b>(2,508,149)</b>	<b>-</b>

## 4 Financial risk management (*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:

	2011 €	2010 €
<b>Fixed rate instruments</b>		
Investments – Debt securities held-to-maturity	1,000,000	1,600,000
Investments – Debt securities available-for-sale	9,567,315	1,000,010
Loans and advances to banks	3,000,000	7,887,683
Loans and advances to customers	19,281,374	16,219,498
Balance receivable from Central Bank of Malta	4,350,000	-
Debt securities issued	(8,792,718)	(8,733,363)
Amounts owed to customers	(26,294,042)	(27,659,453)
	<u>2,111,929</u>	<u>(9,685,625)</u>
<b>Variable rate instruments</b>		
Balances receivable from Central Bank of Malta	938,371	885,071
Balance owed to Central Bank of Malta	(7,000,000)	-
Investments – Debt securities held-to-maturity	28,186,574	28,186,574
Loans and advances to banks	3,337,124	3,165,183
Amounts owed to customers	(28,340,448)	(25,059,352)
	<u>(2,878,379)</u>	<u>7,177,476</u>

##### 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.

An increase of 1% in the market prices for available-for-sale investments would lead to an increase in other comprehensive income and in equity amounting to €95,673 (2010: €10,000). A decrease of 1% would have an equal but opposite effect in other comprehensive income and equity.

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 4 Financial risk management (*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 monthly basis include a 100 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 €
<b>2011</b>		
+100 basis points	(28,784)	(28,784)
-100 basis points	18,734	18,734
<b>2010</b>		
+100 basis points	71,775	71,775
-100 basis points	(59,114)	(59,114)

#### 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 is matched with 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. Under the scenario that all foreign currencies fluctuate up or down by 20% against the Euro, the fair values of financial assets and liabilities would fluctuate, up or down by €3,856 (2010: €6,994) respectively.

## Notes to the Financial Statements

For the Year Ended 31 December 2011

### 4 Financial risk management (*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:

	2011			2010		
	Euro €	Other currencies €	Total €	Euro €	Other currencies €	Total €
Cash	1,104	-	1,104	1,218	-	1,218
Investments:						
- Debt securities						
held-to-maturity	29,186,574	-	29,186,574	29,786,574	-	29,786,574
- Debt securities						
available-for-sale	9,567,315	-	9,567,315	1,000,010	-	1,000,010
- Equities available-for-sale	3,653	-	3,653	3,653	-	3,653
Loans and advances to banks						
and balances receivable from						
Central Bank of Malta	10,974,714	650,781	11,625,495	10,153,341	1,784,596	11,937,937
Loans and advances to customers						
and credit cards	19,281,374	-	19,281,374	16,219,498	-	16,219,498
Factored receivables - gross	16,018,298	-	16,018,298	16,605,593	-	16,605,593
	<b>85,033,032</b>	<b>650,781</b>	<b>85,683,813</b>	<b>73,769,887</b>	<b>1,784,596</b>	<b>75,554,483</b>
<b>Financial liabilities</b>						
Balance owed to						
Central Bank of Malta	7,000,000	-	7,000,000	-	-	-
Debt securities issued	8,792,718	-	8,792,718	8,733,363	-	8,733,363
Amounts owed to customers	53,300,349	1,334,141	54,634,490	51,026,656	1,692,149	52,718,805
	<b>69,093,067</b>	<b>1,334,141</b>	<b>70,427,208</b>	<b>59,760,019</b>	<b>1,692,149</b>	<b>61,452,168</b>

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

# Notes to the Financial Statements

For the Year Ended 31 December 2011

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## 4 Financial risk management (*continued*)

### 4.5 Market risk (*continued*)

#### 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.

##### *Fair value and price verification control*

The majority of the financial assets and liabilities of the Bank are carried at cost or amortised cost less impairment losses and not fair value.

##### *Investments – Debt securities available-for-sale*

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 2011.

##### *Investments – Debt securities held-to-maturity*

This category of assets is carried at amortised cost. The instruments are unquoted and quoted market price for similar instruments is not available. There is no other appropriate or workable method of reasonably estimating the fair value of these unquoted investments for disclosure purposes.

##### *Investments – Equity instruments available-for-sale*

The Bank has an interest in an unquoted equity investment as disclosed in note 13.4. The investment is measured at fair value. Fair value has been determined by reference to the amount recoverable which is represented by the notional amount of the investment.

##### *Loans and advances to banks and customers*

This category of assets is reported net of impairment allowances to reflect the estimated recoverable amounts. Loans and advances to banks are repriceable within 3 months. 47% (2010: 40%) of loans and advances to customers are repriceable within 3 months while 53% (2010: 60%) are repriceable within five years or more. The fact that the majority of this category of financial assets has a short term contractual repricing coupled with the fact that interest rates reflect current market rates, the carrying amounts of these financial assets approximate their fair values.

##### *Amounts owed to customers*

This category of liabilities is carried at amortised cost and amounts to €54,634,490 (2010: €52,718,805). 54% (2010: 87%) of the Bank's amounts owed to 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, that are repriceable upon their contractual maturity date, it is not practicable to determine fair value with sufficient reliability. Fair value is therefore taken to be the amount payable at the date of the statement of financial position.

##### *Balance owed to Central Bank of Malta*

The loans contracted by the Bank during the current year with Central Bank of Malta are carried at amortised cost.



## 4 Financial risk management (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.

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 Bank's liquidity risk management focuses on structuring both the asset and liability portfolio so as to maintain diversity of funding sources and a spread of asset and liability maturities. It is the Bank's policy to reduce exposure to liquidity risk by matching, as much as possible, assets and liabilities in different maturity periods. A significant proportion of deposits are pledged, which contributes to the reduction of liquidity risk.

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

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

	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 €
<b>At 31 December 2011</b>						
<b>Financial assets</b>						
Cash	1,104	-	-	-	-	1,104
Investments:						
Debt securities held-to-maturity	1,000,000	-	-	24,051,574	4,135,000	29,186,574
Equity shares	-	-	-	-	3,653	3,653
Debt securities available-for-sale	9,567,315	-	-	-	-	9,567,315
Loans and advances to banks and balances receivable from Central Bank of Malta	8,570,132	3,000,000	55,363	-	-	11,625,495
Loans and advances to customers	8,981,374	-	-	9,700,000	600,000	19,281,374
Factored receivables – gross	8,350,417	5,695,727	1,972,154	-	-	16,018,298
	<u>36,470,342</u>	<u>8,695,727</u>	<u>2,027,517</u>	<u>33,751,574</u>	<u>4,738,653</u>	<u>85,683,813</u>
<b>Financial liabilities</b>						
Balance owed to Central Bank of Malta	-	3,000,000	-	4,000,000	-	7,000,000
Amounts owed to customers	28,400,771	1,353,183	1,590,197	23,290,339	-	54,634,490
Debt securities issued	-	-	-	8,792,718	-	8,792,718
	<u>28,400,771</u>	<u>4,353,183</u>	<u>1,590,197</u>	<u>36,083,057</u>	<u>-</u>	<u>70,427,208</u>

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 4 Financial risk management (*continued*)

### 4.6 Liquidity risk (*continued*)

	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 €
At 31 December 2010						
<b>Financial assets</b>						
Cash	1,218	-	-	-	-	1,218
Investments:						
Debt securities held-to-maturity	1,600,000	-	-	20,691,574	7,495,000	29,786,574
Equity shares	-	-	-	-	3,653	3,653
Debt securities available-for-sale	1,000,010	-	-	-	-	1,000,010
Loans and advances to banks and balances receivable from Central Bank of Malta	11,937,937	-	-	-	-	11,937,937
Loans and advances to customers	6,519,498	-	-	9,700,000	-	16,219,498
Factored receivables – gross	8,867,949	6,618,295	1,119,349	-	-	16,605,593
	<u>29,926,612</u>	<u>6,618,295</u>	<u>1,119,349</u>	<u>30,391,574</u>	<u>7,498,653</u>	<u>75,554,483</u>
<b>Financial liabilities</b>						
Balance owed to Central Bank of Malta	-	-	-	-	-	-
Debt securities issued	-	-	-	8,733,363	-	8,733,363
Amounts owed to customers	27,795,371	17,858,059	710,036	6,355,339	-	52,718,805
	<u>27,795,371</u>	<u>17,858,059</u>	<u>710,036</u>	<u>15,088,702</u>	<u>-</u>	<u>61,452,168</u>

#### 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:

	2011	2010
As at 31 December	137%	182%
Average for the year	180%	191%
Maximum for the year	233%	301%
Minimum for the year	137%	105%

## 4 Financial risk management (continued)

### 4.6 Liquidity risk (continued)

#### 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 inflow/ (outflow)	Repayable on demand	Between one and three months	Between three months one year	Between one and and five years
	€	€	€	€	€	€
<b>At 31 December 2011</b>						
Debt securities issued	8,792,718	(10,926,000)	-	-	(481,500)	(10,444,500)
Balance owed to Central Bank of Malta	7,000,000	(7,135,479)	-	(3,009,479)	-	(4,126,000)
Amounts owed to customers	54,634,490	(56,941,385)	(28,403,065)	(1,404,804)	(1,649,355)	(25,484,162)
	<u>70,427,208</u>	<u>(75,002,864)</u>	<u>(28,403,065)</u>	<u>(4,414,283)</u>	<u>(2,130,855)</u>	<u>(40,054,662)</u>
<b>At 31 December 2010</b>						
Debt securities issued	8,733,363	(11,407,500)	-	-	(481,500)	(10,926,000)
Balance owed to Central Bank of Malta	-	-	-	-	-	-
Amounts owed to customers	52,718,805	(53,985,917)	(26,536,371)	(18,613,370)	(253,943)	(8,582,233)
	<u>61,452,168</u>	<u>(65,393,417)</u>	<u>(26,536,371)</u>	<u>(18,613,370)</u>	<u>(735,443)</u>	<u>(19,508,233)</u>

### 4.7 Operational risks

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 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 €391,118 as at 31 December 2011 (2010: €350,310).

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 5 Interest receivable on loans and advances

	2011 €	2010 €
On loans and advances to banks	54,072	25,999
On loans and advances to customers	1,624,367	1,518,279
	<u>1,678,439</u>	<u>1,544,278</u>

## 6 Interest expense and similar charges

	Note	2011 €	2010 €
Interest expense:			
On amounts owed to banks		32,104	14,833
On amounts owed to customers		1,129,752	1,173,548
On debts securities issued		477,946	255,921
		<u>1,639,802</u>	<u>1,444,302</u>
Amortisation of debt issuance costs	21	59,355	30,368
		<u>1,699,157</u>	<u>1,474,670</u>

## 7 Net fee and commission income

	2011 €	2010 €
Straight-through-processing fees	594,338	591,447
Commissions from factoring services	1,331,717	1,077,002
<b>Fee and commission income</b>	<u>1,926,055</u>	<u>1,668,449</u>
SWIFT and bank charges	(38,227)	(38,921)
<b>Fee and commission expense</b>	<u>(38,227)</u>	<u>(38,921)</u>
<b>Net fee and commission income</b>	<u>1,887,828</u>	<u>1,629,528</u>

## Notes to the Financial Statements

For the Year Ended 31 December 2011

### 8 Net trading gains

Net trading gains comprise exchange rate differences.

### 9 Impairment allowances

	2011 €	2010 €
<b>Write-downs</b>		
Factored receivables		
- collective allowances	9,566	(120,087)
- specific allowances	(40,160)	(25,864)
Credit cards and overdrafts	(5,167)	-
	<u>(35,761)</u>	<u>(145,951)</u>

### 10 Profit before income tax

10.1 Profit before income tax is stated after charging fees payable, exclusive of VAT, to the Bank's auditors during 2011 for:

	€
Auditors' remuneration	23,980
Other assurance services	16,800
Other non-audit services	22,985
	<u>63,765</u>

10.2 Staff costs incurred by the Bank during the year are analysed as follows:

	2011 €	2010 €
Directors' fees	29,309	26,130
Staff costs:		
- wages, salaries and allowances	269,832	239,891
- defined contribution social security costs	13,831	12,351
	<u>312,972</u>	<u>278,372</u>

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

	2011 No.	2010 No.
Managerial	3	3
Supervisory and clerical	5	5
	<u>8</u>	<u>8</u>

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 11 Income tax expense

### 11.1 Total income tax expense

	Note	2011 €	2010 €
Current tax expense			
Current year		820,020	747,855
Deferred tax			
Origination and reversal of temporary differences	22	(58,584)	(2,846)
		<u>761,436</u>	<u>745,009</u>

11.2 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:

	2011 €	2010 €
Profit before income tax	2,298,379	1,895,146
Income tax at the applicable tax rate of 35%	(804,433)	(663,301)
Income tax effect of:		
Different tax rates	51,131	(73,677)
Depreciation charges not deductible by way of capital allowances	(7,492)	(7,005)
Non-taxable income	137	137
Non-deductible expenses	(779)	(1,163)
Tax expense	<u>(761,436)</u>	<u>(745,009)</u>

## 12 Earnings per share

Earnings per share is calculated on the total comprehensive income of the Bank for the year ended 31 December 2011 amounting to €1,662,760 (2010: €1,160,112) divided by 280,000 (2010: 280,000), being the equivalent number of ordinary shares in issue and ranking for dividend during the year. During the year there was an increase in the number of ordinary shares issued through the capitalisation of part of the capital contribution (see note 24.1). The calculation of earnings per share for the comparative year has been therefore adjusted retrospectively and based on the revised number of shares held at the end of the current year.

## Notes to the Financial Statements

For the Year Ended 31 December 2011

### 13 Investments

13.1 Investments comprise:

	2011 €	2010 €
Held-to-maturity debt securities	29,186,574	29,786,574
Available-for-sale debt securities	9,567,315	1,000,010
Available-for-sale equity instruments	3,653	3,653
	<b>38,757,542</b>	<b>30,790,237</b>

13.2 At 31 December 2011, €28,190,227 (2010: €28,190,227) of investment securities are expected to be recovered more than 12 months after the reporting date.

13.2 Held-to-maturity debt securities comprise unquoted non-convertible nominative bonds amounting to €28,186,574 (2010: €28,186,574) issued by related parties (note 29.1) and acquired on issuance by the Bank and Malta Government Treasury bills amounting to €1,000,000 (2010: €1,600,000). The unquoted non-convertible nominative bonds are cash secured by amounts owed to customers held by the Bank.

13.3 Available-for-sale debt securities comprise Malta Government Stocks amounting to €8,846,315 and local corporate bonds amounting to €721,000 acquired by the Bank during the year. As at 31 December 2011, the Malta Government Stocks held by the Bank were pledged in favour of Central Bank of Malta to cover the Bank's participation in the Euro-system financing operations which amounted to €7,000,000 (2010: €Nil) at that date.

13.4 Equity instruments available-for-sale comprise:

	2011 €	2010 €
Unquoted equity holding		
- Society for Worldwide Interbank Financial Telecommunications SCRL		
2 ordinary shares fully paid up	3,653	3,653

13.5 The movement in investments may be summarised as follows:

	Held-to-Maturity	Available-for-sale	Total
<b>At 1 January 2010</b>	28,942,299	3,653	28,945,952
Acquisitions	17,017,585	990,640	18,008,225
Capitalisation of interest	856,378	-	856,378
Fair value movement	-	9,370	9,370
Maturity	(17,029,688)	-	(17,029,688)
<b>At 31 December 2010</b>	<b>29,786,574</b>	<b>1,003,663</b>	<b>30,790,237</b>
<b>At 1 January 2011</b>	<b>29,786,574</b>	<b>1,003,663</b>	<b>30,790,237</b>
Acquisitions	4,487,306	9,903,981	14,391,287
Disposals	(5,098,466)	(1,539,900)	(6,638,366)
Realised gains	11,160	17,399	28,559
Fair value movement	-	185,825	185,825
<b>At 31 December 2011</b>	<b>29,186,574</b>	<b>9,570,968</b>	<b>38,757,542</b>

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 14 Loans and advances to banks

	2011 €	2010 €
Repayable on call and at short notice	2,686,342	2,510,406
Term loans and advances	3,650,782	8,542,460
	<u>6,337,124</u>	<u>11,052,866</u>

## 15 Factored receivables

	2011 €	2010 €
Receivables factored without recourse	16,018,298	16,605,593
Allowance for uncollectibility:		
- Specific	(66,024)	(25,864)
- Collective	(165,167)	(174,733)
	<u>(231,191)</u>	<u>(200,597)</u>
	<u>15,787,107</u>	<u>16,404,996</u>

Of the carrying amount of factoring receivables as at 31 December 2011, the Bank pledged an amount of €14,903,155 (2010: €14,576,196) in favour of the trustee holding the security granted by the Bank on trust for the benefit of all holders of debts securities issued by the Bank (see note 21).

Allowances	€
<b>At 1 January 2011</b>	<b>200,597</b>
Net increase	30,594
<b>At 31 December 2011</b>	<b><u>231,191</u></b>

An allowance for uncollectibility is provided against receivables factored without recourse, other than exposures to European governmental agencies.



## 16 Other loans and advances to customers

### 16.1 Term loans and advances

	Note	2011 €	2010 €
Term loans and advances to related parties	29.1	<b>18,855,000</b>	15,924,000
Credit cards and overdrafts		<b>426,374</b>	295,498
		<b>19,281,374</b>	16,219,498

**16.2** At 31 December 2011, loans and advances to customers amounting to €10,300,000 (2010: €9,700,000) are expected to be recovered in excess of 12 months after the reporting date.

**16.3** Loans and advances to customers amounting to €15,255,000 (2010: €15,924,000) are cash secured by amounts owed to customers held by the Bank and no allowance for uncollectibility is thus considered necessary. An additional €600,000 (2010: €Nil) are secured by a pledge on shares held by two directors of the Bank in a local company (in which the Bank has no direct or indirect interest). No allowance for uncollectibility is therefore considered necessary on these loans to directors.

**16.4** Credit card balances are stated net of allowance for collective impairment amounting to €5,167 (2010: €Nil).

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 17 Property and equipment

	Cost/ Revalued amount		Cost		
	Premises and Total improvements €	€	Computer hardware €	Other equipment €	Motor vehicles €
<b>Cost/revalued amount</b>					
At 1 January 2010	2,265,486	1,646,482	253,806	359,375	5,823
Acquisitions	515,826	405,542	98,937	11,347	-
At 31 December 2010	2,781,312	2,052,024	352,743	370,722	5,823
At 1 January 2011	2,781,312	2,052,024	352,743	370,722	5,823
Acquisitions	139,068	23,352	6,259	76,328	33,129
<b>At 31 December 2011</b>	<b>2,920,380</b>	<b>2,075,376</b>	<b>359,002</b>	<b>447,050</b>	<b>38,952</b>
<b>Depreciation</b>					
At 1 January 2010	682,316	138,980	225,723	313,608	4,005
Charge for the year	61,680	21,113	20,909	18,495	1,163
At 31 December 2010	743,996	160,093	246,632	332,103	5,168
At 1 January 2011	743,996	160,093	246,632	332,103	5,168
Charge for the year	73,428	22,506	26,249	22,072	2,601
<b>At 31 December 2011</b>	<b>817,424</b>	<b>182,599</b>	<b>272,881</b>	<b>354,175</b>	<b>7,769</b>
<b>Carrying amount</b>					
At 1 January 2010	1,583,170	1,507,502	28,083	45,767	1,818
At 31 December 2010	2,037,316	1,891,931	106,111	38,619	655
<b>At 1 January 2011</b>	<b>2,037,316</b>	<b>1,891,931</b>	<b>106,111</b>	<b>38,619</b>	<b>655</b>
<b>At 31 December 2011</b>	<b>2,102,956</b>	<b>1,892,777</b>	<b>86,121</b>	<b>92,875</b>	<b>31,183</b>

The carrying amount of premises and improvements that would have been included in the financial statements had these assets been carried at cost less depreciation is €928,058 (2010: €916,482).

## Notes to the Financial Statements

For the Year Ended 31 December 2011

### 18 Intangible assets

	<b>Computer software €</b>
<b>Cost</b>	
At 1 January 2010	1,340,047
Acquisitions	144,306
At 31 December 2010	<u>1,484,353</u>
At 1 January 2011	1,484,353
Acquisitions	78,034
<b>At 31 December 2011</b>	<b><u>1,562,387</u></b>
<b>Amortisation</b>	
At 1 January 2010	984,375
Charge for the year	205,792
At 31 December 2010	<u>1,190,167</u>
At 1 January 2011	1,190,167
Charge for the year	185,433
<b>At 31 December 2011</b>	<b><u>1,375,600</u></b>
<b>Carrying amount</b>	
At 1 January 2010	355,672
At 31 December 2010	<u>294,186</u>
<b>At 1 January 2011</b>	<b><u>294,186</u></b>
<b>At 31 December 2011</b>	<b><u>186,787</u></b>

As at 31 December 2011, capital expenditure authorised but not contracted for amounted to €445,000 (2010: €35,989).

## Notes to the Financial Statements

For the Year Ended 31 December 2011

### 19 Other assets

	2011 €	2010 €
Accrued income	1,756,956	910,915
Accounts receivable and prepayments	191,618	223,465
	<u>1,948,574</u>	<u>1,134,380</u>

Accrued income on bonds and loans receivable from related parties (see note 29.1) amounted to €1,695,240 (2010: €903,183).

### 20 Amounts owed to customers

	2011 €	2010 €
Repayable on demand	28,340,448	26,536,371
Term deposits	26,294,042	26,182,434
	<u>54,634,490</u>	<u>52,718,805</u>

Amounts owed to customers include an amount of €46,193,321 (2010: €47,029,755) owed by the Bank to related parties (see note 29.1).

### 21 Debt securities issued

	2011 €	2010 €
Debt securities issued at amortised cost	8,792,718	8,733,363
At 1 January	8,733,363	-
Funds raised by issue during the year	-	9,000,000
Debt issuance costs during the year	-	(297,005)
	<u>8,733,363</u>	<u>8,702,995</u>
Amortisation of debt issuance costs during the year	59,355	30,368
At 31 December	<u>8,792,718</u>	<u>8,733,363</u>

In the comparative year, the Bank issued debt securities amounting to €9,000,000 at 5.35%, maturing in 2015. These notes are secured by a pledge on factored receivables amounting to €14,903,155 (2010: €14,576,196) (refer to note 15). These debt securities constitute the general, direct, unconditional and secured obligations of the Bank and shall, at all times, rank pari passu without any priority or preference among themselves.

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

## Notes to the Financial Statements

For the Year Ended 31 December 2011

### 22 Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets 2011 €	Liabilities 2011 €	Net 2011 €	Assets 2010 €	Liabilities 2010 €	Net 2010 €
Excess of capital allowances over depreciation	-	(23,345)	(23,345)	-	(69,713)	(69,713)
Collective impairment allowance	59,316	-	59,316	61,156	-	61,156
Specific impairment allowance	23,108	-	23,108	9,052	-	9,052
Revaluation of property	-	(337,109)	(337,109)	-	(340,993)	(340,993)
Fair value movements	-	(67,171)	(67,171)	-	(3,279)	(3,279)
	<b>82,424</b>	<b>(427,625)</b>	<b>(345,201)</b>	70,208	(413,985)	(343,777)

Movement in temporary differences relating to:

	At 1 January 2011	Recognised profit or loss	Recognised in equity	At 31 December 2011
Excess of capital allowances over depreciation	(69,713)	46,368	-	(23,345)
Collective impairment allowances	61,156	(1,840)	-	59,316
Specific impairment allowances	9,052	14,056	-	23,108
Revaluation of property	(340,993)	-	3,884	(337,109)
Fair value movements	(3,279)	-	(63,892)	(67,171)
	<b>(343,777)</b>	<b>58,584</b>	<b>(60,008)</b>	<b>(345,201)</b>

	At 1 January 2010	Recognised profit or loss	Recognised in equity	At 31 December 2010
Excess of capital allowances over depreciation	(5,219)	(64,494)	-	(69,713)
Collective impairment allowances	2,868	58,288	-	61,156
Specific impairment allowances	-	9,052	-	9,052
Revaluation of property	(344,877)	-	3,884	(340,993)
Fair value movements	-	-	(3,279)	(3,279)
	<b>(347,228)</b>	<b>2,846</b>	<b>605</b>	<b>(343,777)</b>

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 23 Accruals and deferred income

	2011 €	2010 €
Accrued interest payable	660,943	1,026,630
Deferred factoring commissions	149,679	150,363
Other accrued expenses	129,040	149,642
	<b>939,662</b>	<b>1,326,635</b>

Accruals and deferred income includes amounts due to related parties (see note 29.1) amounting to €480,378 (2010: €855,110).

## 24 Share capital and reserves

### 24.1 Share capital

	2011 No.	2010 No.
On issue at 1 January:		
Issued for cash	54,762	54,762
Issued in lieu of dividend payment	105,238	105,238
Issued during the year:		
Issued in lieu of dividend payment	120,000	-
On issue at 31 December – fully paid	<b>280,000</b>	<b>160,000</b>

At 31 December 2011, the authorised share capital comprised 400,000 ordinary shares (2010: 400,000) of €25 each. During the year there was an increase in the number of ordinary shares issued through the capitalisation of capital contribution (see note 12). The Bank's issued ordinary shares are equally held by IBL I Limited and IBL T Limited, which are 100% indirect subsidiaries of VMKG PLLC (the ultimate parent).

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.

### 24.2 Capital Contribution

These amounts represent irrevocable and unconditional contributions by the shareholders, are interest free and repayable at the sole discretion of the Bank.

### 24.3 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 or disposal of the revalued property. This reserve is not distributable except on realisation of the assets through sale.

## 24 Share capital and reserves (*continued*)

### 24.4 Fair value reserve

The fair value reserve comprises the cumulative net change in the fair value of available-for-sale financial assets net of deferred tax effect until the investments are derecognised or impaired.

### 24.5 Depositor compensation scheme reserve

The depositor compensation scheme reserve represents amounts set aside by the Bank from its retained earnings. As at 31 December 2011, a total amount of €37,425 (2010: €37,425) was placed with Central Bank of Malta by the Bank and pledged in favour of the Depositor Compensation Scheme.

### 24.6 Availability of reserves for distribution

	2011 €	2010 €
Distributable	9,382,529	10,077,502
Non-distributable	791,508	676,787
	<u>10,174,037</u>	<u>10,754,289</u>

### 24.7 Dividends

During the current year, before the issue of new shares, the Bank declared and paid an interim dividend amounting to €12.50 (2010: €Nil) per ordinary share that amounted to €2,000,000 (2010: €Nil).

After 31 December 2011, the directors proposed a dividend of €5.36 per ordinary share in respect of 2011 amounting to €1,500,000. The proposed dividends have not been provided for and there are no income tax consequences.

## 25 Commitments

	2011 €	2010 €
Unutilised factoring, overdraft facilities and credit card commitments	<u>21,984,511</u>	<u>21,709,573</u>

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

Factoring commitments are granted to customers at prevailing market rates at transfer date.

## Notes to the Financial Statements

For the Year Ended 31 December 2011

### 26 Net cash generated from/(absorbed by) operating activities

	2011 €	2010 €
Profit for the year:	1,536,943	1,150,137
Adjustments for:		
Depreciation and amortisation	258,861	267,472
Income tax expense	761,436	745,009
Impairment allowance	35,761	145,951
Interest receivable on debt securities	(1,780,770)	(1,261,998)
Interest expense on debt securities	477,946	255,921
Realised gains on disposal of investments	(28,559)	-
Amortisation of transaction costs on debts securities issued	59,355	30,368
	<u>1,320,973</u>	<u>1,332,860</u>
Change in loans and advances to customers and factored receivables	(3,129,630)	(6,211,730)
Change in amounts owed to customers and to Central Bank of Malta and accruals and deferred income	<u>8,541,279</u>	<u>(2,610,229)</u>
	<u><u>6,732,622</u></u>	<u><u>(7,489,099)</u></u>

### 27 Cash and cash equivalents

	2011 €	2010 €
Cash	1,104	1,218
Balances with Central Bank of Malta	5,288,371	885,071
Loans and advances to banks with contractual maturity of three months or less	6,337,124	11,052,866
	<u>11,626,599</u>	<u>11,939,155</u>

### 28 Operating leases

The future minimum lease payments for the Bank under non-cancellable operating lease rental payable to a third party are as follows:

	2011 €	2010 €
Less than one year	3,463	7,405
Between one and five years	-	3,463
	<u>3,463</u>	<u>10,868</u>

The Bank leases two motor vehicles under an operating lease. During the year ended 31 December 2011, €8,873 was recognised as an expense in the statement of comprehensive income in respect of operating leases (2010: €11,808).

In case of termination of the lease contract, the Bank is entitled to pay liquidation damages equivalent to 50% of the rental charges due from the date of termination for the period of all unexpired leases including all rental charges due to the termination of the contract.



## 29 Related parties

### 29.1 Related party transactions

Related parties are related by virtue of having common directors. 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 Paepsemiaan, 28-30, 1070 Brussels, Belgium.

### 29.2 Related party transactions

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

	2011 €	2010 €
Interest receivable and similar income	3,138,975	2,739,340
Fees and commissions receivable	1,885,637	1,630,414
Other operating income	10,979	4,193
	<u>897,651</u>	<u>891,618</u>
Interest expense		

### 29.3 Related party balances

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

	2011 €	2010 €
<b>Assets</b>		
Loans and advances to customers	18,855,000	15,924,000
Investments	28,186,574	28,186,574
Prepayments and accrued income	1,695,240	903,183
	<u></u>	<u></u>
<b>Liabilities</b>		
Amounts owed to customers	46,193,321	47,029,755
Debt securities issued to director	150,000	150,000
Accruals and deferred income	480,738	855,110
	<u></u>	<u></u>

### 29.4 Transactions with key management personnel

	2011 €	2010 €
Compensation to key management personnel	160,713	151,956
Loans advanced to directors	600,000	-
Secured notes acquired by director	-	150,000
	<u></u>	<u></u>

### 29.5 Ultimate controlling party

Magdalena De Roeck, Countess Alexis d'Oultremont and Peter Van Marcke have an indirect beneficial interest in the shareholding of the Bank through their indirect shareholding in the ultimate parent (see note 29.1).

# Notes to the Financial Statements

For the Year Ended 31 December 2011

## 30 Operating segments

**30.1** 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 comprehensive income.

### 30.2 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.

	2011 €	2010 €
<b>Revenue</b>		
Malta	284,264	62,720
Belgium	5,101,000	4,412,005
	<u>5,385,264</u>	<u>4,474,725</u>
<b>Non-current assets</b>		
Malta – property, equipment and intangible assets	<u>2,289,743</u>	<u>2,331,502</u>

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

Information above revenues, costs and balances as a result of transactions with this group is set out in note 29.

### 31 Accounting estimates and judgements

**31.1** The directors considered the development, selection and disclosure of the Bank's critical accounting policies and estimates and the application of these policies and estimates. Estimates and judgements are continually evaluated and are based on historical and other factors, including expectations of future events that are believed to be reasonable under the circumstances

#### **31.2 Critical accounting judgements in applying the Bank's accounting policies**

Certain critical accounting judgements in applying the Bank's accounting policies are described below.

##### ***31.2.1 Classification of held-to-maturity investments***

The Bank follows the guidance in IAS 39 on classifying non-derivative financial assets with fixed or determinable payments and fixed maturity as held-to-maturity. The classification requires significant judgement. In making this judgment, the Bank evaluates its intention and ability to hold such investments to maturity. If the Bank fails to keep these investments to maturity other than for specific circumstances, for example, selling an insignificant amount close to maturity, it will be required to reclassify the entire class as available-for-sale. The investments would therefore be measured at fair value instead of at amortised cost.

##### ***31.2.2 Impairment losses on loans and advances and factored receivables***

The Bank reviews its loan portfolio to assess impairment on an ongoing basis as relevant generic data is observed concerning risks associated with loans and factored receivables with similar risk characteristics. As a result, the Bank makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans and factored receivables, before the decrease is actually identified with an individual loan or factored receivable in that portfolio. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

##### ***31.2.3 Revaluation of premises***

The Bank's premises are measured at revaluation 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 open market valuation provided by independent valuers on 14 August 2007 of the property disclosed in note 17 was €1,747,030. The directors applied a downward adjustment of €232,937 to limit the revaluation to what they believe is the lower range of the fair open market value.



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## Independent Auditors' Report

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

### Report on the Financial Statements

We have audited the financial statements of Izola Bank p.l.c. (the "Bank"), as set out on pages 2 to 47, which comprise the statements of financial position as at 31 December 2011 and the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

#### *Directors' Responsibility for the Financial Statements*

As explained more fully in the Directors' Responsibilities Statement set out on page xi of the Annual Report, the directors are responsible for the preparation of financial statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU, the Companies Act, 1995 (Chapter 386, Laws of Malta) (the "Act"), and the Banking Act, 1994 (Chapter 371, Laws of Malta), 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.

#### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Article 179 of the Act, and Article 31 of the Banking Act, 1994 (Chapter 371, Laws of Malta), and may not be appropriate for any other purpose.

In addition, we read the other information contained in the Annual Report 2011 and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent material misstatements of fact or material inconsistencies with the financial statements.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

KPMG, a Maltese civil partnership, is a member firm of 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 Members of Izola Bank p.l.c.

### *Opinion on Financial Statements*

In our opinion, the financial statements:

- give a true and fair view of the Bank's financial position as at 31 December 2011, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU; and
- have been properly prepared in accordance with the Companies Act, 1995 (Chapter 386, Laws of Malta), and the Banking Act, 1994 (Chapter 371, Laws of Malta).

### *Report on Other Legal and Regulatory Requirements*

Matters on which we are required to report by the Banking Act, 1994 (Chapter 371, Laws of Malta)

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;
- the Bank's financial statements are in agreement with the books of account; 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.

Matters on which we are required to report by exception by the Companies Act, 1995 (Chapter 386, Laws of Malta) (the "Act"), other than those reported upon above

We have nothing to report in respect of the following matters where the Act requires us to report to you if, in our opinion:

- the information given in the Directors' Report for the financial year for which the financial statements are prepared is not consistent with the financial statements; or
- certain disclosures of directors' remuneration specified by the Act are not made.

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## Independent Auditors' Report *(continued)*

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

*Report required by Listing Rule 5.98 issued by the Listing Authority in Malta on the Directors' Statement of Compliance with the Code of Principles of Good Corporate Governance (the "Principles") outlined in Appendix 5.1 to Chapter 5 (Continuing Obligations) of the Listing Rules (the "Appendix").*

Listing Rule 5.97 requires an Issuer whose securities are admitted to trading on a Regulated Market operating in Malta to prepare a corporate governance statement. In addition, as an Issuer registered in Malta, Listing Rule 5.94 requires that the Bank endeavours to adopt the Principles and to prepare a report explaining how it has complied with the provisions of the Appendix.

Our responsibility as independent auditors of the Bank, is laid down by Listing Rule 5.98, which requires us to issue a report on the Directors' Statement of Compliance with the Principles, which is set out on pages vii to x.

We review the Directors' Statement of Compliance, and report as to whether this Statement provides the disclosures required by Listing Rule 5.97. We are not required to, and we do not, consider whether the Board's 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.

In our opinion, the Directors' Statement of Compliance set out on pages vii to x provides the disclosures required by Listing Rule 5.97 issued by the Listing Authority of Malta.

Kevin Mifsud (Director) for and on behalf of

**KPMG**

23 March 2012

Registered Auditors

KPMG, a Maltese civil partnership, is a member firm of KPMG International Cooperative ("KPMG International"), a Swiss entity.

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**APPENDICES**  
**2011**

<b>APPENDIX I</b>	<b>Pillar 3 Disclosures as at 31 December 2011</b>	<b>52 - 64</b>
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# Appendix I

Pillar 3 Disclosures as at 31 December 2011

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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 financial year ending 31st December 2011 and have been included in the Annual Report for 2011.

The Bank has in place a formal policy to comply with the disclosure requirements laid down in Banking Rule BR/07/2010 and the revised BR/07/2011. 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 and future business expansion. 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 active in the property, building and construction sector. Credit concentration risk is mitigated by the Group's vast experience in this sector and local and in depth knowledge of the customer base. The Bank is fully able to take advantage of this experience and local knowledge.



## 1 RISK MANAGEMENT OBJECTIVES AND POLICIES *(continued)*

### 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 COMMITTEE STRUCTURE

The Bank's Board of Directors comprises 8 non-executive directors and meets quarterly throughout the year. In addition the Board delegates specific responsibilities to the Board Committee, the Audit Committee and the Credit Committee. The Board has also established an Asset and Liabilities Committee which is a management committee that reports to the Board quarterly.

### Board Committee

**Composition:** The Board Committee comprises three non-executive directors and the Chief Executive Officer.

**Main Functions:** The Board Committee acts in an advisory capacity to the Board.

**Frequency:** This Committee meets on an ad-hoc basis throughout the year.

### Credit Committee

**Composition:** A minimum of 2 independent non-executive directors.

**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 Committee

**Composition:** A minimum of 3 independent non-executive directors.

## 2 BOARD AND COMMITTEE STRUCTURE *(continued)*

### **Audit Committee *(continued)***

**Main Functions:** The primary purpose of the Audit 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 and the accuracy of its reporting and financial results 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 operational risk controls
- 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.

### **Asset and Liability Management Committee (ALCO).**

**Composition:** This committee is chaired by the Chief Executive Officer with the Financial Controller and Finance Officer as members.

**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 on a monthly basis and reports to the Board on a quarterly basis.

### 3 OWN FUNDS

During the year ended 31 December 2011, 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 2011.

#### Composition of Own Funds

TOTAL OWN FUNDS				
1.0.0	Original Own Funds	€'000s	€'000s	€'000s
	<b>Paid up capital</b>			
1.1.1	Ordinary shares (i)	7,000		
<b>1.1.5</b>	<b>Total Paid Up Capital</b>		<b>7,000</b>	
	<b>Reserves</b>			
1.1.6	Retained profits/Capital contribution (ii,iii)	9,383		
<b>1.1.12</b>	<b>Total Reserves</b>		<b>9,383</b>	
<b>1.1.14</b>	<b>Total Gross Original Own Funds</b>		<b>16,383</b>	
<b>1.2.0</b>	<b>Deductions</b>			
1.2.2	Intangible assets (other than goodwill)	187		
<b>1.2.10</b>	<b>Total Deductions (sum of items 1.2.1 to 1.2.9)</b>		<b>187</b>	
<b>1.2.11</b>	<b>TOTAL Original Own Funds BEFORE deduction of prudential filters (item 1.1.14 less item 1.2.10)</b>		<b>16,196</b>	
<b>1.3.7</b>	<b>TOTAL Original Own Funds AFTER application of prudential filters BEFORE Other Deductions brought forward from excess in Additional Own Funds (item 1.2.11 less item 1.3.6)</b>		<b>16,196</b>	
<b>1.4.0</b>	<b>TOTAL Original Own Funds AFTER application of prudential filters and AFTER Other Deductions brought forward from excess in Additional Own Funds (item 1.3.7 less item 1.3.8)</b>			<b>16,196</b>
<b>2.0.0</b>	<b>Additional Own Funds</b>			
	<b>Lower Tranche</b>			
2.1.6	Fixed term preference shares	-		
2.1.9	Collective provisioning (iv)	170		
2.1.10	Minority interests	-		
<b>2.1.11</b>	<b>Total Lower Tranche Additional Own Funds</b>		<b>170</b>	
<b>2.2.0</b>	<b>Deductions</b>			
2.2.1	Excess of the limits of the lower tranche of the Additional Own Funds (note 1)	-		
<b>2.2.3</b>	<b>Total Deductions (sum of items 2.2.1 and 2.2.2)</b>		<b>-</b>	
<b>2.2.4</b>	<b>TOTAL Additional Own Funds BEFORE the application of prudential filters (sum of items 2.1.5 and 2.1.11, less item 2.2.3)</b>		<b>170</b>	
<b>2.3.0</b>	<b>IFRS Prudential Filters: Increases to Additional Own Funds</b>			
2.3.2	Additions in relation to fair value movements on AFS financial assets			
2.3.2.3	Unrealised net gains on other AFS financial assets (v)	128		
2.3.3	Additions in relation to fair value movements on revaluation of immovable property			
2.3.3.1	Unrealised net gains on revaluation of own use property (vi)	626		
<b>2.3.6</b>	<b>Total Increase attributable to IFRS Prudential Filters</b>		<b>754</b>	
<b>2.4.0</b>	<b>TOTAL Additional Own Funds AFTER application of prudential filters</b>		<b>924</b>	
<b>2.6.0</b>	<b>TOTAL Eligible Additional Own Funds</b>			<b>924</b>
<b>3.0.0</b>	<b>TOTAL Gross Own Funds</b>			<b>17,120</b>
<b>4.0.0</b>	<b>Supplementary Own Funds</b>			
<b>4.3.0</b>	<b>TOTAL Supplementary Own Funds</b>			<b>-</b>
<b>5.0.0</b>	<b>TOTAL OWN FUNDS</b>			<b>17,120</b>

# Appendix I

Pillar 3 Disclosures as at 31 December 2011

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## 3 OWN FUNDS (*continued*)

### Composition of Own Funds (*continued*)

- i. Ordinary Shares: At 31 December 2011, the authorised and issued share capital comprised 280,000 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 2010 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 2011

	Capital Requirement
	€ 000s
Central Government or Central Banks	-
Corporates	1,585
Institutions	131
Other	261
<b>Total</b>	<b>1,977</b>

### 4.3 Market Risk Capital Requirement

The market risk capital requirement of the Bank is not significant, comprising a foreign exchange risk charge of €2,144.

### 4.4 Operational Risk Capital Requirement

The gross income registered by the Bank in 2008, 2009 and 2010 amounted to €2,441,822, €2,419,404 and €2,987,791 respectively. The operational risk capital requirement for 2011 amounted to €391,118.

## 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 Board Committee and 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 CREDIT RISK (continued)

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

#### *Impaired factored receivables*

These comprise factored receivables for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the factored receivables agreements.

Table 5.1 Allowance for impairment on factored receivables

	2011 €	2010 €
Factored receivables - gross	16,018,298	16,605,593
Collectively determined	16,018,298	16,605,593
Allowance for impairment	165,167	174,733
Specific allowance for impairment	66,024	25,864

#### *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.

At 31 December 2011, 6% of the Bank's factored receivables were past due but not impaired.

Table 5.2 Neither past due nor impaired loans and securities

	2011 €	2010 €
Loans and advances to customers	19,281,374	16,219,498
Loans and advances to banks	6,337,124	11,052,866
Investment securities	38,757,542	30,790,237
	64,376,040	58,062,601

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

#### *Allowances for impairment*

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its factored receivables portfolio. The main components of this allowance are a specific loss component that relates to individually impaired receivables, and a collective loss allowance established for groups of factored receivables in respect of losses that have been incurred but have not been identified and subjected to individual assessment for impairment.

	2011 €	2010 €
Allowance for impairment on factored receivables	231,191	200,597

## 5 CREDIT RISK *(continued)*

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

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

	Exposure as at 31/12/2011	Average Exposure for period to 31/12/2011
	€ 000s	€ 000s
Central Government or Central Banks	15,156	10,238
Corporates	63,260	73,019
Institutions	7,037	6,463
Other	4,238	4,406
Total	89,691	94,126

Table 5.4 Geographic distribution of exposure classes

	Malta	Europe	Rest of the World	Total
	€ 000s	€ 000s	€ 000s	€ 000s
Central Government or Central Banks	15,156	-	-	15,156
Corporates	159	63,097	4	63,260
Institutions	1,868	5,169	-	7,037
Other	2,571	1,667	-	4,238
Total	19,754	69,933	4	89,691

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## 5 CREDIT RISK *(continued)*

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

Table 5.5 Distribution of the exposures by industry/counterparty type

	Central Government or Central Banks	Corporates	Institutions	Other	Total
	€ 000s	€ 000s	€ 000s	€ 000s	€ 000s
Monetary Financial Institutions	5,288	-	7,037	-	12,325
Sovereigns	9,868	-	-	-	9,868
Manufacturing	-	3,412	-	-	3,412
Wholesale and retail trade	-	10,479	-	-	10,479
Real estate, renting and business activities	-	30,330	-	2,289	32,619
Construction	-	18,864	-	-	18,864
Education	-	53	-	-	53
Other	-	122	-	1,949	2,071
Total	15,156	63,260	7,037	4,238	89,691

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	6,289	-	8,867	15,156
Corporates	26,769	32,002	4,489	63,260
Institutions	6,316	-	721	7,037
Other	4,238	-	-	4,238
Total	43,612	32,002	14,077	89,691



## 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 2011
	€ 000s	€ 000s
Central Government or Central Banks	-	-
Corporates	237	36
Institutions	-	-
Other	-	-
Total	237	36

*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 2011
	€ 000s	€ 000s
Malta	-	-
Europe	237	36
Rest of the World	-	-
Total	237	36

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### 5 CREDIT RISK *(continued)*

#### 5.4 Past Due Exposures and Impaired Assets *(continued)*

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

	Individual & collective provisions
	€ 000s
Opening balance	201
Amounts written off	-
Charged to income statement	36
Closing balance	237

### 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.

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+	6,316	6,316
3	50%	Fitch BBB to BBB-	721	721

## 6 STANDARDISED APPROACH TO CREDIT RISK *(continued)*

### 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 BR/04/2010 (Appendix 2).

*Table 6.2 Central Government and Central Bank*

Credit Quality Step	Risk Weight	Banking Regulation	Exposure	Exposure After CRM
			€ 000s	€ 000s
1	0%	BR/04/2010 App.2, I.2, 1.3	5,289	5,289
2	0%	BR/04/2010 App 2, I.2, 1.4	9,867	9,867

### 6.3 Exposure to Corporates

A large part of corporate exposures have a 0% risk weighting as they are cash secured. The rest are allocated a 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%	BR/04/2010	43,442	-
5	100%	BR/04/2010	19,818	19,818

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## 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 2011.

*Table 8.1 Exposure value covered by eligible financial collateral*

	€ 000s
Central Government or Central Banks	-
Corporates	42,842
Institutions	-
Other	600
Total	43,442

## 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 Comprehensive Income**

	2011	2010	2009	2008	2007
	€	€	€	€	€
Interest receivable and similar income	3,459,209	2,806,276	2,722,905	3,529,298	3,367,821
Interest payable and similar charges	(1,699,157)	(1,474,670)	(1,261,842)	(1,928,582)	(1,998,106)
<b>Net interest income</b>	<b>1,760,052</b>	<b>1,331,606</b>	<b>1,461,063</b>	<b>1,600,716</b>	<b>1,369,715</b>
Fee and commission income	1,887,828	1,629,528	958,341	841,106	775,264
Other operating income	41,416	26,657	16,126	17,401	19,434
Other operating charges	(1,355,156)	(946,694)	(868,774)	(868,536)	(786,812)
Net impairment losses	(35,761)	(145,951)	(7,784)	(17,011)	(83,849)
	<b>2,298,379</b>	<b>1,895,146</b>	<b>1,558,972</b>	<b>1,573,676</b>	<b>1,293,752</b>
Income tax expense	(761,436)	(745,009)	(160,702)	(200,666)	(188,714)
<b>Profit for the year</b>	<b>1,536,943</b>	<b>1,150,137</b>	<b>1,398,270</b>	<b>1,373,010</b>	<b>1,105,038</b>
Other comprehensive income or the year, net of income tax	125,817	9,975	-	-	-
Total comprehensive income for the year	<b>1,662,760</b>	<b>1,160,112</b>	<b>1,398,270</b>	<b>1,373,010</b>	<b>1,105,038</b>
<b>Earnings per share</b>	<b>5.94</b>	<b>4.14</b>	<b>4.99</b>	<b>4.90</b>	<b>3.95</b>

## Appendix II

### Five-Year Summary

#### Statement of Financial Position

	2011	2010	2009	2008	2007
	€	€	€	€	€
<b>ASSETS</b>					
Cash	1,104	1,218	850	779	466
Balances with Central Bank of Malta	5,288,371	885,071	504,998	385,852	1,117,828
Investments	38,757,542	30,790,237	28,945,952	26,307,884	25,568,878
Loans and advances to banks	6,337,124	11,052,866	11,219,096	9,788,398	9,168,258
Factored receivables	15,787,107	16,404,996	5,338,919	4,362,518	2,916,099
Other loans and advances to customers	19,281,374	16,219,498	21,140,261	15,030,861	14,255,000
Property and equipment	2,102,956	2,037,316	2,016,686	2,009,850	2,106,232
Intangible assets	186,787	294,186	-	-	-
Other assets	1,948,574	1,134,380	1,305,893	1,423,935	1,294,187
<b>Total assets</b>	<b>89,690,939</b>	<b>78,819,768</b>	<b>70,472,655</b>	<b>59,310,077</b>	<b>56,426,948</b>
<b>LIABILITIES</b>					
Balance owed to Central Bank of Malta	7,000,000	-	1,500,000	-	-
Amounts owed to customers	54,634,490	52,718,805	53,915,259	45,196,148	44,510,872
Debt securities in issue	8,792,718	8,733,363	-	-	-
Deferred tax liabilities	345,201	343,777	347,228	382,449	372,811
Current tax payable	804,831	942,899	230,043	228,666	201,847
Accruals and deferred income	939,662	1,326,635	885,948	1,756,089	967,703
<b>Total liabilities</b>	<b>72,516,902</b>	<b>64,065,479</b>	<b>56,878,478</b>	<b>47,563,352</b>	<b>46,053,233</b>
<b>EQUITY</b>					
Called up share capital	7,000,000	4,000,000	4,000,000	4,000,000	4,000,000
Property revaluation reserve	626,059	633,271	640,483	647,695	654,907
Fair value reserve	128,024	6,091	-	-	-
Depositor compensation scheme reserve	37,425	37,425	51,417	-	-
Capital contribution	7,206,170	7,449,182	7,449,182	-	-
Retained earnings	2,176,359	2,628,320	1,453,095	7,099,030	5,718,808
<b>Total equity attributable to equity holders of the Bank</b>	<b>17,174,037</b>	<b>14,754,289</b>	<b>13,594,177</b>	<b>11,746,725</b>	<b>10,373,715</b>
<b>Total liabilities and equity</b>	<b>89,690,939</b>	<b>78,819,768</b>	<b>70,472,655</b>	<b>59,310,077</b>	<b>56,426,948</b>
<b>Memorandum items</b>					
Commitments	21,984,511	21,709,573	6,835,420	5,917,759	3,502,027

**Statement of Cash Flows**

	2011 €	2010 €	2009 €	2008 €	2007 €
<b>Net cash from/(used in) operating activities</b>	<b>5,774,534</b>	<b>(7,524,098)</b>	<b>2,205,610</b>	<b>(923,261)</b>	<b>2,413,681</b>
<b>Cash flows from investing activities</b>					
Payments to acquire property, equipment and intangible assets	(217,100)	(582,290)	(182,889)	(141,712)	(101,655)
Payments to acquire investments	(14,391,288)	(1,834,914)	(1,850,356)	-	(1,635,000)
Proceeds from disposals of investments	6,638,366	-	-	-	1,636,097
Interest received from investments	1,615,774	1,452,518	1,038,253	953,450	787,226
<b>Net cash (used in)/from investing activities</b>	<b>(6,354,248)</b>	<b>(964,686)</b>	<b>(994,992)</b>	<b>811,738</b>	<b>686,668</b>
<b>Cash flows from financing activities</b>					
Dividends paid to shareholders	(2,000,000)	-	-	-	-
Net capital contribution received	2,756,988	-	339,297	-	-
Issue of debt securities	-	9,000,000	-	-	-
Capitalised cost related to the issue of debt securities	-	(297,005)	-	-	-
Interest paid on debt securities	(489,830)	-	-	-	-
<b>Net cash from financing activities</b>	<b>267,158</b>	<b>8,702,995</b>	<b>339,297</b>	<b>-</b>	<b>-</b>
<b>(Decrease)/Increase in cash and cash equivalents</b>	<b>(312,556)</b>	<b>214,211</b>	<b>1,549,915</b>	<b>(111,523)</b>	<b>3,100,349</b>

**Accounting Ratios**

	2011 €	2010 €	2009 €	2008 €	2007 €
Net interest income and other operating income to total assets	4.18	3.79	3.46	4.15	3.84
Operating expenses to total assets	1.62	1.39	1.24	1.49	1.54
Profit before tax to total assets	2.56	2.40	2.21	2.65	2.29
Pre-tax return on capital employed	14.03	13.46	12.08	14.18	13.31
Profit after tax to equity	8.95	7.80	10.29	11.69	10.65

## Appendix III

### Supplementary Financial Information

#### Directors' interest in the share capital of the Bank or in any related company as at 31 December 2011

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

Magdalena De Roeck, Countess Alexis d'Oultremont and Peter 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, Countess Alexis d'Oultremont and Peter 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
<b>IBL I Limited C 16321</b>				
VMT S.A	Ordinary	24,999	100	€24.79
IVM S.A	Ordinary	1	100	€24.79
<b>IBL T Limited C 16322</b>				
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 31 December 2011

IBL I Limited	Ordinary "A"	140,000	100	€25.00
IBL T Limited	Ordinary "B"	140,000	100	€25.00

#### Number of Shareholders

Class	Number of Shares	Number of Holders
Class A	140,000	1
Class B	140,000	1
Range	Class "A"	Class "B"
1 - 5000	-	-
5001 & over	1	1

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





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