Bank of Valletta
Office of the Company Secretary
House of the Four Winds,
Triq l-Imtieħen, Il-Belt Valletta VLT 1350 - Malta
T: (356) 2131 2020 F: (356) 2275 3711
E: customercare@bov.com **bov.com**

BOV/353

COMPANY ANNOUNCEMENT

The following is a Company Announcement issued by Bank of Valletta p.l.c. (the Bank) pursuant to Listing Rules 5.16.18 and 5.16.21, issued by the Listing Authority

Quote

Annual General Meeting - Agenda

The following resolutions are being presented for consideration at the 45th Annual General Meeting of Bank of Valletta p.l.c. (the Company), which is scheduled for Thursday 9 May 2019 at 10.00 hours at the Hilton Malta, St Julians:

Ordinary Resolutions

1. That the Profit and Loss Account and Balance Sheet for the financial year from 1 January 2018 to 31 December 2018, and the Directors' and Auditors' Reports thereon, be hereby received and approved.

2. That the re-appointment of KPMG Malta jointly with KPMG LLP (UK), as auditors, be hereby approved, and that the Board of Directors be hereby authorised to fix their remuneration.

Ordinary Resolutions – Special Business

3. That, on Tuesday 11 June 2019, the amount of €53,077,206 from the Company's reserves is capitalised for the purpose of a bonus share issue of 53,077,206 fully paid ordinary shares of a nominal value of €1.00 per share, representing 1 bonus share for every 10 shares held, to be allotted to the members appearing on the register of members of the Company as at the close of business on Tuesday 11 June 2019 (Eligible Members), thereby increasing the issued share capital from the current 530,772,064 shares to 583,849,270 shares of €1.00 each share fully paid up, resulting in a paid up capital of €583,849,270.

   Since the allocation ratio of bonus shares to registered shares held by the Eligible Member is 1 bonus share for every 10 shares held, in the allocation process the Company shall, where the number of shares held by the Eligible Member is not exactly divisible by 10, round up the allocation to the nearest share whenever the mathematical result of the allocation formula contains a fractional entitlement which is of 0.5 of a share or more, and round down to the nearest share in the event that the mathematical result of the allocation formula contains a fractional entitlement which is of less than 0.5 of a share.

4. That the Directors be and are hereby authorised to issue a financial instrument up to a maximum amount of €150 million in nominal value that qualifies for additional tier one capital, which may include a conversion option into ordinary shares of the Company at a pre-specified trigger point, without first offering the said instruments to shareholders proportionately to their holdings.

Extraordinary Resolution – Special Business

5. That the existing Memorandum and Articles of Association of the Company be hereby revoked and substituted in its entirety by the new memorandum and articles of association a copy of which may be obtained from the Company's website www.bov.com under the Investor Relations section

(https://www.bov.com/content/bov-agm-2019) or from the Office of the Company Secretary at the House of the Four Winds, Triq l-Imtieħen, Il-Belt Valletta VLT 1350.

Publication of information related to the Annual General Meeting, can be found on the Bank's website https://www.bov.com/content/bov-agm-2019.

Election of Directors

Pursuant to the rotation of directors provisions stipulated in Article 28 of the Bank's Articles of Association, a vacancy has arisen for three (3) Non-Executive Directors.

One out of these three vacancies, namely Taddeo Scerri, is appointed by a Qualifying Shareholder of the Bank, pursuant to Article 25 of the Articles of Association. In this regard, the Bank received the recommended candidate from the Qualifying Shareholder and Taddeo Scerri was reconfirmed for re-appointment by the Government of Malta, as Chairman and Director of the Bank.

In so far as the two other vacancies are concerned, the Bank received two nominations from the Non-Qualifying Shareholders, namely nominations relating to James Grech and Joseph M. Zrinzo.

Since all nominees were deemed by the Nominations and Governance Committee to be fit and proper to act as Directors of the Bank, no election will take place during the forthcoming AGM.

The appointments of Taddeo Scerri, James Grech and Joseph M Zrinzo are subject to regulatory approval.

All other incumbent Directors (Executive and Non-Executive Directors) shall remain in office pursuant to the Articles of Association.

Annual Report and Financial Statements for Financial Year ended 31 December 2018

Bank of Valletta p.l.c. is hereby publishing its 2018 Annual Report and Audited Financial Statements which are attached to this company announcement. The 2018 Annual Report and Audited Financial Statements can also be viewed at the registered office of the Company at 58, Zachary Street, Valletta and on the Bank's website at https://www.bov.com/documents/bov-agm-2019---annual-report.

Unquote

Dr. Ruth Spiteri Longhurst B.A., LL.D.
Company Secretary

18 April 2019

Bank of Valletta p.l.c.

Annual Report & Financial Statements

2018

BOV Bank of Valletta

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Anita Mangion
Antonio Piras
Joseph M Zrinzo

COMPANY SECRETARY

Ruth Spiteri Longhurst

MANAGEMENT BOARD

Mario Mallia (Chief Executive Officer)
Ernest John Agius (Chief Operations Officer)
Joseph Agius (Chief Technology Officer)
Miguel Borg (Chief Risk Officer)
Kenneth Farrugia (Chief Business Development Officer – Investments)
Albert Frendo (Chief Business Development Officer – Credit)
Elvia George (Chief Finance Officer)

Rudolph Gatt (Secretary)

AUDITORS

KPMG

LEGAL ADVISORS

Camilleri Preziosi

NOTICE OF MEETING

The Annual General Meeting of the Bank will be held at the Grand Master Suite, Hilton Malta, St Julians, on Thursday 9 May 2019 at 10.00 a.m.

Bank of Valletta p.l.c.
BOV Centre
Triq il-Kanun
Santa Venera SVR 9030
Malta

Tel: (+356) 2275 3000
Fax: (+356) 2275 3711
www.bov.com
E-mail: customercare@bov.com

Bank of Valletta p.l.c.
Registered Office:
58, Triq San Żakkarija
Il-Belt Valletta VLT 1130
Malta
Registration Number C 2833

Bank of Valletta p.l.c. is a public limited company licensed to conduct Investment Services business by the Malta Financial Services Authority.

Bank of Valletta p.l.c. is authorised to act as a trustee by the Malta Financial Services Authority.

Bank of Valletta p.l.c. is an enrolled tied insurance intermediary of MAPFRE MSV Life p.l.c. (MMSV). MMSV is authorised and regulated by the Malta Financial Services Authority to carry on long term business under the Insurance Business Act 1998.

Board of Directors and Group Company Secretary

Taddeo Scerri

Chairman

C N&G R NED *

Taddeo Scerri was appointed Chairman of the Bank in December 2016. Mr Scerri had been serving as Director of the Bank as from April 2013. Mr Scerri used to chair the Bank's Audit Committee and was a member of the Bank's Remuneration Committee and of the Asset Liability Management Committee. He currently chairs the Board's Nominations and Governance Committee, the Remuneration Committee and the Credit Committee.

A qualified accountant by profession, Mr Scerri was the managing partner of RSM Malta until his retirement in 2015. He was the chairman of the local UEFA Clubs Licensing Board and was also a member of the Malta Football Association's finance committee.

Stephen Agius

Director

A N&G NED *

Appointed to the Board in December 2016. Stephen Agius is currently a member of the Nominations and Governance Committee and the Audit Committee. Mr Agius works as a chief of information and development with the National Telecom Regulatory Authority. Apart from his role in strategic information management, he is currently coordinating a number of national initiatives aimed at supporting E-inclusion and digital participation. For five years, Mr Agius served as member of the board of directors of Enemalta p.l.c. and Engineering Resources Limited. Prior to his current role, Mr Agius occupied various positions where he was responsible for a number of large scale projects both locally and abroad in areas related to enterprise resource planning, billing, integration, business intelligence and data warehousing and process modelling. Mr Agius is also a visiting senior lecturer at the University of Malta. He studied computer science and information systems and gained an honours Bachelor degree from the University of Greenwich (UK) followed by an MBA in e-Business from the University of Malta.

Alan Attard

Director

C&CP RM NED

Appointed to the Board in December 2016. Alan Attard is currently a member of the Compliance and Crime Prevention Committee and the Risk Management Committee. He joined the Bank in 1987. For the past fourteen years, he has held various managerial positions including serving as branch manager of several branches. At present, Mr Attard is the branch manager of Floriana branch which is classified as one of the Bank's premier branches. In July 2015, he was elected as trustee on the board of trustees of the BOV Employees' Foundation serving as secretary to the said board until recently, when he was appointed as chairman.

Paul V Azzopardi

Director

C&CP RM NED *

Appointed to the Board in December 2016. Paul V Azzopardi is currently the chairman of the Compliance and Crime Prevention Committee and deputy chairman of the Risk Management Committee. He set up and managed Azzopardi Financial Services between 1989 and 2006 and subsequently worked in investments in Ontario, Canada, as director and portfolio manager. Mr Azzopardi was sponsoring and corporate stockbroker of the Bank from 1992 until 2006, and also served in the same roles for the funds of BOV Asset Management Limited and other companies. Mr Azzopardi is the author of "Behavioural Technical Analysis", two other books on investments and contributes regularly to the press. He lectured at the University of Malta and the School of Continuing Studies, University of Toronto. Mr Azzopardi holds a first degree in accountancy from the University of Malta, an MBA from the University of British Columbia, is a Fellow of the Malta Institute of Accountants and a Certified Public Accountant. Mr Azzopardi is also Director of BOV Asset Management Limited.

Miguel Borg

Director

E ED

Appointed to the Board in July 2017. Miguel Borg joined the Bank in November 2007 in the role of Risk Management Consultant. Mr Borg was appointed Chief Risk Officer of the Group in November 2014 and is a member of the Management Board and of the Ethics Committee. As Group Chief Risk Officer, he leads the risk management function with the responsibility of developing and recommending the Group's risk governance framework, risk appetite and limits. Mr Borg is responsible for Risk Management, Legal Services and Credit Risk Sanctioning Departments. Until 31 January 2019, Mr Borg was also responsible for the Bank's compliance and anti-financial crime functions. Mr Borg chairs the Governance, Risk and Compliance Committee. Mr Borg is a director of BOV Asset Management Limited and chairs the Risk and Regulatory Committee of BOV Asset Management Limited and the Risk Committee of MAPFRE MSV Life p.l.c. He is a member of the Bank's Asset Liability Management Committee. Mr Borg is also chairman of the Central Co-Operative Fund. Prior to joining the Bank, he worked at the Central Bank of Malta. Mr Borg holds a Master of Arts in Economics from the University of Malta. He lectures at the University of Malta.

James Grech

Director

C RM NED

Appointed to the Board in December 2014. James Grech joined the Bank in 1998 and currently is the Executive Head of Foreign Bank Relationships Department. He is a member of the Credit Committee and Risk Management Committee. He also serves as a member on the European's Banking Federation-correspondent banking taskforce and also served as chairman of the board of trustees of the BOV Employees' Foundation. Mr Grech's career commenced as a management accountant with a local accounting firm. For the period 2004 till 2008, he also served as Worker Director of the Bank. In December 2014, he got elected on the Board from the shareholders of the Bank and still holds this position to date. Mr Grech is a director of other local companies and a recognised member of the Institute of Directors (UK). Mr Grech holds an Honours Degree in Management and a Masters in Business Administration from Henley Management College (UK). His dissertation focused on the effectiveness of Board Performance and Corporate Governance. He has lectured on Financial Services at the Malta College of Arts, Science and Technology, and on Corporate Governance at the University of Malta.

Alfred Lupi
Director
A C C&CP E NED *

Appointed to the Board in December 2015. Alfred Lupi currently chairs the Audit Committee and the Ethics Committee. He is also a member of the Credit Committee and the Compliance and Crime Prevention Committee. He is a professional accountant with an economics degree and currently engaged in management consultancy. Mr Lupi was chief financial officer in two major companies and the Executive Chairman of Pavi Shopping Complex p.l.c. He was a director of the Central Bank of Malta and served as Acting Governor. Mr Lupi chaired the Accountancy Board and was a member of its Quality Assurance Oversight Committee. Mr Lupi has held a number of board appointments mainly in the financial sector.

Mario Mallia
Director
C E ED

Appointed to the Board in July 2017. Mario Mallia joined the Bank in September 1979 and was appointed as the Bank's Chief Executive Officer in January 2016. He has carried out various other executive roles at the Bank, including those of Chief Finance Officer, Chief Risk Officer and Chief Operations Officer. Mr Mallia is chairman of the BOV Management Board and the Asset Liability Management Committee. He is a member of the Credit Committee and Ethics Committee. He is also a director on the board of MAPFRE MSV Life p.l.c. Mr Mallia graduated in accountancy from the University of Malta, holds the Certified Public Accountant warrant and is a Fellow of the Malta Institute of Accountants.

Anita Mangion
Director
C&CP R NED *

Appointed to the Board in December 2016. Anita Mangion is a member of the Remuneration Committee and deputy chairperson of the Compliance and Crime Prevention Committee. Ms Mangion is an experienced Business and IT Consultant. Her area of specialisation is Technology Intrapreneurship. During the last sixteen years she consulted to such effect, different local and international entities in various sectors as well as start-ups, where she successfully drove critical projects to completion and implemented sustainable profitable frameworks. Ms Mangion graduated in Executive MBA (eBusiness); B.Com. Management Hons and B.Sc. Business and Computing from the University of Malta. Additionally, she studied Business and IT at Indiana University (USA), and Technology Entrepreneurship and New Business Operations at the University of Malta in joint collaboration with Oxford University (UK). For four years, Ms Mangion served as board director at Malta Industrial Parks Limited (MIP). At MIP she was also entrusted to oversee the Tenders Committee, was a member of the Audit Committee and chaired the ICT Steering Committee.

Antonio Piras
Director
A R NED *

Appointed to the Board in December 2016. Mr Antonio Piras is currently the deputy chairman of the Remuneration Committee and a member of the Audit Committee. Mr Piras occupies the role of deputy chairman of Banca UBAE (Rome) and director of the boards of Iacobucci Aerospace HF (Rome). He was previously vice chairman of Eurofidi Soc. Consortile Garanzia Fidi s.c.a.r.l. (Turin). Until 2014, Antonio used to be the CEO of Equitalia Centro S.p.A (Florence) and chairman and CEO of other companies of Equitalia Group. In 1971 he started his career at UniCredit Group, former Credito Italiano, holding various key roles in the Italian commercial network until 1997. In 1998, he was appointed as CEO of UniCredit Factoring (Milan), Deputy General Manager of Banca dell'Umbria, chairman and CEO of Pekao Leasing Sp.z.o.o (Warsaw) and Leasing Fabryczny Sp.z.o.o (Lublin), CEO of UniRiscossioni S.p.A. (Turin), all companies held by UniCredit, from where he ended his career as Senior Executive Vice President in 2009.

Joseph M Zrinzo
Director
A N&G RM NED *

Appointed to the Board in December 2013. Joseph M Zrinzo currently chairs the Board's Risk Management Committee. Mr Zrinzo is a member of the Audit Committee and the deputy chairman of the Nominations and Governance Committee. Mr Zrinzo also serves as a member of the BOV Arts Committee. He currently serves as managing director of a group of family companies, as board director of other local companies, committee member of the Cultural Heritage Advisory Committee and is an active member of philanthropic associations. Over the years, Mr Zrinzo served as director on boards of various local and international companies. He was a founder member of the Malta Shareholders' Association and has vast experience of international trade.

Ruth Spiteri Longhurst
Group Company Secretary

Appointed Group Company Secretary in April 2016. Previously she occupied the post of Executive Head of the Compliance Department within the Bank. Dr Spiteri Longhurst is also the company secretary of MAPFRE MSV Life p.l.c., BOV Asset Management Limited and BOV Fund Services Limited. Dr Spiteri Longhurst graduated Doctor of Laws from the University of Malta in 2001 and obtained Master of Arts in Financial Services in 2004. Dr Ruth Spiteri Longhurst has been employed with the Bank for the past seventeen years.

A	Audit Committee
C&CP	Compliance and Crime Prevention Committee
C	Credit Committee
E	Ethics Committee
N&G	Nominations and Governance Committee
R	Remuneration Committee
RM	Risk Management Committee
ED	Executive Director
NED	Non-executive Director
*	Independent

Chairman's Statement

Taddeo Scerri

A year of challenges and a year of growth

BOV reported strong results that demonstrate the underlying robustness and profit generating capacity of the Group's business model. The Bank recorded a Profit before tax of €71.2 million for the year ended 31st December 2018 after providing for a litigation provision of €75 million. Profit before deducting the provision thus amounts to €146.2 million, a 5.8% increase on the annualised results for 2017.

The quality of the balance sheet improved with the Group's Core Equity Tier 1 ratio increasing from 16.1% to 18.3%. The fundamentals are strong as the Group reported growth in a number of core business lines including home loans, credit cards and payments.

2018 was a year of many challenges. The unrelenting disruption and competition faced by the Bank and its subsidiaries intensified during the year. Moreover, as announced in the interim results, the Bank decided to make provisions for material litigation and claims as a result of the legal issues arising from legacy business. The litigation provision is subject to ongoing review in the light of developments. As a result of these legacy legal issues, the Board, following extensive discussion with its banking supervisors, decided to wind-down some non-core business lines and to suspend cash dividends for 2018.

The Board is taking all measures within its powers to defend the Bank's interests in all such legacy litigation cases. Whilst acknowledging the reality, that litigation remains a long drawn out affair with uncertain outcomes, we remain optimistic that the Bank should be able to manage the different situations in a manner which should allow it overcome these challenges. However, prudent management demands that whilst defending the Bank's position in the best possible manner, we should nonetheless prepare for possible adversities and the uncertainties that litigation inherently entails. Accordingly, we feel that the decision to strengthen the capital of the Bank by and through maximum profit retention is the right decision designed to safeguard the long-term interest of the Bank and all its stakeholders and shareholders.

STRATEGIC PRIORITIES

BOV made significant progress in the execution of the VISION 2020 strategy. The strong financial results from ongoing operations, in spite of much higher operating costs being imposed by tighter regulatory initiatives, are due in large part to the implementation of a number of strategic actions and demonstrate good progress.

VISION 2020 is a strategy for all stakeholders, and reflects our purpose and vision: *Maintaining a strong stable Institution, providing sustainable and equitable returns to shareholders whilst delivering a superior customer experience and developing BOV into the most accessible Bank.*

The foundation of the Bank's long-term strategy is the protection and enhancement of a sound and solid business model to ensure stability, sustainability, and value creation. The Board believes that in the current environment value creation and risk management are inseparable. During the past months, the Bank delivered on a number of strategic actions including successful implementation of a capital optimisation programme, strengthening of the control functions, winding-down of non-core business lines and significant improvement in asset quality. These initiatives are aimed at creating long-term shareholder value.

The focus of BOV's strategy is the customer. The Bank wants to deliver a superior customer experience based on customer centricity and on wider accessibility. The introduction of more stringent anti-money laundering procedures has unavoidably affected customer experience, especially at the on-boarding stage. The Bank will work relentlessly and will invest as necessary, to improve efficiency and accessibility always in the context of the enterprise-wide standards, reputational integrity and regulations for prevention of financial crime.

Our strategy involves more streamlined and risk based processes designed to improve efficiency. This is expected to start bearing results as the Core Banking Transformation (CBT) programme will be implemented towards the end of 2019. Moreover, the Bank is engaging with FinTech companies to drive innovation, improve accessibility and create new revenue streams.

STRENGTHENING CORPORATE GOVERNANCE

BOV is committed to maintain high standards of, and best practice in, corporate governance. The corporate ethos is based on integrity, accountability, fairness and transparency.

The Board regularly reviews the corporate governance framework to ensure that it remains appropriate in the light of an evolving business model, the long-term strategy, and the changing financial and regulatory landscape. The appropriate composition of the Board of Directors is a critical component of the company's internal governance and supervisory framework. We need to ensure the right balance of skills and experience within the Board at an individual and on a collective basis. Apart from determining personal suitability, the Nominations and Governance Committee needs to ensure the collective balance of skills and suitability of the company's board and committees.

The Board, following consultation and advice from its supervisory authorities, is proposing a change in the Memorandum and Articles of Association that is designed to allow the Board of Directors to work towards the required balance of skills round

The Board's main strategic objective is safeguarding the long-term stability and sustainability of the Institution

the boardroom table. The recommendation is to increase the maximum number of Directors of the Bank by another two Non-Executive Members that may be co-opted by the Board in the event that regulatory requirements so dictate or if, in the opinion of the Nominations and Governance Committee, the then current composition of the Board does not have the appropriate mix of collective skills, knowledge and experience. In those instances, notwithstanding that all nine positions of Non-Executive Directors may be duly occupied, the Committee shall recommend to the Non-Executive Directors the co-option to the Board of Directors of up to an additional two Non-Executive Directors, having the appropriate skills, knowledge and experience. This change is designed to ensure that the Board will continue to perform effectively with competent and engaged members having the right skills and knowledge. If approved by the shareholders at the 2019 Annual General Meeting, the Board may well be composed of thirteen members; nine elected Non-Executive Directors, two co-opted Non-Executive Directors, if required, and two Executive Directors, the CEO and the CRO. I believe that this Board will have the necessary mix of skills and experience that will ensure the appropriate focus on the long-term strategy to ensure a stable, sustainable and profitable Bank.

IMPROVING CYBER RESILIENCE

BOV suffered a very sophisticated cyber-attack on 13 February 2019 resulting in eleven fraudulent payment transactions totalling to an equivalent of €12.9 million emanating from the Bank's foreign payment accounts. Senior Management took immediate actions to protect the Company and managed to resume operations after a few hours. The Bank is taking all the necessary actions to recover these funds. This demonstrates the resilience of the Organisation and the effectiveness of the Bank's business continuity plans. Nevertheless, the Bank has already commenced modernising and enhancing its security infrastructure in order to build a stronger cyber-resilient ecosystem.

As cyber threats continue to grow and evolve, the Bank will strengthen its cyber security program to stay ahead of threat actors. The Board is committed to enhance its oversight with the establishment of the Information Technology (IT) Oversight Committee chaired by an Independent Non-Executive Director. The Committee will assist the Board of Directors in fulfilling its oversight responsibilities in relation to the digital ecosystem including cyber security, the Core Banking Transformation (CBT) programme, and innovative technologies including FinTech and RegTech. The Committee will engage specialised technical expertise to assist and advice on the digital ecosystem.

STRATEGIC CAPITAL MANAGEMENT

The Board's main strategic objective is safeguarding the long-term stability and sustainability of the Institution, even if it should encounter situations of extreme stress. The way to achieve this objective is to continue strengthening capital. The chief source of ongoing capital accretion is profit retention, i.e. the reinvestment of profits within the business.

The legacy legal issues faced by the Bank led the Board to focus on conserving capital in order to strengthen the loss absorbing capacity of the Institution. The Board, following extensive discussions with its banking supervisors, decided responsibly to suspend cash dividend payment for the year. The Board thus gave priority to long-term stability over short-term return, in furtherance of the strategic objectives of the Bank.

The Board resolved to propose for the approval of the General Meeting, the issue of bonus shares to its shareholders, in the ratio of one for every ten shares held. Bonus shares may offer some fiscal benefits to certain shareholders, and at the same time act as a capital conservation measure, as distributable reserves are converted into permanent capital.

The Board is very much aware that shareholders are major stakeholders in the Bank, and legitimately expect to receive dividends as part of their return on investment. The Board therefore intends to resume dividend payments in line with the dividend policy as soon as prudent judgement so permits and with guidance from its supervisors.

During the second half of the current year, the Bank will issue an Additional Tier 1 Contingent instrument, commonly referred to as AT1 bond. The Bank is planning a €150 million issue that will be targeted to institutional investors. This instrument will carry a significant loss absorption capacity. It will qualify as Additional Tier 1 capital leading to a substantial increase in the Bank's Tier 1 capital ratio. This capital issue will ensure that the Bank is prepared and compliant with the European Banking Authority (EBA) proposed Supervisory Review and Evaluation Process (SREP) guidelines issued in 2018. It will also place the Bank in a strong position to meet the additional regulatory measures for stronger provisioning methodologies that will become effective in the coming years. Moreover, the Bank intends issuing a subordinated bond in the third quarter of 2019 which will replace the one maturing in June 2019.

LOOKING AHEAD

The Board is committed to protect and enhance the Bank's financial strength by managing risks in a prudent and responsible way. Looking ahead, profitability will unavoidably be affected by loss of revenues through the de-risking process, the amortisation of the significant investment in the core IT system, the cost of increasing capital buffers, and higher regulatory and compliance costs.

The Board and Senior Management will remain focused on the timely and effective implementation of the strategic objectives to ensure the continued success of the Institution and long-term returns for our shareholders.

I wish to thank our employees for their hard work and professionalism. I am grateful to our many shareholders and customers for their continued confidence in the Bank.

BOV remains firmly committed to our customers and to the Maltese economy.

Taddeo Scerri
Chairman
15 March 2019

Chief Executive Officer's Review

Mario Mallia

Meeting challenges through growth

It has been a year of multiple challenges and satisfactory growth for the BOV Group. Challenges ranging from intensifying competition from new players; to legacy litigation cases which arose from business lines which the Bank is in the final stages of exiting; to the need for more advanced anti-financial crime and anti-money laundering measures; to continued extreme low level of interest rates in the Euro Area, which is out of synch with the strong economic growth being experienced in Malta; and from compliance with new regulation such as GDPR and MiFID II, including the necessary IT development and the training of staff.

These, and other challenges, led the Board to give top priority to the strengthening and conservation of the Bank's capital. Capital acts as a shock absorber, providing a buffer against unexpected future losses. The higher the capital, the greater is the Bank's resilience in the face of unforeseeable events, rendering the Bank safer and its business model more sustainable. This consideration led the Board to decide, in consultations with the supervisory authorities, against the distribution of cash dividends for Financial Year 2018. Prudence demands that, at a time of exceptional challenges, the Board sacrifices short-term benefits to shareholders - dividends - in the interests of the longer term strength of the Bank.

A YEAR OF GROWTH

I have so far described 2018 in terms of the challenges that it has posed, and of the way in which the Bank has responded in terms of capital conservation. However, the year was also one of growth for the Bank's business. We have experienced sustained demand for credit, especially as regards home loans. Income from a number of business lines, including investment services, credit cards and payments also recorded satisfactory growth. Despite the aforementioned challenges, and the associated costs, the Group recorded a profit before litigation provision of €146.2 million, equivalent to a post-tax return on equity of 9.9% per annum, compared to the 7.3% average return on equity for banks in the Euro Area.

This is a strong result, which was achieved in an economic environment characterised by very different traits. On the one hand, the Maltese economy continued with its strong

The Maltese economy is currently generating wealth at a sustained rate

performance, providing a benign environment for business activity. On the other hand, the "low-for-long" interest rate environment persisted, with historically low, and indeed negative, yields continuing to put banking sector profits under pressure.

Local economic growth continued apace, with the GDP growing by 6.9% in real terms [2017: 6.7%], with the strongest growth driver being consumption expenditure. The Labour Force Survey for the third quarter of 2018 estimated an unemployment rate of 3.7%, down from 4.0% for the same quarter in 2017. During the same period an increase in both the labour force and activity rate was noted. The Central Bank of Malta is anticipating an increase in total employment of 3.3% and an unemployment rate of 3.8% for 2019. Total employment is expected to increase by a further 3.0% in 2020 and the unemployment rate is expected to stand at 3.9%.[1] This positive economic environment helps in a significant way to improve the quality of the Bank's lending book.

REVIEW OF PERFORMANCE

The Group recorded a profit before tax of €71.2 million for the year, after providing for a litigation provision of €75 million. Profit before deducting provision, thus, amounts to €146.2 million, as compared to the result of €174.7 million for the fifteen months ending on 31 December 2017. Pre-tax return on equity was of 14.9% (2017: 16.5%), while the Cost-to-Income ratio stood at 49.1% (2017: 47.3%).

Group operating income totalled €257.8 million, comprising interest margin (€156.5 million), fee income (€81.1 million), trading and dividend income (€18.0 million) and fair value gains on investments (€2.0 million). Interest margin and fee income both showed strong growth over the corresponding twelve month period last year, while the other two income sources showed a decline.

Interest margin remained the Group's core source of income, accounting for 60.7% of total operating income. Growth in interest income was driven by a strong performance by the credit business. Loans and advances, net of provisions, grew by almost 5%, and this compensated for a slight easing of average interest rates receivable on lending. Growth was registered across all areas of lending, but especially in the home loans portfolio, which increased by €120 million over the year.

Fee income also registered a healthy growth, the main drivers being credit-related fees, credit card services, payment services and deposit products. On the other hand, trading and exchange income showed a decrease, caused mostly by competitive pressure on exchange margins and by the Group's ongoing de-risking programme.

Income from the Group's insurance and life assurance interests also came under pressure, due mainly to continuing low yields and adverse movements on investment market prices.

Operating expenses of €130.6 million were, on average, 8% higher than the previous period. During the period under review the Bank continued with the multi-year Core Banking Transformation (CBT) programme and also implemented a number of new systems and upgrades which impacted IT related costs. The Group continued with its investment in human resources, primarily in areas relating to Anti-Money Laundering (AML) and other control functions. Additional professional services were engaged during the year, mostly related to the de-risking programme currently underway.

Group results were, however, boosted by substantial recoveries on impaired lending, which led to a net impairment reversal of €10.8 million. This is the result of the Group's continued focus on improving the credit quality of its asset portfolios. Non-performing loans make up 5.3% of the credit book, a significant improvement over the 6.5% reported in December 2017. In turn, expected credit losses cover 33.4% of these non-performing exposures, most of which remain well and tangibly secured.

The Maltese economy is currently generating wealth at a sustained rate, resulting in a highly liquid economy. Most of the liquidity generated finds its way into the banking sector, with the result that banks are carrying considerable amounts of liquid assets. Liquidity implies considerable costs for banks, especially in view of the negative benchmark rates being applied

[1] *Central Bank Quarterly Review 2019: 1*

by the European Central Bank and international prime banks. The Bank has attempted to mitigate the liquidity burden by passing some of the cost to corporate customers holding high balances on their accounts. The imposition of this High Balance Fee, a necessary measure in the current situation, has helped to alleviate the cost of holding liquidity, and to temper the inflow of non-retail deposits.

Nevertheless, customer deposits grew by €314 million, or 3.1%, to reach €10.4 billion. This inflow, in turn, fuelled the €326 million (2.8%) growth recorded in total assets, which have now exceeded €12 billion. Advances at amortised cost, net of provisions, grew by €201 million, or 4.8%, and stand at €4.4 billion. Investments and bank balances amount to €7.4 billion, a growth over 2017 of 1.7%.

The Group's equity base increased to €994 million, an increase of 3.3% during the year. The Group's Core Equity Tier 1 ratio is of 18.3%, compared to 16.1% a year ago.

The Bank is currently involved in a number of litigation cases, the most material of which arose from its past involvement in the Trusts and Custody businesses. Management remains convinced, on the basis of counsel's advice, that the Bank's legal position in these cases is strong. Nevertheless, the Board has deemed it prudent to set aside the amount of €75 million as a provision against potential losses from litigation and claims. This is a judgment call based on the situation prevailing as at December 2018, and is subject to ongoing review in the light of developments.

REVIEW OF BUSINESS

The Group has continued the restructuring of its business model, with the objective of lowering its risk profile. The de-risking programme is multi-faceted, and includes the winding down of certain business lines, the re-dimensioning of others, the revision of the Risk Appetite Framework, the enhancement of risk policies and comprehensive training programmes covering the entire organisation from the Board of Directors downwards.

The Bank is in the process of winding down the Trusts and Custody business, and has terminated thousands of customer relationships which no longer fit within its risk appetite. The Customer Acceptance Policy has been revised, and the Bank is no longer considering relationships with customers that have no nexus with Malta - a criterion which has been articulated in precise and concrete terms. All customer onboarding has now been centralised in three specialised centres, as has the review and remediation of all customer files.

The programme is being conducted by a dedicated Chief Business Restructuring Officer under the oversight of a Steering Committee chaired by the Chairman of the Board of Directors.

Two important milestones were achieved during 2018. In March, the Bank opened its new Representative Office in London. For the first time, BOV has a physical presence in what is recognised as the global hub of financial services. This move was driven by the Bank's corporate strategy, which sees this office as an important link in the existing network of representative offices to

The Group has recorded a robust performance on its credit business during 2018

make BOV a point of reference for international clients seeking to relocate to or invest in Malta especially in the context of Brexit. The second milestone was achieved in November, when the Bank inaugurated its Premium Banking Centre in Santa Venera. The aim here is to provide the Bank's premium customers with a centre of excellence and a top-quality business environment for their interaction with the Bank.

The Group has recorded a robust performance on its credit business during 2018. Gross Loans and Advances to customers increased by 3% during the financial year 2018 to reach €4.6 billion. This was achieved through a multi-pronged approach as reflected in the Bank's business plan and seeking to leverage on the country's economic prosperity in ensuring the supply of credit both at commercial and retail levels. During the year under consideration more than €850 million of new lending was made.

The Bank was also very active in ensuring that the SME segment, which continues to be one of the main pillars of the Bank's customer base, be further serviced in an effective manner in line with their specific needs. The Bank has been very active in ensuring that SMEs are supported in their different financing requirements. The JAIME product, a risk sharing instrument with the European Investment Bank, ensured that in the last financial year more than 150 SMEs were serviced for facilities exceeding €12 million. The Bank is now in the final process to top up the JAIME product with additional funding. The JAIME top-up will ensure that the Bank can continue servicing SMEs, primarily micro enterprises, and including start-ups, in their financing requirements through the provision of low interest loans and with minimal security requirements.

The Bank also launched a risk sharing instrument with the Malta Development Bank, in liaison with the Family Business Office, to support and encourage succession planning and business transfer. As businesses are reaching their third and fourth generation from the time that Malta gained its Independence, ensuring a robust succession planning, especially for family businesses, is becoming much more important to safeguard the businesses' going concern and sustainable growth. In the meantime, the Bank is looking at ways in which it can further support SMEs in their financing requests with additional risk sharing products, while providing tailor-made solutions to our corporate customers. The Bank experienced positive results during the year on the consumer finance side with an absolute growth in balances of €129 million, which is equivalent to an increase of more than 6% year-on-year. This level of performance ensured that very good market share levels were maintained both in the Home Loans and Personal Loans segments. Such results have to be considered in the context of an evolving market, and where customers are becoming more discerning in their requirements.

During the course of this financial year, BOV has organised a number of initiatives in support of its various line of business activities. Insofar as the business customer segment is concerned, the Bank has continued to extend its support through various agreements entered into with a number of business associations operating in Malta and Gozo. Through these arrangements, apart from supporting these associations to fulfil their remit, the Bank has co-organised various initiatives to provide information on themes and topics relevant to the business segment within its client base. In fact, a number of information sessions were organised covering

EU funding opportunities, the use of trade finance, workplace pension planning and wealth management, among others.

In relation to its wider personal customer segment, the Bank has further sustained the organisation of various investor education initiatives covering numerous banking related themes that are of particular interest and relevance to its clients. These included lectures on succession and powers of attorney, family law and matrimonial regime, and the Depositor Compensation Scheme.

BOV was active in engaging the millennial segment of its customer base, by launching the BOV Club 2018 package which is specifically designed for students who are about to embark on post-secondary and tertiary education. The package includes basic deposit accounts as well as financing solutions and debit/credit card offerings.

On the theme of investment services, BOV Fund Services, the Group's fund servicing arm, has sustained its initiatives in attracting international fund administration business through the organisation of various international promotional initiatives. On the other hand, BOV Asset Management, the Group's asset management arm, has continued to develop the Bank's pensions-related proposition which is planned to be launched over 2019.

Lastly, on the digital front, during 2018, the Bank launched an improved version of its internet banking platform which featured a number of improved functionalities and provided a significantly improved customer experience. In the meantime, the Bank continued with its Core Banking Transformation programme, the aim of which is to deliver greatly enhanced service efficiencies and powerful management tools. The Oracle Flexcube solution that the Bank is implementing will also serve as a state-of-the-art platform for the development of the Group's future digital channels. The Group recognises that financial technology and digitalisation are fundamental for its long-term prospects, and is investing heavily in laying sound and future-proof foundations for these initiatives.

BOV IN THE COMMUNITY

BOV takes pride at being the largest Bank of Maltese origin and ownership, and is committed to support not just the national economy, but the entirety of Maltese society, in all its many facets, including the arts, the environment, sports, education and the national heritage.

It is within this context that BOV remains committed to be a leading patron of the arts and culture, supporting major artistic initiatives such as the Opera at the Manoel Theatre and at the two major theatres in Gozo, all of which showcase the best Maltese talent alongside renowned international stars. This year also saw the 26th edition of the BOV Retrospective

Art Exhibition, which was a celebration of Joseph Calleja, the pioneer of Kinetic Art, held at the *Gran Salon* at the Museum of Archaeology in Valletta. This was Calleja's last major event as he sadly passed away in December 2018.

The Bank is supporting the restoration of this same venue, namely the *Gran Salon* at the Auberge de Provence in Valletta. This beautiful baroque hall, with its richly decorated walls, is among the more captivating features of the Auberge de Provence (which houses the National Museum of Archaeology), and boasts one of only five wooden trussed roofs still surviving from the era of the Knights of St John.

Other major restoration projects in which the Bank is involved include the restoration of the 17th Century Crucifix found at the Franciscan Church of St Mary of Jesus (Ta' Ġieżu), known as the "miraculous Crucifix", which is undergoing an extensive conservation by the Arts Conservation Consortium; and the artistic roof of the Chapel of St Paul in Valley Road, Birkirkara.

The natural environment continues to rank high on BOV's agenda. The Bank has, in collaboration with Nature Trust, launched the publication *Trees and Shrubs of the Maltese Islands*, which is aimed at propagating knowledge and appreciation of Malta's flora and fauna. Around 6,000 school children have also experienced nature education through *Dinja Waħda*. This is BirdLife Malta's educational programme for primary schools, for which the Bank is the chosen educational partner.

As a major contributor to the Malta Community Chest Fund Foundation, the *L-Istrina* BOV Piggy Bank Campaign strengthens the principle of solidarity among schoolchildren while contributing to the overall *L-Istrina* fundraising effort together with a substantial contribution by the Bank.

In the field of sports, the Bank remains a major supporter of sporting initiatives in Malta, that include football, basketball, water polo, horse racing and sailing. BOV also supports the *Youth Development Scheme*, which, in collaboration with SportMalta, provides athletes the necessary funds for training camps and competitions beyond our shores, an effort that will guarantee a crop of fine athletes in the near future.

CONCLUSION

The Bank is currently following a multi-year strategic plan, dubbed internally as VISION 2020. The vision is for a stable, low risk and profitable Bank which services the financial needs of operators within the Maltese economy, through an integrated network of virtual and physical distribution channels. We are investing heavily - in technology, resources and training - in order to turn that vision into reality, in the interests of the Institution and its stakeholders.

I wish to conclude by acknowledging the invaluable contribution being made by each stakeholders' group - customers, shareholders, directors, supervisory authorities, management and all employees - and to thank them for their constant support towards the Bank.

Mario Mallia
Chief Executive Officer
15 March 2019

Management Board

Mario Mallia
Chief Executive Officer

Mario Mallia joined the Bank in September 1979. He was appointed as the Bank's Chief Executive Officer in January 2016. He has carried out various other executive roles at the Bank, including those of Chief Finance Officer, Chief Risk Officer and Chief Operations Officer. Mr Mallia is chairman of the BOV Management Board and the Asset Liability Management Committee. He is a member of the Credit Committee and Ethics Committee. He is also a director on the board of MAPFRE MSV Life p.l.c. Mr Mallia graduated in accountancy from the University of Malta, holds the Certified Public Accountant warrant and is a Fellow of the Malta Institute of Accountants. Mr Mallia was appointed as an Executive Director to the Board of Directors in July 2017.

Ernest John Agius
Chief Operations Officer

Ernest John Agius was appointed Chief Operations Officer in May 2016. His previous position within the Bank was that of Change Management Executive, responsible for the setting up of the Change Management Function, which incorporates Process Management.

Mr Agius's career in the financial services sector spans more than thirty two years during which he has held a number of senior executive positions within the Business and IT.

As Chief Operations Officer, Mr Agius is responsible for the Bank's overall Operations, Facilities Management, Administration, Security, Health & Safety, Procurement, Architect's Services, Customer Service Centre, Customer Issues and Change Management. Mr Agius is responsible for the overall business management of projects, including the Core Banking Transformation programme.

Mr Agius has been a member of the Management Board since June 2016. He chairs the BOV Property Committee and the BOV Procurement Committee.

Joseph Agius
Chief Technology Officer

Joseph Agius was appointed Chief Technology Officer in October 2014, and became a member of the Bank's Management Board in October 2016.

Since joining the Bank in 1985, Mr Agius has garnered over thirty years experience in IT and Financial Services. In this time, he has been actively involved in the implementation of various mission critical projects.

In his role as Chief Technology Officer, Mr Agius is responsible for driving the Bank's IT strategy. He is a strong proponent for modernisation in IT, and running IT as a business with its inherent business value.

Presently, his primary focus is on leading the Bank's strategic initiatives on core retail banking transformation and digital banking. In his role as Chief Technology Officer, Mr Agius chairs the Bank's IT Steering Committee.

Joseph Agius is currently a non-executive director on the Board of the Malta Information Technology Agency.

Mr Agius holds an Honours degree in Computer Science from the University of Reading and an MBA in eBusiness from Grenoble Graduate School of Business. He is also a Chartered Engineer and member of the British Computer Society.

Miguel Borg
Chief Risk Officer

Miguel Borg joined the Bank in November 2007 in the role of Risk Management Consultant. Mr Borg was appointed Chief Risk Officer of the Group in November 2014 and is a member of the Management Board and of the Ethics Committee. As Group Chief Risk Officer, he leads the risk management function with the responsibility of developing and recommending the Group's risk governance framework, risk appetite and limits. Mr Borg is responsible for Risk Management, Legal Services and Credit Risk Sanctioning Departments. Until 31 January 2019, Mr Borg was also responsible for the Bank's compliance and anti-financial crime functions. Mr Borg chairs the Governance, Risk and Compliance Committee. Mr Borg is a director of BOV Asset Management Limited and chairs the Risk and Regulatory Committee of BOV Asset Management Limited and the Risk Committee of MAPFRE MSV Life p.l.c. He is a member of the Bank's Asset Liability Management Committee. Mr Borg is also chairman of the Central Co-Operative Fund. Prior to joining the Bank, he worked at the Central Bank of Malta. Mr Borg holds a Master of Arts in Economics from the University of Malta. He lectures at the University of Malta. Mr Borg was appointed as an Executive Director to the Board of Directors in July 2017.

Albert Frendo
Chief Business Development Officer - Credit

Albert Frendo is an accountant by profession and currently occupies the post of Chief Business Development Officer - Credit of the Group responsible for the Credit and Treasury functions. His career at the Bank spans over thirty years with wide ranging experience in cost management and financial reporting, risk management and credit finance (both commercial and retail finance). For twelve years, he headed the Bank's Risk Management Department and was later assigned with the management of the Bank's overall Credit Portfolio, responsible for a number of key credit areas including Corporate, SME, Consumer and Trade Finance, Collections and Collateral Management. Lately, he was also assigned with the responsibility of the Treasury function. Mr Frendo was entrusted with the successful launching and management of the first Risk Sharing Instruments aimed at SMEs in Malta including JEREMIE, CIP SMEG and SME Initiative (JAIME). He is a member of the Bank's Management Board, Provisions Committee, the Bank's Asset Liability Management Committee (ALCO), Non Performing Loans (NPL) Committee and IT Steering Committee. Mr Frendo holds a degree in Accountancy from University of Malta and a Masters in Business Administration, with specialization in Management Consulting, from Grenoble Graduate School of Business in France.

Kenneth Farrugia
Chief Business Development Officer - Investments

Kenneth Farrugia joined the Bank in 1985 and has since occupied various positions within the Bank. Mr Farrugia currently holds the post of Chief Business Development Officer - Investments and sits on the Management Board.

Mr Farrugia is amongst others responsible for the improvement of the Bank's market position, as well as the achievement of financial growth and long-term strategic business goals. He currently sits on the Board of Directors of BOV Asset Management Limited, and is also a director on the board of the Vilhena Funds SICAV p.l.c. Mr Farrugia is a Fellow of the Institute of Sales and Marketing Management in the UK.

Elvia George
Chief Finance Officer

Elvia George is the Chief Finance Officer of the Group, a post she has occupied since May 2008. In this role she is responsible for all the core areas of Finance, Management Reporting and the published Group Financial Statements as well as other areas within the Group. Ms George is a member of various committees and boards within and outside the Group including voluntary organisations.

Ms George is a certified public accountant, graduating with first class honours in accountancy from the University of Malta and a Fellow of the Malta Institute of Accountants. Besides lecturing at the University of Malta, where her area of expertise is accounting for financial institutions, she also supervises a number of students in their dissertation during their final year of the professional degree of the Masters in Accountancy or for an MA in Financial Services. She is involved with the Malta University Examination Panel and has also served as a member of the Accountancy Board for a number of years.

Corporate Social Responsibility (CSR)

Bank of Valletta has established itself as the leading supporter of a wide spectrum of community activities involving Sports, Arts and Culture, Education, Environment, Heritage, Philanthropy and Business. The sustained investment in the Bank's Corporate Social Responsibility (CSR) programme has registered a vast positive impact reaching various segments of society.

The European Commission had defined CSR as "the responsibility of enterprises for their impacts on society". For us at Bank of Valletta, CSR represents our commitment to society and the environment, underpinned by policies, practices and initiatives that we carry out with genuine transparency and honesty.

At Bank of Valletta, we are focused on responsible business growth while caring for our environment and society in general for the benefit of current and future generations. Through these efforts, we are facilitating economic growth, supporting the development of our employees and assisting our clients in achieving their goals.

Below are some highlights of our initiatives throughout 2018:

Customers

Premium Banking Centre Inauguration

BOV's new Premium Banking Centre in Santa Venera is a direct investment to provide the Bank's high net worth customers, with an enhanced level of service in a comfortable and confidential environment.

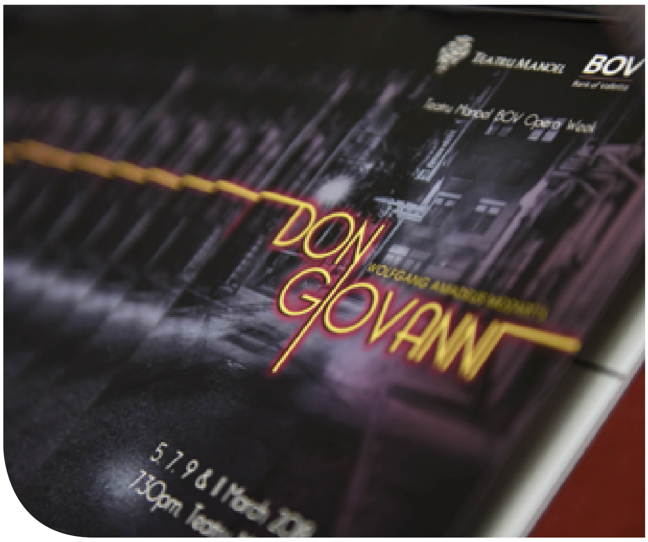
New Representative Office in London

BOV's new Representative Office in London gives the Bank a physical presence in London, the cosmopolitan hub of financial services. This is driven by the Bank's corporate strategy which sees this office as an important link in the existing network of representative offices which make Bank of Valletta accessible to a wider customer base.

Arts & Culture

Opera

Bank of Valletta remains committed to be the leading patron of the local Arts & Culture, supporting major artistic initiatives such as the Opera at the Manoel Theatre and the two major theatres in Gozo showcasing the best Maltese talent alongside renowned international stars.



BOV Retrospective Art Exhibition

The 26th Edition of the BOV Retrospective Art Exhibition was a celebration of Joseph Calleja, the pioneer of Kinetic Art, held at the Gran Salon at the Museum of Archaeology in Valletta, a venue being restored through BOV's support. This was Calleja's last major event as he sadly passed away in December 2018.

Heritage

Restoration of Gran Salon

Bank of Valletta is supporting the restoration of the 'Gran Salon' at the Auberge de Provence in Valletta. The Gran Salon is among the more captivating features of the Auberge de Provence (National Museum of Archaeology), with its richly painted walls and boasts one of the only five wooden trussed roofs still surviving from the Knight's period.

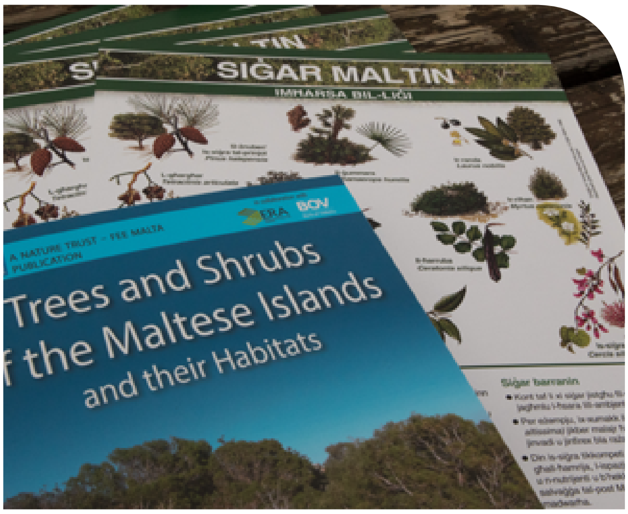
Ta' Ġieżu Crucifix

The 17th Century miraculous Crucifix found at the Franciscan Church of St Mary of Jesus (Ta' Ġieżu) will undergo an extensive conservation by the Arts Conservation Consortium through the support of Bank of Valletta. The miraculous Crucifix draws countless pilgrims to its shrine for spiritual comfort as well as to admire a unique work of art.

Environment

Dinja Waħda

Around 6,000 school children experienced nature education through Dinja Waħda. This is BirdLife Malta's educational programme for primary schools, and Bank of Valletta is the chosen educational partner for this initiative.



Nature Trust

The Environment continues to rank high on the Bank's Agenda. Bank of Valletta, in collaboration with Nature Trust launched 'Trees and Shrubs of the Maltese Islands', a publication aimed at propagating knowledge about Malta's flora and fauna to help protect them.

Social

Malta Community Chest Fund Foundation

As a major contributor to the Malta Community Chest Fund Foundation, the L-Istrina BOV Piggy Bank Campaign strengthens the principle of solidarity among schoolchildren while contributing to the overall L-Istrina fundraising effort together with a substantial contribution by the Bank.

Staff Initiatives

The Bank promotes solidarity among its staff members and organises a number of initiatives where employees participate in fun activities, such as a 'Crazy Socks Day' and also make a donation towards charitable institutions, resulting in a positive philanthropic impact.

Sports

Sports

Bank of Valletta is a major supporter of sporting initiatives in Malta, that include football, basketball, water polo, horse racing and sailing among others. This support promotes a healthy lifestyle in a competitive environment while providing entertainment to the fans and spectators.

Youth Development Scheme

Our future athletes need the best training from an early stage. The Youth Development Scheme in collaboration with SportMalta provides athletes with the necessary funds for training camps and competitions beyond our shores, an effort that will guarantee a crop of top athletes in the near future.

Education

Read with Me

Fostering a love of reading from a young age is the main aim of the Read With Me / Aqra Magħi programme which promotes shared reading experiences focussing on early literacy and parental education.

Discover Valletta

Because education is not confined to the classroom, BOV and the V18 Foundation collaborated on 'Discover Valletta', a series of short stories, narrated by Trevor Zahra, linked to twenty-four landmarks in the Capital City. The narratives are available in audio-format with dedicated flash cards and to date, over 18,000 packs have been distributed to schoolchildren in Malta and Gozo.

Joseph Calleja Foundation

The BOV Joseph Calleja Foundation continues to support an ever increasing number of upcoming Maltese performance artists. This initiative runs parallel to the 'Vulnerable Child' programme that promotes the use of music as therapy for children.

The Marigold Foundation – BOV in the Community

The 'Marigold Foundation - BOV in the Community' is BOV's social link with the community. Bank of Valletta actively collaborates in various initiatives organised by the Foundation such as the Pink October Campaign and the support to various local NGO's.

CONCLUSION

For Bank of Valletta, Corporate Social Responsibility is an ongoing journey. Further details about the Bank's Corporate Social Responsibility may be found under Principle 12 of the Corporate Governance Statement of Compliance on page 48.

Directors' report as at 31 December 2018

The Directors present their 45th Annual Report, together with the audited financial statements of the Bank of Valletta Group (the Group) and the Bank for the Financial Year ended 31 December 2018.

Principal Activities

The Bank of Valletta Group comprises Bank of Valletta p.l.c. (the Bank) and two subsidiary companies namely BOV Asset Management Limited (BOV AM) and BOV Fund Services Limited (BOV FS). The Group also has two equity-accounted investee companies, MAPFRE Middlesea p.l.c. and MAPFRE MSV Life p.l.c. The Group's principal activities are set out below.

The Group offers banking, financial and investment services and connected activities within the domestic Maltese market. The principal activities of the Bank comprise the following:

1) The receipt and acceptance of customers' monies for deposit in current, savings and term accounts which may be denominated in Euro and other major currencies,

2) The provision of loans and advances to a wide array of customers, and

3) The provision of investment services, covering a comprehensive suite of investment products and services that meet the customers' needs throughout their lifecycle, including stockbroking, advisory and discretionary portfolio management services.

The Group also provides a number of other services, including, bancassurance, corporate advisory, fund management, fund administration, and other services, such as 24-hour internet banking service, issuance of major credit cards, night safe facilities, automated teller machines, foreign exchange transactions, outward and inward payment transfers.

In most part, the activities of the Bank are licensable activities regulated under the domestic and EU financial regulatory framework.

Pursuant to Article 177 (2) of the Companies Act, (Chapter 386, of the Laws of Malta) the Directors declare that the Bank has embarked upon a strategic review of its business model, with the aim of re-dimensioning, or exiting from, businesses and customer relationships which are deemed to carry inordinately high risk. This review is resulting in the closure of a substantial number of relationships which no longer fit within the Bank's risk appetite, or where the risk involved is not justified by return. This may also involve foregoing short-term revenue streams in favour of the long-term sustainability of the Bank.

Information on the performance of the Bank is found under the CEO's Review.

The Parent Company

Bank of Valletta p.l.c. is licensed to carry out the business of banking and investment services in terms of the Banking Act,1994 (Chapter 371, Laws of Malta) and the Investment Services Act,1994 (Chapter 370, Laws of Malta). The Bank is an enrolled tied insurance intermediary of MAPFRE MSV Life p.l.c. under the Insurance Intermediaries Act, 2006 (Chapter 487, Laws of Malta).

The Bank offers the entire range of retail banking services as well as the sale of financial products such as units in collective investment schemes. The Bank also offers investment banking services, including underwriting and management of Initial Public Offerings (IPOs) as well as custody services.

The Subsidiaries

BOV AM provides management services for collective investment schemes and portfolio management services for professional institutional clients. BOV AM is a fully owned subsidiary of the Bank and has three regulatory functions: Asset Management, Risk Management and Compliance.

BOV FS is also a fully owned subsidiary of the Bank and is a recognised fund administrator by the Malta Financial Services Authority. BOV FS provides a comprehensive suite of services to fund managers and fund promoters, as well as a full suite of fund administration including fund accounting, shareholder registry services, regulatory reporting and corporate services.

Equity-Accounted Investees

MAPFRE MSV Life p.l.c. operates as a life assurance company licensed under the Insurance Business Act, 1998 (Chapter 403, Laws of Malta). MAPFRE Middlesea p.l.c. is engaged in the business of insurance, including group life assurance.

At the Annual General Meeting held on 5 March 2019, the Directors of MAPFRE MSV Life p.l.c. approved the payment of a net special dividend of €16 million from past retained earnings of which €8 million will be received by Bank of Valletta p.l.c.

Directors' report as at 31 December 2018 (continued)

Strategic Initiatives of the Bank

The Board of Directors has articulated clear corporate goals for the Bank and has set Strategic Initiatives for the years 2018 to 2020. These goals, which describe what the Bank aims to achieve in the long-term, are as follows:

1) Financial stability and sustainability;
2) Protection of the interests of depositors; and
3) Provision of a sustainable and equitable return to Shareholders.

The Board has further identified a number of corporate strategies, which define the ways in which the Bank plans to achieve its goals. The principal strategies are:

- Digitalisation
- Core Banking Transformation (CBT)
- Long-Term Financial Stability
- Governance and Regulation
- Revision of the Business Model
- Resourcing

Principal Risks and Uncertainties pursuant to Article 177 of the Companies Act, 1995 (Chapter 386, Laws of Malta)

The Directors are aware of the various risks faced by the Group as a result of its involvement in different business lines and operations.

A number of measures are in place to ensure that such risks and uncertainties are maintained at acceptable levels and are in line with the Group's risk appetite and strategy of sustainable, long-term growth and profitability. In line with the Bank's Policy, the Risk Appetite Statement and Framework was reviewed and approved by the Board of Directors in June 2018. The document lays out the responsibilities of various stakeholders, including the Board of Directors and Senior Management, and establishes a number of qualitative and quantitative parameters for acceptable risk taking.

In line with the provisions of the Risk Appetite Statement and Framework, Senior Management is responsible for the day-to-day monitoring and control of risk taking, subject to the regular oversight of the Board of Directors through the Risk Management Committee. The overall structure is aimed at ensuring a sound risk culture supported by a performance management system that discourages excessive risk taking.

The key risks faced by the Group include credit risk, market risk, operational risk and liquidity risk. These, and other risks and uncertainties inherent in the business, require sound capital management to ensure adequacy against regulatory requirements and adverse events. With this in mind, the Group regularly sets out and reviews capital targets in line with actual and forecast business levels and monitors performance against such targets on a regular basis. A more detailed explanation of key risks and capital management is included within the Capital and Risk Management Report as well as Note 39 to the Financial Statements.

The Directors also recognize the fact that the Group may be subject to reputation and litigation risk as a result of its actions and operations. Conscious of the serious repercussions such risks may have on the Group's and the various stakeholders' wellbeing, both the Board of Directors and Senior Management exercise zero tolerance to conduct risk and aim to instil the highest levels of ethical behaviour through a number of appropriate policies, procedures and controls.

Operational Overview

A review of the business of the Group for the period ended 31 December 2018 and an indication of future developments are provided in the Chairman's Statement and the Chief Executive Officer's Review, which can be found in the front section of this Annual Report.

Dividends

Having taken note of extensive discussions with regulators, the Board of Directors resolved not to declare an interim dividend and does not intend to recommend a final cash dividend for Financial Year 2018.

At the forthcoming Annual General Meeting, the Board of Directors is proposing a bonus share issue of 1 share for every 10 shares held. This will result in the issue of an additional 53,077,206 shares and thereby increasing the issued Share Capital from the current 530,772,064 shares to 583,849,270 shares of €1.00 each fully paid up, resulting in a paid up capital of €583,849,270.

Directors' report as at 31 December 2018 (continued)

Board of Directors

The following Directors served on the Board during Financial Year 2018:

Taddeo Scerri (Chairman)
Stephen Agius
Alan Attard
Paul V Azzopardi
Miguel Borg
James Grech
Alfred Lupi
Mario Mallia
Anita Mangion
Antonio Piras
Joseph M Zrinzo

Directors' Responsibilities

The Directors are required by the Companies Act, 1995 (Chapter 386, Laws of Malta) to prepare financial statements in accordance with International Financial Reporting Standards as adopted by the EU which give a true and fair view of the state of affairs of the Group and the Bank as at the end of the financial year and of the profit or loss of the Group and the Bank for the year then ended. In preparing the financial statements, the Directors should:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable; and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Group and the Bank will continue in business as a going concern.

The Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy at any time the financial position of the Group and the Bank, and which enable the Directors to ensure that the financial statements comply with the Banking Act, 1994 (Chapter 371, Laws of Malta) and the Companies Act, 1995 (Chapter 386, Laws of Malta) and with the requirements of Article 4 of the Regulation on the application of IFRS as adopted by the EU. This responsibility includes designing, implementing and maintaining such internal controls as the Directors determine necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error. The Directors are also responsible for safeguarding the assets of the Group and the Bank, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

After reviewing the Group's plans for the coming financial years, the Directors are satisfied that at the time of approving these financial statements, it is appropriate to continue adopting the going concern basis in preparing these financial statements.

Auditors

A resolution to re-appoint KPMG Malta jointly with KPMG LLP (United Kingdom) as auditors of the Bank will be proposed at the forthcoming Annual General Meeting (AGM). KPMG Malta and KPMG LLP (United Kingdom) have expressed their willingness to remain in office.

Going concern – Listing Rule 5.62

The financial statements are prepared on a going concern basis. The Directors regard that pursuant to Listing Rule 5.62, this is appropriate, after due consideration of the Bank's profitability, liquidity, the statement of financial position, capital adequacy and solvency. Specifically, the Directors have prepared financial and capital plans for the next five years which show that the Bank is in a position to continue operating as a going concern for the foreseeable future. These plans take into account risks facing the Bank, including but not limited to, the potential crystallisation of known contingent liabilities.

Information Pursuant to Listing Rule 5.64

Authorised Share Capital

The Bank has an authorised share capital of €1,000 million divided into 1,000 million ordinary shares with a nominal value of €1.00 each.

Issued Share Capital and the Scrip Dividend Programme

The issued shares of the Bank consist of one class of ordinary shares with equal voting rights attached.

Following the approval of the Shareholders of the Bank, during the Annual General Meeting held on 10 May 2018, the Bank's issued share capital increased (following the rights issue completed during 2017) from €420 million to €525 million divided into 525 million ordinary shares with a nominal value of €1.00 each.

Directors' report as at 31 December 2018 (continued)

During the Annual General Meeting held on 10 May 2018, the shareholders were offered the right to elect to receive the final dividend either in cash or by the issue of new shares through a Scrip Dividend Programme.

The optional Scrip Dividend Programme was communicated to shareholders on 12 April 2018 wherein the price of new shares issued under the Scrip Dividend Programme (the Attribution Price) had been established at €1.667. The Attribution Price was calculated using the average of the three weighted average prices based on trading effected on the 9, 10 and 11 April 2018 and a discount of 5% was applied to the said average of the three prices. The Scrip Dividend Programme represented a 35.25% take up of the potential issue of new shares under the Scrip Dividend Programme and was equivalent to €9,622,030.69.

Following the Scrip Dividend Programme, the Bank's issued share capital increased to 530,772,064 fully paid ordinary shares with a nominal value of €1.00 each.

A final gross dividend of €0.08 per share was paid on 18 May 2018, to those shareholders who had elected to receive the dividend in cash.

Shareholding Structure

Clause 4.3 of the Bank's Memorandum of Association provides that, with the exception of existing large shareholders, presently the Government of Malta and UniCredit S.p.A., no person may at any time, whether directly or indirectly and in any manner whatsoever, acquire such number of shares in the Bank, as would in aggregate be in excess of 5% of the issued share capital of the Bank.

As at 31 December 2018, Malta Government Investments Limited had a shareholding in the Bank of 0.48% and National Development and Social Fund (NDSF) had a shareholding in the Bank of 2.88%. Both entities are fully owned by the Government.

Any shareholder holding in excess of 50% of the issued share capital of the Bank or if no such shareholder exists, the shareholder holding the highest number of shares not being less than 25% of the issued share capital, may appoint the Chairman. As also explained in more detail below, Qualifying Shareholders with 10% or more of the shares in issue are entitled to recommend one Director for every 10% holding.

The Directors confirm that as at 31 December 2018, shareholding in excess of 5% of the issued share capital of the Bank was held directly by:

Government of Malta	25.0%
UniCredit S.p.A.	10.2%

Appointment of Directors

The rules governing the appointment and replacement of the Bank's Directors are contained in Articles 24 to 31 of the Bank's Articles of Association. More details on the appointment and rotation process of Directors is found under the Corporate Governance Statement of Compliance, under principle 3.

An extraordinary resolution approved by the shareholders in general meeting is required to amend the Memorandum and Articles of Association.

Powers of Directors

The Board of Directors has the power to transact all business of whatever nature, not expressly reserved by the Memorandum and Articles of Association of the Bank, to be exercised by the Bank in general meeting or by any provisions contained in any provision contained in any applicable laws.

The shareholders in general meeting authorised the Board to exercise during the Prescribed Period, all the powers of the Bank to issue and allot shares up to an aggregate nominal amount equal to the Prescribed Amount. The Prescribed Period refers to a term of five years approved during an Extraordinary General Meeting held on 27 July 2017 and which term expires on the 26 July 2022. This authority is renewable for further periods of five years each.

Directors' Service Contracts

The Directors have service contracts with the Bank. More information on the Directors' service contracts can be found under the Remuneration Report.

Collective Agreements

The relative Collective Agreements regulate the compensation payable to employees in case of resignation, redundancy or termination of employment for other reasons.

Directors' report as at 31 December 2018 (continued)

It is hereby declared that as at 31 December 2018, information required under Listing Rules 5.64.5, 5.64.7 and 5.64.10 was not applicable to the Bank.

Amendments to the Memorandum of Association

The Bank's Memorandum of Association was revised during the period under review and approved by the Shareholders during the Annual General Meeting held on 10 May 2018.

Pursuant to this revision to the Memorandum of Association, a large shareholder (namely any person who currently holds more than 5% of the Bank's issued share capital) being a bank, credit institution, financial institution, insurance company or licensed collective investment scheme, shall be able to sell its large shareholding, namely any holding of more than 5% of the Bank's issued share capital, to any of the following institutions:

- banks
- credit institutions
- financial institutions
- insurance companies or
- licensed collective investment schemes

Insurance companies and licensed collective investment schemes were included in the list of eligible institutions which are now able to acquire and hold a large shareholding in the Bank. This provision therefore allowed large shareholders who wished to dispose of their large shareholding, a broader segment in the market to whom they could sell and dispose of their shares as one holding, whilst at the time ensuring that only institutions which are subject to regulation and licensing could be the holders of a large shareholding in the Bank.

Information pursuant to Listing Rule 5.70.1

There were no material contracts to which the Bank, or any one of its subsidiaries, was a party and in which anyone of the Bank's Directors was directly or indirectly interested.

Declaration pursuant to Investment Services Rule R4-4.3.4

Pursuant to Investment Services Rule R4-4.3.4, it is hereby declared that during the reporting period, there were no breaches of Standard Licence Conditions or other regulatory requirements.

Whistleblowing

The Bank has in place a Whistleblowing Policy aimed to encourage reporting of improper practices and suspected wrongdoing in a controlled manner which safeguards the confidentiality of the whistleblower. The nature of the disclosures made through the Whistleblowing process are reported to the Audit Committee.

Information pursuant to the Sixth Schedule of the Companies Act, 1995 (Chapter 386, Laws of Malta)

Branches, Agencies and Centres

The Bank has the following Branches, Agencies and Centres around Malta and Gozo:

- 36 Branches offering both deposit taking and lending services
- 5 Business Centres
- 6 Investment Centres
- 4 Agencies offering deposit services only
- 1 Sub-Agency/Satellite Branch offering both deposit and lending services which reports to the "parent" branch

Besides the above local Branches, the Bank has four Representative Offices, one in Milan which was opened in 1996, one in Libya (temporarily closed) which was opened in 2002, one in Brussels, opened in 2012 and another one in London which was opened in March 2018.

Research and Development

In light of the business sector in which it operates, the Bank does not consider research and development as a main area of activity.

Events occurring after the end of the accounting period

On 13 February 2019, eleven unauthorised international outward payments denominated in different currencies and totalling to an equivalent of €12.9 million, were discovered by the Bank during a routine reconciliation process. As at the date of publication, part of these unauthorised payments have already been recovered. More details on this incident can be found in Note 43 of the financial statements.

Directors' report as at 31 December 2018 (continued)

Non-Financial Disclosures

Environmental Friendly Measures – The Bank's ongoing commitment to promote Green practices within the community and determination to decrease the carbon footprint led to various Green Initiatives that included installations of modern, energy efficient Heating Ventilation Air Conditioning (HVAC) systems, continuous disinfection and cleaning of ducting systems at various branches, replacement of lights to energy efficient Light Emitting Diodes (LED) light fittings and installations of PV Cells which generated electrical energy and which resulted in lower electricity consumption costs. The Bank also participated in the annual global initiative Earth Hour by switching off the BOV Centre and Legal Office façade lights during the hour indicated, with the aim of reducing electricity consumption. The Bank also participated in the European Week for Waste Reduction. Waste Separation and Recycling of Electronic Waste was ongoing throughout the reporting period.

Human Resources Matters – The Bank is covered by a Collective Agreement which binds the relationship between the organisation and its employees. The prevailing Collective Agreement includes a number of Family Friendly measures ensuring employee matters are looked after, including but not limited to Flexible Work Arrangements, Adoption/Fostering Leave, Bereavement Leave, Community Work Leave, Employee Welfare and an Employee Wellness Allowance. Moreover, the Bank has in place a number of policies ensuring respect for human rights including a Bullying Policy, Health and Safety Policy, a Code of Ethics and an Equality Policy. Related to the latter, the Bank has been awarded the Equality Mark, in recognition of the Bank's non-discriminatory approach to its workforce.

Employee Assistance Programme - This programme assists employees resolve personal or work related problems that critically hinder their ability to carry out responsibilities at work. The Bank, in conjunction with the Richmond Foundation, also offers its staff members free Mental Health Care related services. The Bank's Performance Management System is divided in four quadrants, namely Financial, Process, Customer and Employee, out of which 60% are non-financial key performance indicators.

Anti-Corruption and Bribery Matters – The Bank has a zero tolerance policy towards bribery and corruption and is committed to applying high standards of honesty and integrity. Recognising that bribery and corruption can have a negative effect on its shareholders, its clients and the wider financial industry, the Bank will be setting up a dedicated Unit as part of its Anti-Financial Crime Department. The Bank will also be implementing initiatives to address key bribery and corruption risks including policies, procedures and training.

Other than as disclosed in note 43 to the financial statements, there were no subsequent events which would have otherwise warranted an adjustment to or disclosure in these financial statements.

Statement by the Directors pursuant to Listing Rule 5.68

We, the undersigned, declare that to the best of our knowledge, the financial statements prepared in accordance with the applicable accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank and its subsidiaries included in the consolidation taken as a whole, and that this report includes a fair review of the performance of the business and the position of the Bank and its subsidiaries included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Approved by the Board of Directors and authorised for issue on 15 March 2019 and signed on its behalf by:

Taddeo Scerri Chairman	Mr Mario Mallia Director and Chief Executive Officer

Capital & risk management report 31 December 2018

Pillar 3 Disclosures

Basis for preparation

The Basel III capital adequacy framework consists of three complementary pillars: Pillar 1 provides a framework for measuring minimum capital requirements for the credit, market and operational risks faced by banks; Pillar 2 addresses the principles of the supervisory review process, emphasizing the need for a qualitative approach to supervising banks; Pillar 3 requires banks to publish a range of disclosures aimed at providing further insight on the capital structure, adequacy and risk management practices.

This Capital and Risk Management Report provides Pillar 3 disclosures for Bank of Valletta Group (hereinafter referred as 'BOV' or 'the Group') in accordance with disclosure requirements under Part Eight of EU Regulation No. 575/2013 Capital Requirements Regulation 'CRR'. During 2017, the EBA released guidelines on disclosure requirements which aim to improve the comparability and consistency of institution's Pillar 3 disclosures. These guidelines, applicable as from December 2017, provide detailed disclosure requirements for credit risk, counterparty credit risk, market risk and capital requirements. The Basel Committee on Banking Supervision has published the updated Pillar 3 disclosures requirements in December 2018 which complete the Pillar 3 framework, aiming to promote market discipline through regulatory disclosure requirements.

The Bank publishes these disclosures on an annual basis as part of the Annual Report in accordance with Article 433 of the CRR. A reference has been added in cases where the information addressing Pillar 3 requirements is included in other parts of the Annual Report.

This Capital and Risk Management Report is not subject to external audit, except where a disclosure is equivalent to that made in the Financial Statements which adhere to International Financial Reporting Standards (IFRS) as adopted by the EU. Nonetheless, this Capital and Risk Management Report has been verified internally and was approved by the Bank's Audit Committee and the Board of Directors (BoD). The Bank is satisfied that internal verification procedures ensure that these Additional Regulatory Disclosures are presented fairly.

Section 1: BOV Risk Management

It is the core function of every bank to take risks consciously with the aim of managing them to achieve a return. The Group is consistently working towards achieving the required balance between profitability and growth against reasonable risk levels.

The Group's Risk Appetite Framework (RAF) articulates the types and level of risk, both quantitatively and qualitatively, that the Group is willing to take in pursuit of the strategic objectives. The RAF ensures that all material risks are kept within appropriate limits, both to safeguard the financial sustainability of the Group, as well as to meet the needs of the stakeholders (including depositors, shareholders and regulators). The risk appetite is embedded across the Group through a number of policies, limits and controls which are monitored on a frequent basis to ensure that risk taking activity remains within the Group's risk appetite. Any breaches or early warning signals are escalated to the CEO and/or CRO and further to the Risk Committee, the Compliance and Crime Prevention Committee or the BoD as applicable, for immediate action. To maintain an environment where staff are comfortable raising concerns, the Bank also has a whistleblowing policy and the respective procedures in place. During 2018, the Group's RAF was reviewed and approved by the BoD in line with the Bank's policy.

Within this context, the Bank's organisational structure is built upon a framework that promotes a transparent and efficient, enterprise-wide risk management culture wherein the behaviour, attitude and decisions reflect risk awareness and mitigation across the Group. Great importance is given to the risk governance structure, which includes corporate value statements, codes of conduct and ethics, policies, procedures and risk assessment. The Group strives to strengthen and build upon the existent risk values so as to minimise risk exposure to insignificant levels. The Group's risk culture supports the core competency and business strategy. One of the high priority objectives of the second line of defence is to instil a cultural awareness which helps to establish a robust risk management and control process. This is done through risk awareness and compliance training for all employees, various workshops and the continuous sharing of information between different departments and business lines.

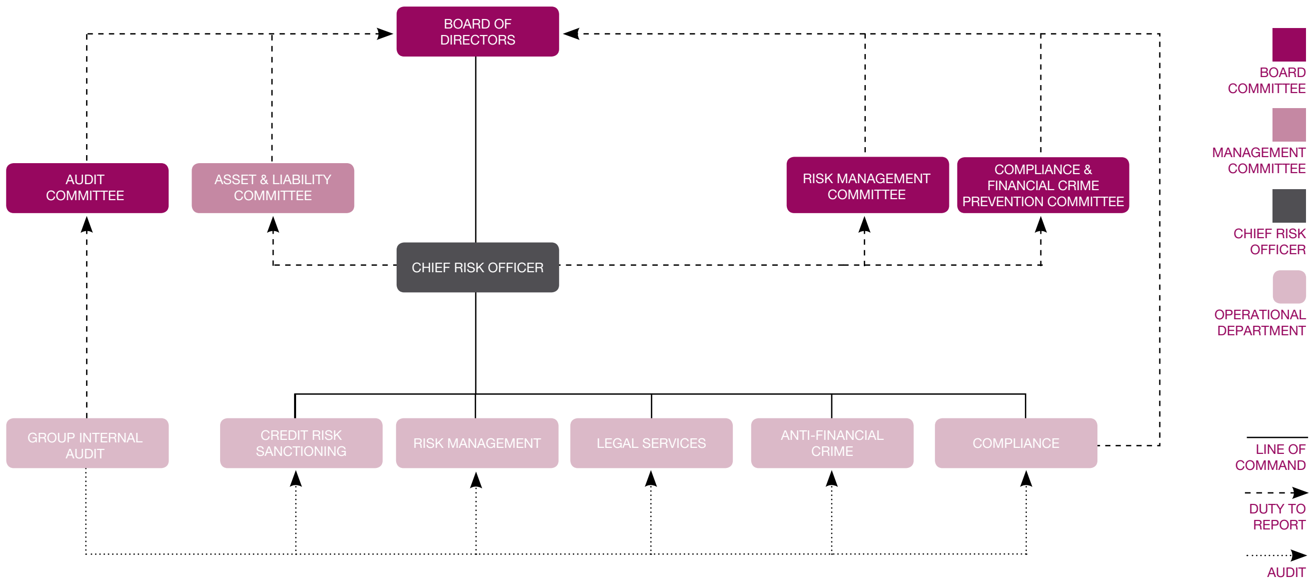
The Bank adopts different layers of defence and segregates duties to reinforce the currently implemented risk control mechanisms. Such approach is embraced through the application of the three lines of defence model. The first line of defence is executed by the functions that own and manage risks, namely the business units. The second line is executed by the functions that oversee risks, namely Risk Management, Compliance, Anti-Financial Crime and Legal Departments; and the third line is executed by Group Internal Audit, which is the function that provides independent assurance to the Board. This means that responsibility for risk management resides at all levels within the Bank. The Group continues to adopt and strengthen the three lines of defence by ensuring effectiveness of the risk management framework which includes constant monitoring and assurance. The risk governance framework enhances the understanding of existing and emerging risks through cooperation between all three lines and ensures the effective execution of risk management controls. The collective effort across different lines of defence ensures that the Group's risk culture is recognised as an essential factor to achieve compliance and strategic objectives.

The Board of Directors is ultimately responsible for the effectiveness of the risk governance framework and declares that the Group has in place adequate systems and controls relative to the Group's risk profile and business. As at end of December 2018, the Management Body declares that the Group's risk profile remained well within the Group's risk appetite and tolerance limits as established by the Board.

Capital & risk management report 31 December 2018 (continued)

Risk Governance

The Bank's risk governance structure is represented below:



The following points give a brief description of the main functions of the second line of defence.

The Risk Management Department is responsible for the overall risk management of the Bank. In order to ensure integrity, the Risk Management Department operates independently of the Bank's business activities. This Department has a number of units including:

- *Credit Risk Management Unit (CRMU).* The Unit's objective is to safeguard the soundness of the loan portfolio, to ensure sustainable credit growth and to enable a diversified portfolio aligned with the Bank's risk appetite. CRMU is responsible for the development and maintenance of the Credit Policy, which sets out the Bank's core principles governing the provision of credit. The Unit is also responsible for measuring and managing asset quality in line with the prevailing banking rules.

- *Enterprise Risk Management Unit (ERMU)*. ERMU takes a holistic enterprise-wide view of the risks taken on by the Bank in carrying out its business and ensures that these are consistent with the overall risk appetite framework. It is a central unit which is responsible for the management of risk reporting, risk data governance and portfolio risk management. The Unit is responsible for internal stress tests and is also actively involved in the compilation of the Internal Capital Adequacy Assessment Programme (ICAAP), Internal Liquidity Adequacy Assessment Programme (ILAAP) and the Recovery Plan.

- *Supervisory Coordination Unit (SCU).* The Unit's objective is to establish a strong and sustainable relationship with the Joint Supervisory Team and liaise with all three lines of defence and senior management to follow up all actions as required by the regulator. The Unit is responsible for the coordination, compilation and submission of regulatory documents and information, including the ICAAP, ILAAP; data collection of resolution planning and regulatory periodic stress tests conducted by the ECB.

- *Economic & Risk Research Unit.* The Unit brief includes the monitoring of the Bank's economic environment with special focus on the local and European economy. The Unit is responsible for conducting all mathematical, statistical and economic research that is required by the Bank.

- *Operational Risk Management Unit.* The core operational risk function is responsible to coordinate and oversee the identification, assessment, management and reporting of operational risks. It is also responsible for the implementation of the Operational Risk Management Framework (ORMF). The key elements of the ORMF are the risk register, risk identification, monitoring of risk indicators, loss database, business continuity and scenario analysis. The Unit is also responsible for the mitigation of operational risks events through the procurement of adequate and cost-effective insurance cover. In addition, the Unit has an information security function which analyses and communicates information security risks and evaluates their potential impact on the business processes.

- *Risk Coordination Unit.* The objective of this Unit is to be the direct link between the first and the second line of defence by increasing the awareness of risk responsibilities and cultivating a risk culture so that risk can be owned and managed within each business unit.

Capital & risk management report 31 December 2018 (continued)

The *Credit Risk Sanctioning Department* is responsible for conducting independent financial and risk analysis of lending and investment proposals that fall under the dual-voting system and to ensure that these are within the risk appetite communicated by the BoD.

The *Legal Services Department* ensures that the Bank's interests are duly safeguarded and that the Bank is kept duly updated with all legislative developments. This enables the Bank to map the way forward and be legally prepared even in terms of the Bank's processes.

The *Anti-Financial Crime Department* has a second line of defence function and supports the frontline employees by providing guidance and assistance in the development and implementation of policies, procedures, systems and controls to counteract financial crime, money laundering, counter terrorism financing, bribery and corruption, and fraud. The Department is also responsible to ensure that the Bank is compliant with International Sanctions.

The Money Laundering Reporting Officer is the Bank's liaison with the Financial Intelligence Analysis Unit.

The *Compliance Department* is responsible to ensure that the Bank and its subsidiaries operate in line with regulatory requirements. The Compliance Department monitors regulatory developments and assesses the impact and applicability of rules and regulations. It also carries out specific and thematic reviews on various functions, while ensuring that the Group has effective policies for mitigating reputational and conduct risk. It provides regular training on regulatory obligations and requirements emanating from internal policies and procedures.

During 2019 the Nominations and Governance Committee approved changes in the organisation structure. The main change relates to the compliance function that will report directly to the Group Chief Compliance Officer, with a direct reporting line to the Board of Directors.

Key Risks

The Group has specific risk appetite statements for all of its material risks which are reviewed on a regular basis.

The main categories of risk related to the business model to which the Group is exposed are shown in the following table. Further details on how these risks are identified and managed at different levels of the organisation can be found in the relevant sections as highlighted below.

Capital Adequacy Management	The ability to hold sufficient capital to meet both regulatory requirements and shareholder expectations. *[Notes to the Financial statements note 39.7; Pillar 3 disclosures Section 3, 4 and 5]*
Credit Risk	The risk of financial loss if a customer or counterparty fails to meet an obligation under a contract *[Notes to the Financial statement note 39.2; Pillar 3 disclosures Section 6]*
Market Risk	The risk that the fair value or future cash flows will fluctuate because of changes in market prices. Given that the Group does not operate a Trading book, market risk is limited to interest rate risk, currency risk and other price risk. *[Notes to the Financial statement note 39.4; Pillar 3 disclosures Section 7]*
Non-Financial Risks	The risk of losses resulting from inadequate or failed processes, people and internal systems, or from external events. This includes risks related to compliance failures, misconduct, technology or operational losses. *[Pillar 3 disclosures Section 8]*
Liquidity Risk	It is the risk of incurring losses due to the inability of meeting obligations as they become due and can be categorised into two types: • Funding liquidity risk which results when the Group cannot fulfil its obligations due to being unable to obtain new funding. • Market liquidity risk which occurs when the Group is unable to sell or transform its liquidity buffers into cash without incurring significant losses. *[Notes to the Financial statement note 39.3; Pillar 3 disclosures Section 10]*

The BoD, Management Board (MB), the Risk Management Committee and various other committees are presented with risk reports on a regular basis to ensure adequate risk management, enabling them to monitor and continuously manage risks. These reports provide insight on particular risks, highlighting the current position, compliance with set limits and sensitivity analysis. Key risk indicators included in the Risk Appetite Statement are monitored by the BoD on a regular basis to ensure adherence to risk appetite limits. The BoD receives risk reports, including the ICAAP and ILAAP documents which provide a review of the Group's capital and liquidity adequacy.

Section 2: Scope of application of the regulatory framework

The accounting framework used in preparing the consolidation of the Group's financial statements is IFRS as adopted by the EU, whereas the prudential consolidation in the statement of capital is based on CRR 575/2013. The following table provides an overview of the accounting and regulatory consolidation methods for each entity within the Group. Further information on the Group's equity accounted investees and subsidiaries can be found in note 18 and 19 to the Financial Statements, respectively.

Capital & risk management report 31 December 2018 (continued)

EU LI3 - Outline of the differences in the scopes of consolidation (entity by entity)

Name of the entity	Method of accounting consolidation	Method of regulatory consolidation		Description of the entity
		Full consolidation	Deducted	
Bank of Valletta plc	Full consolidation	x		Credit institution
BOV Fund Services Ltd	Full consolidation	x		Fund Administration
BOV Asset Management Ltd	Full consolidation	x		Fund Management
MAPFRE MSV Life plc	Equity method of accounting		x	Life Assurance
MAPFRE Middlesea plc	Equity method of accounting		x	Insurance

Section 3: Own Funds

3.1 Capital Overview

The Group maintains its objective of actively managing capital in an integrated way, seeking to fulfil the regulatory requirements, guarantee solvency, and maximise profit. Through this holistic approach the Group is able to achieve long-term sustainability and identify growth opportunities that provide a sustainable risk-return performance. The Group's capital management approach aims to ensure a sufficient level of capitalisation to absorb unexpected losses from its risk.

Capital metrics and the successful implementation of the ICAAP process are continuously monitored by the BoD, the Asset Liability Management Committee (ALCO), and the MB. The BoD regularly receives information and reports from the lines of defence and all other functions and action is taken on emerging issues of concern. They also ensure that the three lines are operating uniformly and according to best practice. The MB meets on a weekly basis to oversee the overall management of the Bank. The MB formulates risk strategies and risk profiles, including policies that are conducive to the achievement of the organisation's goals. ALCO meets on a monthly basis to analyse financial information and to assess the impact that the various types of risks arising from changes in interest rates, exchange rates and the market, have on the profitability and capital of the Bank. Through this structured monitoring, it is ensured that the Group remains adequately capitalised to achieve the strategic objectives set by the BoD.

The Group has a comfortable solvency position which exceeds the minimum requirements of the European Central Bank (ECB) and other regulations. The Group's Common Equity Tier 1 (CET1) ratio was reported at 18.26% as at end 2018. This improvement in the capital position enabled the Bank to comply with increases in the regulatory capital requirements and to implement the Bank's strategic initiatives. Following this year's results and having taken note of extensive discussions with the regulators, the BoD resolved not to declare an interim dividend and final cash dividend for financial year 2018.

3.2 Capital Instruments

The Group's capital base is composed of CET1 and Tier 2 capital, as defined in Part Two of the CRR. In line with new regulations, the Group is continuously monitoring and focusing towards further strengthening its CET1 capital which is the highest form of quality capital, thus providing the greatest level of protection against losses. The Group's capital base is primarily composed of issued common shares and retained earnings, which form part of CET1 capital – the Group's core capital. In line with the CRR, the Group's capital is subject to relative deductions. The main deductions relate to intangible assets, unrealised gains and losses and the reserve held against the depositor compensation scheme which is an added requirement in national legislation. In accordance with Section 3, Chapter 2, Title I, Part Two of CRR there were no other items requiring deductions from Own Funds. As at the end of the financial year both the Group's significant investments and deferred taxation were below the 10% threshold as stipulated in Article 48(1) of the CRR.

The Group has four subordinated bonds in issue and these are included as part of Tier 2 Capital as they fully qualify for the provisions listed under CRR (575/2013) Part Two, Title 1, Chapter 4, and Article 63. Specifically, these instruments rank after the claim of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled. The 5.35% and the 4.80% Euro subordinated bonds are redeemable at par within the next five years (15 June 2019 and 15 March 2020 respectively) and thus the amortised amount is eligible for inclusion in Own Funds.

In accordance with Article 492 of the CRR, the Group is required to complete an own funds disclosure template set out below.

During the second half of 2019, the Group will issue an Additional Tier 1 Contingent instrument. The Group is planning an issue of €150 million targeted to institutional investors. This capital issue will ensure that the Group is compliant with the EBA's proposed SREP guidelines issued in 2018. Moreover, the Group intends issuing a subordinated bond in the third quarter of 2019 to replace the maturing 5.35% subordinated bond.

Capital & risk management report 31 December 2018 (continued)

	Own funds as at December 2018	**Dec-18**
	CET1 CAPITAL	**€'000s**
	Common Equity Tier 1 capital: instruments and reserves	
1	Capital instruments and the related share premium accounts	580,049
2	Retained earnings	302,086
3	Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards)	50,034
3a	Funds for general banking risk	6,323
6	**Common Equity Tier 1 capital before regulatory adjustments**	**938,492**
	Common Equity Tier 1 (CET1) capital : regulatory adjustments	
8	Intangible assets (net of related tax liability) (negative amount)	(42,043)
18	Direct and indirect holdings by an institution of CET1 instruments of financial sector entities where the institution has a significant investment in those entities	-
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related liability where the conditions in 38 (3) are met, negative amount)	-
	Amount exceeding the 17.65% threshold (negative amount)	
23	*of which: Significant direct and indirect holdings by the institution of the CET1 instruments of financial sector entities*	-
25	*of which: Deferred tax assets arising from temporary differences*	-
	Amount to be deducted from or added to CET1 capital with regard to additional filters and deductions required pre CRR	(43,060)
28	**Total regulatory adjustments to Common Equity Tier 1 (CET1)**	**(85,103)**
29	**Common Equity Tier 1 (CET1) Capital**	**853,389**
	TIER 2 CAPITAL	
46	Capital instruments and the related share premium accounts	133,016
51	**Tier 2 (T2) capital before regulatory adjustments**	133,016
56	Regulatory adjustments applied to Tier 2 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out	
57	**Total regulatory adjustments to Tier 2 (T2)**	**-**
58	**Tier 2 (T2) Capital**	**133,016**
59	**TOTAL CAPITAL**	**986,405**
	TOTAL Risk Weighted Assets	
59a	Risk weighted assets in respect of amounts subject to pre-CRR treatment and transitional treatments	
	of which deferred tax assets not deducted from CET1 capital	179,423
	of which direct holdings by the institution of the CET1 instruments of financial sector entities not included in CET1 capital	132,174
60	**TOTAL Risk Weighted Assets**	**4,673,540**
	Capital ratios and buffers	
62	Tier 1 capital	**18.26%**
63	Total capital	**21.11%**
64	Institution specific buffer requirement	7.91%
65	*of which: capital conservation buffer requirement*	1.88%
66	*of which: countercyclical buffer requirement*	0.03%
67	*of which: Other Systemically Important Institution (O-SII) buffer*	1.50%
68	Common Equity Tier 1 available to meet buffers	13.76%
	Amounts below the thresholds for deductions	
73	The part of the holdings of CET1 instruments of financial sector entities (as defined in Article 4(1)(27) of CRR) where the institution has a significant investment but which is below the 10 % threshold in Article 48(1) point (b) of CRR.	52,870
75	Deferred tax assets arising from temporary differences (amount below 10% threshold)	71,769

Capital & risk management report 31 December 2018 (continued)

In accordance with Part Eight Article 437 of the CRR the following table discloses the main features and the terms and conditions of Tier 1 and Tier 2 instruments.

Capital Instruments Main Features	BOV Ordinary Shares	5.35% BOV Subordinated Bonds 2019	4.8% BOV Subordinated Bonds 2020	3.5% BOV Subordinated Notes 2030 Series 1	3.5% BOV Subordinated Notes 2030 Series 2
1 Issuer	Bank of Valletta plc	Bank of Valletta plc	Bank of Valletta plc	Bank of Valletta plc	Bank of Valletta plc
2 Unique identifier	MT0000020116	MT0000021262	MT0000021270	MT0000021312	MT0000021320
3 Governing Law(s) of the instrument	Maltese Law	Maltese Law	Maltese Law	Maltese Law	Maltese Law
Regulatory Treatment					
4 Transitional CRR rules	Common Equity Tier 1	Tier 2	Tier 2	Tier 2	Tier 2
5 Post-transitional CRR rules	Common Equity Tier 1	Tier 2	Tier 2	Tier 2	Tier 2
6 Eligible at solo/(sub)consolidated / solo & (sub)consolidated	Solo & (Sub) consolidated	Solo & (Sub) consolidated	Solo & (Sub) consolidated	Solo & (Sub) consolidated	Solo & (Sub) consolidated
8 Amount recognised in regulatory capital	EUR 525 million	EUR 4.5 million	EUR 16.9 million	EUR 66.9 million	EUR 44.7 million
9 Nominal amount of instrument	EUR 525 million	EUR 50.0 million	EUR 70.0 million	EUR 66.9 million	EUR 44.7 million
9a Issue Price	N/A	At par (€100 per bond)	At par (€100 per bond)	At par (€100 per bond)	At par (€100 per bond)
9b Redemption Price	N/A	At €100	At €100	At €100	At €100
10 Accounting classification	Share Equity	Liability- amortised cost	Liability- amortised cost	Liability- amortised cost	Liability- amortised cost
11 Original date of issuance	26 August 1992	15 June 2009	15 March 2010	22 December 2015 and 6 April 2016 *	22 December 2015 and 6 April 2016 **
12 Perpetual or dated	N/A	Dated	Dated	Dated	Dated
13 Original maturity date	N/A	15 June 2019	15 March 2020	8 August 2030	8 August 2030
14 Issuer call subject to prior supervisory approval	No	No	No	No	No
Coupons/dividends					
17 Fixed or floating dividend coupon	Floating	Fixed	Fixed	Fixed	Fixed
18 Coupon rate and any related index	N/A	5.35%	4.80%	3.50%	3.50%
19 Existence of dividend stopper	No	No	No	No	No
20a Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary	Mandatory	Mandatory	Mandatory	Mandatory
20b Fully discretionary, partially discretionary or mandatory (in terms of amount)	Partially discretionary	Mandatory	Mandatory	Mandatory	Mandatory
21 Existence of step up or other incentive to redeem	N/A	No	No	No	No
22 Noncumulative or cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative	Non-cumulative
23 Convertible or non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible	Non-convertible
30 Write-down features	No	No	No	No	No
35 Position in subordination hierarchy in liquidation	Subordinated to the Issuer's (BOV) subordinated bonds	Subordinated to other outstanding, unsubordinated and unsecured obligations of the Issuer (BOV), present and future.	Subordinated to other outstanding, unsubordinated and unsecured obligations of the Issuer (BOV), present and future.	Subordinated to other outstanding, unsubordinated and unsecured obligations of the Issuer (BOV), present and future.	Subordinated to other outstanding, unsubordinated and unsecured obligations of the Issuer (BOV), present and future.
Non-compliant transitional features	No	No	No	No	No

* €52,705,800 were issued on 22 December 2015 (Tranche 1 - MT0000021312) and €14,214,700 were issued on 6 April 2016 (Tranche II -MT 0000021338) These two tranches were subsequently merged on 8 August 2016 into ISIN MT0000021312

** €22,294,200 were issued on 22 December 2015(Tranche 1-MT0000021320) and €22,376,200 were issued on 6 April 2016 (Tranche II -MT 0000021346) These two tranches were subsequently merged on 8 August 2016 into ISIN MT0000021320

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3.3 Reconciliation of Own Funds to audited Financial Statements

The table below provides a full reconciliation of the Group's own funds to the statement of financial position within the audited financial statements for the period ended 31 December 2018.

Reconciliation between accounting and regulatory scope of consolidation

	Group 2018 € 000
Common Equity Tier 1	
As per Statement of Financial Position	
Called up share capital	530,772
Share premium account	49,277
Retained earnings	364,050
Revaluation reserves	50,034
Less: Own Funds adjustments	
Investments in Associates	(55,641)
Depositor Compensation Scheme reserve	(43,060)
Intangible assets	(42,043)
	853,389
Tier 2	
As per Statement of Financial Position	
Subordinated liabilities	234,241
Less: Accrued Interest Payable	(2,650)
Amortisation of subordinated loan capital	(98,575)
	133,016
Total Own Funds	**986,405**

Section 4: Capital Requirements (CRR Article 438)

4.1 Overview of Pillar 1 capital requirements

The Group uses the following approaches to calculate the own funds requirements for Pillar I risks.

- The *Standardised Approach for credit risk*. Risk weights for the Treasury Portfolio are determined by taking the worst credit rating provided by eligible External Credit Assessment Institutions (ECAIs) – Fitch, Moody's and S&P. Regulatory risk weights are used for unrated exposures and the lending portfolio.
- The *Basic Indicator Approach for operational risk.* Under this approach the Group allocates capital by taking 15% of the average gross income of the preceding three years.
- The *Basic Method with respect to the Group's foreign exchange risk.* The capital charge for foreign exchange risk using the Basic Method is calculated at 8% of the higher of the sum of all the net short positions and the sum of all the net long positions in each foreign currency.
- A minimum capital requirement is also determined for non-credit obligation assets (i.e. 'other assets' on the balance sheet) in line with the CRD IV 575/2013.

In addition to the above, *Banking Rule BR/15: Capital Buffers of Credit Institutions authorised under the Banking Act, 1994*, requires additional buffers, viz. the Capital Conservation Buffer (CCB), Countercyclical Capital Buffer (CCyB), Other-Systemically Important Institutions (O-SII) buffer, and Systemic Risk Buffer. These buffers are aimed at strengthening the resilience of the Group and have entered into force as from January 2016, with full application as from January 2019. Automatic restrictions on capital distributions apply if the Group's CET1 capital falls below the level of its CRD IV combined buffer.

The Group is also required to maintain an institution-specific CCyB based on the geographical location of the relevant credit exposure. Following Article 130(1) of Directive 2013/36/EU (CRD) the institution-specific countercyclical capital buffer is calculated by multiplying the total risk exposure amount (TREA) with the weighted average of the countercyclical buffer rates as calculated in line with Article 140 CRD. In line with Article 440 of the CRR the table below discloses the geographical distribution of the Group credit exposures relevant for the calculation of the institution-specific CCyB and the amount of the institution specific CCyB.

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Country	Credit Exposure	RWA	Own Funds	CCyB Rate	CCyB Capital Charge
	€000	€000	€000		
Czech Republic	4,596,373	6,894,293	551,543	1.00%	5,515
Lithuania	1,081	811	65	0.50%	0
Norway	10,674,845	4,604,679	368,374	2.00%	7,367
Sweden	33,900,957	22,429,150	1,794,332	2.00%	35,887
United Kingdom	31,452,689	19,992,312	1,599,385	1.00%	15,994
Others	5,400,843,430	2,621,804,498	209,744,360	0.00%	-
	5,481,469,375	**2,675,725,742**	**214,058,059**		**64,764**

Total Risk Exposure Amount	4,673,540,197
Institution Specific Countercyclical Buffer Rate	0.03%
Institution Specific Countercyclical Buffer Requirement	1,413,990

In accordance with Article 438(c) to (f) of the CRR, the following table provides an overview of the total RWA and the capital requirement for credit risk split by the different exposure classes as well as capital for operational risk, foreign exchange risk, and credit valuation adjustment risk. No capital is allocated for market risk as the Bank does not operate a trading book. The Bank has no exposure in items representing securitisation positions. Moreover, the capital allocated to settlement risk and commodities risk is nought. The exposure value is equal to the total on-balance sheet and off-balance sheet net of value adjustments and provisions and post Credit Conversion Factor (CCF). As shown in the table below, during the last financial year the Bank refined the RWA calculation which resulted in a shift of exposures from the Secured by mortgages on immovable property to the Retail and Corporate exposure classes.

EU OV1 – Overview of RWAs

		31 December 2017		31 December 2018	
		RWA amounts	Minimum capital requirements	RWA amounts	Minimum capital requirements
		€000	€000	€000	€000
1	**Credit risk (including CCR)**	**4,322,145**	**345,772**	**4,187,652**	**335,012**
2	of which the standardised approach	4,322,145	345,772	4,187,652	335,012
	Central government or central banks	8,154	652	2,062	165
	Regional government or local authorities	53,263	4,261	39,355	3,148
	Public sector entities	36,624	2,930	36,448	2,916
	Multilateral development banks	-	-	-	-
	International organisations	-	-	-	-
	Institutions	761,014	60,881	666,872	53,350
	Corporates	1,119,653	89,572	1,266,826	101,346
	Retail	288,232	23,059	539,149	43,132
	Secured by mortgages on immovable property	1,319,536	105,563	832,784	66,623
	Exposures in default	163,081	13,046	190,522	15,242
	Items associated with particular high risk	51,599	4,128	110,823	8,866
	Covered bonds	-	-	-	-
	Claims in the form of CIU	-	-	-	-
	Equity exposures	70,106	5,608	46,202	3,696
	Other items	450,883	36,071	456,610	36,529
6	**CCR**	**10,984**	**879**	**20,338**	**1,627**
7	Of which Mark to Market	5,306	424	6,354	508
12	Of which CVA	5,679	454	13,984	1,119
13	**Settlement risk**	**-**	**-**	**-**	**-**
19	**Market risk***	**2,435**	**195**	**1,935**	**155**
20	Of which the standardised approach	2,435	195	1,935	155
23	**Operational risk**	**449,427**	**35,954**	**463,615**	**37,089**
24	of which the basic indicator approach	449,427	35,954	463,615	37,089
27	**Amounts below the thresholds for deduction (subject to 250% risk weight)**	**292,326**	**23,386**	**311,596**	**24,928**
29	**TOTAL CAPITAL REQUIRED**	**4,784,992**	**382,799**	**4,673,540**	**373,883**

**Own Funds allocated for Commodities Risk is equal to zero*

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4.2 Internal Capital Adequacy Assessment Process (ICAAP) and stress testing

The ICAAP document is prepared on an annual basis and includes an assessment of the current and future capital requirements. The main objective of the ICAAP is to ensure that the level of available capital exceeds the bank's minimum regulatory capital requirements, given the Bank's strategy and risk profile. The ICAAP also includes a number of stress tests which are applied to assess the resilience of the Bank's capital to severe but plausible events and identify any potential vulnerabilities. Apart from encompassing the adequacy of capital requirements for Pillar 1 risks, the ICAAP includes the identification of other material residual risks to which the Bank is or might be exposed to as a consequence of its activities and overall environment. These include concentration risk, interest rate risk in the banking book, reputational risks and other material risks. The BoD and senior management strongly believe that the ICAAP will continue to act as an important contribution to the strengthening of the risk management practices and capital adequacy of the Bank.

The Group's internal stress testing is based on various scenarios and sensitivity analysis. On a regular basis various sensitivity assessments are performed on credit risk, interest rate risk and liquidity risk. Stress tests are an important means of analysing the risk profile since they give management a better understanding of how the Group's revenue streams and capital are impacted by macroeconomic changes. The Bank also participates in the Supervisory Review and Evaluation Process (SREP) EU-wide external stress test conducted by the ECB. The purpose of such an exercise is to assess the robustness of the Single Supervisory Mechanism (SSM) banks under stressed conditions and their ability to absorb losses in various economic scenarios.

Section 5: Leverage Ratio (CRR Article 451)

The Leverage Ratio was introduced into the Basel III framework as a non-risk-based backstop limit, to supplement risk-based capital requirements. Its purpose is to limit the leverage effects in the balance sheet as it is a volume-based measure calculated as fully phased in Tier 1 capital divided by Total exposure in line with CRR Article 429. The latter is composed of on-balance sheet assets plus off-balance sheet exposures, such as undrawn commitments and derivatives potential future exposures, less amounts permitted to be deducted for Tier 1 capital.

As at December 2018, the actual leverage ratio increased by 46 basis points to 6.86% (Dec 2017: 6.40%) with a Tier 1 Capital of €853.4 million and with total leverage exposure of €12,438 million. The increase in the ratio is mainly due to Tier 1 capital increasing by a larger percent then the leverage exposure. This lies well above the 3% minimum requirement and thus no additional capital is required. The leverage ratio is monitored and reported to the BoD on a frequent basis in line with the risk appetite framework to ensure that the risk of excessive leverage is managed.

	Leverage Ratio	**Dec-18 €000s**
1	On-balance sheet items (excluding derivatives and SFTs)	12,142,597
2	Asset amounts deducted in determining Tier 1 capital	(85,103)
3	**Total on-balance sheet exposures (excluding derivatives and SFTs)**	**12,057,494**
4	Replacement cost associated with all derivatives transactions	4,391
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	13,786
11	**Total derivatives exposures**	**18,177**
17	Off-balance sheet exposures at gross nominal amount	2,164,605
18	Adjustments for conversion to credit equivalent amounts	(1,802,198)
19	**Total Other off-balance sheet exposures**	**362,408**
20	Tier 1 Capital	853,389
21	Leverage ratio total exposure measure	12,438,079
22	**Actual Leverage Ratio (transitional)**	**6.86%**
	Statutory Minimum	*3.00%*

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

	Summary reconciliation of accounting assets and leverage ratio exposures	**Dec-18 €000s**
1	Total assets as per published financial statements	12,146,988
4	Adjustments for derivatives financial instruments	13,786
6	Adjustments for off-balance sheet items	362,408
7	Other adjustments	(85,103)
8	**Leverage ratio total exposure measure**	**12,438,079**

The following table provides a split-up of the on-balance sheet exposures, excluding derivatives.

	Table LRspl: Split-up of on balance sheet exposures (excludng derivatives, SFTs and exempted exposures)	**Dec-18 €000s**
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	12,142,591
EU-2	Trading book exposures	-
EU-3	Banking book exposures, of which:	12,142,591
EU-4	Covered Bonds	-
EU-5	Exposures treated as sovereign	4,325,171
EU-6	Exposures to regional government, MDB, international organisations and PSE not treated as sovereigns	594,180
EU-7	Institutions	1,881,725
EU-8	Secured by mortgages of immovable properties	2,178,782
EU-9	Retail exposures	768,806
EU-10	Corporate	1,671,199
EU-11	Exposures in default	155,746
EU-12	Other exposures	566,981

Section 6: Credit Risk

6.1 Management of Credit Risk

Credit risk is the risk of suffering financial loss should any of the Bank's counterparties fail to fulfil their contractual payment obligations. The Group's exposure to credit risk arises mainly through its lending and investment activities and represents the Group's largest regulatory capital requirement. This is subject to rigorous monitoring and control.

The credit risk management function is responsible for ensuring that the Bank's credit risk is properly managed. The main objectives of credit risk management are to: (i) maintain a framework of controls to ensure that credit risk-taking is based on sound credit risk management principles; (ii) identify, assess, and measure credit risk clearly, both on an individual level as well as on a portfolio basis, limiting undesirable concentrations of exposure by counterparty, sector and geography; and (iii) monitor credit risk while ensuring that risk-reward objectives are met.

The Bank has in place a number of policies, tailored for each type of business, which articulate the Bank's appetite towards credit risk. These include (i) Business Lending; (ii) Home Loans; (iii) Personal Lending and Credit Cards; (iv) E-Commerce; (v) Trade Finance; (vi) Property Lending; and (vii) Treasury management. These policies are underpinned by core principles related to compliance with the Group's ethical standards, clear definition of responsibilities, the existence and implementation of procedures, limits that ensure a high degree of diversification, and thorough analysis of risk. Procedures for the consideration and monitoring of exceptions to each policy are included in the respective policy document.

Policies are reviewed periodically to keep them aligned with the ever-changing market conditions, new regulations and the Bank's risk appetite, and are approved by the BoD. During the financial year 2018, the Bank focused mainly on the fine-tuning/review and updating of the Business Lending Policy. In order to provide a more succinct articulation of credit quality, parts of the business lending policy were removed and included in other policies mainly related to the management of non-performing loans. These included policies related to (i) Forbearance; (ii) Collateral; (iii) Early Warning Indicators; (iv) Non-performing loans and Arrears Management; (v) Debt Recovery Management; and (vi) Write offs. The Bank is also in the process of updating its Trade Finance and Consumer Lending policies.

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6.2 Approval authorities

The Bank has in place a dual voting system with regards to business related transactions, governed by the Business Credit Policy. New lending facilities are sanctioned through a vote by Business Sanctioning Officers and a vote by Risk Sanctioning Officers, in accordance with the relative limits. For proposals above a certain limit, authorisation is sought from higher levels within the Bank or from the Credit Committee appointed by the BoD. Lending officers are each allocated a voting limit based on their individual capabilities and experience, and the nature and scale of lending in the business unit where they are posted. Voting limits are approved by the Chief Risk Officer and ratified by the Management Board.

Other areas such as Trade Finance, E-Commerce, Debt Management and Consumer Lending exposures exceeding a threshold defined by the Bank, are also subject to the dual voting system and governed by their respective policies.

The dual voting system does not govern other Consumer Lending for which a separate discretionary lending limits system applies, in the majority of cases aided by the use of a credit scorecard. The latter analyses data and grades customers according to their creditworthiness. Borderline cases are referred and become subject to the normal approval process in line with the appropriate discretionary lending limits. The Bank has been using the credit scorecard for a number of years, and this has evolved from a generic to a bespoke application after an adequate history of defaults was accumulated.

The investment portfolio is managed by the Treasury Department and it is the Bank's strategy to buy and hold instruments until maturity rather than for trading purposes. Investment proposals are allocated limits according to the Treasury Management Policy (TMP) with a 'four-eye' approach applied when an investment proposal falls outside the criteria set out in the Bank's TMP. The Credit Risk Sanctioning Department undertakes an independent analysis of proposals which are then submitted to the Credit Committee for their consideration. The Credit Committee's approval is also required for exposures exceeding limit set in the TMP.

6.3 Quantitative information on credit risk exposures

Institutions are required to comply and publicly disclose information in accordance with Article 435(1) of Part Eight of the CRR at least on annual basis.

In accordance with the EBA guidelines on Pillar 3 disclosure requirements, the following table shows the net exposure values, before accounting for the effects of credit risk mitigation, as at December 2018 and December 2017 by exposure classes and the average net exposure value of this financial period; based on the last four end-of-calendar quarter observations.

	EU CRB-B: Total and average net amount of exposures € millions	**Net value of exposures at the end of Dec 2018**	**Average net exposures over the period**	**Net value of exposures as at December 2017**
15	**Total IRB approach**	-	-	-
16	Central governments or central banks	4,337	4,010	3,813
17	Regional governments or local authorities	210	244	264
18	Public sector entities	73	72	73
19	Multilateral development banks	276	197	140
20	International organisations	36	9	-
21	Institutions	1,882	2,019	2,127
22	Corporates	3,146	3,098	3,170
23	Of which: SMEs	2,221	2,042	1,982
24	Retail	1,392	1,172	948
25	Of which: SMEs	108	90	64
26	Secured by mortgages on immovable property	2,179	2,424	2,649
27	Of which: SMEs	492	613	761
28	Exposures in default	199	217	181
29	Items associated with particularly high risk	86	67	37
30	Covered bonds	-	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-	-
32	Collective investments undertakings	-	-	-
33	Equity exposures	46	60	70
34	Other exposures	446	431	428
35	**Total Standardised Approach**	**14,307**	**14,019**	**13,899**
36	**Total**	**14,307**	**14,019**	**13,899**

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6.3.1 Concentration Risk

Concentration risk occurs when the Bank has significant exposures to one counterparty or to a group of connected counterparties, or to counterparties with similar characteristics within a given economic sector or to counterparty operating in the same geographical area. The Bank experiences concentration risk in its lending and investment activities due to the structure of the local economy and the size of the domestic financial sector.

As part of the Group's credit risk management approach and in order to avoid undue concentrations, the Bank has systems in place to identify, measure and monitor Single Name, Sectoral and Geographical concentrations. The systems and controls allow the Bank to ensure adherence to prudential limits set by the BoD and/or the Regulatory Authority to single counterparty or groups of related counterparties; the Board and senior management being informed on a regular basis on the level of concentration in the Bank's portfolio.

In terms of the Bank's Risk Appetite Framework (RAF), the Bank has defined and regularly monitors the following indicators related to concentration risk:

(a) Single-name exposure by Sovereign to CET1;
(b) Sectoral exposure by property lending to CET1;
(c) Non-performing loans ratio (NPL ratio as defined by EBA);
(d) Coverage ratio which gauges the degree of credit risk mitigation relating to NPLs.

Furthermore, the Bank is at all times compliant with CRR Article 395 relating to large exposures to single names including connected clients.

At the present time, the Bank does not make use of credit default swaps (CDS) and does not practice netting of on- and off-balance sheet exposures as a credit risk mitigation technique. Information on the total exposure amount covered by financial guarantees is provided in EU CR3 in section 6.1.5.

The Bank analyses its concentration risk in the advances and investment portfolios. The Herfindahl-Hirschman Index (HHI) calculated using risk-weighted assets to better reflect the degree of risk sensitivity is used to assign a capital add-on (%) to credit risk. This results in an amount of capital allocated against concentration risk under Pillar2.

The following tables show the distribution of the exposures (net values of on-balance sheet and off-balance sheet) by geographical distribution, industry and residual maturity broken down by exposure classes in line with CRR Article 442(d/e/f).

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EU CRB-C: Geographical breakdown of exposures € millions		Net value								
		MALTA	GERMANY	FRANCE	UNITED KINGDOM	UNITED STATES	NETHERLANDS	AUSTRALIA	OTHER COUNTRIES	TOTAL
6	**Total IRB approach**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
7	Central governments or central banks	3,858	172	44	-	-	6	-	257	4,337
8	Regional governments or local authorities	53	12	35	-	-	26	-	84	210
9	Public sector entities	73	-	-	-	-	-	-	-	73
10	Multilateral development banks	-	-	-	-	-	-	-	276	276
11	International organisations	-	-	-	-	-	-	-	36	36
12	Institutions	40	138	184	244	114	123	196	843	1,882
13	Corporates	2,724	33	45	23	118	78	-	125	3,146
14	Retail	1,388	0	0	1	0	0	0	3	1,392
15	Secured by mortgages on immovable property	2,157	0	2	6	2	0	1	11	2,179
16	Exposures in default	194	-	-	0	-	-	-	5	199
17	Items associated with particularly high risk	86	-	-	-	-	-	-	-	86
18	Covered bonds	-	-	-	-	-	-	-	-	-
19	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-
20	Collective investments undertakings	-	-	-	-	-	-	-	-	-
21	Equity exposures	24	-	-	1	6	-	-	14	46
22	Other exposures	446	-	-	-	-	-	-	-	446
23	**Total standardised approach**	**11,043**	**355**	**310**	**276**	**240**	**233**	**196**	**1,654**	**14,307**
24	**Total**	**11,043**	**355**	**310**	**276**	**240**	**233**	**196**	**1,654**	**14,307**

Note to EU CRB-C Table: 'Other countries' account for circa 12% of the total net exposure value; this grouping comprises 45 different countries. The main ones are Canada, Sweden, Norway, Belgium and Austria.

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	EU CRB-D: Concentration of exposures by industry or counterparty types € millions	Financial and Insurance Activities	Households and Individuals	Public administration and defence, compulsory social security	Wholesale and retail trade	Manufacturing	Transportation and storage	Others	Total
6	**Total IRB approach**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
7	Central governments or central banks	3,254	-	1,079	-	-	-	4	4,337
8	Regional governments or local authorities	-	-	192	0	-	11	8	210
9	Public sector entities	-	-	73	-	-	-	-	73
10	Multilateral development banks	-	-	276	-	-	-	-	276
11	International organisations	-	-	36	-	-	-	-	36
12	Institutions	1,882	-	-	-	-	-	-	1,882
13	Corporates	571	31	1	478	191	158	1,717	3,146
	of which: SMEs	270	0	1	402	115	139	1,294	2,221
14	Retail	5	1,169	-	81	22	8	107	1,392
	of which: SMEs	5	0	-	39	16	3	46	109
15	Secured by mortgages on immovable property	24	1,568	0	126	58	19	383	2,179
	of which: SMEs	24	-	0	102	43	18	305	493
16	Exposures in default	2	37	-	21	14	29	96	199
17	Items associated with particularly high risk	27	4	-	5	1	0	50	86
18	Covered bonds	-	-	-	-	-	-	-	-
19	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-
20	Collective investments undertakings	-	-	-	-	-	-	-	-
21	Equity exposures	12	-	17	-	-	-	17	46
22	Other exposures	-	-	-	-	-	-	446	446
23	**Total standardised approach**	**5,778**	**2,809**	**1,673**	**710**	**285**	**225**	**2,827**	**14,307**
24	**Total**	**5,778**	**2,809**	**1,673**	**710**	**285**	**225**	**2,827**	**14,307**

Note to EU CRB-D Table: The industry being quoted in this table is by NACE Level 1 of the debtor.

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EU CRB-E: Maturity of Exposures € millions		Net Exposure Value On demand	<= 1 year	> 1 year <= 5 years	> 5 years	No stated maturity	Total
6	**Total IRB approach**	**-**	**-**	**-**	**-**	**-**	**-**
7	Central governments or central banks	3	3,492	478	360	4	4,337
8	Regional governments or local authorities	2	69	89	51	0	210
9	Public sector entities	-	-	-	73	-	73
10	Multilateral development banks	-	34	186	56	-	276
11	International organisations	-	-	31	5	-	36
12	Institutions	262	611	999	10	-	1,882
13	Corporates	624	266	358	1,084	814	3,146
	of which: SMEs	830	56	16	705	614	2,221
14	Retail	109	247	94	596	346	1,392
	of which: SMEs	41	3	18	48	-	109
15	Secured by mortgages on immovable property	125	4	88	1,962	-	2,179
	of which: SMEs	109	3	72	309	-	493
16	Exposures in default	49	34	24	55	37	199
17	Items associated with particularly high risk	13	12	40	17	5	86
18	Covered bonds	-	-	-	-	-	-
19	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-
20	Collective investments undertakings	-	-	-	-	-	-
21	Equity exposures	-	-	-	-	46	46
22	Other exposures	-	-	-	-	446	446
23	**Total standardised approach**	**1,187**	**4,767**	**2,385**	**4,268**	**1,699**	**14,307**
24	**Total**	**1,187**	**4,767**	**2,385**	**4,268**	**1,699**	**14,307**

6.4 Credit Risk Adjustments

6.4.1 Past due and Impaired

In accordance with Article 178 of the CRR, the Bank defines non-performing exposures (NPL) as those that satisfy either or both of the following criteria: (i) material exposures which are more than 90 days past due; and/or (ii) the debtor is assessed as unlikely to pay (UTP) its credit obligations in full without realisation of collateral, regardless of the existence of any past due amount or of the number of days past due.

As from 1st January 2018, the Bank adopted IFRS 9 and approved the new Provisioning Policy. The new framework outlines a ‘three-stage’ model for impairment based on changes in credit quality since initial recognition:

- Stage 1 – performing exposures which are not credit-impaired;
- Stage 2 – underperforming exposures where a significant increase in credit risk was determined; and
- Stage 3 – nonperforming exposures which are credit-impaired.

Under IFRS 9, a financial asset is deemed to be credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset, have occurred. Evidence that a financial asset is credit-impaired include observable data about a number of events, namely significant financial difficulty on the part of the issuer or borrower, a breach of contract (such as a default or past due event), and when a concession has been granted to the borrower by the lender due to the borrower’s financial difficulty. A specific allowance is set aside to cover the unsecured portion when cash flows from operations plus the estimated realisable value of any collateral held are considered insufficient to recover the full exposure.

The Bank has a comprehensive internal rating system designed to reflect the risk inherent in each lending relationship, identify problematic loans in a timely manner and thereby assist in the creation of a quality loan book. The Bank’s loan portfolio is analysed according to the twelve grading levels within the internal credit rating system. The relative rating is primarily determined by the operating performance of the account and by other qualitative criteria. Exposures are analysed on a regular basis to determine whether there is impairment in the customer’s business which merits a change in rating. For regulatory and high level internal reporting, the twelve grading levels are regrouped in three categories: Performing, Under-performing and Non-performing in line with the three stages of the IFRS 9 model.

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6.4.2 Impairment Allowances and Coverage

The Provisions Committee is responsible for developing and maintaining the Bank's provisioning methodology. It is composed of representatives from the following functions: Finance, Risk, Debt Management and Credit with the latter attending as observers.

IFRS 9 replaced the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. Since a forward-looking approach is adopted, the occurrence of a credit event is not a prerequisite for the quantification of probable credit losses as at reporting date. The ECL is determined by multiplying the exposure at default (EAD) by the probabilities of default (PDs) and also includes an adjustment relating to the effective recovery rates post-default. The PDs are projected over a future time horizon on the basis of three alternative macroeconomic scenarios – base, downside, and upside – as required by the IFRS 9 accounting standard. Further detail on the calculation of the ECL can be found in the note 39.2.1.2 to financial statements.

As defined in Regulation 183/2014 the following shall be classified as specific credit adjustments:

a) losses recognised in the profit or loss account for instruments measured at fair value that represent credit risk impairment under the applicable accounting framework;
b) losses as a result of current or past events affecting certain exposures;
c) losses for which historical experience, adjusted on the basis of current observable data, indicates that the loss has occurred but the institution is not yet aware which individual exposure has suffered these losses.

Accordingly, the Group's impairment allowances calculated under IFRS 9 are classified as specific credit risk adjustments and in line with CRR article 111 are deducted from the accounting values in order to determine the exposure value of an asset for risk weighted assets calculations. (Further details related to impairment allowances can be found in the following notes to the Financial Statements – 17; 39.2) The Group does not account for any general credit risk adjustments.

6.4.3 External Credit Assessment Institutions (ECAIs)

The Standardized Approach (SA) requires banks to use the risk assessments prepared by ECAIs to be able to determine the risk weights to be applied. For treasury investments, the Bank uses three of the EBA recognized ECAIs – Fitch, Moody's and S&P - and uses the worst of the best two approach in line with the CRR for capital allocation purposes. The Bank maps these external rating to the credit quality steps in line with EBA guidelines. Where no external rating is available, the standardized approach provide specific risk weights which need to be applied depending mainly on the counterparty type.

Credit Quality Step	Fitch	S&P	Moody's
1	AAA to AA-	AAA to AA-	Aaa to Aa3
2	A+ to A-	A+ to A-	A1 to A3
3	BBB+ to BBB-	BBB+ to BBB-	Baa1 to Baa3
4	BB+ to BB-	BB+ to BB-	Ba1 to Ba3
5	B+ to B-	B+ to B-	B1 to B3
6	CCC+ and below	CCC+ and below	Caa1 and below

6.4.4 Credit quality of the Bank's exposures

In line with the EBA guidelines on disclosures, the tables below provide information on the credit quality of the Bank's assets by exposure class, industry and geography as at December 2018. Impaired exposures are equal to the defaulted exposures which are classified as IFRS 9 Stage 3 exposures.

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	EU CR1-A: Credit quality of exposures by exposure class and instrument € millions	Gross carrying values of Defaulted exposures	Gross carrying values of Non-defaulted exposures	Specific credit risk adjustment	Accumulated write-offs*	Credit risk adjustment charges of the period	Net values
15	**Total IRB approach**	-	-	-	-	-	-
16	Central governments or central banks	-	4,337	0	-	-	4,337
17	Regional governments or local authorities	-	210	0	-	2	210
18	Public sector entities	-	73	0	-	-	73
19	Multilateral development banks	-	276	0	-	-	276
20	International organisations	-	36	0	-	-	36
21	Institutions	-	1,881	0	-	-	1,881
22	Corporates	-	3,172	26	-	16	3,146
23	Of which: SMEs	-	2,243	22	-	12	2,221
24	Retail	-	1,404	11	-	4	1,392
25	Of which: SMEs	-	110	2	-	1	108
26	Secured by mortgages on immovable property	-	2,180	2	-	-	2,179
27	Of which: SMEs	-	493	1	-	-	492
28	Exposures in default	278	-	78	28	15	200
	Of which: SMEs	165	-	56	28	1	109
29	Items associated with particularly high risk	-	94	9	0	0	86
30	Covered bonds	-	-	-	-	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-
32	Collective investments undertakings	-	-	-	-	-	-
33	Equity exposures	-	46	-	-	-	46
34	Other exposures	-	446	-	-	-	446
35	**Total standardised approach**	**278**	**14,155**	**126**	**29**	**38**	**14,307**
36	**Total**	**278**	**14,155**	**126**	**29**	**38**	**14,307**
37	Of which: Loans and advances	245	7,970	126	-	38	8,090
38	Of which: Debt securities	-	3,422	-	-	-	3,422
39	Of which: Off-balance-sheet exposures	33	2,763	-	-	-	2,795

* Accumulated write-offs for the period October 2011 to December 2018
* Credit risk adjustment charges include additions (ECL movement) and new accounts.

EU CR1-B: Credit quality of exposures by industry or counterparty types € millions	Gross carrying values of Defaulted exposures	Gross carrying values of Non-defaulted exposures	Specific credit risk adjustment	Accumulated write-offs*	Credit risk adjustment charges	Net values
Financial and Insurance Activities	3	5,779	4	1	2	5,778
Households and Individuals	50	2,780	22	3	7	2,809
Manufacturing	22	275	13	5	4	285
Public administration and defence, compulsory social security	0	1,672	0	-	0	1,673
Transportation and storage	32	197	4	-	1	225
Wholesale and retail trade	30	694	14	1	5	710
Others	140	2,759	70	19	19	2,828
Total	**278**	**14,155**	**126**	**29**	**38**	**14,307**

Note to EU CR1-B Table: The industry being quoted in this table is by NALE Level 1 of the debtor.
Note - Net Values is equal to Gross carrying values less credit risk adjustments

* Accumulated write-offs for the period October 2011 to December 2018
* Credit risk adjustment charges include additions (ECL movement) and new accounts.

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EU CR1-C: Credit quality of exposures by geography € millions	Gross carrying values of					
	Defaulted exposures	Non-defaulted exposures	Specific credit risk adjustment	Accumulated write-offs*	Credit risk adjustment charges	Net values
MALTA	272	10,896	126	29	38	11,043
GERMANY	-	356	0	-	0	356
FRANCE	-	310	0	-	0	310
UNITED KINGDOM	1	275	0	-	0	276
UNITED STATES	-	240	0	-	0	240
NETHERLANDS	-	233	0	-	0	233
AUSTRALIA	-	196	0	0	-	196
OTHERS	5	1,649	-	0	-	1,654
Total	**278**	**14,155**	**126**	**29**	**38**	**14,307**

* Accumulated write-offs for the period October 2011 to December 2018
* Credit risk adjustment changes include additions (ECL movement) and new accounts.

The following table provides an ageing analysis of accounting on-balance sheet past due exposures regardless of their impairment status. None of the debt securities were past due as at end of the financial period 2018.

EU CR1-D: Ageing of past-due exposures € millions		Gross carrying values					
		≤ 30 days	> 30 days ≤ 60 days	> 60 days ≤ 90 days	> 90 days ≤ 180 days	> 180 days ≤ 1 year	> 1 year
1	Loans	113	24	6	26	13	108
2	Debt securities	-	-	-	-	-	-
3	**Total exposures**	**113**	**24**	**6**	**26**	**13**	**108**

The Bank has in place various units set up with the aim of assisting obligors at an early stage and thereby helping prevent migration to non-performing state. When the latter has already occurred or is deemed inevitable, other units focus on reducing, remediating or recovering non-performing loans. Each unit, depending on the stage, exposure and severity of the Non-performing Loans (NPLs), has its internal procedures in order to strive towards achieving the desired results.

As from 2018, the Bank has finalised the policies and procedures regarding the management of NPLs. The new NPL process has warranted greater independence in the management of such exposures and to this effect, a new department – the Business Support Department was set up to carry out this function. A Non-performing Loans Committee was formed with a view to enhance monitoring over exposures displaying an increased likelihood of default.

During the financial year 2018, the Bank continued with its write-off exercise on non-performing loans wherein a number of exposures were transferred off-balance sheet. The Write-offs Committee is entrusted with the sanctioning of definite write-offs as per limits defined by the Board of Directors. The below tables provide a breakdown of the amount of exposures written-off during 2018 by number of days delinquent segregated by exposure class, economic sector and geography.

Exposures written off (in Million EUR) in 2018 by exposure class	Days Delinquent							
	≤ 30 days	> 90 days ≤ 180 days	> 180 days ≤ 1 year	> 1 year	NA	Total	Specific credit risk adjustment	P&L Impact
High Risk Areas	-	-	-	0	15	16	15	1
Past Due 90 Days+	0	0	0	30	1	31	19	12
Total	0	0	0	30	17	47	34	13

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Exposure written off (in € Million) in 2018 by economic sector	Days Delinquent ≤ 30 days	> 90 days ≤ 180 days	> 180 days ≤ 1 year	> 1 year	NA	Total	Specific credit risk adjustment	P&L Impact
Accommodation and food service activities	-	-	-	12	0	12	8	4
Construction	-	-	-	1	0	1	0	0
Financial and Insurance Activities	-	-	-	1	0	1	1	1
Human health services and social work activities	-	-	-	2	-	2	1	1
Manufacturing	-	-	-	8	0	8	6	2
Households and Individuals	0	0	0	1	1	2	0	2
Real estate activities	-	-	-	1	15	16	15	1
Wholesale and retail trade	0	-	-	5	1	5	3	2
Total	0	0	0	30	17	47	34	13

Exposures written off (in € Million) in 2018 by country	Days Delinquent ≤ 30 days	> 90 days ≤ 180 days	> 180 days ≤ 1 year	> 1 year	NA	Total	Specific credit risk adjustment	P&L Impact
MALTA	0	0	0	30	17	47	34	13
Total	0	0	0	30	17	47	34	13

Forbearance measures represent concessions granted by the Bank to borrowers when they are considered to be unable to meet the original terms and conditions of the contract due to financial difficulties. Through forbearance measures, the Bank may modify the terms and conditions of the contract to allow the borrower sufficient ability to service the debt or refinance the contract. Rigorous assessment is undertaken to ensure that restructuring is only allowed in those cases where the underlying fundamentals are sound and where the customer is expected to meet the revised obligations. When the concession is due to financial difficulty, the account is marked as forborne. As part of its asset quality measure, CRMU reviews the financial difficulty tests and determines whether the facility is to be categorised as Forborne.

The table below provides an overview of non-performing and forborne exposures as at 31 December 2018.

EU CR1-E: Non-performing and forborne exposures € millions		Gross carrying values of performing and non-performing exposures						
			Of which performing but past due > 30 days and < = 90 days	Of which performing forborne	Of which non-performing			
						Of which defaulted	Of which impaired	Of which forborne
010	Debt securities	3,422	-	-	-	-	-	-
020	Loans and advances	8,350	20	16	244	-	244	102
030	Off-balance sheet exposures	2,795	NA	1	57	-	NA	1

€ millions		Accumulated impairment and provisions and negative fair value adjustments due to credit risk				Collaterals and financial guarantees received	
		On performing exposures		On non-performing exposures		On non-performing exposures	Of which forborne exposures
			Of which forborne		Of which forborne		
010	Debt securities	1	-	-	-	-	-
020	Loans and advances	28	2	79	33	164	-
030	Off-balance sheet exposures	9	-	10	-	-	-

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6.5 Credit Risk Analysis and Mitigation

An assessment of the borrower's ability to service and repay the proposed debt is undertaken for each credit request and is a key element when considering an application for credit. In particular, before making any commitments, the Bank carries out an in-depth review of the borrower and ensures that it has a thorough knowledge of all the structural aspects of the borrower's operations and that adequate monitoring will be possible. Consideration is also given to the sector in which the borrower operates in terms of economic prospects and potential growth along with the Bank's sectoral default history.

All credit exposures are regularly reviewed for objective evidence of impairment, either individually or as part of a collective assessment, with a view to taking early recovery action. In addition, hindsight overviews are carried out on a sample basis by CRMU to strengthen the credit decision-making process wherein the judgement of the initial decision-makers is reviewed to determine the extent to which such decision-makers were in compliance with Bank policies and procedures in approving the credit application concerned. This ensures that the quality of the lending portfolio is properly and regularly monitored by an independent authority, so that any necessary remedial action can be taken.

The granting of credit facilities is primarily based on the capacity to repay, rather than placing primary reliance on credit risk mitigants. The mitigation of credit risk is however a key aspect of effective risk management used to address the risk inherent in individual exposures. The nature and level of collateral required depends on a number of factors, including but not limited to: the amount of the exposure; the type of facility provided; the term of the facility; the amount of the counterparty's contribution; and an evaluation of the level of the credit risk or probability of default involved. The main types of collateral accepted by the Bank are listed in the Collateral Policy.

Collateral is taken into account at a haircut which is applied to the market value and is only accepted as the main source of repayment in property development and other exceptional cases. The Collateral Policy includes details on the requirements of the appraisers and the valuation methodologies. Immovable properties held as collateral against material exposures are subject to regular revaluation in order to maintain a constant true picture of their values. The Bank also monitors the value of immovable properties regularly, mainly through the use of the property price index. This ensures that the value being relied on as collateral adequately reflects the current value of the property. The Bank's collateral policy includes also details on the collateral valuations at recovery stage as well as those properties which are ready for disposal by the Bank.

At facility sanctioning stage, the Bank also mitigates credit risk through the adoption of terms and provisions known as covenants - both financial and non-financial – which allows the Bank to take action when a borrower's default risk increases. These may permit a reduction of the maximum amount of borrowing under the commitment, increases in collateral, repricing and, in a worst-case scenario, a call-in of facilities.

Investment exposures and limits are regularly reviewed upon changes in credit ratings or outlook so as to prompt any mitigating action if required. Credit risk in the investment portfolio is mitigated through limits set in the TMP. These limits are set on the level of credit risk undertaken in relation to any counterparty exposure in accordance with external ratings issued by major rating agencies. The TMP also sets limits in respect of settlements and derivatives.

Settlement risk is the risk of loss due to failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed. This risk is mitigated through settlement limits assigned to counterparties based on external credit ratings or by effecting payment on a delivery versus payment (DVP) basis.

6.5.1 Quantitative information on credit risk mitigation

The tables below provide information on the balance sheet exposure value (carrying amount net of provisions), that is covered by eligible collateral in line with CRR requirements.

EU CR3: CRM techniques - Overview € millions		**Exposures Total unsecured - Carrying amount**	**Exposures Total secured - Carrying amount**	**Exposures secured by Immovable Property collateral**	**Exposures secured by Financial Guarantees**	**Exposures secured by Credit Derivatives**	**Exposures secured by Other Eligible Collateral**
1	Total Loans and Advances	5,547	2,699	2,199	389	-	111
2	Total Debt Securities	3,422	-	-	-	-	-
3	**Total exposures**	**8,969**	**2,699**	**2,199**	**389**	**-**	**111**
4	*of which Defaulted*	*125*	*44*	*42*	-	-	*2*

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	EU CR4 – Standardised approach – Credit risk exposure and CRM effects € millions	Exposures net of provisions before CCF and CRM		Exposures post CFF and CRM		RWA after SME factor and RWA density	
		On-Balance sheet amount	Off-Balance sheet amount	On-Balance sheet amount	Off-Balance sheet amount	RWAs	RWA density
1	Central governments or central banks	4,325	12	4,325	1	2	0.05%
2	Regional government or local authorities	210	0	210	0	39	18.74%
3	Public sector entities	73	-	73	-	36	50.00%
4	Multilateral development banks	276	-	276	-	-	0.00%
5	International organisations	36	-	36	-	-	0.00%
6	Institutions	1,882	-	1,882	-	667	35.44%
7	Corporates	1,671	1,475	1,303	194	1,267	84.58%
8	Retail	769	624	690	59	539	71.98%
9	Secured by mortgages on immovable property	2,179	-	2,179	-	833	38.23%
10	Exposures in default	156	43	142	11	191	124.76%
11	Exposures associated with particularly high risk	75	11	73	1	111	150.00%
15	Equity	46	-	46	-	46	100.00%
16	Other items	446	-	446	-	457	102.39%
17	**Total**	**12,143**	**2,165**	**11,680**	**266**	**4,188**	**35.05%**

EU CR5: Standardised approach Exposure Value € millions	Risk Weight								
	0%	20%	35%	50%	75%	100%	150%	250%	Total
Central governments or central banks	4,316	10	-	-	-	-	-	-	4,326
Regional government or local authorities	53	147	-	-	-	10	-	-	210
Public sector entities	-	-	-	73	-	-	-	-	73
Multilateral development banks	276	-	-	-	-	-	-	-	276
International organisations	36	-	-	-	-	-	-	-	36
Institutions	-	1,000	-	838	-	35	9	-	1,882
Corporates	-	168	-	176	-	1,154	-	-	1,498
Retail	-	-	-	-	749	-	-	-	749
Secured by mortgages on immovable property	-	-	1,586	592	-	-	-	-	2,179
Exposures in default	-	-	-	-	-	77	76	-	153
Exposures associated with particularly high risk	-	-	-	-	-	-	74	-	74
Covered bonds	-	-	-	-	-	-	-	-	-
Institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-
Collective investment undertakings	-	-	-	-	-	-	-	-	-
Equity	-	-	-	-	-	46	-	-	46
Other items	165	14	-	-	-	142	-	125	446
Total	**4,845**	**1,340**	**1,586**	**1,679**	**749**	**1,464**	**158**	**125**	**11,946**

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6.6 Counterparty Credit Risk

The CRR defines 'counterparty credit risk' (CCR) as the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. The Group is exposed to CCR through it's over the counter (OTC) derivative exposures, which are used to hedge against adverse interest rate and currency movements. To calculate the CCR, the Group follows the Mark-to-Market approach (as defined in Article 274 of the CRR) where a pre-defined add-on is added to the current positive fair value of the contract, taking into consideration the netting arrangements in place. This is prepared with the purpose of accounting for potential future changes (as per Article 298 of the CRR).

EU CCR1 - Analysis of CCR exposure by approach
€ millions

		Replacement cost/current market value	Potential future credit exposure	EAD post CRM	RWAs
1	Mark to market	1.02	7.02	8.04	5.31

EU CCR3 – Standardised approach – CCR exposures by regulatory portfolio and risk
€ millions

		Risk Weight													
		0%	2%	4%	10%	20%	35%	50%	70%	75%	100%	150%	Others	Total	of which unrated
6	Institutions			5.49		4.83		5.39						15.71	
7	Corporates										0.38			0.38	0.38
10	Other items*										2.10			2.10	2.10
11	**Total**			**5.49**		**4.83**		**5.39**			**2.48**			**18.19**	**2.48**

**These include derivatives which serve as 'back-to-back' to derivatives created for Collective Investment Schemes.*

EU CCR8 - Exposures to CCPs
€ millions

		a	b
		EAD post CRM	RWAs
1	Exposures to QCCPs (total)	5.49	4.22
2	Exposures for trades at QCCPs (excluding initial margin and default fund contributions); of which	5.49	4.22
4	(ii) Exchange traded derivatives	5.49	4.22
11	Exposures to non-QCCPs (total)	12.69	9.76
12	Exposures for trades at non-QCCPs (excluding initial margin and default fund contributions); of which	12.69	9.76
13	(i) OTC derivatives	12.69	9.76

Internal limits and collateral management procedures are in place to address situations where the probability of default of a particular counterparty is positively correlated to the exposure with the same counterparty. This is referred to as wrong way risk, whereby both the mark-to-market exposure and the riskiness of the counterparty, increase simultaneously. The TMP, which sets the limits on the maximum exposures held in derivatives, assumes that the business relationship with most counterparties is an ongoing one; therefore the limits are primarily based on the worst long-term credit rating of the counterparty. For requests falling outside the TMP, these are also reviewed by Credit Risk Sanctioning Department and approved by the Chief Risk Officer or the BoD according to the exposure. Limits are reviewed annually or more frequently in the event of a downgrade of the counterparty. The Finance Department monitors on a monthly basis the hedge effectiveness of the Bank's derivatives.

The Bank ensures that an ISDA agreement with the respective counterparties is in place prior to effecting a transaction and that the agreement covers the deal in question. Furthermore, in order to secure the collateral, the Bank enters into an agreement with the counterparties in accordance with the Credit Support Annex (CSA) under the ISDA agreement. The CSA is a schedule to the ISDA Master Agreement. By virtue of such CSAs, a party to a derivative that has exposure to its counterpart will post collateral to cover such exposure by way of an outright title transfer of such collateral. All CSAs that the Bank has in place are of a two-way nature. Variation margin is exchanged on a daily basis.

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The Credit Rating Downgrade Threshold clause in some CSA agreements is designed to trigger a series of events which may include the termination of transactions by the non-affected party if the credit rating of the affected party falls below a specified level. Nevertheless, the amount of collateral posted will not change in the event the Bank suffers a credit rating downgrade. The Bank does not have any credit derivative hedges in place and does not hold any credit reserves with respect to counterparty credit risk, since the collaterals and margins in place are deemed to suffice.

'Credit Valuation Adjustment' (CVA) is defined by the CRR as an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty. This adjustment reflects potential mark-to-market losses due to counterparty migration risk on bilateral OTC derivative contracts. The CVA charge is computed in accordance with the Standardised Method as defined in Article 384 of the CRR.

EU CCR2 – CVA capital charge

€ millions		Exposure value	RWAs
4	All portfolios subject to the standardised method	18.18	13.98

Section 7: Market Risk

7.1 Nature of Market Risk

Market risk is the risk that the Bank's earnings or capital will be adversely affected by the volatility of market rates or prices such as interest rate, credit spread and foreign exchange rates. The Group's exposure to market risk is limited given that it does not operate a trading book. Accordingly, the Group's exposure to market risk comprises three types of risk: (i) interest rate risk in the banking book; (ii) currency risk; and (iii) equity price risk.

7.2 Interest Rate Risk in the Banking Book

Interest rate risk refers to the probability of incurring financial losses due to adverse movements in the interest rates. The Bank is exposed to Interest Rate Risk in the Banking Book (IRRBB) from mismatches between interest rate sensitive assets and liabilities held in the banking book. The institution does not hold a trading book and is exempted from trading book capital requirements in terms of CRR Article 94.

The Bank has an Interest Rate Risk Policy which clearly describes the approaches through which interest rate risk is identified, evaluated, monitored, managed, and reported to higher management. The Policy also outlines the structure, responsibilities, and controls that manage, oversee, and control the interest rate positions of the Bank, respectively.

The Bank's exposure to interest rate risk is monitored and evaluated on a monthly basis by the Risk Management Department (RMD) and Asset Liability Management Committee (ALCO). The RMD is the owner of the Interest Rate Risk Policy; its main role is to establish prudent interest rate risk management principles, set up adequate risk control procedures, and provide relevant recommendations to ALCO. The principal role of ALCO is that of managing the balance sheet to attain an optimal balance between risk – in particular solvency and market risks – and return. Additionally, ALCO has the role of executing advice on risk and return towards the business as well as exercising executive authority in the field of interest rate management.

The Board of Directors is ultimately responsible for the interest rate risk assumed by the Bank and the manner in which this risk is managed to ensure that it is aligned with the interest rate risk strategy and risk appetite.

7.2.1 The Measurement of Interest Rate Risk

Risk management processes are in place to contain and limit the interest rate risk exposure without negatively affecting the profitability of the Bank. IRRBB is quantified, managed, and controlled under two distinct but complimentary approaches viz. the economic value of equity (EVE) and the earnings-based approach. Both approaches measure risk on the hypothesis of a constant balance sheet and of an unchanged or stable business model through the projection period. The Bank's interest rate risk quantification model is re-run on a quarterly basis.

The EVE approach measures the interest rate risk by observing the change in the theoretical value of the banking book. On the other hand, the earnings-based approach focuses on the impact on the net interest income following changes in the interest rates.

Impact on the Economic Value of Equity

As the interest rate increases/decreases, the monetary value of owning an instrument offering a fixed rate of interest decreases/increases. If this position is not perfectly offset by changes in the value of other instruments held by the Bank – thereby, in technical risk terms, denoting an open position – an economic loss materialises. Such open positions mostly result from differences in the nominal/principal values, varied residual terms to maturities and different interest rate reset dates.

The economic loss (or gain) is estimated through the interest rate term structure – commonly referred to as the yield curve – which measures the relationship between the discount rates and the time to maturity. Changes to the yield curve – in technical risk terms, the curve risk – are a reflection of the anticipated future interest rates, inflation and economic growth.

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The discount rate provides the present value of the Bank's expected future cash flows. It is representative of a risk-free yield curve and is generally a representation of either the secured interest rate swap curve or, in the absence of such, a high credit rating government yield curve.

In case of positions with no contractual maturity, these are slotted in the Overnight bucket except for a share of the Non-Maturity Deposits (NMDs). NMDs are characterised by a lack of defined contractual maturity and to this effect, depositors may withdraw the available balance without prior notice. Nonetheless, a significant share of the on-demand deposits is stable over time; such is referred to as 'core deposits'. Core deposits are highly unlikely to reprice as a result of changes in the interest rates. Therefore, this share of deposits is reallocated into different short- and medium-term time buckets based on the behaviours of the customers and split according to depositor characteristics into core and non-core deposits. The data fed into the model relating to interest cash outflows and inflows, is based on a series of recent historical monthly figures, which pattern is extrapolated over a future 12-month horizon. Accordingly, the effect of prepayments on interest cash flows is inherently captured in the methodology applied.

Impact on the Net Interest Income

Interest rate changes affect the sensitivity of earnings in the short-term by changing the magnitude of net interest income and the level of other interest sensitive income and expenses. This approach provides information necessary to manage and optimize the risk-return position as well as the structure of the balance sheet from an earnings based point of view.

ALCO monitors on a regular basis the current rates being paid on liabilities and the rates earned on its assets. This method allows management to effectively monitor the interest earning potential of the present balance sheet.

In order to remain within the Bank's guidelines, the Bank consciously chooses low risk/return treasury assets in order to maintain a high-quality portfolio. During the financial year under review, the ECB maintained the marginal lending facility at 0.25% and the deposit facility rate at -0.40%. These rates are expected to remain at present levels over the foreseeable future.

On a regular basis the Bank also monitors the sensitivity of the financial assets and liabilities to parallel shifts in the yield curve of 200 basis points over a time horizon of one year. Interest rate risk arises from the different re-pricing characteristics of the Bank's interest-sensitive assets and liabilities and from the mismatch between interest rate-sensitive assets and liabilities. Sensitivity of the net interest income is expounded in Note 39.4.1 appended to the Financial Statements.

Simulations and IRRBB capital charge

In the IRRBB EVE model, 6 prescribed interest rate shock scenarios are simulated to estimate the capital charged with respect to IRRBB. These simulations are generated every quarter and subsequently reported to ALCO. The table below depicts the sensitivity of reported equity and projected net interest income to the interest rate movements, split by currency.

	Sensitivity of reported equity to interest rate movements		Sensitivity of projected net interest income to interest rate movements	
€ millions	**200bp Parallel increase**	**200bp Parallel decrease**	**200bp Parallel increase**	**200bp Parallel decrease**
2018				
At 31 December	26	5	210	(67)
Of which:				
EUR	44	(14)	(12)	(48)
USD	(9)	11	12	(12)
GBP	(3)	0	5	(3)
AUD	(7)	7	(5)	(5)
Other Currencies	1	0	210	1
2017				
At 31 December	37	(8)	10	(104)
Of which:				
EUR	52	(22)	(19)	(83)
USD	(13)	13	16	(11)
GBP	(1)	0	4	(2)
AUD	0	0	4	(4)
Other Currencies	(1)	0	6	(4)

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As at December 2018, the capital charge with respect to the IRRBB read €18.8 million. Such quantification was fine-tuned as required by relative EBA Guidelines issued in 2018 – EBA/GL/2018/02 – which involved applying 6 interest rate shocks. The final capital charge emanated from the 'Steepener' shock which explored a steepening of the yield curve (where short-term rates decrease and long-term rates increase). This capital charge quantification also included a 50% weighting of positive impacts and 100% negative impacts arising from the prescribed shocks, in line with said regulation. Further information related to interest rate risk can be found in the notes to the Financial Statements Note 39.4.1

7.3 Currency Risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Treasury management policy sets limits on the level of net exposure by currency which are monitored on a daily basis. Further information related to currency risk can be found in the notes to the financial statements Note 39.4.2.

7.4 Exposures to equities not included in the trading book (CRR Article 447)

The Group is exposed to equity price risks arising from the holding of equity instruments classified either as fair value through other comprehensive income or at fair value through profit or loss. The overall strategy of the equity portfolio is to earn regular dividends and not invest in highly volatile equities. The investment portfolio has a relatively small allocation to equity investments amounting to approximately €45.2 million as at end-December 2018.

All equities are priced at mark-to-market, however price changes are passed through the income statement for equities classified within the FVTPL portfolio, whereas for those classified within the FVOCI portfolio, price changes are accounted for in other comprehensive income. The fair value of all equities corresponds to their market value and there were no material deviations between the two. During FY2018:

- Fair value movement on FVTPL equity holdings amounted to: €1.76 million;
- Fair value movement through reserves - FVOCI Equities: (-)€1.71million;
- Gain/Loss on FVOCI Equities transferred to Retained Profits during FY18: €1.9 million;
- Latent revaluation gains / losses included in Common Equity Tier 1 Capital amount to €10.7 million.

The Bank also has exposures to private equities. These amounted to €0.36 million as at end-December 2018, split into €0.19 million in Venture Capital and €0.17 million in Non-Trading Equity.

Section 8: Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, which can lead to adverse customer impact, reputational damage or financial loss. Operational risk is inherent to all business lines, support functions, products, activities, processes and systems.

The Risk Appetite Framework prescribes that the Group aims to minimise operational risk whilst ensuring that its operations are regulatory compliant, efficient and cost-effective. This is achieved through early identification, measurement monitoring and mitigation of risk by ensuring that adequate and effective controls are in place, supported by appropriate capital and/or insurance arrangements.

Operational risk arises from day-to-day operations and may impact any business line or function within the Group. Operational Risk can manifest itself in a number of ways and can take various forms including but not limited to fraud (internal/external), non-availability of latest technology, loss of data, staff absenteeism on large scale, natural disaster and system failures or process malfunction. Operational risks are mostly process, systems or people related albeit operational risk may arise equally from failure to embrace regulatory changes.

8.1 The Management of Operational Risk

In line with common industry practice, BOV applies the three lines of defence model for operational risk governance. Operational risk is managed across the Group through an operational risk framework and operational risk policies. The operational risk framework includes a risk control assessment process, risk impact likelihood analysis, key risk and control indicators, risk appetite, an event management and operational loss process. The Operational Risk Management Unit (ORMU) which is the second line of defence acts independently from risk generating business lines. It is primarily tasked with delivering and upholding a robust operational risk management framework and culture across the BOV Group. Although ownership and accountability for operational risk resides with business, the ORMU co-ordinates, supervises and provides direction for the consistent identification, assessment, monitoring and reporting on operational risks and controls. The unit is responsible for the design, development, delivery and continuous improvement of the operational risk management framework through the provisioning of the appropriate infrastructure, tools and methodology for rolling out operational risk management throughout the Group, ensuring that the overall risk portfolio is managed in line with the operational risk management policy. ORMU is also responsible to develop and review policies and procedures to ensure that operational risks are managed effectively. The identification and assessment of operational risk exposure across the various business lines is primarily upheld through risk and control assessments. Risk assessments involve the identification and evaluation of risks, including recommendations for managing and mitigating such risks. To support the risk identification process the Bank makes use of audit findings, internal loss data and

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scenario analysis. Operational risk exposures are mapped to the Group Risk Register which comprises key risks originating from forty-seven process areas. The process of cataloguing risks is designed to confirm that risks have been identified, assessed and are being managed effectively in accordance with the Bank's Operational Risk Management Policy.

ORMU maintains a repository of loss data which captures and records operational risk loss events and near misses. Loss data is used for regulatory and management reporting purposes. It is also relevant in capital modelling when calculating capital for Pillar II Operational risks. Events which are considered material are assessed and escalated to Senior Executive Management to ensure that remedial action is taken to avoid repeated incidents of similar nature.

ORMU is also responsible for ensuring that the Group is resilient and has contingencies in place in the event of business disruption.

The Group has in place a robust enterprise-wide Business Continuity Plan (BCP) which extends across all critical business lines and functions. BCPs for critical activities and IT systems are regularly tested, thus ensuring timely recovery from disruptions and expedite access to data. The Group's Incident Management Team works in liaison with the ORMU to effectively manage the organisation's efforts where widespread threats require a more co-ordinated approach.

ORMU is in the process of strengthening and modernising completely its management of operational risk through the acquisition of a dedicated Operational Risk Management system that consolidates information related to risks, loss events and controls. The implementation of this system will enhance the Group's risk culture and maturity of its operational risk framework. This would enable the Group adopt a more proactive, forward looking and effective approach in managing risks.

The Group currently uses the Basic Indicator Approach to apportion capital for operational risk and accordingly allocates 15% of the average gross income over three years in line with Basel III guidelines.

The operational risk regulatory capital requirement for the Group as at December 2018 is €34.5 million (Notional Risk Weighted Assets €431.1 million).

8.2 Monitoring and Mitigation of Operational Risk

The Group continues to invest in strengthening its control environment leveraging on automation to optimise the efficiency and effectiveness of the control design. Material risks are reported and escalated to the Group's governance structures in order to give Executive Management and Board Committee member's visibility of these risks and a medium to ensure that corrective action, to lower risk exposure, has been taken. The treatment and mitigation of risk is key to ensure that the Group risk profile remains within the risk appetite. The Group employs a mix of risk mitigation strategies, including avoidance, mitigation, transfer (through insurance) and acceptance. Given the nature and magnitude of the threat the Group decides which strategy would be a best fit to lower the likelihood and financial impact arising from a risk event. High impact risk events are mitigated through comprehensive insurance coverage. The Group has different classes of Insurance covers to protect the Group's assets and core operations. A specialised team within ORMU works in close liaison with the Group's Insurance Brokers and the Group's different business units to ensure that the insurance cover held aligns with the Group's risk profile.

The monitoring and reporting of operational risk is primarily undertaken by ORMU. The Group maintains a formal approach to operational risk event escalation, whereby material events are identified, captured and if required escalated to the Group's governance structure. Event root cause analysis is carried out to determine, where possible, any mitigation plans needed to ensure that the control framework remains effective and meet ongoing threats and any emerging risks.

8.3 Information Security Risk

Information security risk refers to the risk of loss caused by deliberate or accidental loss, alteration, falsification or leakage of information, or by destruction, disruption, errors or misuse of information systems. The Group adopts various international standards in its integrated approach to managing information security and privacy risks amidst threats that exploit increasing complexity and connectivity of systems. Such efforts have the fundamental objective of ensuring the confidentiality, integrity, availability and privacy of the Group's information assets.

In order to fulfil the proper processing of information assets and prevent loss or leakage of information, the Group has developed a number of qualitative measures to reduce such risks through its organisational structure. Such implementations include

- Effective governance through a security organisational structure, with resources having specific responsibilities for information security issues,
- The establishment of information security policies, procedures and standards,
- An information security awareness and training programme
- The implementation of a security infrastructure and systems to ensure a stable information security environment.

This approach to the management of information security risks seeks to align to global standards, in particular ISO/IEC 27001/2.

In recognition of the risks associated with evolving cyber threats, and as part of our ongoing commitment towards ensuring the security of information systems, the Group will be enhancing and investing further in security controls and employee awareness in this and related areas.

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As part of the ongoing commitment towards ensuring the security of information systems, the Group will be focusing on the prevalent Information Security risks within the industry; which include logical access control management. A holistic approach will be applied based on the analysis of both systems, and operational procedures, and appropriate action plans set up to resolve any deviations from the Group's established policy.

The Group has invested a significant amount of human capital towards its Core Banking Transformation programme which is expected to be implemented towards the end of FY2019. This project will replace a number systems and reduce the information security risk profile of the Group.

On 13 February 2019 the Group suffered a sophisticated cyber-attack resulting in eleven unauthorised international outward payments totalling an equivalent of €12.9 million. The Group is taking all the necessary actions to recover the funds. The Group has already taken steps to re-dimension the IT security framework. More information can be found in note 43 to the financial statements.

Section 9: Remuneration Policy

The Bank has a Remuneration Policy aimed at aligning individual rewards with the Bank's performance, business strategy, risk appetite, values and long-term interests. It also encourages a prudent approach to risk taking. The Policy deals with the remuneration of all staff members including members of the MB, in accordance with regulation incorporated in the Capital Requirements Directive. Additional disclosures on the governance process related to remuneration have been made under the Remuneration Report section in this report.

The target population defined as Identified Staff for the purposes of this Disclosure represents 5.4% of total number of employees in the Group. Identified staff is determined in line with recommended EBA Regulatory Technical Standards[1] and includes:

- senior executives responsible for material business units/business lines or internal control functions including Risk, Compliance and Audit;
- executives of Support Functions;
- other employees who are members of committees with collective authority to commit to risk exposures per transaction beyond 0.5% of CET1 Capital; and
- employees who, individually or as part of a committee take, approve or veto decisions on new products, material processes or material systems.

For the purposes of remuneration, Identified Staff have been split into business areas according to EBA guidelines[2]. The table below includes the total fixed and variable remuneration and the number of beneficiaries for each business area. All fixed and variable remuneration were paid in cash.

Remuneration of Identified staff	Supervisory Function^	Management Function^	Investment Banking^	Independent Control Functions^	Retail Banking^	Asset Management^	Corporate Functions^	All Other^
Management Body	15	7						
Number of identified staff (IF)			2	22	35	1	12	5
IF in senior management positions			1	5	15	1	12	3
Total fixed remuneration	€ 377,504	€ 818,865	€ 146,979	€ 1,231,061	€ 2,223,873	€ 66,293	€ 852,332	€317,641
Total variable remuneration	Nil	€ 68,823	€ 7,300	€ 260,410	€ 861,772	€ 2,000	€ 45,081	€21,864
Total variable remuneration	Nil	8.4%	4.97%	21.15%	38.75%	3.02%	5.29%	6.88%

^as defined in EBA guidelines EBA/GL/2014/8. None of the employees individually earn over €500,000. There are no amounts of outstanding deferred remuneration and no deferred remuneration was awarded during the financial year.
The above figures include the Bank's subsidiaries.

Notes to the Table:

- the fixed remuneration of the management function and the retail banking function includes the amounts of €77,159 and €66,000 respectively, representing remuneration earned for additional roles performed within the supervisory function across the Group
- the variable remuneration of the management function includes also remuneration earned from a SICAV
- variable remuneration for identified staff includes performance related bonuses and other discretionary benefits, including also discretionary voluntary retirement lump sums paid
- None of the employees individually earn over €500,000
- There are no amounts of outstanding deferred remuneration and no deferred remuneration was awarded during the financial year

[1] EBA Final Draft Regulatory Technical Standards EBA/RTS/2015/09 dated 16 July 2015
[2] EBA Guidelines on the remuneration benchmarking exercise EBA/GL/2014/08 dated 16 July 2014

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Link between Pay and Performance

The variable portion of remuneration is linked to the level of profit earned by the Bank during the relative financial period. The calculation of the bonus attributed to the staff in the clerical and managerial grades is determined in the Collective Agreement and is based on the profit achieved by the Bank. The bonus is distributed to employees in proportion to the performance achieved by the individual and in accordance with their respective grades. Employees in the executive grade are also eligible for an annual bonus determined by the Bank's performance and their individual performance. Annual bonus entitlements are also applicable to the CEO and members of the MB as highlighted under the Remuneration Report. The CEO and members of the Management Board have waived their annual bonus for FY 2018. The Bank does not pay variable remuneration in equity, equity-linked or other eligible instruments to any category of staff.

The application of the proportionality principle, according to instructions published by the Malta Financial Services Authority (MFSA) in 2015, prescribes that the provisions of CRR relating to variable pay in instruments and deferral rule are to be fully applied if an individual staff member is remunerated with a variable pay of more than €100,000, or for lower values where variable pay is more than 100% of the fixed pay of the individual concerned.

Performance Management System

Key Performance Indicators (KPIs), by which employees' performance is measured, provide individual, unit and organisation level targets aligned with the strategic objectives of the Group.

In order to avoid rewarding individuals for taking excessive risks, KPIs have been designed to account for the Group's long term interest and values, with quality and compliance measures receiving a strong weighting at target setting stage. Financial and non-financial performance indicators are based on a balanced scorecard approach and therefore, financial targets are counterbalanced by process, customer satisfaction and employee development measures. In line with principles set out in the Remuneration Policy, the Bank exercises focus on quality and compliance centric measures, so as to promote moderation and consideration of risk-taking within the Group's business areas. Performance targets are reviewed periodically to ensure that these are aligned to specific strategic and operational objectives set out by the Board of Directors, covering not only business generation, but also other areas of importance such as compliance with prevalent regulation and internal policies and procedures, on boarding and customer due diligence, non-performing borrowing, quality of service and others.

Section 10: Liquidity Risk

During 2017, the EBA issued guidelines – EBA/GL/2017/01 – which aim to harmonise the disclosures in line with CRR 575/2013 Article 435(1) in relation to liquidity risk. Additional disclosures relating to liquidity risk are provided in Note 39.3 to the financial statements.

Liquidity risk is the risk that a bank is unable to meet its current or future payment obligations as they fall due, and/or to replace funds when they are withdrawn, even when this occurs unexpectedly. Funding liquidity risk arises when a bank is not able to efficiently meet various cash flow and collateral needs without affecting its daily operations and/or financial position. In contrast, market liquidity risk arises when a bank is not able to easily offset or eliminate positions at the market price because of inadequate market depth and/or market disruption. The Bank has always taken the management of liquidity risk very seriously; to this end, the objective of the Bank's liquidity risk management actions is to ensure that both foreseeable and unpredicted funding commitment can be met when due and at a reasonable cost.

The Asset Liability Management Committee (ALCO) is responsible to oversee the Bank's asset mix including the oversight of liquidity risk, implement relevant policies, ensure proper reporting, consider plans for actions, and contribute to liquidity stress testing exercises. The Enterprise Risk Management Unit (ERMU), ensures that prudent parameters are established within which sound liquidity risk management and control activities are carried out by the respective risk and control owners. The unit selects, adopts, implements, and updates appropriate liquidity risk models, metrics, and other risk evaluation tools. Relevant liquidity risk-related information is communicated to higher management including ALCO. Treasury Department is entrusted to manage and monitor the Bank's liquidity, resulting from the liquidity surplus/deficit emanating from non-discretionary operations on a daily basis within the parameters set by ALCO, to ensure a constant state of readiness should an exceptionally high demand for liquidity arise at any time. Statutory Reporting Department (SRD) is responsible to compile and submit all the required regulatory reporting related to liquidity risk. The Board of Directors (BoD) is ultimately responsible for the liquidity risk assumed by the Bank and the manner it is managed and controlled.

In line with the Bank's risk appetite and in order to mitigate liquidity risk, adequate measures are established in a number of policies and procedures as highlighted below:

- The Liquidity Risk Management Policy sets out the overarching principles relating to the management of liquidity risk, and also articulates the control activities relating to the identification, quantification, reporting and monitoring of such risks. The ultimate objective is to maintain structurally sound liquidity profiles;
- The Treasury Management Policy (TMP) sets out the parameters for identifying and monitoring the treasury activity of the Bank. Control procedures involve formalized limits which are monitored on an ongoing basis to ensure that the Bank maintains a highly diversified marketable investment portfolio that can be easily liquidated in times of need. The Bank maintains an ongoing presence in funding markets and ensures that standby unsecured credit lines are kept active, even

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if it does not have an immediate liquidity need to address. This is intended to sustain an enduring inter-bank relationship with fund providers. This is mostly done within the European market. A number of Global Master Repurchase Agreement with foreign banks are also in place to provide access to repurchase agreement (repo) borrowing;

- The Internal Liquidity Adequacy Assessment Process (ILAAP) contains detailed qualitative and quantitative information of the Bank's processes and methodology used to measure and manage funding liquidity risk and market liquidity risk. To better assist the liquidity management and to ensure the adequacy of the liquidity tolerance levels, the ILAAP document includes a set of sensitivity analyses and liquidity stress testing;
- The use of scenario analysis and stress testing constitutes a forward-looking approach which helps to proactively identify and analyse the liquidity risk which might be latent under benign conditions but, if triggered, could have serious implications on a bank. The output results from stress testing analysis help the BoD and senior management to agree on a course of action designed to avoid or mitigate such risks. The said stress testing results provide a good indication of the level of capital and/or liquidity which might be needed to absorb losses should the risks exposures materialise.
- The Contingency Funding Plan sets out the strategies that will be activated in case of excessive liquidity demand. It includes a well-defined process and action plan for responding to severe disruptions to the Bank's ability to fund some or all of its activities. This would ensure sufficient liquidity resources for meeting all liabilities when they fall due.

The BoD is satisfied with the Bank's liquidity adequacy and mitigants in place. In fact, in the last ILAAP report (December 2017), it was not deemed necessary to allocate Pillar II capital against liquidity risk. This was driven by the high degree of confidence that the Bank was in a position to address daily liquidity obligations and withstand a period of liquidity stress; it must also be viewed in the context of a situation of excess liquidity which has prevailed for several years.

ALCO continuously analyses the best way to utilise the excess liquidity and monitors the Bank's liquidity position by following the liquidity risk tolerance levels set out in the Bank's Risk Appetite Framework.

The Bank enjoys a favourable funding base with stable and diversified customer deposits, which provide the vast majority of the Bank's total funding. The Bank maintained its highly liquid position during this financial period, with its loan portfolio fully funded by deposits. The Loan-to-Deposit (LtD) ratio (net of interest in suspense) has eased further throughout this period, standing at 44.20% as at December 2018 (December 2017, 44.26%). The relative decrease in the LtD ratio was driven by the fact that the rise in customer deposits somewhat outstripped the rate of increase exhibited over the loan portfolio reflecting the degree of confidence by external stakeholders in the institution.

The Liquidity Coverage Ratio (LCR) requires credit institutions to promote short-term resilience to potential liquidity disruptions thereby eliminating, or significantly reducing, structural mismatches between assets and liabilities. In terms of LCR requirements, credit institutions must hold sufficient unencumbered high quality liquid assets (HQLA) to withstand the excess of severe liquidity outflows over inflows that could be expected to accumulate over a 30-day stressed period. During such a period, a credit institution should be able to convert quickly its liquid assets into cash without recourse to central bank liquidity or public funds. The Bank calculates and monitors the LCR in line with the relative regulatory dictum – Commission Delegated Regulation (EU) 2015/61 – on a monthly basis. As at end of December 2018, the Bank was well positioned with an LCR of 297% (December 2017, 149%). Such level very comfortably exceeds the minimum threshold of 100% representing full ratio phase-in as from 2019.

The inter-year rise in LCR approximated 148%. Such change is a material one which warrants amplification. It is mainly attributable to two main factors:

- The high level of high quality liquid assets held by the Bank, towards which inter alia, the significant ECB reserves count;
- The Bank refined its LCR quantification methodology in particular through a far more accurate split between retail and non-retail deposits within the customer deposit base.

The table disclosed below shows quantitative information of LCR which complements Article 435 (1)(f) of Regulation (EU) No 575/2013. The LCR components of the previous quarters have been restated in line with the above explained change in customer deposits classification.

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	EU LIQ 1 - LCR Disclosure table										
	Scope of consolidation (solo)	**Total unweighted value**					**Total weighted value**				
	Currency and units (€ million)										
	Quarter ending on	**Dec-17**	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**	**Dec-17**	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**
	Number of data points used in the calculation of averages: 5	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**	**1**
	High - Quality Liquid Assets										
1.0	Total high-quality liquid assets (HQLA)						4,336.0	4,317.0	3,911.3	4,283.0	4,567.6
	Cash - Outflows										
2.0	Retail deposits and deposits from small business customers, of which:	5,693.6	5,829.7	5,919.6	6,106.2	6,210.8	372.8	382.0	386.5	400.9	408.2
3.0	*Stable deposits*	4,006.1	4,097.8	4,181.7	4,267.4	4,325.1	200.3	204.9	209.1	213.4	216.3
4.0	*Less stable deposits*	1,687.6	1,731.9	1,737.9	1,838.8	1,885.6	172.5	177.1	177.4	187.6	191.9
5.0	Unsecured wholesale funding	3,080.8	2,935.1	2,692.1	2,766.5	2,742.3	1,397.2	1,346.0	1,198.8	1,245.1	1,246.2
6.0	*Operational deposits (all counterparties) and deposits in networks of cooperative banks*	122.2	185.6	106.6	122.3	104.0	30.6	46.4	26.6	30.6	26.0
7.0	*Non - operational deposits (all counterparties)*	2,958.6	2,749.5	2,585.5	2,644.1	2,638.2	1,366.6	1,299.6	1,172.2	1,214.5	1,220.2
8.0	*Unsecured debt*	-	-	-	-	-	-	-	-	-	-
9.0	Secured wholesale funding						-	-	-	-	-
10.0	Additional requirements	1,529.8	1,516.0	1,586.7	1,561.5	1,599.8	110.4	125.4	115.4	116.1	125.5
11.0	*Outflows related to derivative exposures and other collateral requirements*	-	-	-	-	-	-	-	-	-	-
12.0	*Outflows related to loss of funding on debt products*	-	-	-	-	-	-	-	-	-	-
13.0	*Credit and liquidity facilities*	1,529.8	1,516.0	1,586.7	1,561.5	1,599.8	110.4	125.4	115.4	116.1	125.5
14.0	Other conctractual funding obligations	-	-	-	-	-	-	-	-	-	-
15.0	Other contingent funding obligations	85.2	88.9	96.9	116.0	112.7	4.3	4.4	4.8	5.8	5.6
16.0	**Total Cash Outflows**						1,884.7	1,857.8	1,705.5	1,767.9	1,785.6
	Cash - Inflows										
17.0	Secured lending (e.g. reverse repo)	-	-	-	-	-	-	-	-	-	-
18.0	Inflows from fully performing exposures	165.3	177.5	151.9	100.1	216.2	160.8	174.1	145.8	96.6	209.4
19.0	Other cash inflows	53.4	140.3	49.1	34.8	37.1	53.4	140.3	49.1	34.8	37.1
EU - 19a	(Difference between total weighted inflows and total weighted outflows arising from transactions in third countries where there are transfer restrictions or which are denominated in non-convertible currencies)						-	-	-	-	-
EU - 19b	(Excess inflows from a related specialised credit institution)						-	-	-	-	-
20.0	**Total Cash Inflows**						214.3	314.4	195.0	131.4	246.4
EU - 20a	**Fully exempt inflows**	-	-	-	-	-	-	-	-	-	-
EU - 20b	**Inflows subject to 90% cap**	-	-	-	-	-	-	-	-	-	-
EU - 20c	**Inflows subject to 75% cap**	218.7	317.8	201.1	134.9	253.3	214.3	314.4	195.0	131.4	246.4
							Total Adjusted Value				
21	**Liquidity Buffer**						4,336.0	4,317.0	3,911.3	4,283.0	4,567.6
22	**Total Net Cash Outflows**						1,670.4	1,543.4	1,510.6	1,636.5	1,539.1
23	**Liquidity Coverage Ratio (%)**						259.6%	279.7%	258.9%	261.7%	296.8%

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The Net Stable Funding Ratio (NSFR) is defined as the amount of available stable funding relative to the amount of required stable funding, used to monitor the structural long-term funding position of the Bank. Albeit it is not yet a binding standard, the Bank voluntarily quantifies the NSFR metric on a quarterly basis. Once more, the results are that the institution well exceeds the 100% minimum level prescribed by the Basel Committee for Banking Supervision of the Bank for International Settlements.

Section 11: Risk Management in Subsidiary Companies

The Group has two fully owned subsidiaries: BOV Asset Management Limited ("BOVAM") and BOV Fund Services Limited ("BOVFS").

BOVAM, formerly known as Valletta Fund Management Limited, was registered as a limited liability company under the laws of Malta on the 6 June 1995. BOVAM is licensed by the Malta Financial Services Authority (MFSA), to provide investment management services to collective investment schemes and qualifies as a 'Maltese Management Company' in terms of the Investment Services Act (Marketing of UCITS) Regulations (Subsidiary Legislation 370.18), by virtue of a licence issued on 22 September 1995. On 17 March 2017, BOVAM extended its licence to offer services beyond collective investment schemes. Upon extension of the licence, BOVAM started offering portfolio management service to institutional clients. Furthermore, BOVAM has had its licence extended to offer portfolio management service to retirement schemes and retirement funds.

BOVAM is the appointed manager of Vilhena Funds SICAV plc which is a company organised as a multi-fund investment company with variable share capital pursuant to the Companies Act, Cap 386 of the Laws of Malta, registered on 10 October 1997, bearing registration Number SV4 and licensed by the MFSA as a collective investment scheme pursuant to the Investment Services Act, Cap 370 of the Laws of Malta and the UCITS Directive. BOVAM is responsible to ensure that the investment limits and risk parameters of the Vilhena Funds SICAV plc and its sub-funds are adhered to. A risk management policy is in place.

BOVAM is also the appointed manager of the BOV Investment Funds which is a common contractual fund licenced by the MFSA as a collective investment scheme pursuant to the Investment Services Act and the UCITS Directive. BOVAM is responsible to ensure that the investment limits and risk parameters of the BOV Investment Funds and its sub-funds are adhered to. A risk management policy is in place.

Collectively, the sub-funds of the Vilhena Funds SICAV plc and of the BOV Investment Funds as well as the institutional clients will be referred to as 'portfolios'.

BOVAM has three regulatory functions, Asset Management, Risk Management and Compliance Monitoring. Risk Management and Compliance Monitoring are core functions of the company's culture and operations. Both functions are interlinked and work together to:

a) Ensure compliance with limits laid out in the UCITS directive, MFSA rules, Vilhena Funds SICAV plc and BOV Investment Funds Prospectus and respective Fund Supplements;
b) Ensure that risk measurement arrangements, processes and techniques on the portfolios' positions are in place, and that their contribution to the overall risk profile of the portfolios are accurately measured and documented;
c) Conduct periodic stress tests and scenario analyses to address risks arising from potential changes in market conditions that might adversely impact the portfolios;
d) Establish, implement and maintain a documented system of internal limits concerning the measures used to manage and control the relevant risks of the portfolios;
e) Ensure that the current level of risk complies with the risk limits set; and
f) Establish, implement and maintain adequate procedures that, in the event of actual or anticipated breaches to the risk limits of the portfolios, result in timely remedial actions.

The risk management techniques applied are appropriate and proportionate to the nature, scale and complexity of the BOVAM's activities and of the UCITS it manages. From time to time, BOVAM reviews its measurement techniques to ensure that these remain appropriate and effective, depending on the investment strategies of the portfolios it manages.

BOVAM has a robust governance structure. It has documented policies and procedures in place and a comprehensive risk register identifying primary and consequential risks. For all the risks outlined in the risk register, BOVAM has internal control principles that enable it to operate in an efficient and diligent way.

Moreover, the BoD of BOVAM has established a Risk and Regulatory Committee ("RRC"), whose terms of reference are laid out in an appropriate document. This Committee is, amongst others, responsible to ensure that BOVAM has an appropriate risk management process in place. The RRC is also responsible to monitor, on a regular basis, the effective implementation of the risk management process, such that BOVAM is able to monitor, measure and manage at any time the various risks of the positions and their contribution to the overall risk-profile of the portfolios.

BOV Fund Services (formerly Valletta Fund Services) was set up in 2006 as a fully owned subsidiary of the Bank to provide asset managers with a comprehensive suite of administration services to investment funds. BOV Fund Services is recognised to provide fund administration services by the MFSA, and is also licensed as a Corporate Service Provider in terms of the Company Service Providers Act, 2013. In providing its services, BOV Fund Services is exposed to both operational and reputation risks, and to a lesser extent also market risks. To mitigate these risks, BOV Fund Services has in place compliance and risk monitoring internal audit programs through the Company's Compliance and Risk Management Division, aimed at reviewing the processes and the corresponding control procedures. In addition, audits of the Company's various operations are undertaken by the Group's Internal

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Audit department. BOV Fund Services has also engaged an independent audit firm to perform a biennial ISAE 3402 examination of its processes and controls, which consists of an evaluation of the design and operating effectiveness of the controls of the Company. In relation to managing reputation risks, BOV Fund Services carries out an extensive due diligence process on its potential clients and has in place the necessary procedures to ensure that the business is compliant with prevention of money laundering regulations.

In view of the dependency of the Company on its various IT systems, BOV Fund Services has in place a detailed business continuity plan in order to appropriately manage the incidence of business interruptions and disaster recovery.

Moreover, the BOV FS Risk and Compliance Committee was set up by the Board of Directors of BOV Fund Services Limited (BOV FS) during Financial Year 2018, to assist the Board in fulfilling its oversight responsibilities in relation to the risk management and compliance framework and the governance structure that supports it. Amongst other tasks, the Committee reviews relevant policies and report to the Board on the adequacy or otherwise thereof, and also provides advice and guidance to the BOV FS Board on the Risk Appetite and related tolerances, ensuring that such tolerances are within the Group's Risk Appetite. The Committee also oversees the procedures, practices and activities of BOV FS and of any person employed with or acting for or on behalf of BOV FS for the purpose of ensuring that the compliance obligations of BOV FS are being discharged according to law and that the internal rules, procedures and guidelines are complied with. The Committee meets at least on a quarterly basis unless further required, and the Chief Officer Fund Business attend the Meeting by way of invitation.

CRR References

CRR Articles	Description	Reference
Article 435	Risk management objectives and policies	Section 1, 10 and 11
Article 436	Scope of application	Section 2
Article 437	Own funds	Section 3
Article 438	Capital requirements	Section 4
Article 439	Exposure to counterparty credit risk	Section 6.6
Article 440	Capital buffers	Section 4
Article 441	Indicators of global systemic importance	N/A
Article 442	Credit risk adjustments	Section 6
Article 443	Unencumbered assets	Note to the Financial Statement 39.3
Article 444	Use of ECAIs	Section 6.4.3
Article 445	Exposure to market risk	Section 7
Article 446	Operational risk	Section 8
Article 447	Exposures to equities not included in the trading book	Section 7.4
Article 448	Exposure to interest rate risk on positions not included in the trading book	Section 7.2
Article 449	Exposure to securitisation positions	N/A
Article 450	Remuneration policy	Section 9 and Remuneration Report
Article 451	Leverage	Section 5
Article 452	Use of IRB Approach to credit risk	N/A
Article 453	Use of credit risk mitigation techniques	Section 6.5
Article 454	Use of advances measurements approaches to operational risk	N/A
Article 455	Use of Internal Market Risk models	N/A

Corporate governance statement of compliance

A. INTRODUCTION

Pursuant to the Listing Authority Listing Rules, Bank of Valletta p.l.c. (the Bank) as a company whose equity securities are listed on a regulated market, should endeavour to adopt the Code of Principles of Good Corporate Governance (the Code) contained in Appendix 5.1 to Chapter 5 of the Listing Rules. In terms of Listing Rule 5.94, the Bank is obliged to prepare a report explaining how it has complied with the Code. For the purposes of the Listing Rules, the Bank is hereby reporting on the extent of its adoption of the Code.

The Board of Directors (the Board) is committed to the values of truth, transparency, honesty and integrity in all its actions. The Board strongly believes that the Bank benefits from having in place more transparent governance structures and from improved relations with the market which enhance market integrity and confidence. The Board acknowledges that the Code recommends principles for the Board and the Bank's management to pursue objectives that are in the interest of the Bank and its shareholders.

Good corporate governance is the responsibility of the Board, and in this regard the Board has adopted a corporate decision-making and supervisory structure that is tailored to suit the requirements of the Bank's constitutional documents as well as its size, nature and operational needs. In addition, while the structure provides flexibility and an efficient decentralisation of selective decision-making, it concurrently provides a system of checks and balances. The Board believes that any structure which is adopted must be geared to meet the necessary standards of accountability and probity, and considers that the structure which it has adopted does so.

As demonstrated by the information set out in this Statement, together with the information contained in the Remuneration Report and in the Nominations Report, the Bank believes that it has, save as indicated herein, in the section entitled Non-Compliance with the Code, throughout the accounting period under review, applied the principles and complied with the provisions of the Code. In the Non-Compliance section, the Board indicates and explains the instances where it has departed from or where it has not applied the Code.

B. COMPLIANCE WITH THE CODE

Principle 1: The Board

The Board's role and responsibility is to provide the necessary leadership, to set strategy and to exercise good oversight and stewardship. The Board is composed of a Chairman, two Executive Directors and eight Non-Executive Directors. This mix of Executive and Non-Executive Directors on the Board enables the Non-Executive Directors to exercise their monitoring function over the management and the executive arm of the Board at the level of the Board. Moreover, the fact that the Chief Executive Officer (CEO) is also an Executive Director on the Board, enables the Board to be in receipt of timely and appropriate information in relation to the business of the Bank and Management's performance. As a result, the Board can contribute effectively to the decision-making process, whilst at the same time exercising prudent and effective controls.

The Board delegates specific responsibilities to a number of Committees, notably the Credit Committee, the Audit Committee, the Risk Management Committee, the Compliance and Crime Prevention Committee, the Ethics Committee, the Remuneration Committee and the Nominations and Governance Committee, each of which operates under formal Terms of Reference approved by the Board.

Further details in relation to the Committees and the responsibilities of the Board is found under Principles 4 and 5 of this Statement.

Principle 2: Chairman and Chief Executive Officer (CEO)

The Bank's current organisational structure incorporates the position of a CEO. The position of the Chairman and that of the CEO are occupied by different individuals. Their respective positions have been defined with specific roles rendering these positions completely separate from one another. This separation of roles of the Chairman and the CEO avoids concentration of authority and power in one individual.

The Chairman is responsible to lead the Board and to set its agenda. The Chairman ensures that the Board's discussions on any issue put before it go into adequate depth, that the opinions of all the Directors are taken into account and that all the Board's decisions are supported by adequate and timely information. The Chairman ensures that the CEO develops a strategy which is agreed to by the Board.

On the other hand, the CEO, besides being an Executive Director, leads the Bank's Management Board, which is the highest decision-making body within the Bank.

More information on the Bank's Management Board can be found under the section entitled Management Committees, within this Statement.

Corporate governance statement of compliance (continued)

Principle 3: Composition of the Board

The Board considers that during the year under review the size of the Board, whilst not being too large as to be unwieldy, was appropriate, taking into account the size of the Bank and its operations. The combined and varied knowledge, experience and skills of the Board members provided a balance of competences that are required and add value to the proper functioning of the Board.

Independence of Directors

During the year under review, the Board consisted of seven Independent Non-Executive Directors (including the Chairman), two Non-Independent Non-Executive Directors (as indicated on pages (ii) and (iii) of the Annual Report) and two Executive Directors. In determining the independence or otherwise of its Directors, the Board has considered, amongst others, the notion of independence as contained in the Code, the Bank's own practice as well as general good practice principles. The Board believes that, by definition, employment with the Bank renders Directors Alan Attard and James Grech as Non-Independent from the Institution. However, this should not, in any manner, detract from the said Non-Independent Directors' ability to maintain independence of analysis, decision and action at all times. Moreover, having considered their role within the Board and their roles and duties as Bank employees, the Bank deems Mr Attard and Mr Grech to be Non-Executive Directors.

Appointment of Non-Executive Directors

The Board of Directors consists of a minimum of seven and a maximum of twelve individuals. A maximum of three are to be appointed as Executive Directors whilst the remaining nine are to be Non-Executive Directors.

The appointment of the nine Non-Executive Directors is governed by article 25 of the Articles of Association and appointments may be made as follows:

(a) By Qualifying Shareholders – namely members holding at least 10% of the issued share capital of the Bank having voting rights, that are entitled to nominate, for the approval of the Nominations and Governance Committee, one person for each 10% voting shares held; and

(b) By Non-Qualifying Shareholders not having a Qualifying Shareholding, but who individually or in aggregate hold not less than €50,000 in nominal value of shares having voting rights in the Bank and who are entitled to make recommendations for the approval of the Nominations and Governance Committee; or

(c) By the Nominations and Governance Committee itself seeking the recruitment of fit and proper persons having the right attributes that can add value to the Board of Directors.

All Non-Executive Directors are appointed by the Bank's shareholders during the Annual General Meeting.

Appointment of Executive Directors

The appointment of Executive Directors is regulated by article 24 of the Articles. In accordance with the said article, the CEO of the Bank shall ex officio become an Executive Director by virtue of his office and shall remain in office until the tenure of office as CEO.

The Non-Executive Directors shall appoint at least one other Executive Director on the Board from amongst the Senior Management and may also appoint a third Executive Director if the Non-Executive Directors consider it in the best interests of the collective knowledge and competence of the Board to do so. To date one additional Executive Director has been appointed and that position is held by the Chief Risk Officer, which is in line with the Bank's strategic initiatives to highlight risk management even at Board level.

Nominations and Governance Committee

All Directors, irrespective of the manner in which they are proposed, can only take office following the approval of their nomination by the Nominations and Governance Committee. In this context, the Nominations and Governance Committee is the organ that, after having scrutinised the list of candidates to ensure that the Board will have the appropriate collective knowledge, experience and competence, will then place the list of approved candidates for election at the Annual General Meeting. More information on the Nominations and Governance Committee is found under the Nominations Report.

The appointment of all Directors is subject to regulatory approval.

Rotation of Directors

The Bank has a system of rotation of Directors aimed at ensuring a certain level of continuity within the Board of Directors. The system of rotation of Directors contemplates the retirement of one-third of the Non-Executive Directors in each year, with the remaining two-thirds of the Board retaining office. This is aimed at providing stability of policy-making and implementation by retaining a majority of the Board in place for a period of at least three years at any time. Those Directors whose turn it is to retire from office, pursuant to the rotation system, will be eligible for reappointment, subject to approval by the Nominations and Governance Committee. The Directors to retire first shall be determined as follows:

Corporate governance statement of compliance (continued)

a) Those Non-Executive Directors who wish to retire and who do not seek reappointment prior to the full term of their appointment;

b) To the extent that there are no Non-Executive Directors who wish to retire and who do not seek reappointment prior to the full term of their appointment, those who retire first shall be the Non-Executive Directors who have been longest in office, including by virtue of re-election, since their first election, but as between persons who became Directors on the same day or in the event that the duration in office cannot be properly determined those to retire shall (unless they otherwise agree among themselves) be determined by lot.

A retiring Director shall only be eligible for re-election provided that such person did not occupy the office of Non-Executive Director for an aggregate period of more than 12 years in any period of 15 years.

Pursuant to Article 28.2 of the Bank's Memorandum and Articles of Association, one-third of the Bank's Non-Executive Directors will retire at the forthcoming Annual General Meeting. Thus, three vacancies for Non-Executive Directors will arise. Out of the three vacancies, one is to be appointed by a Qualifying Shareholder of the Bank. Insofar as the two (2) other vacancies are concerned, there were as many nominations by the Non-Qualifying Shareholders as there were vacancies. Since all three (3) nominees were deemed by the Nominations and Governance Committee to be fit and proper to act as directors, no election will take place during the forthcoming Annual General Meeting.

Number of directorships held by members of the Board of Directors, including the appointment on the Board of Bank of Valletta p.l.c.

Name	Number of Directorships held – Executive Director (ED) and Non-Executive Director (NED)
Stephen Agius	1 NED
Alan Attard	1 NED
Paul V Azzopardi	2 NED + 1 ED
Miguel Borg	3 NED + 1 ED
James Grech	3 NED
Alfred Lupi	3 NED
Mario Mallia	2 NED + 1 ED
Antonio Piras	3 NED
Joseph M Zrinzo	2 NED

Taddeo Scerri and Anita Mangion are not subject to the provisions of Article 91 of the CRD IV and Article 14 (3) (a) of the Banking Act, 1994 (Chapter 371, Laws of Malta) as regards the number of directorships held by them in view of their appointment in a national representative capacity.

Principles 4 and 5: The Responsibilities of the Board and Board Meetings

The Board meets approximately twice a month, unless further meetings are required for the Board to discharge its duties effectively. The Board discusses and decides upon matters relating to the Bank's business. During the financial year under review, the Board met 26 times. Credit proposals are not discussed at Board level but are considered by the Credit Committee which was specifically set up for this purpose during financial period 2017. More information on the Credit Committee can be found under the section entitled Board Committees.

The Board regularly reviews and evaluates corporate strategy, major operational and financial plans, risk policies, performance objectives and business alternatives. The strategy, processes and policies adopted for implementation are regularly reviewed by the Board so that corrective measures can be taken to address any deficiencies and ensure the future sustainability of the enterprise. The Board also monitors implementation and corporate performance within the parameters of all relevant laws, regulations and codes of best business practice. The Board has a formal schedule of matters reserved for its decision and also delegates specific responsibilities to Board Committees.

The Board ensures that it has the appropriate policies and procedures in place which guarantee that the Bank and its employees maintain the highest standards of corporate conduct, including compliance with applicable laws, regulations, business and ethical standards.

Corporate governance statement of compliance (continued)

Notice of the dates of upcoming meetings, together with supporting material, are circulated well in advance to Directors to allow ample time to appropriately consider the information prior to the next board meeting. Furthermore, advance notice is also provided of ad hoc meetings to allow sufficient time to re-arrange commitments.

After each Board meeting, minutes that faithfully record attendance, matters discussed and decisions taken, are prepared and circulated to all Directors as soon as practicable after the meeting.

Members of Senior Management attend Board Meetings by invitation on a regular basis.

Members	**Meetings Held: 26** **Meetings attended by member**
Taddeo Scerri (Chairman)	25
Stephen Agius	25
Alan Attard	23
Paul V Azzopardi	25*
Miguel Borg	23
James Grech	20
Alfred Lupi	24
Mario Mallia	25
Anita Mangion	23**
Antonio Piras	25***
Joseph M Zrinzo	26

*17 by video/tele conferencing
**2 by video/tele conferencing
***12 by video/tele conferencing

Board Committees

The Board also delegates specific responsibilities to Committees, which operate under their respective formal Terms of Reference. In this respect, the Board has established the following Committees:

Credit Committee

The Credit Committee was set up by the Board to discuss and decide upon credit proposals. The Committee also considers and decides upon investment limits and write-offs on loan bank balances which require a level of authority higher than that of the Bank's Executives. The Committee further considers credit related issues which the Bank's Executives may wish to escalate.

Members	**Meetings Held: 24** **Meetings attended by member**
Taddeo Scerri (Chairman)	22
James Grech	19
Alfred Lupi	20
Mario Mallia	21

The Executive Chairman's Office, the Chief Risk Officer, the Executive Credit Risk Sanctioning, the Chief Business Development Officer – Credit and the Chief Officer Corporate Finance attend the Credit Committee by invitation.

The Audit Committee

The Audit Committee's Terms of Reference include the monitoring of the financial reporting process, the effectiveness of the Bank's internal control, internal audit and risk management systems and the audit of the Bank's annual and consolidated accounts. 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 high level at all times. The Audit Committee has established internal procedures and monitors these on a regular basis. The Audit Committee also scrutinizes and approves related party transactions as per the Related Party Transaction Policy. The Audit Committee considers the materiality and the nature of the related party transactions carried out by the Bank to ensure that the arms' length principle is adhered to at all times. The Audit Committee is also responsible for managing the Board's relationships with internal and external auditors.

In terms of Listing Rules 5.117, 5.118 and 5.118A, the Audit Committee is composed of four Non-Executive Directors, all of whom are considered as independent of the Bank, since they are free from any business, family or other relationship with the Bank or its management that may create a conflict of interest such as to impair their judgement.

Corporate governance statement of compliance (continued)

Alfred Lupi FCCA, FIA, BSc Econ is a Non-Executive Director. He is a professional accountant with an economics degree and is currently engaged in consultancy services. He is appointed Chairman of the Audit Committee by the Board and is the Director whom the Bank considers as competent in accounting. Alfred Lupi is independent of the Bank.

Stephen Agius is a Non-Executive Director appointed on the Bank's Board of Directors in 2016. During his career he occupied various positions where he was responsible for large scale projects both local and abroad. Mr Agius is also a visiting lecturer at the University of Malta. More detail on his brief resume is found on pages ii and iii of this Report. He is independent of the Bank and is considered as competent to be a member of the Audit Committee.

Antonio Piras is a Non-Executive Director appointed on the Bank's Board of Directors in 2016. During his career he held various senior positions as was further detailed in his brief resume on pages ii and iii of this Report. He is independent of the Bank, and is considered as competent to be a member of the Audit Committee.

Joseph M Zrinzo is a Non-Executive Director appointed on the Bank's Board of Directors in 2013. Mr Zrinzo has various Board directorship experiences on a number of companies. He also served as a member of various committees. He is independent of the Bank and is considered as competent to be a member of the Audit Committee.

In view of the diverse skills and professional experience of each of the Audit Committee Members, the Bank considers the Audit Committee as a whole to have the adequate competence and meet the independence criteria as required by Listing Rule 5.118.

Members	**Meetings Held: 14** **Meetings attended by member**
Alfred Lupi (Chairman)	13
Stephen Agius	12
Antonio Piras	11*
Joseph M Zrinzo	14

*8 by video/tele conferencing

The CEO, the Chief Risk Officer and the Chief Group Internal Auditor attend Audit Committee meetings.The Chief Financial Officer, the Executive Risk Management and a representative of the External Auditors attend the Audit Committee meetings by invitation. KPMG Malta are the Group's statutory auditors. A designated person from the Office of the Company Secretary acts as Secretary to the Audit Committee.

The Remuneration Committee – This is considered under the Remuneration Report.

The CEO, the Chief Risk Officer and the Chief Officer Ethics and Employee Development attend the Remuneration Committee meetings. The Company Secretary acts as Secretary to the Remuneration Committee.

The Nominations and Governance Committee – This is considered under the Nominations Report.

The CEO and the Chief Risk Officer attend the Nominations and Governance Committee meetings. The Company Secretary acts as a Secretary to the Nominations and Governance Committee.

The Risk Management Committee

The Risk Management Committee assists the Board in assessing the different types of risks to which the organisation is exposed. This Committee is responsible for the proper implementation and review of the Group's risk policies related mainly, but not restricted to, Credit, Market and Operational Risks. It reports to the Board on the adequacy, or otherwise, of such policies. The Committee is also responsible to review delegated limits, together with an oversight of the Group's monitoring and reporting systems, to ensure regular and appropriate monitoring and reporting on the Group's risk positions.

During the period under review, there were seven Risk Management Committee Meetings and all members attended all seven meetings. Paul V Azzopardi attended 6 of these meetings via video conference.

The CEO, the Chief Risk Officer and the Risk Committee Consultant attend Risk Management Committee meetings.The Chief Financial Officer, the Chief Officer Group Internal Audit, the Executive Risk Management and the Head Supervisory Coordination Unit attend the Risk Management Committee meetings by invitation. A designated person from the Office of the Company Secretary acts as Secretary to the Risk Management Committee.

The above information on the Risk Management Committee, together with the information contained in Section 1 of the Capital and Risk Management Report included in this Annual Report, is also to be considered as a disclosure for the purposes of Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

Corporate governance statement of compliance (continued)

The Compliance and Crime Prevention Committee

The primary objective of the Compliance and Crime Prevention Committee is to assist and guide the Board of Directors in the discharge of their obligations imposed from time to time by regulation in the area of financial services and in light of the Bank acting as a credit and financial institution licensed to provide services under different laws and within the framework of the Compliance Function as defined in the Compliance Charter and as approved by the Board of Directors. The Committee is also responsible to assist the Bank in combatting financial crime and money laundering activities.

The CEO and the Chief Risk Officer attend Compliance and Crime Prevention Committee meetings. The Chief Business Development Officer – Investments, the Executive Group Compliance, the Executive Anti-Financial Crime and the Money Laundering Reporting Officer attend the Compliance and Crime Prevention Committee meetings by invitation. A designated person from the Office of the Company Secretary acts as Secretary to the Compliance and Crime Prevention Committee.

During the period under review, there were five Compliance and Crime Prevention Committee Meetings and all members attended all five meetings. Paul V Azzopardi attended three of these meetings via video conference.

Ethics Committee

The Ethics Committee is a Board appointed Committee and its Terms of Reference have likewise been approved by the Board. The aim of the Committee is to develop a BOV Group Ethics Policy, regularly review such policy in line with best practice and oversee the investigation of any breaches to the Ethics Policy. The Committee is chaired by one of the Non-Executive Directors of the Bank and is composed of the Chief Executive Officer, the Chief Risk Officer, the Chief Ethics and Employee Development and the Chief Officer Group Internal Audit. A designated person from the Office of the Company Secretary acts as Secretary to the Ethics Committee. The Committee meets on a bi-annual basis and during the period under review, two meetings were held. All members attended both meetings.

Business Restructuring Action Committee (BRAC)

The BRAC assists the Board in ensuring that the implementation process of the business restructuring plan is in line with the Bank's strategy. The Committee is responsible to oversee and monitor the implementation plan and to take executive decisions with respect to the plan as are necessary or desirable for the efficient and effective implementation of the plan. The BRAC reports to the Board on work undertaken by the Committee on a regular basis. The Committee meets on a monthly basis and is composed of the Chairman, the Chief Executive Officer, the Chief Risk Officer, the Chief Business Development Officer Investments and the Chief Business Restructuring Officer. A designated person from the Risk Management Department acts as Secretary to the Business Restructuring Action Committee. The BRAC is a temporary Committee and will be dissolved once the Business Restructuring exercise is completed.

Management Board Suitability

The Nominations and Governance Committee undertakes a suitability assessment of members proposed to the Management Board, which assessment is based on such individual's knowledge, skills and expertise. Following such suitability assessment, the Nominations and Governance Committee nominates, and recommends for Board Approval, members of the Management Board.

Management Committees

The Management Board is responsible for recommending strategy to the Board of Directors. Upon Board approval of such strategy, the Management Board becomes responsible for its execution. Execution includes, inter alia, ensuring adequate resourcing, proper internal controls, evaluating performance, and ensuring the timely implementation of the strategic initiatives within budget.

The Bank's Management Board meets on a regular basis. It is chaired by the CEO and is composed of the following members:

- The Chief Operations Officer
- The Chief Risk Officer
- The Chief Finance Officer
- The Chief Business Development Officer – Investments
- The Chief Business Development Officer – Credit
- The Chief Technology Officer

The Chief Officer Ethics and Employee Development regularly attends meetings of the Management Board whilst other Chief Officers and Bank Executives attend Management Board meetings by invitation.

The **Asset Liability Management Committee (ALCO)** is an integral part of the Bank. The Committee takes an integrated view in managing the Bank's assets and liabilities to achieve an optimal balance between risk and return. ALCO evaluates the asset and liability cash flows, and the management of integrated exposures at a consolidated level, to enable it to give strategic direction to the business. Consideration is given, inter alia, to solvency, liquidity and interest rate risks. It also provides guidance in respect of risk

Corporate governance statement of compliance (continued)

and return to the business, and exercises executive authority in the area of interest rate management by setting the interest rates payable on retail deposit products. Additionally, the Committee monitors hedging strategies and hedge effectiveness in respect of the aforementioned risks, as well as asset mix, liabilities and balance sheet growth. ALCO also monitors the capital adequacy of the Group on a continuous basis, making use of capital forecasts to ensure that enough capital is readily available at all times to meet the demand arising from business growth and regulation. The Committee meets at least once a month to review the balance sheet risks and ensures its prudent management. ALCO is chaired by the CEO and is composed of members of Senior Management.

The **Provisions Committee** is responsible to ensure that Expected Credit Loss (ECL) is in line with IFRS 9 requirements. It will challenge, amend or approve key management judgements applied to ECL. The Committee is also responsible to assess significant credit risk assessments performed by the first lines of defence (Credit and Treasury departments) in relation to the determination of the application of the staging criteria together with the appropriateness of the impairment allowances measured by the Finance Department in accordance with the expected loss model prescribed by IFRS 9. The Committee, which meets on a regular basis, is chaired by the Chief Finance Officer and is composed of members of Senior Management from Credit, Debt Management, Finance and Risk Management.

The **IT Steering Committee** is responsible for the effective and cost-efficient application of information technologies, related personnel resources and funding in support of the objectives and needs of the Bank. The Committee meets at least every two months unless further meetings are required. The IT Steering Committee is chaired by the Chief Technology Officer and is composed of members of Senior Management.

The **Procurement Committee** is responsible for the approval of procurement of goods and services that exceed limits afforded to management and to make recommendations to the Management Board and to the Board of Directors on the award of contracts that exceed a defined value. The Committee meets at least once a month unless further meetings are required. The Committee is chaired by the Chief Operations Officer and is composed of members of Senior Management.

The **Core Banking Transformation Steering Committee** is responsible for overseeing the implementation of the new selected core banking solution, together with overseeing the transformation required in line with the Bank's operations. The Committee takes into consideration current banking practices that need to be transformed in order to adopt the solution selected. The Committee meets on a monthly basis, is chaired by the CEO and is composed of members of Senior Management.

The **Anti-Money Laundering Committee (AMLC),** as appointed by the Management Board of the Bank is responsible to provide effective management oversight over the Group's main AML initiatives. The AMLC is also responsible to review and approve recommendations of the three Working Groups established to assist the AMLC in fulfilling its function, namely the Client Onboarding and Monitoring Working Group, Policies and Procedures Working Group and the AML Remediation and Initiatives Working Group. It is also responsible to submit its recommendations on AML policies and plans, to the Compliance and Crime Prevention Committee and/or Board of Directors; decide on the onboarding and termination of clients as escalated by the Working Group on Client Onboarding and Monitoring; and take any other material decision related to AML. The new AMLC replaced the previously known Anti-Financial Crime Committee.

The AMLC is chaired by the Chief Executive Officer and is composed of members of senior management as well as the Group Chief Compliance Officer, the Chair of the Working Group on Client Onboarding and Monitoring and the Chair of the Working Group on AML Policies & Procedures.

The **New Product Approval Committee (NPAC)** ensures the enhancement of long term value creation for the benefit of all stakeholders. The aim is to ensure adequate due diligence before a new product or service is launched by understanding and vetting its features. The Committee aims to identify and mitigate potential risks which impact both the product or service and the Group. The NPAC makes the final decision to either approve, decline or recommend changes to the proposed product or service.

The Committee also provides guidance and recommendations to the Board of Directors in case of a new business line. The NPAC is appointed by the Management Board and is chaired by the Chief Risk Officer to ensure a risk adequate approach and the necessary degree of intervention in relation to product development, hence also ensuring that the new proposed product or service falls within the Group's risk appetite.

The **Property Committee** ensures that the BOV Group's property management and capital projects related to property, are carried out in accordance with adopted policies, principles, strategies and the applicable legal framework. The Committee is chaired by the Chief Operations Officer and is composed of representatives from the Office of the Company Secretary, Architect Services Unit, the Administration and Risk functions.

The **Trustee Services Steering Committee (TSSC)** was set up to oversee that the winding down of the Trusts business is aligned with stated strategy and to monitor the interim management of the Trusts business during the winding down period. It is responsible to inter alia advise on and recommend processes to mitigate and manage potential costs and risks related to the winding down process, take decisions in line with Board approved policies and strategies, review changes in regulations that may have an impact on the business, and keep under review any litigation involving trustee services.

The main purpose of the **Custody Committee** is to approve, extend or decline business proposals from Fund clients under the remit

Corporate governance statement of compliance (continued)

of the Custody Unit. The Custody Committee is required to review both new and existing businesses presented by the Custody Unit and ensure that adequate due diligence on new clients is completed in line with internal policies. It should also verify that Custody carry out periodic follow ups in order to establish any material changes that may pose a risk and therefore require a reassessment of the particular client or clients.

The **Human Resources Steering Committee (HRSC**) is responsible to oversee the Human Resources (HR) Strategy, HR Policy development and implementation, direct the Group's HR Department towards effective HR management through overseeing all HR plans and initiatives and act as a consultative body for HR matters within the Bank. The Committee provides advice, input and direction to the Group's HR Department regarding matters impacting HR Strategy and its respective implementation. This Committee is chaired by the Chief Executive Officer and is composed of members of Senior Management and the Bank's HR external consultant.

Principle 6: Information and Professional Development

The CEO is appointed by the Board and is inter alia responsible for the recruitment and selection of Senior Management and consults with the Nominations and Governance Committee and with the Board on the appointment of Senior Management. Training of management and employees is a priority and internal and external training is provided by the Bank’s Training Centre specifically set up for this purpose. The Bank also has a system in place which monitors management and staff morale.

On joining the Board, a Non-Executive Director is provided with briefings by the CEO and Chief Officers on the activities of the Bank. All Directors are provided with appropriate induction training and a dossier that, apart from incorporating relevant information on the Bank, also includes the Bank’s Policy documents.

Directors may, where they judge it necessary to discharge their duties as Directors, take independent professional advice on any matter at the Bank’s expense. Directors have access to the advice and services of the Company Secretary, who is responsible for ensuring adherence to Board procedures as well as good information flows within the Board and its Committees.

Informative sessions on risk management, corporate governance and business ethics, and training sessions on the capital regime were organised during the period under review for the Board and for the members of the Management Board. In addition, the Company Secretary directs members of the Board to seminars or conferences which serve as professional development for Directors in the discharge of their functions on the Board and on the Committees.

Principle 7: Evaluation of the Board’s Performance

During the period under review, the Nominations and Governance Committee undertook an evaluation of the performance of the Board, the Chairman and the Board Committees. The evaluation exercise was conducted through a Board Effectiveness Questionnaire prepared by the Nominations and Governance Committee. The results of the Questionnaire were analysed by the Nominations and Governance Committee and discussed at Board level.

From the Board Effectiveness Questionnaire, the following points emerged:

- All Board Members support and debate the Company’s strategy and values enabling them to set the tone from the top.
- The Board communicates effectively with all of the company’s stakeholders and seeks their feedback.
- Board Members recognise the role which they and their colleagues are expected to play and have the appropriate skills and experience for that role.
- The Chairman and the CEO work well together and their different skills and experience complement each other.
- The Board has open channels of communication with senior executive management and others and is properly briefed.
- There is suitable separation of responsibilities between the Chairman, Board of Directors and the CEO.
- The Terms of Reference for the Board are appropriate, with clearly defined roles and responsibilities, ensuring that the right issues are being addressed.
- Conflicts of Interest are adequately disclosed and dealt with.

Principle 8: Committees

The **Remuneration Committee** is dealt with under the Remuneration Report, which also includes the Remuneration Statement of Compliance in terms of Code Provisions 8.A.3 and 8.A.4.

The **Nominations and Governance Committee** is dealt with under the Nominations Report as per Listing Rule 8.B.7.

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

The Bank recognises the importance of maintaining a dialogue with its shareholders and of keeping the market informed to ensure that its strategies and performance are well understood.

The Board is of the view that during the year under review the Bank has communicated effectively with the market through a number of company announcements and press releases.

Corporate governance statement of compliance (continued)

The Bank also communicates with its shareholders through the Bank's Annual General Meeting (AGM) (further detail is provided under the section entitled General Meetings). All Directors attend the AGM and are available to answer questions, if necessary.

The Chairman and the CEO also ensure that sufficient contact is maintained with major shareholders to understand issues and concerns. The Chairman also ensures that arrangements are made for all Directors to attend the AGM and for the Chairmen of the Audit Committee, Remuneration and Nomination and Governance Committees to be available to answer questions at the AGM.

Apart from the AGM, the Bank communicates with its shareholders by way of the Annual Report and Financial Statements, by publishing and sending to the shareholders its results on a six-monthly basis and through a bi-annual newsletter to shareholders. The Bank's website (www.bov.com) also contains information about the Bank and its business, including an Investor Relations Section.

In addition, the Bank holds a meeting for stockbrokers and financial intermediaries, usually twice a year, to coincide with the publication of its Financial Statements. Other meetings with stockbrokers and financial intermediaries are held as necessary. From time to time, the Bank also holds meetings with the Malta Association of Small Shareholders.

The Office of the Company Secretary maintains two-way communication between the Bank and its investors. Individual shareholders can raise matters relating to their shareholdings and the business of the Group at any time throughout the financial year and are given the opportunity to ask questions at the AGM or submit written questions in advance. In terms of Article 18.3 of the Articles of Association of the Bank and Article 129 of the Companies Act,1995 (Chapter 386, Laws of Malta), the Directors may call an Extraordinary General Meeting on the requisition of shareholders holding not less than one-tenth of the paid up share capital of the Company.

Principle 11: Conflicts of Interest

The Directors are strongly aware of their responsibility to act at all times in the interest of the Bank and its shareholders as a whole and of their obligation to avoid conflicts of interest. The latter may, and do arise on specific matters. In such instances, the Bank ensures that such conflicts, actual or potential, are managed in the best interest of the Bank.

A Director is therefore required to make full and frank disclosure with respect to any matter where there is a potential or actual conflict, whether such conflict arises from personal interests or the interests of the companies in which such person is a Director or officer and the said Director is excused from the meeting and accordingly is not involved in the Bank's Board discussion on the matter and does not vote on any such matter.

On joining the Board, and regularly thereafter, the Directors are informed of their obligations on dealing in securities of the Bank within the parameters of the law, including the Listing Rules, as well as the Bank's Code of Conduct for Securities Transactions, and Directors follow the required notification procedures.

Directors' interest in the share capital of the Bank as at 31 December 2018 was as follows:

	Beneficial Interest*
Alan Attard	14,782 shares
Paul V Azzopardi	9,153 shares
Miguel Borg	6,941 shares
Alfred Lupi	31,094 shares
Joseph M Zrinzo	199,295 shares

**Includes any shares held by spouses or partners*

Alan Attard held 15,749,945 shares by way of non-beneficial interest in his capacity as one of the five trustees of the BOV Employees' Foundation.

No Director has any other benefit or non-beneficial interest in the share capital of the Bank.

As at 31 December 2018, the Directors below also held the following:

	Beneficial Interest**	
Alan Attard	4,000	BOV 5.35% BOV Subordinated Bonds
Joseph M Zrinzo	35,000	BOV 3.5% BOV Subordinated Notes 2030 Series 2 Tranche 1
	31,500	BOV 4.8% BOV Subordinated Bonds 2020
	11,700	BOV 5.35% BOV Subordinated Bonds 2019

***Includes any holdings by spouses or partners*

Corporate governance statement of compliance (continued)

Principle 12: Corporate Social Responsibility

"We are committed to play a leading and effective role in the Country's sustainable development, whilst tangibly proving ourselves to be responsible and caring citizens of the community in which we operate."

As Malta's Leading Bank, Bank of Valletta p.l.c. leads by example, responsibly committing to substantial investment in the communities in which it operates. In addition to the economic responsibility towards its shareholders, customers and the Maltese economy, the Bank is a very active supporter of an array of social activities. It remains strongly committed to the development of society by promoting various cultural, educational and sports activities and nurturing a deep appreciation for the Country's heritage and the environment.

The Bank's primary asset is its talented and multi-skilled workforce, which is empowered and trained to offer an excellent customer experience. BOV offers a positive work environment, training opportunities and other family-friendly measures enabling its employees to achieve a healthy work-life balance. BOV holds the Equality Mark certification, awarded by the National Commission for the Promotion of Equality (NCPE) in recognition of its workplace, free of discrimination. Employees are also encouraged to fulfil their role in the community by participating in events like blood donation drives and dress down days in aid of Non-Governmental Organisations organised throughout the year. Meanwhile, teams across the Bank organise various initiatives for the benefit of others within their community. Furthermore, Bank of Valletta strongly supports its BOV Sports and Social Club, subsidising a number of varied activities where staff have the opportunity to build stronger teamwork in a social setting.

As a strong sign of commitment towards its top net worth customers, in 2018 the Bank has inaugurated its Premium Banking Centre in Santa Venera, offering an adequate environment which is more conducive to business and forging strong customer relationships. Away from our shores, the Bank has opened a Representative Office in London, complementing the ones in Milan and Brussels to promote its services abroad. For its esteemed local customers, Bank of Valletta operates the largest network of branches, covering the Maltese islands like no other bank. Supplementing its branch network, the Bank operates five Business Centres, a Corporate Centre, six Investment Centres and a Wealth Management office.

The Bank differentiates itself from competition through a superior Customer Experience to its customers. Having an extensive customer base with varying needs and expectations and operating multiple face-to-face and online channels makes this objective far from easy. The Bank is currently making a considerable capital expenditure to modernise its Core Banking system to better serve its customers. The unrelenting support of all staff over the past months is a strong sign of commitment towards the Bank and our customers. In the coming months we will witness this project come to fruition.

The Bank's extensive Corporate Social Responsibility programme leaves a positive impact across a wide spectrum of the community, supporting an array of initiatives to ensure a balanced societal development. The Bank's investment in CSR is distributed on seven important pillars, ensuring a far-reaching and effective investment for current and future generations. The highlights of Financial Year 2018 are the following:

Arts and Culture – Being named the European Capital of Culture for 2018, our capital city - Valletta has taken heightened importance on an international level. Bank of Valletta was chosen as the Preferred Partner of Valletta 2018 Foundation, supporting the promotional, artistic and cultural activities that have given a vibrant boost to Valletta over the whole year. The Bank sponsored performances at the Manoel Theatre and the two theatres in Gozo - Astra and Aurora. BOV also retained its status of a leading sponsor of the Malta Philharmonic Orchestra. The Bank has continued to endorse the Maltese Tenor Joseph Calleja as well as the BOV Joseph Calleja Children's Choir. The BOV Retrospective Arts Exhibition this year featured works of art by renowned artist Joseph Calleja, who has since, regretfully, passed away to eternal life.

Heritage – Following an extensive restoration process supported by the Bank, the crowned statue of St Joseph and baby Jesus, known as San Ġużepp ix-Xiħ has been unveiled during a ceremony which took place at the Mdina Cathedral. 'The Martyrdom of St Lawrence', the largest painting by Italian Master Mattia Preti in Malta also underwent restoration through the support of Bank of Valletta. The Bank renewed its continued support to the conservation of the 16th Century baroque '*Grand Salon*' at the Auberge de Provence in Valletta, being undertaken under the supervision of Heritage Malta. Bank of Valletta is also sponsoring an extensive conservation of the 17th Century miraculous Crucifix at Ta' Ġieżu Church in Rabat. Furthermore, the Bank is supporting the conservation of a number of paintings by the late artist Professor Giuseppe Briffa, adorning the ceilings of St. Paul's Church in Birkirkara. Meanwhile, the Bank continued to partner 'Fondazzjoni Wirt Artna', not only in relation to safeguarding historical gems but also vis-a'-vis its Hands-On Heritage programme which focuses on educating the younger generation about our rich past by offering students the unique opportunity to handle period instruments and tools, and learn how they were used.

Natural Environment – The Bank renewed its support to 'Dinja Waħda', a nationwide education and awareness program that runs across Primary Schools by the NGO BirdLife Malta. Targeting thousands of school children, this program aims to instil in them a deeper appreciation for Malta's fauna and flora. The Bank supported the publication of "Trees and Shrubs of the Maltese Islands and their Habitats", an initiative by Nature Trust to disseminate a stronger sense of awareness and responsibility towards trees on our islands. As part of its commitment towards the environment, this year's BOV Calendar has featured a number of typical Maltese animals, many of which were in danger of extinction in recent years. Furthermore, a number of staff activities have been organised under the wing of the BOV Sports and Social Club.

Education – The Bank renewed its collaboration with the National Literacy Agency towards the Read with Me programme which is run free of charge in various centres across Malta and Gozo, in a bid to help overcome illiteracy by targeting children aged 0 to 4 years and

Corporate governance statement of compliance (continued)

their parents/guardians. This is done by providing the environment and the professionals who make reading time a fun experience for everyone involved. The Bank also organised dedicated sessions for its own employees and their children at BOV Centre. As part of its role of Preferred Partner of the Valletta 2018 Foundation, Bank of Valletta supported the Discover Valletta project, bringing a series of short stories, written by Trevor Zahra and linked to twenty-four landmarks in Valletta, to over 18,000 students.

Philanthropy – Social causes continue to rank highly on the Bank's agenda. Since it was set up in 2014, the Marigold Foundation – BOV in the Community acts as a Trust that manages requests by NGOs and individuals with philanthropic objectives. The BOV Joseph Calleja Foundation, on the other hand, is a partnership between the Bank and the internationally renowned Maltese tenor that raises funds to support talented youth in fulfilling their artistic goals. Dress downs organised during the period under review, supported the Pink October initiative in aid of Breast Cancer and Crazy Socks day in aid of Down Syndrome Association (Malta). Meanwhile, the Bank dedicated its Cards for Charity campaign towards 'Caritas – Malta'. L-Istrina BOV Piggy Bank campaign collected over €58,370 from schools and the Bank's contribution towards the Malta Community Chest Fund was €200,000. Various other initiatives are spearheaded from staff across the Bank for the benefit of an array of voluntary organisations and NGOs. BOV staff show solidarity towards each other by donating a part of their salary on a monthly basis and/or vacation leave to those passing through difficult times.

Sport – The Bank has become synonymous with Maltese sport due to its unwavering support to a number of disciplines over the years. The Bank supports Maltese soccer through the BOV Premier League and the BOV Player of the Month awards. Bank of Valletta sponsors basketball, water polo, horse racing and other sport activities along the year. Furthermore, through SportMalta the Bank extended its support to the Youth Development Scheme for a number of Maltese athletes who have not yet reached the age of 18. The Scheme provides financial assistance to these youngsters to participate in international competitions beyond our shores. Through the BOV Sports and Social Club the Bank gives financial support to its staff in various kinds of sport such as soccer, bowling, tennis and running.

Strategic Alliances – The Bank continued to work closely with the main representative bodies and business associations, such as the Malta Chamber of Commerce, Enterprise and Industry, the Malta Hotels and Restaurants Association, the Gozo Business Chamber, the Chamber of Engineers, the Airline Pilots Association (ALPA) and the Institute of Healthcare Professionals. In 2018, Bank of Valletta sponsored several business initiatives and conferences, facilitating open discussion about topical issues of interest to businesses in Malta.

The Corporate Social Responsibility initiatives highlighted above are a manifestation of the Bank's unwavering commitment to the communities in which it operates. It is our philosophy to respect the environment and assist in the development of society, not just from an economic perspective, but from a holistic standpoint. We firmly believe that the success of Bank of Valletta stems from the trust that we enjoy from our customers and as a responsible corporate citizen, it is our strategy to continue investing in the community so that we grow together, sharing current and future success.

C. NON-COMPLIANCE WITH THE CODE

Principle 4 (Code Provision 4.2.7)

The Code recommends "the development of a succession policy for the future composition of the Board of Directors and particularly the executive component thereof, for which the Chairman should hold key responsibility". Although the Bank does not have a Succession Policy per se, the concept of Rotation of Directors (as further explained under Principle 3 above) was introduced to ensure continuity at Board level and is embedded within the Bank's Memorandum and Articles of Association.

Principle 6 (Code Provision 6.4.4)

During the financial year under review the Bank did not have a system in place to establish a succession plan for Senior Management. This notwithstanding, the Bank has always been successful in appointing suitable individuals internally. Moreover, the Bank is currently working on a succession planning policy.

Principle 9 (Code Provision 9.3 and 9.4)

Code Provision 9.3 requires the Bank to have in place a mechanism to resolve conflicts between minority shareholders and controlling shareholders. Code Provision 9.4 requires that minority shareholders should be allowed to formally present an issue to the Board of Directors. Both Code Provisions were not applicable to the Bank during the financial year.

Listing Rules – Section 5.97.8 – Policy on Diversity

The Bank does not have a Diversity Policy vis-à-vis the Board of Directors and the Management Board, however it ensures that the Bank is diverse in terms of skills, competency, gender and age. In the Maltese environment, it is difficult to ensure gender diversity at Board level, which is a nationwide problem.

The Bank is Equality Certified and has an Equality Policy. The Equality Mark is a certification awarded to companies that make gender equality one of their values and whose management is based on the recognition and promotion of the potential of all employees irrespective of their gender and caring responsibilities.

Furthermore, the Bank has policies in place which encourage and promote family-friendly measures such as child-care leave and child-care subsidies.

Corporate governance statement of compliance (continued)

D. INTERNAL CONTROL

Authority to manage the activities of the Bank is delegated to the CEO within the limits set by the Board.

The Board is ultimately responsible for the Bank's systems of internal control and for reviewing their effectiveness. Such systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives, and can only provide reasonable as opposed to absolute assurance against material misstatement or loss. Through the Audit Committee, the Risk Management Committee and the Compliance and Crime Prevention Committee, the Board reviews the process and procedures to ensure the effectiveness of the Group's systems of internal control, which are monitored by the Group Internal Audit Department.

The key features of the Group's systems of internal control are as follows:

Organisation

The Group operates through the Board of Directors of subsidiary companies and equity-accounted investee companies with clear reporting lines and delegation of powers.

Control Environment

The Group is committed to the highest standards of business conduct and seeks to maintain these standards across all of its operations. Group policies and employee procedures are in place for the reporting and resolution of fraudulent activities. The Group has an appropriate organisational structure for planning, executing, controlling and monitoring business operations in order to achieve Group objectives.

Risk Identification

The Management of each of the Group members is responsible for the identification and evaluation of key risks applicable to their areas of business. The risk management model adopted by BOV is the classic "three lines of defence model" wherein the first line of defence is constituted by the functions that own and manage risks, namely the business units; the second line is constituted by the functions that oversee risks, namely Risk Management, Compliance and Anti-Financial Crime; and the third line is constituted by Internal Audit, which is the function that provides independent assurance. The Risk Management function, within the second line of defence, falls under the responsibility of the Chief Risk Officer, and operates within a wider Bank structure that reflects the risk appetite and risk management philosophy articulated by the Board of Directors.

Reporting

Functional, operating and financial reporting standards are applicable to all entities of the Group. These are supplemented by operating standards set, as required, by the Bank's Board and the Management Board. Systems and procedures are in place to identify, control and to report on the major risks including credit risk, changes in the market prices of financial instruments, liquidity, operational error and fraud. Exposure to these risks is monitored by ALCO and by the Risk Management Committee. The Board receives periodic management information giving comprehensive analysis of financial and business performance including variances against budgets.

E. LISTING RULE 5.97.5

The information required by this Listing Rule is found in the Directors' Report.

F. GENERAL MEETINGS

The general meeting is the highest decision making body of the Bank. A general meeting is called by twenty-one days' notice and it is conducted in accordance with the Articles of Association of the Bank.

The Annual General Meeting (AGM) deals with what is termed as "ordinary business", namely, the receiving or adoption of the annual financial statements, the declaration of a dividend, if any, the appointment of the auditors, Board authorisation to fix the auditors' emoluments and the Election of Directors. Other business which may be transacted at a general meeting (including at the AGM) will be dealt with as Special Business.

All shareholders registered in the Shareholders' Register on the Record Date as defined in the Listing Rules, have the right to attend, participate and vote in the general meeting. A shareholder or shareholders holding not less than 5% in nominal value of all the shares entitled to vote at the general meeting may request the Bank to include items on the agenda of a general meeting and/or table draft resolutions for items included in the agenda of a general meeting. Such requests are to be received by the Bank at least forty six days before the date set for the relative general meeting.

A shareholder who cannot participate in the general meeting can appoint a proxy by written or electronic notification to the Bank. Every shareholder represented in person or by proxy is entitled to ask questions which are pertinent and related to items on the agenda of the general meeting and to have such questions answered by the Directors or by such persons as the Directors may delegate for that purpose.

Remuneration report as at 31 December 2018

1. Terms of Reference and Membership of the Remuneration Committee

The Remuneration Committee (the Committee) is charged with overseeing the development and implementation of the remuneration and related policies of the Group. Its primary purpose is to make recommendations to the Board of Directors on the remuneration policy of the Group, support the Board of Directors in overseeing the remuneration system's design and operation and ensure that remuneration is appropriate and consistent with the Bank's culture, long term business and risk appetite, performance and control environment as well as with any legal or regulatory requirements. The role of the Committee is to devise the appropriate remuneration packages needed to attract, retain and motivate Directors, as well as key function holders required for the proper governance of the Group.

The Committee is composed of Taddeo Scerri (Chairman), Anita Mangion and Antonio Piras as members, all of whom are Independent Non-Executive Directors. The Chief Executive Officer, the Chief Risk Officer and the Chief Officer Ethics and Employee Development attend meetings of the Committee. The Company Secretary acts as secretary to the Committee.

2. Meetings

The Committee held five meetings during the period under review, which were attended by all members.

3. Remuneration Statement

3.1 Remuneration Policy – Executive Management

The Board of Directors determines the framework of the overall remuneration policy for Executive Management based on recommendations from the Committee. The Committee, on the recommendations of the Chief Executive Officer, then establishes the individual remuneration arrangements of the Group's Executive Management, namely the members of the Management Board and Heads of Departments.

The Committee is also charged with considering and determining requests for early retirement based on exceptional circumstances, which must be assessed by the Bank on a case by case basis.

The Remuneration Policy applies consistently to all employees within the Group. Its objective is to align employees' remuneration with the Group's performance, business strategy and business models, risk appetite framework, values and long term goals. The overriding principle of the Remuneration Policy is that individual performance is evaluated according to both quantitative/ financial and qualitative/behavioural measures. Further details about the Bank's Remuneration Policy are found in the Capital and Risk Management Report.

The Committee considers that the current Executive Management remuneration packages are based upon the appropriate local market equivalents and are adequate for the responsibilities involved. The Committee is of the opinion that the remuneration packages are such, so as to enable the Bank to attract, retain and motivate executives having the appropriate skills and qualities, in order to ensure the proper management of the organisation. Such packages should therefore be kept under constant review.

Hereinafter, for the purposes of this Remuneration Statement, references to "Senior Executives" shall mean the Chief Executive Officer and the other six members of the Management Board.

Senior Executives are in full employment with the Bank on an indefinite contract but their appointment on the Management Board is on a definite contract. They enjoy the health insurance arrangements and death in service benefits as all Bank employees. Senior Executives are also entitled to the use of a company car. Certain members of the Management Board have a clause in their contract, wherein should their contract be terminated without due reason, they may be eligible for monetary compensation. Share options and profit sharing are not part of the Group's Remuneration Policy. Subject to the foregoing, the terms and conditions of the Management Board members' contracts are considered as commercially sensitive information.

The Chief Executive Officer's remuneration is reviewed and approved by the Committee. The Chief Executive Officer is eligible for an annual bonus entitlement by reference to the attainment of pre-established objectives and targets as approved by the Committee. The Members of the Management Board are also eligible for an annual bonus entitlement. The CEO and members of the Management Board have waived their annual bonus for Financial Year 2018.

The Members of the Management Board are eligible for an annual salary increase within a maximum salary range approved by the Committee.

No supplementary pension or other pension benefits are payable to the Senior Executives. Insofar as early retirement schemes are concerned, the Senior Executives are subject to the schemes which are set out and defined in the Collective Agreement (for Managerial and Clerical Grades) as may be applicable to employees from time to time.

The Committee is of the view that the amount of performance bonus paid out at all staff levels is not significant.

Remuneration report as at 31 December 2018 (continued)

Total emoluments received by Senior Executives during Financial Year 2018 are reported below under section 3.3 in terms of Code Provisions 8.A.5.

Variable Remuneration of Senior Executives (Management Board)

The Variable Remuneration of Senior Executives is determined by the Remuneration Committee. During Financial Year 2018 Management Board members qualified for a collective performance-related pay system but waived their annual bonus. The payment of bonuses payable to the Management Board members was linked to the performance and achievement of the objectives of the Management Board. The objectives of the Management Board were based partly on financial targets (financial ratios) and partly on qualitative targets (qualitative ratios).

3.2 Remuneration Policy – Directors

The Board of Directors is composed of Executive and Non-Executive Directors. Directors' remuneration is determined and regulated by service contracts as detailed below. The maximum annual aggregate emoluments that may be paid to the Directors is approved by the shareholders at the General Meeting in terms of Article 33.1 of the Bank's Articles of Association. The aggregate emoluments of all directors of €450,000 per annum, was fixed at an Extraordinary General Meeting held on 27 July 2017. This amount excludes the salaries of Directors in the Bank's employment.

Service Contracts for Directors

The Directors have service contracts with the Bank, none of which provide for severance payments upon termination of their respective directorship. In terms of the said service contracts, the Directors are entitled to certain benefits after the termination of their directorship, including discounts on products and services offered by the Group. Service contracts regulate the term of office of Non-Executive Directors, referring specifically to the concept of Rotation of Directors provided within the Memorandum and Articles of Association (as further explained under Principle 3 of the Corporate Governance Statement of Compliance). The Chief Executive Officer is appointed as Executive Director, on an ex officio basis, by virtue of his role of Chief Executive Officer. Moreover, the second Executive Director on the Board has a term of office of three (3) years and shall thereafter be eligible for re-appointment. Vacation of office of Directors shall be served in writing. Service contracts also provide for the Directors' powers and duties vis-à-vis the Bank and their obligation to dedicate sufficient time to carry out their responsibilities. Directors are obliged to avoid conflicts of interest and shall take reasonable steps to keep the Bank's matters confidential. Directors' emoluments are designed to reflect the time committed by Directors to the Bank's affairs, including the different Board Committees of which Directors are members, and their responsibilities on such Committees. None of the Directors, in the capacity as a Director of the Bank, is entitled to profit sharing, share options or pension benefits. In terms of non-cash benefits, Directors are entitled to health insurance and to a refund of out-of-pocket expenses.

The Directors' fees as approved by the Board of Directors are as follows:

Directors' Fees	**€**
Chairman	80,000
All other Directors (both Executive and Non-Executive)	20,500
Board Committees Fees	
Chairman	5,000
Members	3,000

Two of the Non-Executive Directors, as well as both the Executive Directors, are employees of the Bank and therefore also receive remuneration by virtue of their employment.

Total fees received by Directors during Financial Year 2018 are reported below under section 3.3 in terms of Code Provisions 8.A.5.

Remuneration Policy Review

During the year under review, the Remuneration Policy has been updated with the following changes:

i) The Remuneration Policy of the Bank of Valletta Group has become consistently applicable to all employees within the Group. The objective was to align employees' remuneration with the Group's performance, business strategy and business models, risk appetite framework, values and long-term goals.
ii) The policy ensured that the fixed-to-variable threshold will be maintained within the limits as specified in the regulation and as agreed with the Supervisory Authority.
iii) The policy review introduced Malus and Clawback arrangements.

Further changes to the Remuneration Policy are expected during the Financial Year 2019.

Remuneration report as at 31 December 2018 (continued)

3.3 Code Provision 8.A.5

Senior Executives' Emoluments (Management Board)

Fixed Remuneration	Group Directors Fees	Variable Remuneration	Share Options	Others
€741,705	€77,159	€63,000	none	non-cash benefits: health insurance and refund of out-of-pocket expenses

Directors' Fees

Fixed Remuneration	Variable Remuneration	Share Options	Others
€371,000	None	None	non-cash benefits: health insurance and refund of out-of-pocket expenses

For the Financial Year under review these were paid as follows:

Directors' fees including benefits – Financial Year 2018	**€**
Taddeo Scerri (Chairman)	97,556
Stephen Agius	27,661
Alan Attard	27,661
Paul V Azzopardi	28,959
Miguel Borg	20,770
James Grech	30,310
Alfred Lupi	33,060
Mario Mallia	24,418
Anita Mangion	27,310
Antonio Piras	26,500
Joseph M Zrinzo	38,060
Total	382,265

Nominations report as at 31 December 2018

The Nominations and Governance Committee

The Nominations and Governance Committee (the Committee) was set up by the Board of Directors and is enshrined within the Bank's Memorandum and Articles of Association. The Committee follows the Nominations Policy and works under the guidance of its Terms of Reference as approved by the Board of Directors.

The role of the Committee is twofold, namely (i) to ensure that the composition of the Board of Directors of the Bank has the appropriate level and mix of experience, skills and competence that are required for the operation of a credit institution and (ii) to ensure that persons occupying the post of Non-Executive Directors meet the requirements of prevailing legislation and regulation.

From time to time, the Board of Directors sets out the Terms of Reference of the Committee. However certain fundamentals are entrenched in the Memorandum and Articles of Association, which set out both the basic role of the Committee as well as its functions, namely:

i) To recommend to the Board of Directors, candidates having the right attributes, including integrity, skill, competence and experience individually; and who can contribute to the collective skills, experience and competence required at Board level;
ii) To make recommendations to the Board of Directors on persons considered as independent to occupy positions on the Board;
iii) To make recommendations on matters such as succession planning, establishment of policies and procedures related to the selection of Senior Management and the optimal size of the Board of Directors and the Management Board;
iv) To ensure that nominations to the Board of Directors are made on merit and in line with the overall requirements of the skills and competence required;
v) To ensure that persons whose nomination is approved and recommended to shareholders or the Board of Directors as the case may be, are in a position to dedicate sufficient time and resources to the office of Director;
vi) To monitor on an ongoing basis any significant additional time commitments of the Board Members;
vii) To evaluate and test each candidate to the Board against guidelines issued from time to time by the Regulators; and
viii) Periodically assess the skills, knowledge and experience that may be required within the Board and make recommendations to the Board.

With a view to avoid possible perceptions of conflicts of interest in the scrutiny and approval of candidates for appointment as Non-Executive Directors, the Articles of Association provide that no member of the Committee shall be present when his nomination as a director or a matter which concerns that member in question, is being evaluated by the Committee. In these instances such member shall be substituted by another director. In this same context, the proposals include a system of rotation that would, as far as practicably possible, ensure that members on the Committee will not have an interest in the scrutiny of other candidates for the same position.

The Committee is composed of three Independent Non-Executive Directors. During Financial Year 2018, the Committee was chaired by the Chairman of the Bank Taddeo Scerri, with Stephen Agius and Joseph M Zrinzo as members. The Chief Executive Officer and the Chief Risk Officer attend meetings of the Committee. The Company Secretary acts as secretary to the Committee. The Committee held nine meetings during the period under review and all members attended all nine meetings.

During Financial Year 2018, the Committee focused on the nomination process for the appointment of Non-Executive Directors on the Board including the conduct of a suitability assessment on candidates seeking appointment on the Board. The Committee was responsible to consider appointments of executives in various roles within the Bank. The Committee was also responsible for the evaluation of the Board's performance, the Chairman's performance and the Board Committees' performance (as further explained under Principle 7 of the Corporate Governance Statement of Compliance).

Disclosures for the purposes of Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms:

While information about every member of the Board is found on pages (ii) and (iii) of the Annual Report, a detailed curriculum vitae of every member of the Board and of the nominees is available at the Office of the Company Secretary.

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c.

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

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

Specifically, with respect to the following matters noted in Listing Rule 5.100, we report whether:

(a) we have identified material misstatements with respect to the disclosures referred to in Listing Rule 5.97.4 and Listing Rule 5.97.5. Where any material misstatements are identified, we are required to provide an indication of the nature of such misstatements; and

(b) the other disclosures required by Listing Rule 5.97 have been provided.

Responsibilities of the Directors

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

Auditors' Responsibilities

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

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

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

We are not required to, and we do not, consider whether the directors' statements on internal control and risk management systems cover all the risks and controls in relation to the financial reporting process or form an opinion on the effectiveness of the Bank's corporate governance procedures or its risks and control procedures, nor on the ability of the Bank to continue in operational existence. Our opinion in relation to the disclosures pursuant to Listing Rule 5.97.4 and Listing Rule 5.97.5 is based solely on our knowledge and understanding of the Bank and its environment obtained in forming our opinion on the audit of the financial statements. We have not performed any procedures by way of audit, verification or review on the underlying information from which the other disclosures required by Listing Rule 5.97 is derived.

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

Conclusion

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

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

In our opinion:

(a) in light of the knowledge and understanding of the Bank and its environment obtained during the course of our audit of the financial statements, we have not identified material misstatements with respect to the following disclosures:
    (i) the information referred to in Listing Rule 5.97.4, included in the directors' Corporate Governance Statement of Compliance, as this relates to the Bank's internal control and risk management systems in relation to the financial reporting process; and
    (ii) the information referred to in Listing Rule 5.97.5, included in the Directors' Report, insofar as it is applicable to the Bank;
(b) the other disclosures required by Listing Rule 5.97 have been included in the directors' Statement of Compliance on Corporate Governance, as these apply to the Bank.

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

Noel Mizzi
Partner, for and on behalf of
KPMG
Registered Auditors,
Portico Building,
Marina Street,
Pietà PTA 9044,
Malta

15 March 2019

Statements of profit or loss

For the year ended 31 December 2018

		The Group		The Bank	
	Note	2018	2017	2018	2017
		12 months to Dec 2018	15 months to Dec 2017	12 months to Dec 2018	15 months to Dec 2017
		€000	€000	€000	€000
Interest and similar income					
- on loans and advances, balances with Central Bank of Malta and treasury bills	2	165,177	198,997	165,177	198,997
- on debt and other fixed income instruments	2	48,719	60,197	48,719	60,197
Interest expense	3	(57,350)	(76,247)	(57,350)	(76,247)
Net interest income		**156,546**	**182,947**	**156,546**	**182,947**
Fee and commission income		92,368	98,787	83,346	87,587
Fee and commission expense		(11,231)	(12,498)	(11,231)	(12,498)
Net fee and commission income	4	**81,137**	**86,289**	**72,115**	**75,089**
Dividend income		1,075	1,925	12,828	17,682
Trading profits	5	18,019	22,290	18,007	22,338
Net gain on investment securities and hedging instruments	6	989	7,022	989	7,022
Operating income		**257,766**	**300,473**	**260,485**	**305,078**
Employee compensation and benefits	7	(65,696)	(79,750)	(63,043)	(76,507)
General administrative expenses		(54,596)	(59,463)	(53,093)	(57,806)
Amortisation of intangible assets	20	(4,607)	(4,933)	(4,607)	(4,933)
Depreciation	21	(5,699)	(7,105)	(5,636)	(7,035)
Net impairment reversals	8	10,816	6,227	10,816	6,227
Operating profit before litigation provision		**137,984**	**155,449**	**144,922**	**165,024**
Litigation provision	33	(75,000)	-	(75,000)	-
Operating profit		**62,984**	**155,449**	**69,922**	**165,024**
Share of results of equity-accounted investees, net of tax	18	8,214	19,287	-	-
Profit before tax	9	**71,198**	**174,736**	**69,922**	**165,024**
Income tax expense	10	(19,788)	(55,238)	(19,357)	(56,180)
Profit for the period		**51,410**	**119,498**	**50,565**	**108,844**
Earnings per share	11	**09c7**	**27c1**	**09c6**	**24c7**

Statements of profit or loss and other comprehensive income

For the year ended 31 December 2018

	Note	The Group		The Bank	
		2018	2017	2018	2017
		12 months to Dec 2018	15 months to Dec 2017	12 months to Dec 2018	15 months to Dec 2017
		€000	€000	€000	€000
Profit for the period		51,410	119,498	50,565	108,844
Other comprehensive income					
Items that may be reclassified subsequently to profit or loss:					
Available-for-sale investments					
- change in fair value		-	1,379	-	1,379
tax thereon		-	(483)	-	(483)
- change in fair value transferred to profit or loss		-	(7,443)	-	(7,443)
tax thereon		-	2,605	-	2,605
Debt investments at FVOCI					
- change in fair value		(1,958)	-	(1,958)	-
tax thereon		685	-	685	-
Items that will not be reclassified to profit or loss:					
Equity investments at FVOCI					
- change in fair value		(1,904)	-	(1,904)	-
tax thereon		666	-	666	-
Property revaluation	21	12,762	2,005	12,762	2,005
tax thereon		(1,276)	(201)	(1,276)	(201)
Remeasurement of actuarial losses on defined benefit plans	35	(3,777)	15	(3,777)	15
tax thereon		1,322	(5)	1,322	(5)
Other comprehensive income for the period, net of tax		6,520	(2,128)	6,520	(2,128)
Total comprehensive income		57,930	117,370	57,085	106,716

The notes are an integral part of these financial statements.

Statements of financial position

As at 31 December 2018

	Note	The Group 2018 €000	The Group 2017 €000	The Bank 2018 €000	The Bank 2017 €000
ASSETS					
Balances with Central Bank of Malta, treasury bills and cash	13	246,299	159,684	246,299	159,684
Financial assets at fair value through profit or loss	14	206,206	326,291	205,227	325,316
Investments	15	3,314,955	3,374,541	3,314,955	3,374,541
Loans and advances to banks	16	3,644,933	3,431,383	3,644,933	3,431,383
Loans and advances to customers at amortised cost	17	4,362,983	4,162,032	4,362,983	4,162,032
Investments in equity-accounted investees	18	108,510	109,461	52,870	52,870
Investments in subsidiary companies	19	-	-	6,230	6,230
Intangible assets	20	42,043	28,453	42,043	28,453
Property and equipment	21	119,155	105,222	118,978	105,048
Current tax		7,606	12,034	7,086	9,379
Deferred tax	22	71,769	60,217	71,769	60,217
Assets held for realisation	40	4,335	5,972	4,335	5,972
Other assets		7,880	5,955	7,880	5,872
Prepayments and accrued income	23	10,314	39,385	8,851	40,317
Total Assets		**12,146,988**	**11,820,630**	**12,094,439**	**11,767,314**
LIABILITIES					
Financial liabilities at fair value through profit or loss	14	8,812	11,957	8,812	11,957
Amounts owed to banks	24	146,021	192,196	146,021	192,196
Amounts owed to customers	25	10,414,908	10,100,625	10,417,999	10,102,164
Debt securities in issue	26	40,197	95,400	40,197	95,400
Deferred tax	22	5,743	4,519	5,743	4,519
Other liabilities	27	196,421	195,751	196,204	195,428
Provisions	33	95,767	2,000	95,767	2,000
Accruals and deferred income	28	539	12,451	-	11,958
Derivatives designated for hedge accounting	29	10,206	12,053	10,206	12,053
Subordinated liabilities	30	234,241	231,591	234,241	231,591
Total Liabilities		**11,152,855**	**10,858,543**	**11,155,190**	**10,859,266**
EQUITY					
Called up share capital	31	530,772	525,000	530,772	525,000
Share premium account	31	49,277	45,427	49,277	45,427
Revaluation reserves	32	50,034	33,194	49,922	33,082
Retained earnings	32	364,050	358,466	309,278	304,539
Total Equity		**994,133**	**962,087**	**939,249**	**908,048**
Total Liabilities and Equity		**12,146,988**	**11,820,630**	**12,094,439**	**11,767,314**
MEMORANDUM ITEMS					
Contingent liabilities	33	335,405	253,851	335,405	253,851
Commitments	34	1,881,392	1,858,191	1,881,392	1,858,191

The notes are an integral part of these financial statements. These financial statements were approved by the Board of Directors and authorised for issue on 15 March 2019 and signed on its behalf by:

Taddeo Scerri
Chairman

Joseph M Zrinzo
Director

Mario Mallia
Director and Chief Executive Officer

Statements of changes in equity

For the year ended 31 December 2018

	Attributable to Equity holders of the Bank				
The Group	Share Capital €000	Share Premium Account €000	Revaluation Reserves €000	Retained Earnings €000	Total €000
At 1 October 2016	**390,000**	**988**	**35,332**	**302,841**	**729,161**
Profit for the period	-	-	-	119,498	**119,498**
Other comprehensive income					
Available-for-sale investments					
- change in fair value, net of tax	-	-	896	-	**896**
- change in fair value transferred to profit or loss, net of tax	-	-	(4,838)	-	**(4,838)**
Property revaluation, net of tax	-	-	1,804	-	**1,804**
Remeasurement of actuarial gains on defined benefit plans, net of tax	-	-	-	10	**10**
Total other comprehensive income	-	-	(2,138)	10	**(2,128)**
Total comprehensive income for the period	-	-	(2,138)	119,508	**117,370**
Transactions with owners, recorded directly in equity:					
Rights issue	105,000	44,439	-	-	**149,439**
Bonus issue	30,000	-	-	(30,000)	**-**
Dividends to equity holders	-	-	-	(33,883)	**(33,883)**
	135,000	44,439	-	(63,883)	**115,556**
At 31 December 2017	**525,000**	**45,427**	**33,194**	**358,466**	**962,087**
Adjustments on initial application of IFRS 9	-	-	9,573	(17,779)	**(8,206)**
Adjusted balance at 1 January 2018	**525,000**	**45,427**	**42,767**	**340,687**	**953,881**
Profit for the year	-	-	-	51,410	**51,410**
Other comprehensive income					
Debt investments at FVOCI					
- change in fair value, net of tax	-	-	(1,273)	-	**(1,273)**
Equity investments at FVOCI					
- change in fair value, net of tax	-	-	(1,238)	-	**(1,238)**
- change in fair value transferred to retained earnings, net of tax	-	-	(1,246)	1,246	**-**
Property revaluation, net of tax	-	-	11,486	-	**11,486**
Release of surplus on sale of property, net of tax	-	-	(462)	462	**-**
Remeasurement of actuarial losses on defined benefit plans, net of tax	-	-	-	(2,455)	**(2,455)**
Total other comprehensive income	-	-	7,267	(747)	**6,520**
Total comprehensive income for the year	-	-	7,267	50,663	**57,930**
Transactions with owners, recorded directly in equity:					
Scrip Dividend	5,772	3,850	-	(9,622)	**-**
Dividends to equity holders	-	-	-	(17,678)	**(17,678)**
	5,772	3,850	-	(27,300)	**(17,678)**
At 31 December 2018	**530,772**	**49,277**	**50,034**	**364,050**	**994,133**

The notes are an integral part of these financial statements.

Statements of changes in equity

For the year ended 31 December 2018 (continued)

	Share Capital €000	Share Premium Account €000	Revaluation Reserves €000	Retained Earnings €000	Total €000
The Bank					
At 1 October 2016	**390,000**	**988**	**35,220**	**259,568**	**685,776**
Profit for the period	-	-	-	108,844	**108,844**
Other comprehensive income					
Available-for-sale investments					
- change in fair value, net of tax	-	-	896	-	**896**
- change in fair value transferred to profit or loss, net of tax	-	-	(4,838)	-	**(4,838)**
Property revaluation, net of tax	-	-	1,804	-	**1,804**
Remeasurement of actuarial losses on defined benefit plans, net of tax	-	-	-	10	**10**
Total other comprehensive income	-	-	(2,138)	10	**(2,128)**
Total comprehensive income for the period	-	-	(2,138)	108,854	**106,716**
Transactions with owners, recorded directly in equity:					
Rights issue	105,000	44,439	-	-	**149,439**
Bonus issue	30,000	-	-	(30,000)	**-**
Dividends to equity holders	-	-	-	(33,883)	**(33,883)**
	135,000	44,439	-	(63,883)	**115,556**
At 31 December 2017	**525,000**	**45,427**	**33,082**	**304,539**	**908,048**
Adjustments on initial application of IFRS 9	-	-	9,573	(17,779)	(8,206)
Adjusted balance at 1 January 2018	**525,000**	**45,427**	**42,655**	**286,760**	**899,842**
Profit for the year	-	-	-	50,565	**50,565**
Other comprehensive income					
Debt investments at FVOCI					
- change in fair value, net of tax	-	-	(1,273)	-	**(1,273)**
Equity investments at FVOCI					
- change in fair value, net of tax	-	-	(1,238)	-	**(1,238)**
- change in fair value transferred to retained earnings, net of tax	-	-	(1,246)	1,246	**-**
Property revaluation, net of tax	-	-	11,486	-	**11,486**
Release of surplus on sale of property, net of tax	-	-	(462)	462	**-**
Remeasurement of actuarial losses on defined benefit plans, net of tax	-	-	-	(2,455)	**(2,455)**
Total other comprehensive income	-	-	7,267	(747)	**6,520**
Total comprehensive income for the year	-	-	7,267	49,818	**57,085**
Transactions with owners, recorded directly in equity:					
Scrip Dividend	5,772	3,850	-	(9,622)	**-**
Dividends to equity holders	-	-	-	(17,678)	**(17,678)**
	5,772	3,850	-	(27,300)	**(17,678)**
At 31 December 2018	**530,772**	**49,277**	**49,922**	**309,278**	**939,249**

The notes are an integral part of these financial statements.

Statements of cash flows

For the year ended 31 December 2018

	Note	The Group		The Bank	
		2018 12 months to Dec 2018	2017 15 months to Dec 2017	2018 12 months to Dec 2018	2017 15 months to Dec 2017
		€000	€000	€000	€000
Cash flows from operating activities					
Interest and commission receipts		280,296	301,893	271,267	290,744
Interest, commission and compensation payments		(54,040)	(73,793)	(54,086)	(73,873)
Payments to employees and suppliers		(125,250)	(137,262)	(118,700)	(133,675)
Operating profit before changes in operating assets and liabilities		101,006	90,838	98,481	83,196
(Increase)/decrease in operating assets:					
Loans and advances		(157,854)	16,706	(157,854)	16,706
Reserve deposit with Central Bank of Malta		(749)	(11,254)	(749)	(11,254)
Fair value through profit or loss financial assets		26,063	66,844	26,063	66,844
Fair value through profit or loss equity instruments		11,671	15,843	11,675	15,680
Treasury bills with original maturity of more than 3 months		(7,662)	(4,503)	(7,662)	(4,503)
Other assets		(288)	(2,638)	(372)	(2,564)
Increase in operating liabilities:					
Amounts owed to banks and to customers		301,801	872,724	303,353	870,840
Other liabilities		(1,331)	17,639	(1,677)	17,523
Net cash from operating activities before tax		272,657	1,062,199	271,258	1,052,468
Tax paid		(20,881)	(42,122)	(21,602)	(41,381)
Net cash from operating activities		251,776	1,020,077	249,656	1,011,087
Cash flows from investing activities					
Dividends received		10,774	8,794	12,828	17,682
Interest received from amortised and other fixed income instruments		54,953	74,725	54,953	74,725
Purchase of debt instruments		(892,021)	(897,650)	(892,021)	(897,650)
Proceeds from sale or maturity of debt instruments		1,021,261	1,155,933	1,021,261	1,155,933
Proceeds from sale of equity instruments		12,296	4,350	12,296	4,350
Purchase of property and equipment and intangible assets		(26,295)	(33,341)	(26,229)	(33,239)
Proceeds from disposal of property and equipment		2,000	-	2,000	-
Net cash from investing activities		182,968	312,811	185,088	321,801
Cash flows from financing activities					
Proceeds from rights issue		-	149,439	-	149,439
Interest paid on debt securities and subordinated liabilities		(13,414)	(17,875)	(13,414)	(17,875)
Repayment of debt securities		(55,400)	-	(55,400)	-
Dividends paid to equity holders		(17,678)	(33,883)	(17,678)	(33,883)
Net cash (used in)/from financing activities		(86,492)	97,681	(86,492)	97,681
Net change in cash and cash equivalents		348,252	1,430,569	348,252	1,430,569
Effect of exchange rate changes on cash and cash equivalents		1,252	772	1,252	772
Net change in cash and cash equivalents after effect of exchange rate changes		347,000	1,429,797	347,000	1,429,797
Net change in cash and cash equivalents		348,252	1,430,569	348,252	1,430,569
Cash and cash equivalents at 1 January		3,278,607	1,848,038	3,278,607	1,848,038
Cash and cash equivalents at 31 December	36	**3,626,859**	**3,278,607**	**3,626,859**	**3,278,607**

The notes are an integral part of these financial statements.

Notes to the financial statements 31 December 2018

1. SIGNIFICANT ACCOUNTING POLICIES

1.1 Basis of preparation

Legal Notice 19 of 2009 as amended by Legal Notice 233 of 2016, Accountancy Profession (Accounting and Auditing Standards) (Amendments) Regulations, 2016, defines compliance with generally accepted accounting principles and practice as adherence to International Financial Reporting Standards (IFRS) as adopted by the EU for financial periods starting on or after 1 January 2008. These Regulations have come into force on 17 June 2016.

Article 4 of Regulation 1606/2002/EC requires that, for each financial period starting on or after 1 January 2005, companies governed by the law of an EU Member State shall prepare their consolidated financial statements in conformity with IFRS as adopted by the EU if, at their reporting date, their securities are admitted to trading on a regulated market of any EU Member State. This Regulation prevails over the provisions of the Companies Act, 1995, (Chapter 386, Laws of Malta) to the extent that the said provisions of the Companies Act, 1995, (Chapter 386, Laws of Malta) are incompatible with the provisions of the Regulation.

Consequently, the separate and the consolidated financial statements are prepared in conformity with IFRS as adopted by the EU.

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

During the previous financial period the Group has changed its accounting reference date from 30 September to 31 December. This set of financial statements covers a twelve month period from 1 January 2018 to 31 December 2018. The comparative period is a fifteen month period from 1 October 2016 to 31 December 2017.

The financial statements have been prepared on the historical cost basis. Assets and liabilities are measured at historical cost except for the following that are measured at fair value: financial assets measured at fair value through other comprehensive income (FVOCI), financial instruments classified at fair value through profit or loss (FVTPL), derivatives and land and buildings. Additionally, assets held for realisation are measured at fair value less costs to sell, if it is lower than their cost.

The financial statements are prepared on a going concern basis. The Directors regard that this is appropriate, after due consideration of the Bank's profitability, liquidity, the statement of financial position, capital adequacy and solvency. Specifically, the directors have prepared financial and capital plans for the next five years which shows that the Bank is in a position to continue operating as a going concern for the foreseeable future. These plans take into account risks facing the bank, including but not limited to, the potential crystallisation of known contingent liabilities.

Changes in accounting policies arising from the adoption of new standards during the year ended 31 December 2018:

IFRS 9 Financial Instruments

The Group adopted IFRS 9 on 1 January 2018, which is the date of initial application of the standard. IFRS 9 has resulted in changes in accounting policies related to the classification and measurement and impairment of financial assets. There are no significant changes in accounting policies for financial liabilities, derivative instruments and derecognition of financial assets and liabilities. The Group has taken advantage of the exemption in IFRS 9 allowing it not to restate comparative information for prior periods with respect to classification and measurement and impairment changes.

Changes in accounting policies brought about by the adoption of IFRS 9 are disclosed in Significant Accounting Policies - Notes 1.3.1 to 1.5.2 below.

Impact of IFRS 9 adoption

Reconciliation of IAS 39 to IFRS 9

The measurement category and the carrying amount of financial assets in accordance with IAS 39 and IFRS 9 at the date of initial application, 1 January 2018, are compared as follows. The differences between IAS 39 and IFRS 9 consist of reclassifications and remeasurements.
- Reclassifications : These adjustments reflect the movement of balances between categories of financial assets with no impact to shareholders' equity. There is no change to the carrying amounts of financial instruments as a result of reclassifications.
- Remeasurements: These adjustments, which include changes to the measurement bases as well as expected credit losses, result in a change to the carrying amounts of the financial instrument, with a corresponding impact (net of tax) on shareholders' equity.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

The Group Financial assets	IAS 39 Measurement category	IAS 39 Carrying amounts €000	Reclassification €000	Remeasurement €000	IFRS 9 Carrying amounts €000	IFRS 9 Measurement category
Balances with Central Bank of Malta, treasury bills and cash	Amortised cost (Loans and receivables)	159,684	-	-	159,684	Amortised cost
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	FVTPL (Designated)	111,417	(73,637)	-	37,780	FVTPL (Designated)
- Debt and other fixed income instruments	FVTPL (Designated)	-	25,015	324	25,339	FVTPL (Mandatory)
- Equity and other non-fixed income instruments	FVTPL (Designated)	64,811	(27,851)	-	36,960	FVTPL (Designated)
- Loans and advances to customers	FVTPL (Designated)	142,573	-	-	142,573	FVTPL (Mandatory)
- Derivative financial instruments	FVTPL (Mandatory)	7,490	-	-	7,490	FVTPL (Mandatory)
		326,291	(76,473)	324	250,142	
Investments						
- Debt and other fixed income instruments	Available-for-sale	139,328	5,181	-	144,509	FVOCI
- Equity and other non-fixed income instruments	Available-for-sale	5,298	27,851	-	33,149	FVOCI
- Debt and other fixed income instruments	Held-to-maturity	3,229,915	43,441	(6,454)	3,266,902	Amortised cost
		3,374,541	76,473	(6,454)	3,444,560	
Loans and advances to banks	Amortised cost (Loans and receivables)	3,431,383	-	(8)	3,431,375	Amortised cost
Loans and advances to customers at amortised cost	Amortised cost (Loans and receivables)	4,162,032	-	(6,442)	4,155,590	Amortised cost
		11,453,931	**-**	**(12,580)**	**11,441,351**	
Current/Deferred tax and equity						
Current tax		(12,034)	-	(369)	(12,403)	
Deferred tax assets		60,217	-	2,668	62,885	
Deferred tax liabilities		(4,519)	-	2,074	(2,445)	
Revaluation reserve		(33,194)	(9,573)	-	(42,767)	
Retained earnings		(358,466)	9,573	8,206	(340,687)	
		(347,996)	**-**	**12,579**	**(335,417)**	

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

Impact of IFRS 9 adoption (continued)

Reconciliation of IAS 39 to IFRS 9 (continued)

There were no changes to the classification and measurement of financial liabilities. The application of IFRS 9 resulted in the reclassifications set out in the table above, which are explained below:

a) Before the adoption of IFRS 9, certain investment securities were voluntarily designated as at FVTPL. The Group considers that these securities are held within a business model whose objective is to hold assets to collect the contractual cash flows. These assets are classified and measured at amortised cost under IFRS 9 as their cash flows represent Solely Payments of Principal and Interest (SPPI).

b) Certain investment securities were voluntarily designated as at FVTPL prior to the adoption of IFRS 9. The Group Central Treasury actively manages the return on the portfolio. The Group's return consists of collecting contractual payments as well as gains and losses from the sale of financial assets. The investment strategy often results in sales activity that is significant in value. The Group considers that under IFRS 9 these securities are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. These assets' cash flows represent SPPI, and they are classified and measured at FVOCI under IFRS 9.

c) Certain investment securities which, prior to the adoption of IFRS 9, were classified as held-to-maturity failed to meet the SPPI criteria under IFRS 9. On adoption of IFRS 9, these securities have accordingly been reclassified to financial assets measured at FVTPL.

d) Upon adoption of IFRS 9, the Group has elected to measure certain investments in equity instruments at FVOCI. Before the adoption of IFRS 9, these securities were generally classified and measured at FVTPL under IAS 39.

e) The Group has elected to measure certain investments in equity instruments as at FVTPL under IFRS 9; these instruments had been measured at FVOCI under IAS 39.

f) The majority of the Group's instruments which were previously classified as available-for-sale are now classified and measured at FVOCI with no changes to their measurement basis.

g) The majority of the Group's instruments which were previously classified as held-to-maturity are now classified and measured at amortised cost with no changes to their measurement basis.

Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles the impairment allowance as at 31 December 2017 measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected credit loss model at 1 January 2018:

Measurement category	Impairment allowance under IAS 39	Remeasurement	Impairment allowance under IFRS 9
	€000	€000	€000
Loans and receivables (IAS 39) / Financial assets at amortised cost (IFRS 9)			
Cash and balances with central banks	-	-	-
Loans and advances to banks	-	8	8
Loans and advances to customers	166,200	(16,579)	149,621
	166,200	(16,571)	149,629
Held-to-maturity (IAS 39) / Financial assets at amortised cost (IFRS 9)			
Investment securities	-	1,050	1,050
Available-for-sale financial instruments (IAS 39) / Financial assets at FVOCI (IFRS 9)			
Investment securities	-	127	127
Loan commitments and financial guarantee contracts			
Loans and advances to customers (loan commitments)	-	23,016	23,016
Total	166,200	7,622	173,822

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

Impact of IFRS 9 adoption (continued)

Reconciliation of impairment allowance balance from IAS 39 to IFRS 9 (continued)

The following table shows the effects of the reclassification of financial assets from IAS 39 categories into the amortised cost category under IFRS 9:

	2018 €000
From fair value through profit or loss financial assets under IAS 39	
Fair value at 31 December 2018	44,480
Fair value gain that would have been recognised during the year ended 31 December 2018 in Profit or Loss if the financial assets had not been reclassified	(1,354)

The following table shows the effects of the reclassification of financial assets from IAS 39 categories into the FVOCI category under IFRS 9:

From fair value through profit or loss under IAS 39	
Fair value at 31 December 2018	24,120
Fair value gain that would have been recognised during the year ended 31 December 2018 in Profit or Loss if the financial assets had not been reclassified	(2,093)

Classification of accrued interest

With the implementation of IFRS 9, the accrued interest receivable and payable are presented within the financial statement assets and liabilities giving rise to interest. In this respect all IFRS 7 and IFRS 9 disclosure requirements for 31 December 2018 now comprise the accrued interest element. Accrued interest receivable amounting to €33,144,000 and accrued interest payable amounting to €11,958,000 as at 31 December 2017 have not been restated to reflect the current year's presentation and that accordingly the corresponding notes to the financial statements do not reflect this change. In the opinion of the directors, such a restatement is not deemed material for the purpose of these financial statements.

IFRS 15

On 1 January 2018 the Group has adopted IFRS 15 - Revenue from contracts with customers. Generally fee and commission income, is recognised as the related services are performed whilst other fee and commission expenses are expensed as the services are received. No material impact on the Group's profits has been registered upon adoption of IFRS 15.

Standards issued but not yet effective

A number of new standards and amendments were endorsed by the EU but effective for periods starting after 1 January 2018 as disclosed hereunder. The directors have assessed the impact of IFRS 16 Leases as disclosed below. The impact that the adoption of other International Financial Reporting Standards will have on the financial statements of the Group and the Bank in the period of initial application is currently being assessed by the directors. These standards and amendments include the following:

Standards:
- IFRS 16 Leases (issued on 13 January 2016) - effective 1 January 2019 (refer to detail below)

Interpretations:
- IFRIC 23 Uncertainty over Income Tax Treatments (issued on 7 June 2017) - effective 1 January 2019
- IFRIC 22 Foreign Currency Translations and Advance Consideration (issued on 8 December 2016) - effective 1 January 2019

Amendments:
- Amendments to IFRS 9: Prepayment Features with Negative Compensation (issued on 12 October 2017) and effective for periods starting on or after 1 January 2019
- Amendments to IAS 28: Long-term interests in Associates and Joint Ventures (issued on 12 October 2017) - effective 1 January 2019

In addition, the following new standards and amendments have not yet been endorsed by the EU:
- Amendments to IFRS 3 Business Combinations (issued on 22 October 2018) - effective 1 January 2020
- Amendments to IAS 1 and IAS 8: Definition of Material (issued on 31 October 2018) - effective 1 January 2020
- Amendments to References to Conceptual Framework in IFRS Standards (issued on 29 March 2018) - effective 1 January 2020

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.1 Basis of preparation (continued)

Standards issued but not yet effective (continued)

- Annual Improvements to IFRS Standards 2015-2017 Cycle (issued on 12 December 2017) and effective for periods starting on or after 1 January 2019
- Amendments to IAS 19: Plan Amendment, Curtailment or Settlement (issued on 7 February 2018) and effective for periods starting on or after 1 January 2019
- IFRS 17 Insurance Contracts (issued on 18 May 2017) - effective 1 January 2021

IFRS 16 Leases

The Group is required to adopt IFRS 16 Leases with effect from 1 January 2019. Under IFRS 16, "Leases", a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The Group has assessed the estimated impact that the initial application of IFRS 16 will have on its consolidated financial statements, as described below. The Group has finalised testing and assessment of controls over its new IT systems; and the Group's financial statements will be presented in line with IFRS 16 as from 1 January 2019.

IFRS 16 introduces a single, on-balance sheet lease accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make future lease payments. There are recognition exemptions for short-term leases and leases of low-value items. Lessor accounting remains similar to the current standard – i.e. lessors continue to classify leases as finance or operating leases.

IFRS 16 replaces existing leases guidance, including IAS 17 *Leases*, IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases – Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease.*

Leases in which the Group is a lessee

The Group's lease arrangements comprise long-term leasehold properties, other immovable property leaseholds, equipment leases and property space for ATMs which were classified as operating leases under IAS 17. As at 31 December 2018, the Group has non-cancellable operating lease commitments amounting to EUR €10.6 million. Under IFRS 16, the Group will recognise new assets (right-of-use asset) and liabilities (lease liabilities) for all it's lease arrangements which were previously classified as operating leases under IAS 17, with the exceptions of some arrangements of low value items or short-term arrangements of one year or less. The Group will apply IFRS 16 on its mandatory adoption date of 1 January 2019 using a modified retrospective approach with no restatement of comparative information. Under this approach, the lease liability is measured at the present value of the remaining lease payments as at 1 January 2019, which management has estimated to amount to €8.6 million, and the right-of-use assets at that date will be equivalent to this lease liability (with no adjustment to equity).

Up until 31 December 2018, the Group recognised an operating lease expense on a straight-line basis over the term of the lease, and recognised assets and liabilities only to the extent that there was a timing difference between actual lease payments and the expense recognised. The nature of expenses related to these leases will change with effect from 1 January 2019 because IFRS 16 replaces the operating lease expense with an amortisation charge for right-of-use assets and interest expense on lease liabilities. In the Group's statement of cash flows, rental payments have been presented as operating cash flows under IAS 17 up until 31 December 2018. Under IFRS 16, these payments are allocated between interest payments and a reduction in the lease liability; whilst the interest payments will continue to be presented under operating cash flows in accordance with the Group's existing policy for interest payments, the portion of the payments relating to reduction in the lease liability will be presented under financing cash flows under IFRS 16.

1.2 Basis of consolidation

The Group financial statements comprise the financial statements of Bank of Valletta p.l.c., (the Bank), a limited liability company domiciled and incorporated in Malta, and its subsidiaries. Subsidiaries are entities controlled by the Group. The Group 'controls' an entity if it is exposed to, or has rights to, variable returns from its involvement with the entity. The Group reassesses whether it has control if there are changes to one or more of the elements of control. This includes circumstances in which protective rights held (e.g. those resulting from a lending relationship) become substantive and lead to the Group having power over an investee. The results of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Intragroup balances, transactions, income and expenses are eliminated on consolidation. Non-controlling interests that represent ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at their present ownership interests' proportionate share in the recognised amounts of the acquiree's identifiable net assets or at fair value. The choice of measurement basis is made on an acquisition-by-acquisition basis. After initial recognition, non-controlling interests in the net assets consist of the amount of those interests at the date of the original business combination and the non-controlling interests' share of changes in equity since the date of the combination.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.2 Basis of consolidation (continued)

The excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets and liabilities is recognised as goodwill and is included within the carrying amount of the investment and assessed for impairment as part of the investment. If the cost of acquisition is less than the Group's share of the net fair value of the identifiable assets and liabilities, the difference is included as income in the determination of the Group's share of the profit or loss in the period in which the investment is acquired. Equity-accounted investees comprise interests in associates. The results and assets and liabilities of equity-accounted investees are incorporated in the consolidated financial statements using the equity method of accounting from the date that significant influence or joint control commences until the date that significant influence or joint control ceases. Equity-accounted investees are those entities in which the Group has significant influence, but not control or joint control over the financial and operating policies. A joint venture is an arrangement in which the Group has joint control, whereby the Group has rights to the net assets of the arrangement rather than rights to its assets and obligations for its liabilities. The significant accounting policies adopted are set out below.

1.3 Financial instruments

1.3.1 Amortised cost and effective interest rate

<u>Policy applicable throughout the period covered by these financial statements</u>

Interest income and expense is recognised using the effective interest method, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the instrument or, when appropriate, a shorter period to that instrument's gross carrying amount. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the instrument but not future credit losses. The calculation includes payments and receipts that are an integral part of the effective interest rate, transaction costs and all other discounts or premiums.

Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability.

The 'amortised cost' of a financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets adjusted for any expected credit loss allowance (or impairment allowance before 1 January 2018).

1.3.2 Interest income and expense

<u>Policy applicable from 1 Jan 2018</u>

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

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

1.3.3 Initial recognition

<u>Policy applicable throughout the period covered by these financial statements</u>

Financial assets and financial liabilities are recognised when a Group entity becomes a party to the contractual provisions of the instrument.

All loans and advances to customers and to banks are recognised when cash is advanced to borrowers.

All purchases and sales of securities are recognised and derecognised on settlement date, which is the date that an asset is delivered to or by the Group.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.3 Financial instruments (continued)

1.3.4 Measurement at initial recognition

Policy applicable throughout the period covered by these financial statements

At initial recognition, the Group measures a financial asset or financial liability at its fair value plus or minus, in the case of financial asset or financial liability not at fair value through profit or loss, transaction costs that are incremental and directly attributable to the acquisition or issue of the financial asset or financial liability, such as fees and commissions. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss are expensed in profit or loss.

Policy applicable from 1 January 2018

With effect from 1 January 2018, an expected credit loss allowance (ECL) is also recognised immediately after initial recognition for financial assets measured at amortised cost and investments in debt instruments measured at FVOCI, as described in note 39.2.1.2, which results in an accounting loss being recognised in profit or loss when an asset is newly originated.

1.4 Financial Assets

1.4.1 Classification and measurement of financial assets

Policy applicable from 1 January 2018

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

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

Debt instruments

Debt instruments are those instruments that meet the definition of a financial liability from the issuer's perspective, such as loans, government and corporate bonds.

Classification and subsequent measurement of debt instruments depend on:
i. the Group's business model for managing the asset; and
ii. the cash flow characteristics of the asset.

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

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest ('SPPI') on specified dates, and that are not designated at FVTPL, are measured at amortised cost. The carrying amount of these assets is adjusted by any expected credit loss allowance recognised and measured as described in note 39.2.1. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.

- Fair value through other comprehensive income (FVOCI): Financial assets that are held for collection of contractual cash flows and for selling the assets, where the assets' cash flows represent solely payments of principal and interest, and that are not designated at FVTPL, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses on specified dates, interest revenue and foreign exchange gains and losses on the instrument's amortised cost which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in 'Net gain on investment securities and hedging instruments. Interest income from these financial assets is included in 'Interest and similar income' using the effective interest rate method.

- Fair value through profit or loss (FVTPL): Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. A gain or loss on a debt investment that is subsequently measured at FVTPL and is not part of a hedging relationship is recognised in profit or loss and presented in the statement of profit or loss within 'Trading profits' in the period in which it arises, unless it arises from debt instruments that were designated at fair value or which are not held for trading, in which case they are presented separately in 'Net investment income'. Interest income from these financial assets is included in 'Interest income' using the effective interest rate method.

Financial assets and liabilities are designated at fair value through profit or loss on initial recognition where such designation results in more relevant information because it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.4 Financial Assets (continued)

1.4.1 Classification and measurement of financial assets (continued)

Business Model Assessment

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

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

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

Cash flows that represent solely payments of principal and interest

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

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

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
- features that modify consideration of the time value of money – e.g. periodical reset of interest rates.

Embedded derivatives

Policy applicable from 1 January 2018

Derivatives may be embedded in another contractual arrangement (a host contract). The Group accounts for an embedded derivative separately from the host contract when:

- the host contract is not an asset in the scope of IFRS 9;
- the host contract is not itself carried at FVTPL;
- the terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract; and
- the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract.

Separated embedded derivatives are measured at fair value, with all changes in fair value recognised in profit or loss unless they form part of a qualifying cash flow or net investment hedging relationship. Separated embedded derivatives are presented in the statement of financial position together with the host contract.

Policy applicable before 1 January 2018

Derivatives may be embedded in another contractual arrangement (a host contract). The Group accounted for an embedded derivative separately from the host contract when:

- the host contract was not itself carried at FVTPL;
- the terms of the embedded derivative would have met the definition of a derivative if they were contained in a separate contract; and
- the economic characteristics and risks of the embedded derivative were not closely related to the economic characteristics and risks of the host contract.

Separated embedded derivatives were measured at fair value, with all changes in fair value recognised in profit or loss unless they formed part of a qualifying cash flow or net investment hedging relationship. Separated embedded derivatives were presented in the statement of financial position together with the host contract.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.4 Financial Assets (continued)

1.4.1 Classification and measurement of financial assets (continued)

Reclassification

The Group reclassifies debt instruments when and only when its business model for managing those assets changes.

Equity instruments

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

On initial recognition of an equity investment that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis and is irrevocable. Other equity instruments are classified as measured at FVTPL.

Gains and losses on such equity instruments are never reclassified to profit or loss and no impairment is recognised. Dividends are recognised in profit or loss (see note 1.22) unless they clearly represent a recovery of part of the cost of the investment, in which case they are recognised in OCI. Cumulative gains and losses recognised in OCI are transferred to retained earnings on disposal of an investment.

Gains and losses on equity investments at FVTPL are included in the 'Trading profits' line in the statement of profit or loss.

Policy applicable before 1 January 2018

Financial assets at fair value through profit or loss, investment securities and loans and receivables

The Group classified its financial assets in the following categories: (i) financial assets at fair value through profit or loss; (ii) investment securities; and (iii) loans and receivables. The classification depended on the purpose for which the investments were acquired.

Financial assets at fair value through profit or loss

This classification included financial assets classified as held for trading, and those designated at fair value through profit or loss upon initial recognition. Derivatives were categorised as held for trading unless they were designated and effective hedging instruments. Financial assets at fair value through profit or loss were initially recognised and were subsequently measured at fair value based on quoted bid prices in an active market (see note 1.4.5).

Interest receivable on financial assets at fair value through profit or loss was included with interest receivable and similar income. All related realised and unrealised gains and losses were included in trading profits in the year in which they arose.

Portfolios of over-the-counter derivatives that were exposed to credit risk and were managed by the Group on the basis of the net exposure to credit risk were measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments were allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

Investment securities

Investment securities were classified into two sub-categories: held-to-maturity and available-for-sale financial assets. Non-derivative investment securities, with fixed or determinable payments and fixed maturity, where the Group had both the positive intent and the ability to hold them to maturity, other than those that upon initial recognition were designated as at fair value through profit or loss, those that were designated as available-for-sale financial assets and those that met the definition of loans and receivables, were classified as held-to-maturity financial assets. Investment securities intended to be held for an indefinite period of time, but which may have been sold in response to needs for liquidity or changes in interest rates, exchange rates or market prices were classified as available-for-sale financial assets. All investment securities were initially measured at fair value plus transaction costs, if any, that were directly attributable to their acquisition.

Those investment securities classified as available-for-sale financial assets were subsequently measured at fair value based on quoted bid prices in an active market, or by reference to a valuation technique if the market was not active, with the exception of equity instruments that did not have a quoted price in an active market for an identical instrument (i.e. a Level 1 input) and whose fair value could not be measured reliably which were measured at cost less any impairment losses. Gains and losses arising from changes in the fair value of securities classified as available-for-sale that were not designated as hedged items in a fair value hedge were recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses on monetary items, until the security was derecognised, at which time the related accumulated fair value adjustments previously recognised in other comprehensive income were included in profit or loss as a reclassification adjustment within net gains or losses on investment securities. With respect to available-for-sale securities that were designated as hedged items in a fair value hedge, gains and losses arising from changes in fair value attributable to the hedged risk were accounted for in profit or loss. Fair value movements attributable to other factors, such as changes in credit status, were recognised in other comprehensive income, except for impairment losses and foreign exchange gains and losses on monetary items. Interest calculated using the effective interest method was recognised in profit or loss.

Those investment securities classified as held-to-maturity financial assets were subsequently measured at amortised cost using the effective interest method, less any impairment losses. Interest calculated using the effective interest method and impairment losses were recognised in profit or loss.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.4 Financial Assets (continued)

1.4.1 Classification and measurement of financial assets (continued)

The Bank, in line with IAS 39, did not classify financial assets as held-to-maturity if it had, during the current financial year or during the two preceding years, sold or reclassified more than an insignificant amount of the held-to-maturity portfolio other than sales or reclassifications that were specifically exempted for the purpose of this requirement. Significance was measured in relation to the total amount of held-to-maturity investments.

Loans and receivables

Loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market, other than those that were held for trading or were designated upon initial recognition as at fair value through profit or loss or as available-for-sale financial assets or those for which the Group may not have recovered substantially all of its initial investment other than because of credit deterioration. These mainly comprised loans and advances to banks and customers.

Loans and receivables were initially measured at fair value plus transaction costs, if any, that were directly attributable to their acquisition, and were subsequently measured at amortised cost using the effective interest method, less any impairment losses. Gains and losses were recognised in profit or loss when the financial asset was derecognised or impaired and through the amortisation process using the effective interest rate (note 1.3.1).

1.4.2 Modification of terms

<u>Policy applicable throughout the period covered by these financial statements</u>

If the terms of a financial asset are modified, the Group evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised (see 1.4.4) and a new financial asset is recognised at fair value.

In the case of loans and advances which encountered actual or apparent financial difficulties, the Group may grant a concession where a customer's financial difficulty indicates that with the original terms and conditions of the contract satisfactory repayment may not be possible.

A concession refers to either of the following:
- a modification of the previous terms and conditions of a contract the customer is considered unable to comply with due to its financial difficulties to allow for sufficient debt service ability, that would not have been granted had the customer not been in financial difficulties;
- a total or partial refinancing of a troubled debt contract, that would not have been granted had the customer not been in financial difficulties.

If the cash flows of the modified asset carried at amortised cost are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the Group recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss.

1.4.3 Impairment

<u>Policy applicable from 1 January 2018</u>

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

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

Note 39.2.1.2 provides more detail of how the expected credit loss allowance is measured.

Presentation of allowance for ECL in the statement of financial position

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

- Financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- Loan commitments and financial guarantee contracts: as a provision;
- Where a financial instrument includes both a drawn and undrawn component, and the Group cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Group presents a combined loss allowance for both components. The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and
- Debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.4 Financial Assets (continued)

1.4.3 Impairment (continued)

Measurement of ECL

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

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

Modification of financial assets

When there is a modification of financial assets' terms (note 1.4.2), the date of renegotiation is considered to be the date of initial recognition for impairment calculation purposes including for the purpose of determining whether a significant increase in credit risk has occurred.

Policy applicable before 1 January 2018

The Group assessed at the end of each reporting period whether there was objective evidence that a financial asset or a group of financial assets were impaired. A financial asset or a group of financial assets were impaired and impairment losses were incurred if there was objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event(s) had an impact on the estimated future cash flows of the financial asset or group of financial assets that could be reliably estimated.

Financial assets carried at amortised cost

The Group considered evidence of impairment for loans and advances at both a specific asset and a collective level. All individually significant loans and advances were assessed for specific impairment. Those found not to be specifically impaired were then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances that were not individually significant were collectively assessed for impairment by grouping together loans and advances with similar risk characteristics.

For held-to-maturity securities carried at amortised cost and quoted in an active market, if there was objective evidence that an impairment loss had been incurred, the amount of the loss was measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that had not been incurred) discounted at the financial asset's original effective interest rate, by reference to the asset's quoted market price.

For individually significant loans and receivables, if there was objective evidence that an impairment loss had been incurred, the amount of loss was measured in line with Banking Rule 09 'Measures Addressing Credit Risks arising from the Assessment of the Quality of Asset Portfolios of Credit Institutions Authorised under the Banking Act 1994' (Chapter 371, Laws of Malta) which was in line with the IAS 39. The measurement of the loss amount took account of the repayment history of the borrower and the value of collateral held against borrowings. Financial assets which did not attract a specific allowance were categorised according to credit risk characteristics and the amount of loss thereon was measured by taking account of the probability of default and loss given default for similar assets, after considering the level of collateral held.

The carrying amount of the asset was reduced through the use of an allowance account and the amount of the loss was recognised in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreased, and the decrease could be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss was reversed through an allowance account, so that the reversal did not result in a carrying amount that exceeded what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal was recognised in profit or loss.

Impairment losses on restructured/refinanced corporate assets (forbearance)

When accounts were classified as 'non-performing' assets, prior to the restructuring (note 1.4.2), they continued to be assessed for impairment individually taking into account the value of the collateral held as confirmed by professional valuations and the available cash flow to service debt over the period of the restructuring. If classified as 'performing' assets, restructured loans continued to be assessed for impairment collectively for inherent losses under the Group's normal collective assessment methodology.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.4 Financial Assets (continued)

1.4.3 Impairment (continued)

Available-for-sale financial assets

When a decline in the fair value of an available-for-sale financial asset had been recognised in other comprehensive income and there was objective evidence that the asset was impaired, the cumulative loss was reclassified from equity to profit or loss. The cumulative loss was measured as the difference between the acquisition cost (net of any principal repayment and amortisation), and the current fair value, less any impairment losses previously recognised in profit or loss.

Impairment losses recognised in profit or loss on equity instruments were not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increased and the increase could be objectively related to an event occurring after the impairment loss was recognised, then the impairment loss was reversed through profit or loss; otherwise, any increase in fair value was recognised through OCI. Any subsequent recovery in the fair value of an impaired available-for-sale equity security was always recognised in OCI. Changes in impairment attributable to application of the effective interest method were reflected as a component of interest income. The impairment loss on investments in equity instruments that did not have a quoted market price in an active market for an identical instrument (i.e. a Level 1 input) and whose fair value could not be reliably measured was recognised in profit or loss and was not reversed in a subsequent period.

The Group wrote off a loan or an investment debt security, either partially or in full, and any related allowance for impairment losses, when Group Credit determined that there was no realistic prospect of recovery.

Impairment losses on held-to-maturity investments and on available-for-sale investments

In the case of financial assets that are either classified as held-to-maturity investments or as available-for-sale investments, objective evidence of impairment includes observable data about the following loss events, as applicable – significant financial difficulty of the issuer (or counterparty), a breach of contract, it becoming probable that the borrower will enter bankruptcy or other financial reorganisation, the disappearance of an active market for that financial asset because of financial difficulties or observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets. In addition to the above loss events, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates or a significant or prolonged decline in the fair value below its cost. The determination of these loss events is based on the analysis of the amortised cost amount against the fair value of the individual security to assess whether declines in value are indicative of impairment.

1.4.4 Derecognition of financial assets

Policy applicable throughout the period covered by these financial statements

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire, or when the Group transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset and the transfer qualifies for derecognition.

1.4.5 Fair valuation of financial assets

Policy applicable throughout the period covered by these financial statements

Where possible, fair value is based on quoted bid prices in an active market. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.5 Financial liabilities

1.5.1 Classification and measurement of financial liabilities

Policy applicable throughout the period covered by these financial statements

Financial liabilities are classified according to the substance of the contractual arrangements entered into, and the definitions of a financial liability and an equity instrument.

Financial liabilities are initially measured at fair value less, in the case of financial liabilities not at fair value through profit or loss, transaction costs that are directly attributable to their issue. Financial liabilities are subsequently measured at amortised cost using the effective interest method, except for financial liabilities at fair value through profit or loss, which are measured at fair value.

Financial liabilities at fair value through profit or loss include financial liabilities classified as held for trading and those designated at fair value through profit or loss upon initial recognition. During the current year and the previous period, the Group did not designate any financial liabilities as at fair value through profit or loss upon initial recognition. Derivatives are categorised as held for trading, unless they are designated and effective hedging instruments.

Financial liabilities that are measured at amortised cost using the effective interest method include amounts owed to banks, amounts owed to customers, debt securities in issue and subordinated liabilities.

The gain or loss on financial liabilities at fair value through profit or loss is recognised in profit or loss. For financial liabilities carried at amortised cost, the gain or loss is recognised in profit or loss when the financial liability is derecognised and through the amortisation process whereby any difference between the proceeds net of transaction costs, and the settlement or redemption is recognised over the term of the financial liability.

1.5.2 Derecognition of financial liabilities

Policy applicable throughout the period covered by these financial statements

A financial liability is derecognised when it is extinguished. This occurs when the obligation specified in the contract is discharged, cancelled or expires.

1.6 Financial guarantee contracts and loan commitments

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

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

- from 1 January 2018: at the higher of the loss allowance determined in accordance with IFRS 9 and the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of IFRS 15; and
- before 1 January 2018: at the higher of the amount representing the initial fair value amortised over the life of the guarantee or the commitment and the present value of any expected payment to settle the liability when a payment under the contract has become probable.

For financial guarantees issued or commitments:
- from 1 January 2018: the Group recognises a loss allowance
- before 1 January 2018: the Group recognised a provision in accordance with IAS 37 if the contract was considered to be onerous.

With effect from 1 January 2018, impairment allowances and provisions on loan commitments that comprise both a drawn and undrawn commitment are presented in accordance with the policy set out in the note 1.4.3 Impairment.

1.7 Offsetting of financial instruments

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

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.8 Derivatives held for risk management purposes and hedge accounting

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets or liabilities. Derivatives held for risk management purposes are measured at fair value in the statement of financial position.

The Group designates certain derivatives held for risk management as well as certain non-derivative financial instruments as hedging instruments in qualifying hedging relationships. On intial desigation of the hedge, the Group formally documents the relationship between the hedging instrument(s) and hedged item(s), including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both on inception of the hedging relationship and on an ongoing basis, of whether the hedging instrument(s) is (are) expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged item(s) during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80-125%. For a cash flow hedge of a forecast transaction, the Group makes an assessment of whether the forecast transaction is highly probable to occur and presents an exposure to variations in cash flows that could ultimately affect profit or loss.

These hedging relationships are discussed below.

Fair value hedges

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognised asset or liability or a firm commitment that could affect profit or loss, changes in the fair value of the derivative are recognised immediately in profit or loss. The change in fair value of the hedged item attributable to the hedged risk is recognised in profit or loss. If the hedged item would otherwise be measured at cost or amortised cost, then its carrying amount is adjusted accordingly.

If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively. However, if the derivative is novated to a CCP by both parties as a consequence of laws or regulations without changes in its terms except for those that are necessary for the novation, then the derivative is not considered expired or terminated.

Any adjustment up to the point of discontinuation to a hedged item for which the effective interest method is used is amortised to profit or loss as an adjustment to the recalculated effective interest rate of the item over its remaining life.

On hedge discontinuation, any hedging adjustment made previously to a hedged financial instrument for which the effective interest method is used is amortised to profit or loss by adjusting the effective interest rate of the hedged item from the date on which amortisation begins. If the hedged item is derecognised, then the adjustment is recognised immediately in profit or loss when the item is derecognised.

Other non-trading derivatives

Other non-trading derivatives are recognised on balance sheet at fair value on initial recognition. If a derivative is not held for trading, and is not designated in a qualifying hedge relationship, then all changes in its fair value are recognised immediately in profit or loss as a component of net income from other financial instruments at FVTPL.

1.9 Sale and repurchase agreements

Securities sold subject to a linked repurchase agreement (‘repos’) are retained in the financial statements at fair value through profit or loss or as investment securities as appropriate, and the counterparty liability is included in amounts owed to banks. Securities purchased under agreements to resell (‘reverse repos’) are not recognised but the amounts paid are recorded as loans and advances to banks. The difference between sale and repurchase price or purchase and subsequent sale price is recognised over the life of the repo/reverse repo agreements using the effective interest method and is treated as interest.

1.10 Investments in subsidiaries and equity-accounted investees

Investments in subsidiaries and equity-accounted investees are initially included in the Bank’s statement of financial position at cost and subsequently at cost less any impairment loss which may have arisen. Interest in equity-accounted investees are accounted for using the equity method at Group level. They are initially recognised at cost, which includes transaction costs. Subsequently, the consolidated financial statements include the Group's share of profit or loss and other comprehensive income of equity-accounted investees, until the date on which significant influence ceases. Dividends from the investments are recognised in profit or loss when its right to receive dividend is established.

Impairment
At the end of each reporting period, the Bank reviews the carrying amount of its investments in subsidiaries and equity-accounted investees to determine whether there is any indication of impairment and if any such indication exists, the recoverable amount of the asset is estimated.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.10 Investments in subsidiaries and equity-accounted investees (continued)

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is the higher of fair value less costs of disposal and value in use. An impairment loss recognised in a prior year is reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, provided that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. Impairment losses and reversals are recognised immediately in profit or loss.

1.11 Property and equipment

Property and equipment are classified into the following classes – land and buildings, IT infrastructure and equipment and other (primarily furniture and fittings).

Property and equipment are initially measured at cost. Subsequent costs are included in the asset's carrying amount when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Expenditure on repairs and maintenance of property and equipment is recognised as an expense when incurred.

Subsequent to initial recognition, freehold and long-term leasehold properties are stated in the statement of financial position at revalued amounts, being the fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Revaluations are performed by a professionally qualified architect on a regular basis such that the carrying amount does not differ materially from that which would be determined using fair values at the end of the reporting period. Any surpluses arising on such revaluation are recognised in other comprehensive income and accumulated in equity as a revaluation reserve unless they reverse a revaluation decrease for the same asset previously recognised in profit or loss, in which case the increase is credited to profit or loss to the extent of the decrease previously charged. Any deficiencies resulting from decreases in value are deducted from this revaluation reserve to the extent that the balance held in this reserve relating to a previous revaluation of that asset is sufficient to absorb these, and charged to profit or loss thereafter.

Other tangible assets are stated at cost less accumulated depreciation and any accumulated impairment losses.

Property and equipment are derecognised on disposal or when no future economic benefits are expected from their use or disposal. Gains or losses arising from derecognition represent the difference between the net disposal proceeds, if any, and the carrying amount, and are included in profit or loss in the period of derecognition.

1.12 Intangible assets

Intangible assets comprise computer software. In determining the classification of an asset that incorporates both intangible and tangible elements, judgement is used in assessing which element is more significant. Computer software which is an integral part of the related hardware is classified as property and equipment and accounted for in accordance with the Group's accounting policy on property and equipment. Where the software is not an integral part of the related hardware, this is classified as an intangible asset. Computer software is externally generated.

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates.

Computer software is initially measured at cost. It is subsequently carried at cost less accumulated amortisation and any accumulated impairment losses.

Computer software is derecognised on disposal or when no future economic benefits are expected from its use or disposal. Gains or losses arising from derecognition represent the difference between the net disposal proceeds, if any, and the carrying amount, and are included in profit or loss in the period of derecognition.

1.13 Depreciation and amortisation

Depreciation on property and equipment and amortisation on intangible assets commence when these assets are available for use and are charged to profit or loss so as to write off the cost or revalued amount of assets, other than land, less any estimated residual value, over their estimated useful life, using the straight line method, on the following bases:

Property and equipment		
Freehold and long-term leasehold buildings	2%	per annum
IT infrastructure and equipment	10% - 25%	per annum
Other (primarily furniture and fittings)	5% - 33%	per annum
Intangible assets		
Computer software	10% - 20%	per annum

The depreciation or amortisation method applied, the residual value and the useful life are reviewed at the end of each reporting period and adjusted if appropriate.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.14 Impairment of property and equipment and intangible assets

At the end of each reporting period the Group reviews the carrying amount of its property and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If such indication exists the recoverable amount is estimated in order to determine the extent of the impairment loss and the carrying amount of the asset is reduced to its recoverable amount. The recoverable amount is the higher of fair value less costs of disposal and value in use.

An impairment loss is recognised immediately in profit or loss, unless the asset is carried at a revalued amount, in which case the loss is recognised in other comprehensive income to the extent that it does not exceed the amount in the revaluation surplus for that asset.

An impairment loss recognised in a prior year is reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, to the extent that it does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. Impairment reversals are recognised immediately in profit or loss, unless the asset is carried at a revalued amount, in which case the impairment reversal is recognised in other comprehensive income, unless an impairment loss on the same asset was previously recognised in profit or loss.

1.15 Provisions, contingent liabilities and contingent assets

Provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the present obligation at the end of the reporting period. If the effect of the time value of money is material, 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. In such case, the unwinding of the discount is recognised as finance cost.

A contingent liability is (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability. Contingent liabilities are not recognised but are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Contingent assets are not recognised. Contingent assets are disclosed where an inflow of economic benefits is probable.

1.16 Non-current assets and disposal groups held for sale

Non-current assets and disposal groups are classified as held for sale if it is highly probable that they will be recovered primarily through a sale transaction rather than through continuing use. Such assets, or disposal groups, are generally measured at the lower of their carrying amount and fair value less costs to sell and the asset or disposal group is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within a reasonable period from the date of classification. Non-current assets are not depreciated (or amortised) while they are classified as held for sale or while they are part of a disposal group classified as held for sale.

1.17 Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and deposits repayable on demand or with a contractual period to maturity of less than 3 months; advances to banks repayable within 90 days from the date of the advance; balances with the Central Bank of Malta, excluding reserve deposit requirements, and treasury bills with an original maturity of less than 3 months. Amounts owed to banks that are repayable on demand or with a contractual period to maturity of less than 3 months and which form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statements of cash flow.

1.18 Dividends payable

Interim dividends are approved by the directors and recognised when paid. Final dividends are recognised as liability upon approval by the shareholders at the Annual General Meeting.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.19 Operating segments

An operating segment is a component of an entity (a) that engages in business activities from which it may earn revenues and incur expenses, (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and (c) for which discrete financial information is available. Unallocated items comprise mainly head office expenses and tax assets and liabilities.

1.20 Fair value

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

Fair value reflects conditions, including but not limited to liquidity in the market, at a specific date and may therefore differ significantly from the amounts which will actually be received on the maturity or settlement date. The Bank's portfolio remains deployed across a wide spread of holdings of moderate duration debt securities issued by quality, credit rated, sovereign, supranational, corporate and financial institutions, as further disclosed in notes 14 and 15 to the financial statements.

The best evidence of fair value of an instrument is a quoted price in an actively traded market for that instrument. The determination of what constitutes an active market is subjective and requires the collation of data and the exercise of judgement. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The Bank determines whether active market conditions exist by taking into consideration various characteristics, including:

- a significant decline in volume and level of trading activity;
- significant variations in available prices either over time or among market participants;
- the absence of or stale prices;
- unusually wide bid/offer spreads; and
- exceptionally minimal transactions when compared with the quantum of the issue in question.

Where it is concluded that an active market does not exist a valuation technique is used. The latter gives consideration to transaction prices in inactive markets, however it makes use of other observable market data which include a combination of the following:

- the risk premium of more active instruments of the same issuer, the same type of debt, the same currency and with the same or similar maturity;
- the spreads payable on Credit Default Swaps of the issuer;
- the risk premium over and above the risk free bonds for similarly rated issuers in the same industry sector;
- yield curve or Discounted Cash Flow (DCF) calculations to maturity using appropriate interest rate/discount factors;
- liquidity adjustments to reflect ability to sell asset over a reasonable timeframe; and
- other overall reasonableness tests.

The main assumptions and estimates which management considers when using valuation techniques are the likelihood and expected timing of future cash flows on the instrument, selecting an appropriate discount rate for the instrument and a risk premium. The valuation techniques used by the Bank incorporate all factors that market participants would consider in setting a price and are consistent with accepted economic methodologies for pricing financial instruments.

1.21 Taxation

Income tax expense comprises current and deferred tax and is recognised in profit or loss, except when it relates to items recognised in other comprehensive income or directly in equity, in which case it is dealt with in other comprehensive income or in equity, as appropriate.

Current tax
Current tax is based on the taxable result for the period. The taxable result for the period differs from the result as reported in profit or loss because it excludes items which are non-assessable or disallowed and it further excludes items that are taxable or deductible in other periods. Current tax also includes any tax arising from dividends. It is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period, and any adjustments in relation to the prior periods.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.21 Taxation (continued)

Deferred tax
Deferred tax is determined under the liability method in respect of all temporary differences between the carrying amount of an asset or liability in the financial statements and its tax base. Deferred tax liabilities are generally recognised for all taxable temporary differences subject to certain exceptions and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled based on tax rates that have been enacted or substantively enacted by the end of the reporting period. 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. Deferred tax is not recognised for temporary differences related to investments in subsidiaries to the extent that it is probable that they will not reverse in the forseeable future.

1.22 Revenue recognition

Revenue is recognised to the extent that it is probable that future economic benefits will flow to the Group and these can be measured reliably. The following specific recognition criteria must also be met before revenue is recognised.

Dividend income from investments is recognised when the right to receive payment has been established.

Interest income and expense is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the instrument or, when appropriate, a shorter period to that instrument's net carrying amount. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the instrument but not future credit losses. The calculation includes payments and receipts that are an integral part of the effective interest rate, transaction costs and all other discounts or premiums.

Generally fee and commission income, is recognised as the related services are performed.

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

Other fee and commission expenses are expensed as the services are received.

1.23 Foreign currency translation

For the purpose of the consolidated and separate financial statements, the presentation currency is the Euro. The functional currency of the Bank and of all its subsidiaries is the Euro.

In preparing the financial statements of the individual group entities, transactions denominated in currencies other than the functional currency are translated at the exchange rates ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to Euro at the rates of exchange ruling at the end of the reporting period. Gains and losses arising from such translation are dealt with in profit or loss and presented with trading income. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Euro at the exchange rate ruling on the date the fair value was measured. Non-monetary assets and liabilities denominated in foreign currencies that are measured in terms of historical cost are not retranslated.

1.24 Employee benefits

The Group and the Bank contribute towards the state pension in accordance with local legislation. The only obligation of the Group and the Bank is to make the required contributions. Costs are expensed in the period in which they are incurred in profit or loss.

For the Group's and the Bank's defined benefit plans, the cost of providing benefits is determined using the projected unit credit method, with estimations being carried out at each reporting date. Past service cost is recognised as an expense at the earlier of the following dates (a) when the plan amendment or curtailment occurs and (b) when the entity recognises related restructuring costs or termination benefits. The amount recognised in the Statement of Financial Position represents the present value of the expected future payments required to settle the obligation resulting from employee service in the current and prior periods. The service cost and the net interest on the net defined benefit liability are recognised in profit or loss. Remeasurements of the net defined benefit liability, comprising actuarial gains and losses are recognised in other comprehensive income and are not reclassified to profit or loss in a subsequent period. Such remeasurements are reflected immediately in retained earnings. Actuarial gains and losses are changes in the present value of the defined benefit obligation resulting from experience adjustments and the effects of changes in actuarial assumptions. Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. Due to the nature of the actuarial assumptions, in accordance with the provisions of IAS 19, Employee Benefits, the Group and the Bank did not involve a qualified actuary in the measurement of their post-employment benefit obligations.

Notes to the financial statements 31 December 2018 (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

1.25 Judgements in applying accounting policies and key sources of estimation uncertainty

The amounts recognised in the financial statements are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of financial statements. The judgements made by management in applying the Group's and the Bank's accounting policies that have the most significant effect on the amounts recognised in the financial statements, together with information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are either disclosed below or in the remaining notes to the financial statements - Refer to note 39.2.1.2.5.

1.25.1 Portfolio valuation

The Group measures portfolios of financial assets and financial liabilities on the basis of net exposures to market risks, then it applies judgement in determining appropriate portfolio-level adjustments such as bid-ask spreads. Such adjustments are derived from observable bid-ask spreads for similar instruments and adjusted for factors specific to the portfolio. Similarly, when the Group measures portfolios of financial assets and financial liabilities on the basis of net exposure to the credit risk of a particular counterparty, then it takes into account any existing arrangements that mitigate the credit risk exposure - e.g. master netting agreements with the counterparty.

1.25.2 Fair value of financial instruments not quoted in active markets

The fair value of financial instruments that are not quoted in active markets is determined by using valuation techniques. Periodically, the Group calibrates these valuation techniques and tests them for validity. Where possible the valuation techniques used by the Group make use of observable data and incorporate all factors that market participants would consider in setting a price and are consistent with accepted economic methodologies for pricing financial instruments. Management is required to make certain assumptions and estimates in arriving at an appropriate fair value, based on available observable market data. A change in assumptions could affect the reported fair value of these financial instruments. Further disclosures are provided in note 39.

1.25.3 Fair value of land and buildings

The fair value of the Group's and the Bank's land and buildings is determined by using valuation techniques as further disclosed in Note 21. In arriving at an estimate of fair value at the end of the reporting period, the Group and the Bank make use of significant unobservable inputs. A change in such inputs could affect the reported fair value of these land and buildings.

1.25.4 Classification of facilities as forborne

Management follows the European Banking Authority technical standard in identifying performing/non-performing exposures and in determining forborne exposures. Judgement is exercised in determining whether the modification of the original terms of a facility are granted, because of financial difficulties, which would result in the exposure being classified as forborne.

1.25.5 Provisions and contingent liabilities

In the ordinary course of operations, the Group faces loss contingencies that may result in the recognition of a liability. Management periodically assesses these issues based on information available and assessments from internal and/or external legal counsel.

The Group is currently involved in various claims and legal proceedings arising out of its normal business operations. Periodically, the status of each significant loss contingency is reviewed to assess the potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, a liability for the estimated loss is provided for. Due to the uncertainties inherent in such matters, provisions are based on the best information available at the reporting date. As additional information becomes available, the potential liability related to pending claims and litigation is reassessed and, if required, estimates are revised. Such revisions in the estimates of the potential liabilities could have a material impact on results of operations and the financial position of the Group. Where an individual provision is material, the fact that a provision has been quantified would not constitute any admission of wrongdoing or legal liability.

Notes to the financial statements 31 December 2018 (continued)

	The Group		The Bank	
	2018 12 months to Dec 2018	2017 15 months to Dec 2017	2018 12 months to Dec 2018	2017 15 months to Dec 2017
	€000	€000	€000	€000
2. INTEREST AND SIMILAR INCOME				
On loans and advances to banks	3,235	1,892	3,235	1,892
On loans and advances to customers	161,942	197,105	161,942	197,105
	165,177	198,997	165,177	198,997
On debt and other fixed income instruments				
- fair value through other comprehensive income	6,359	-	6,359	-
- available-for-sale	-	9,316	-	9,316
- amortised cost	50,268	61,966	50,268	61,966
- fair value through profit or loss	1,993	5,741	1,993	5,741
	58,620	77,023	58,620	77,023
Amortisation of discounts and premiums				
- fair value through other comprehensive income	(1,425)	-	(1,425)	-
- available-for-sale	-	(2,481)	-	(2,481)
- amortised cost	(8,476)	(14,345)	(8,476)	(14,345)
	(9,901)	(16,826)	(9,901)	(16,826)
Net interest income on debt and other fixed income instruments	48,719	60,197	48,719	60,197
	213,896	259,194	213,896	259,194
3. INTEREST EXPENSE				
On amounts owed to banks	6,970	11,622	6,970	11,622
On interest rate swaps	4,023	7,510	4,023	7,510
On amounts owed to customers	19,964	26,625	19,964	26,625
On debt securities in issue	3,473	5,449	3,473	5,449
On subordinated liabilities	9,941	12,426	9,941	12,426
Negative interest on loans to banks, treasury bills and balances with Central Bank of Malta	12,979	12,615	12,979	12,615
	57,350	76,247	57,350	76,247
4. NET FEE AND COMMISSION INCOME				
On loans and advances, similar activities and local business	42,188	41,320	42,188	41,320
On life assurance, fund management and similar activities	20,425	27,682	11,403	16,482
On other activities	18,524	17,287	18,524	17,287
	81,137	86,289	72,115	75,089

The fees and commission presented in this note include income of €6.5 million (2017: €5.2 million) relating to financial assets and financial liabilities not measured at FVTPL.

A significant portion of the fees and commissions earned by the Group are of a one time nature and are recognised at the point in time when the transaction takes place.

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

Notes to the financial statements 31 December 2018 (continued)

	The Group		The Bank	
	2018 12 months to Dec 2018 €000	2017 15 months to Dec 2017 €000	2018 12 months to Dec 2018 €000	2017 15 months to Dec 2017 €000
5. TRADING PROFITS				
Net income on foreign exchange activities	16,963	23,752	16,956	23,803
Fair value movements and net gains on sale of financial instruments designated at fair value through profit or loss	881	(1,462)	876	(1,465)
Fair value movements and net gains on sale of financial instruments mandatorily measured at fair value through profit or loss	175	-	175	-
	18,019	22,290	18,007	22,338
6. NET GAIN ON INVESTMENTS AND HEDGING INSTRUMENTS				
Amortised cost instruments				
- net gain on disposal	818	-	818	-
Available-for-sale assets				
- net gain on disposal	-	7,443	-	7,443
- net revaluation loss attributable to hedged risk	-	(8,432)	-	(8,432)
	818	(989)	818	(989)
Financial assets at FVOCI - debt instruments				
- net revaluation loss attributable to hedged risk	(2,571)	-	(2,571)	-
	(2,571)	-	(2,571)	-
Derivative financial instruments				
- net gain on derivative financial instruments held for hedging	2,742	8,011	2,742	8,011
	989	7,022	989	7,022

Notes to the financial statements 31 December 2018 (continued)

	The Group		The Bank	
	2018 12 months to Dec 2018	2017 15 months to Dec 2017	2018 12 months to Dec 2018	2017 15 months to Dec 2017
	€000	€000	€000	€000
7. EMPLOYEE COMPENSATION AND BENEFITS				
Employee compensation and benefits				
- wages and salaries	55,779	66,130	53,225	62,986
- social security costs	3,726	4,121	3,627	4,022
- retirement benefits	556	3,663	556	3,663
- other staff costs	5,635	5,836	5,635	5,836
	65,696	79,750	63,043	76,507
	No. of persons	**No. of persons**	**No. of persons**	**No. of persons**
The average number of employees are analysed as follows:				
Managerial	578	515	556	493
Supervisory and clerical	1,054	1,055	1,013	1,006
Others	70	43	59	40
	1,702	1,613	1,628	1,539

	€000	€000	€000	€000
8. NET IMPAIRMENT REVERSAL				
Loans and advances to customers				
- expected credit losses	30,988	-	30,988	-
- specific allowances	-	38,667	-	38,667
- collective allowances	-	3,251	-	3,251
- bad debts written off	46,869	13,311	46,869	13,311
	77,857	55,229	77,857	55,229
Loans and advances to customers				
- expected credit losses	(83,310)	-	(83,310)	-
- specific allowances	-	(51,861)	-	(51,861)
- collective allowances	-	(1,984)	-	(1,984)
- recoveries of debts previously written off	(4,717)	(7,611)	(4,717)	(7,611)
	(88,027)	(61,456)	(88,027)	(61,456)
Investments				
- expected credit losses	(646)	-	(646)	-
Net impairment reversals	(10,816)	(6,227)	(10,816)	(6,227)

During the financial year ended 31 December 2018 and the financial period ended 31 December 2017 a number of long outstanding non-performing exposures were written off. As a result, the allowances held in respect of those exposures were duly reversed.

Notes to the financial statements 31 December 2018 (continued)

	The Group		The Bank	
	2018 12 months to Dec 2018	2017 15 months to Dec 2017	2018 12 months to Dec 2018	2017 15 months to Dec 2017
	€000	€000	€000	€000
9. PROFIT BEFORE TAX				
Profit before tax is stated after charging:				
Total remuneration payable to the external auditors of the parent company				
- the audit of financial statements	386	378	356	348
- other assurance services	59	115	54	111
- tax advisory services	25	5	22	3
- other non-audit services	35	70	35	70
	505	568	467	532
Directors' emoluments:				
- fees	408	412	382	412
- directors' salaries as full-time bank employees	426	282	426	282
	834	694	808	694
Compensation to other key management personnel is analysed as follows:				
- other fees	154	73	-	-
- short term employee benefits	513	901	513	901
	667	974	513	901
Total remuneration of directors and other key management personnel	1,501	1,668	1,321	1,595

Notes to the financial statements 31 December 2018 (continued)

	The Group		The Bank	
	2018 12 months to Dec 2018	2017 15 months to Dec 2017	2018 12 months to Dec 2018	2017 15 months to Dec 2017
	€000	€000	€000	€000
10. INCOME TAX EXPENSE				
Through profit and loss				
Current				
- for the period	27,808	46,149	27,377	47,091
- over provision in prior years	(2,500)	-	(2,500)	-
Deferred	(5,520)	9,089	(5,520)	9,089
	19,788	55,238	19,357	56,180

The charge for income tax is based on the taxable profit for the period at a rate of 35%. The income tax expense and the product of accounting profit multiplied by the statutory domestic income tax rate are reconciled as follows:

	The Group 2018 €000	The Group 2017 €000	The Bank 2018 €000	The Bank 2017 €000
Profit before tax	71,198	174,736	69,922	165,024
Tax at the applicable rate of 35%	24,919	61,158	24,473	57,758
Tax effect of:				
Exempt and untaxed dividends	(47)	(56)	(2,907)	(2,460)
Share of results of equity-accounted investees	(2,875)	(6,750)	-	-
Withholding tax on property sales	(98)	26	(98)	26
Depreciation on premises	170	503	170	503
Non-deductible expenses	45	416	45	416
Actuarial losses on defined benefit plans	-	(36)	-	(36)
Tax refund on Visa Gain transaction	(2,500)	-	(2,500)	-
Other differences	174	(23)	174	(27)
Income tax expense	19,788	55,238	19,357	56,180

	The Group 2018 €000	The Group 2017 €000	The Bank 2018 €000	The Bank 2017 €000
Through equity				
On opening retained earnings on adoption of IFRS 9				
- current	369	-	369	-
- deferred	(4,742)	-	(4,742)	-
	(4,373)	-	(4,373)	-
Other comprehensive income				
- current	(1,352)	-	(1,352)	-
- deferred	(66)	(1,907)	(66)	(1,907)
	(1,418)	(1,907)	(1,418)	(1,907)

Notes to the financial statements 31 December 2018 (continued)

	The Group		The Bank	
	2018 12 months to Dec 2018	2017 15 months to Dec 2017	2018 12 months to Dec 2018	2017 15 months to Dec 2017
	cents per share	cents per share	cents per share	cents per share
11. EARNINGS PER SHARE				
Earnings per share	09c7	27c1	09c6	24c7

The earnings per share for the Group and the Bank have been calculated on the profits of the Group and the Bank, as shown in the statements of profit or loss, divided by the weighted average number of shares in issue. The calculation of the earnings per share for 2018 was impacted by the increase in the number of ordinary shares outstanding as a result of the scrip dividend which was applied prospectively.

Earnings per share was calculated on profit attributable to shareholders of the Group €51,410,000 (2017: €119,498,000) and the Bank €50,565,000 (2017: €108,844,000) divided by 528,589,749 (2017: 440,692,054 shares) weighted average number of shares for the period ended 31 December 2018.

12. DIVIDENDS

The amounts of dividends recognised as distributions to equity holders during the period, and the related amount per share, are as follows:

	The Bank			
	2018 12 months to Dec 2018	2017 15 months to Dec 2017	2018 12 months to Dec 2018	2017 15 months to Dec 2017
	cents per share	cents per share	€000	€000
Gross of income tax				
- prior year's final paid	8.0	7.9	42,000	33,228
- interim paid	-	4.5	-	18,900
	8.0	12.4	42,000	52,128
Net of income tax				
- prior year's final paid	5.2	5.1	27,300	21,598
- interim paid	-	2.9	-	12,285
	5.2	8.0	27,300	33,883

Dividend was paid out of profits taxed at 35%.

Notes to the financial statements 31 December 2018 (continued)

	Note	The Group		The Bank	
		2018	2017	2018	2017
		€000	€000	€000	€000
13. BALANCES WITH CENTRAL BANK OF MALTA, TREASURY BILLS AND CASH					
Balances with Central Bank of Malta		99,781	99,032	99,781	99,032
Malta Government Treasury Bills		86,231	4,503	86,231	4,503
Cash	36	60,287	56,149	60,287	56,149
		246,299	159,684	246,299	159,684

Balances with the Central Bank of Malta include Reserve Deposit, in terms of Regulation (EC) No. 1745/2003 of the European Central Bank amounting to €99.8 million (2017: €99.0 million) in respect of both the Group and the Bank. Balances with Central Bank of Malta and Malta Government Treasury Bills are subject to negative interest rates.

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
14. FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS				
Financial assets at fair value through profit or loss				
Financial assets mandatorily measured at FVTPL:				
Debt and other fixed income instruments (note 14.1)	7,778	-	7,778	-
Derivative financial instruments (note 14.3)	4,391	7,490	4,391	7,490
	12,169	7,490	12,169	7,490
Financial assets designated at FVTPL:				
Debt and other fixed income instruments (note 14.1)	31,855	111,417	31,855	111,417
Equity and other non-fixed income instruments (note 14.2)	27,072	64,811	26,093	63,836
Loans and advances to customers (note 17)	135,110	142,573	135,110	142,573
	194,037	318,801	193,058	317,826
	206,206	326,291	205,227	325,316

During the current financial year interest receivable accrued of €0.5 million has been reclassifed from Prepayments and Accrued Income to Financial assets at fair value through profit or loss. Prior year figures have not been restated. Please refer to Significant accounting policies - Note 1.1 Basis of Preparation.

During the year ended 31 December 2018, debt instruments with a nominal value of €12.5 million have been pledged in favour of the Italian Bank Intesa San Paolo against the precautionary warrant of seizure in respect of Deiulemar Trust (note 33).

Financial liabilities at fair value through profit or loss

	The Group 2018	The Group 2017	The Bank 2018	The Bank 2017
Financial liabilities classified as held for trading:				
Derivative financial instruments (note 14.3)	8,812	11,957	8,812	11,957

During the current financial year interest accrued of €0.6 million has been reclassifed from Accruals and Deferred Income to Financial Liabilities at fair value through profit or loss. Prior year figures have not been restated. Please refer to Significant accounting policies - Note 1.1 Basis of Preparation.

Notes to the financial statements 31 December 2018 (continued)

14. FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS (continued)

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
14.1 Debt and other fixed income instruments				
Issued by public bodies				
- local general government	21,989	33,680	21,989	33,680
- foreign general government	13,184	30,660	13,184	30,660
	35,173	64,340	35,173	64,340
Issued by other issuers				
- local banks	-	1,890	-	1,890
- foreign banks	4,460	26,922	4,460	26,922
- foreign other	-	15,437	-	15,437
- local other	-	2,828	-	2,828
	4,460	47,077	4,460	47,077
	39,633	111,417	39,633	111,417
Listing status				
- listed on Malta Stock Exchange	21,989	38,398	21,989	38,398
- listed elsewhere	13,262	72,888	13,262	72,888
- foreign unlisted	4,382	131	4,382	131
	39,633	111,417	39,633	111,417
Summary of movements during the year/period:				
At the beginning of the year/period	111,417	186,015	111,417	186,015
Reclassification on adoption of IFRS 9 (note 1.1)	(48,622)	-	(48,622)	-
Remeasurement on adoption of IFRS 9 (note 1.1)	324	-	324	-
Reclassification of interest receivable accrued	526	-	526	-
Acquisitions	1	821	1	821
Disposals at carrying amount	(22,965)	(69,790)	(22,965)	(69,790)
Movement in fair value	(1,516)	(4,076)	(1,516)	(4,076)
Exchange adjustment	468	(1,553)	468	(1,553)
At the end of the year/period	39,633	111,417	39,633	111,417

14.2 Equity and other non-fixed income instruments

	The Group 2018 €000	The Group 2017 €000	The Bank 2018 €000	The Bank 2017 €000
Issued by other issuers				
- local banks	688	6,148	688	6,148
- foreign banks	-	14,362	-	14,362
- foreign other	22,016	24,479	22,016	24,479
- local other	4,368	19,822	3,389	18,847
	27,072	64,811	26,093	63,836
Listing status				
- listed on Malta Stock Exchange	5,056	25,974	4,077	24,999
- listed elsewhere	1,245	13,617	1,245	13,617
- foreign unlisted	20,771	25,220	20,771	25,220
	27,072	64,811	26,093	63,836
Summary of movements during the year/period:				
At the beginning of the year/period	64,811	79,734	63,836	78,596
Reclassification on adoption of IFRS 9 (note 1.1)	(27,851)	-	(27,851)	-
Acquisitions	4	6,423	-	6,422
Redemption	(215)	-	(215)	-
Disposals at carrying amount	(11,460)	(22,266)	(11,460)	(22,102)
Movement in fair value	1,756	1,345	1,756	1,345
Exchange adjustment	27	(425)	27	(425)
At the end of the year/period	27,072	64,811	26,093	63,836

Notes to the financial statements 31 December 2018 (continued)

14. FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS (continued)

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
14.3 Derivative financial instruments				
Fair value of assets	4,391	7,490	4,391	7,490
Fair value of liabilities	8,812	11,957	8,812	11,957
The above comprise over-the-counter forward exchange contracts and interest rate swaps that have not been designated as hedging instruments stated at fair value with notional amounts analysed with remaining life as follows :				
- less than 3 months	397,454	520,938	397,454	520,938
- between 3 months and 1 year	7,496	41,790	7,496	41,790
- more than 1 year	147,112	171,866	147,112	171,866
	552,062	734,594	552,062	734,594

15. INVESTMENTS

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
Debt and other fixed income instruments				
- measured at FVOCI (note 15.1)	142,907	-	142,907	-
- measured at amortised cost (note 15.2)	3,152,919	-	3,152,919	-
- available-for-sale (note 15.1)	-	139,328	-	139,328
- held-to-maturity (note 15.2)	-	3,229,915	-	3,229,915
Equity and other non-fixed income instruments (note 15.3)				
- measured at FVOCI	19,129	-	19,129	-
- available-for-sale	-	5,298	-	5,298
	3,314,955	3,374,541	3,314,955	3,374,541

During the current financial year interest receivable accrued of €14.6 million has been reclassifed from Prepayments and Accrued Income to Investments as a result of the adoption of IFRS 9 - Financial Instruments. Prior year figures have not been restated. Please refer to Significant accounting policies - Note 1.1 Basis of Preparation.

Investments with a nominal value of €122.2 million (2017: €122.2 million) have been pledged against the provision of credit lines by the Central Bank of Malta.

Investments with a nominal value of €39.7 million have been pledged in favour of the Depositor Compensation Scheme as at 31 December 2018 (2017: €39.7 million).

During the year ended 31 December 2018, debt instruments with a nominal value of €351 million have been pledged in favour of the Italian Bank Intesa San Paolo against the precautionary warrant of seizure in respect of Deiulemar Trust (note 33).

Notes to the financial statements 31 December 2018 (continued)

15. INVESTMENTS (continued)

15.1 Debt and other fixed income instruments measured at FVOCI (available-for-sale as at 31 December 2017)

	The Group		The Bank	
	2018	**2017**	**2018**	**2017**
	€000	**€000**	**€000**	**€000**
Issued by public bodies				
- local general government	64,930	66,080	64,930	66,080
- local public sector	72,904	73,248	72,904	73,248
Issued by other issuers				
- foreign banks	5,073	-	5,073	-
	142,907	139,328	142,907	139,328
Listing status				
- listed on Malta Stock Exchange	137,834	139,328	137,834	139,328
- listed elsewhere	5,073	-	5,073	-
	142,907	139,328	142,907	139,328
Summary of movements during the year/period:				
At the beginning of the year/period	139,328	272,243	139,328	272,243
Reclassification on adoption of IFRS 9 (note 1.1)	5,181	-	5,181	-
Remeasurement on adoption of IFRS 9 (note 1.1)	(2)	-	(2)	-
Reclassification of interest receivable accrued	1,426	-	1,426	-
Disposals at carrying amount	-	(60,300)	-	(60,300)
Redemptions	-	(51,753)	-	(51,753)
Amortisation	(1,425)	(2,481)	(1,425)	(2,481)
Realised profit on disposals	(4,525)	(16,456)	(4,525)	(16,456)
Profit on disposal	-	3,093	-	3,093
Exchange adjustment	2,924	(5,018)	2,924	(5,018)
At the end of the year/period	142,907	139,328	142,907	139,328

As at 31 December 2018 the loss allowance on Debt Instruments at FVOCI amounts to €22,867.

15.2 Debt and other fixed income instruments measured at amortised cost (held-to-maturity as at 31 December 2017)

Issued by public bodies				
- local general government	418,696	496,692	418,696	496,692
- foreign general government	934,143	511,941	934,143	511,941
	1,352,839	1,008,633	1,352,839	1,008,633
Issued by other issuers				
- foreign banks	1,395,571	1,580,844	1,395,571	1,580,844
- foreign other	401,257	640,438	401,257	640,438
- other local	3,252	-	3,252	-
	1,800,080	2,221,282	1,800,080	2,221,282
	3,152,919	3,229,915	3,152,919	3,229,915
Listing status				
- listed on Malta Stock Exchange	421,947	496,692	421,947	496,692
- listed elsewhere	2,203,799	2,097,351	2,203,799	2,097,351
- foreign unlisted	527,173	635,872	527,173	635,872
	3,152,919	3,229,915	3,152,919	3,229,915

At 31 December 2018, the fair value of debt and other fixed income instruments measured at amortised cost, without deducting transaction costs, amounted to €3.2 million (2017: €3.3 million).

Notes to the financial statements 31 December 2018 (continued)

15. INVESTMENTS (continued)

15.2 Debt and other fixed income instruments measured at amortised cost (held-to-maturity as at 31 December 2017) (continued)

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
Summary of movements during the year/period:				
At the beginning of the year/period	3,229,915	3,460,446	3,229,915	3,460,446
Reclassification on adoption of IFRS 9 (note 1.1)	43,441	-	43,441	-
Remeasurement on adoption of IFRS 9 (note 1.1)	(5,192)	-	(5,192)	-
Reclassification of interest receivable accrued	13,127	-	13,127	-
Acquisitions	892,021	897,650	892,021	897,650
Disposals at carrying amount	(223,520)	-	(223,520)	-
Redemptions	(796,923)	(1,043,837)	(796,923)	(1,043,837)
Amortisation	(8,476)	(14,345)	(8,476)	(14,345)
Realised profit on disposals	818	43	818	43
Impairment	(508)	-	(508)	-
Exchange adjustment	8,216	(70,042)	8,216	(70,042)
At the end of the year/period	3,152,919	3,229,915	3,152,919	3,229,915

During the year ended 31 December 2018, the Group sold certain investment securities measured at amortised cost. These sales were made as part of the Bank's strategy for capital optimisation.

15.3 Equity and other non-fixed income instruments measured at FVOCI (available-for-sale as at 31 December 2017)

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
Issued by other issuers				
- local other	17,411	-	17,411	-
- foreign other	-	5,298	-	5,298
- local Banks	166	-	166	-
- local Public	1,552	-	1,552	-
	19,129	5,298	19,129	5,298
Listing status				
- listed on Malta Stock Exchange	19,129	-	19,129	-
- foreign listed	-	5,298	-	5,298
	19,129	5,298	19,129	5,298
Summary of movements during the year/period:				
At the beginning of the year/period	5,298	3,583	5,298	3,583
Reclassification on adoption of IFRS 9 (note 1.1)	27,851	-	27,851	-
Disposals at carrying amount	(12,296)	-	(12,296)	-
Movement in fair value	(1,904)	1,715	(1,904)	1,715
Exchange adjustment	180	-	180	-
At the end of the year/period	19,129	5,298	19,129	5,298

Notes to the financial statements 31 December 2018 (continued)

16. LOANS AND ADVANCES TO BANKS

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
Repayable on call and at short notice	262,013	345,193	262,013	345,193
Term placements with Central Bank of Malta	3,154,289	2,906,971	3,154,289	2,906,971
Term placements with other banks	214,590	173,716	214,590	173,716
Cheques in course of collection	14,041	5,503	14,041	5,503
	3,644,933	3,431,383	3,644,933	3,431,383

Balances with a value of €22.9 million (2017: €27.3 million) were held as collateral against derivative contracts.

Balances held with Central Bank of Malta and with other banks are subject to negative interest rates.

17. LOANS AND ADVANCES TO CUSTOMERS

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
Repayable on call and at short notice	492,017	524,993	492,017	524,993
Term loans and advances	3,978,029	3,803,239	3,978,029	3,803,239
	4,470,046	4,328,232	4,470,046	4,328,232
Less impairment losses	(107,063)	(166,200)	(107,063)	(166,200)
Net loans and advances at amortised cost	4,362,983	4,162,032	4,362,983	4,162,032
Loans and advances designated at fair value through profit or loss (note 14)	135,110	142,573	135,110	142,573
Total loans and advances	4,498,093	4,304,605	4,498,093	4,304,605
Impairment losses				
- expected credit loss allowances	107,063	-	107,063	-
- individually assessed allowances	-	149,998	-	149,998
- collective allowances	-	16,202	-	16,202
	107,063	166,200	107,063	166,200

During the current financial year interest receivable accrued of €15.2 million has been reclassified from Prepayments and Accrued Income and included with Loans and Advances to Customers. Prior year figures have not been restated. Refer to Significant accounting policies - Note 1.1 Basis of Preparation.

During the financial year ended 31 December 2018 and the financial period ended 31 December 2017 a number of long outstanding non-performing exposures, which were mostly provided for, were written off. As a result, the allowances held in respect of those exposures were duly reversed (note 8).

Notes to the financial statements 31 December 2018 (continued)

18. INVESTMENTS IN EQUITY-ACCOUNTED INVESTEES

	The Group 2018 €000	The Group 2017 €000	The Bank 2018 €000	The Bank 2017 €000
At the beginning of the year/period	109,461	97,041	52,870	52,870
Share of results, net of tax	8,214	19,287	-	-
Dividend received	(9,165)	(6,867)	-	-
At the end of the year/period	108,510	109,461	52,870	52,870
Amounts include:				
Local listed	28,489	28,857	22,304	22,304
Local unlisted	80,021	80,604	30,566	30,566
	108,510	109,461	52,870	52,870

On the historical cost basis, shares in equity-accounted investees of the Group, would have been included at a cost of €52.9 million (2017: €52.9 million).

The fair value of the equity-accounted investees that is publicly quoted amounted to €56.9 million at 31 December 2018 (2017: €50.9 million).

The fair values are calculated using observable inputs and are regarded as being Level 1 under IFRS 13.

Details of the associates held by the Group and the Bank are as follows:

Name of company	Equity Interest 2018 %	Equity Interest 2017 %	Class	Incorporated in	Nature of Business
MAPFRE Middlesea p.l.c.	31.08	31.08	Ordinary Shares	Malta	Insurance
MAPFRE MSV Life p.l.c.*	50.00	50.00	Ordinary Shares	Malta	Life Assurance

Name of company	Group's share of results 2018 €000	Group's share of results 2017 €000
MAPFRE Middlesea p.l.c.	2,647	5,468
MAPFRE MSV Life p.l.c.	5,567	13,819
	8,214	19,287

*A further 15.54% (2017:15.54%) is held indirectly via another equity-accounted investee. Although the Bank has an effective participating interest of 65.54% (2017: 65.54%), it does not exercise control over the financial and operating decisions of the associate as it only has the right for equal representation on the Board of Directors of the associate together with the other shareholders. Furthermore, as from 1 October 2011 the Bank is deemed to exercise significant influence on MAPFRE MSV Life p.l.c. as opposed to joint control as a result of a shareholders' agreement which gives the other shareholder control and as from the financial year 30 September 2012 it is being treated as an equity-accounted investee.

The financial statements of the equity-accounted investees are prepared to 31 December. Due to the change in financial year end from September 2017 to December 2017 the share of results of equity-accounted investees for the period ended 31 December 2017 comprise the Group's share of profits and the Group's share of the movement in the valuation of the in-force business of the entities, for the eighteen month period July 2016 to December 2017.

The registered addresses of the associate are as follows:

MAPFRE Middlesea p.l.c.	Middlesea House, Floriana FRN 1442, Malta
MAPFRE MSV Life p.l.c.	The Mall, Mall Street, Floriana FRN 1470, Malta

Notes to the financial statements 31 December 2018 (continued)

18. INVESTMENTS IN EQUITY-ACCOUNTED INVESTEES (continued)

Summarised financial information extracted from the published preliminary statement of annual results of the associates as at 31 December 2018 (2017: as at 31 December 2017) in respect of the equity-accounted investees:

	2018 €000	2017 €000
Total assets	2,318,779	2,214,752
Total liabilities	2,147,085	2,041,272
Revenues	370,221	379,690
Results for the period	14,035	13,521

	The Group	
	2018 €000	2017 €000
Share of net assets of equity-accounted investees	108,510	109,461
Share of results of equity-accounted investees	8,214	19,287

The share of results of equity-accounted investees for comparative period comprise the Group's share of profits and the Group's share of the movement in the valuation of the in-force business of the entities, for the eighteen month period June 2016 to December 2017.

The judgements made by the equity-accounted investees and the key sources of estimation uncertainties are disclosed below:

Estimate of in-force business

Assumptions
The value of in-force business is determined by the directors of the equity-accounted investee based on the advice of the entity's consulting actuaries. The valuation represents the discounted value of projected future transfers to shareholders from policies in force at the year end, after making provision for taxation. In determining this valuation, assumptions relating to future mortality, persistence and levels of expenses are based on experience of the type of business concerned. Gross investment returns assumed vary depending upon the mix of investments held by the associates and expected market conditions. The value depends on assumptions made regarding future economic and demographic experience. The impact of the change of the present value of in-force (PVIF) accounts was 23% of the result for the year. The PVIF represents 35% of the carrying value of the investments in equity-accounted investees.

This valuation assumes a spread of 1% (2017: 1%) between the weighted average projected investment return and the risk adjusted discount factor applied of 6.5% (2017: 6.5%). The calculation also assumes lapse rates varying from 0.5% to 8% per annum (2017: 0.5% to 8% per annum) and an expense inflation rate 3.5% (2017: 3.5%).

Changes in assumptions
Assumptions are reviewed on an annual basis to reflect the development of experience and to improve on the reliability of the estimation process.

Ultimate liability arising from claims made under insurance contracts
There are several sources of uncertainty that need to be considered in the estimate of the liability that the equity-accounted investees will ultimately pay for such claims. In particular insurance risks including exposure to liability can span over more than one accounting year, and this increases the uncertainty surrounding the estimate for final settlement.

In calculating the estimated cost of unpaid claims, the equity-accounted investees uses a combination of estimation techniques, based partly on known information at year end, partly on statistical analysis of historical experience and on actuarial valuations carried out by an independant external actuary.

Notes to the financial statements 31 December 2018 (continued)

19. INVESTMENTS IN SUBSIDIARY COMPANIES

Name of company	Equity interest 2018 %	Equity interest 2017 %	Class	Incorporated in	Nature of Business
BOV Asset Management Limited	100	100	Ordinary	Malta	Fund Management
BOV Fund Services Limited	100	100	Ordinary	Malta	Fund Administration

Name of company Cost/Carrying amount	The Bank 2018 €000	The Bank 2017 €000
BOV Asset Management Limited	5,481	5,481
BOV Fund Services Limited	749	749
	6,230	6,230

The registered address of the above unlisted undertakings is as follows:

BOV Asset Management Limited	58, Triq San Żakkarija, Il-Belt Valletta VLT 1130
BOV Fund Services Limited	58, Triq San Żakkarija, Il-Belt Valletta VLT 1130

All subsidiaries prepared their financial statements to the same date, 31 December.

20. INTANGIBLE ASSETS

	The Group 2018 €000	The Group 2017 €000	The Bank 2018 €000	The Bank 2017 €000
Software				
Cost				
1 January 2018 / 1 October 2016	49,764	29,650	49,764	29,650
Additions	18,197	20,114	18,197	20,114
Assets retired from active use	(1,148)	-	(1,148)	-
31 December	66,813	49,764	66,813	49,764
Accumulated amortisation				
1 January 2018 / 1 October 2016	21,311	16,378	21,311	16,378
Charge for the year	4,607	4,933	4,607	4,933
Accumulated amortisation on assets retired from active use	(1,148)	-	(1,148)	-
31 December	24,770	21,311	24,770	21,311
Carrying amount at 31 December	42,043	28,453	42,043	28,453
Future capital expenditure:				
- contracted but not provided for in the financial statements	14,201	14,188	14,201	14,188
- authorised by the directors but not contracted	16,970	15,758	16,970	15,758

Notes to the financial statements 31 December 2018 (continued)

21. PROPERTY AND EQUIPMENT

	Note	Land and buildings €000	IT infrastructure and equipment €000	Other €000	Total €000
The Group					
Cost or valuation					
30 September 2016		89,754	22,815	29,282	141,851
Additions		2,445	9,067	1,715	13,227
Reclassification from assets held for realisation	40	7,501	-	-	7,501
Assets retired from active use		-	-	20	20
Revaluation		2,005	-	-	2,005
31 December 2017		101,705	31,882	31,017	164,604
Additions		3,006	3,501	1,591	8,098
Assets retired from active use		(429)	(5,593)	(5,500)	(11,522)
Disposals		(1,726)	-	-	(1,726)
Revaluation		12,762	-	-	12,762
31 December 2018		115,318	29,790	27,108	172,216
Accumulated depreciation					
30 September 2016		14,226	15,988	22,063	52,277
Depreciation for the year		1,437	3,938	1,710	7,085
Accumulated depreciation on assets retired from active use		-	-	20	20
31 December 2017		15,663	19,926	23,793	59,382
Depreciation for the year		948	3,308	1,443	5,699
Accumulated depreciation on assets retired from active use		(424)	(5,617)	(5,516)	(11,557)
Disposals		(463)	-	-	(463)
31 December 2018		15,724	17,617	19,720	53,061
Carrying amount at:					
31 December 2017		**86,042**	**11,956**	**7,224**	**105,222**
31 December 2018		**99,594**	**12,173**	**7,388**	**119,155**
The Bank					
Cost or valuation					
30 September 2016		89,715	22,171	27,723	139,609
Additions		2,445	9,067	1,613	13,125
Reclassification from assets held for realisation		7,501	-	-	7,501
Revaluation		2,005	-	-	2,005
31 December 2017		101,666	31,238	29,336	162,240
Additions		3,006	3,501	1,525	8,032
Assets retired from active use		(429)	(5,593)	(5,500)	(11,522)
Disposals		(1,726)	-	-	(1,726)
Revaluation		12,762	-	-	12,762
31 December 2018		115,279	29,146	25,361	169,786
Accumulated depreciation					
30 September 2016		14,133	15,165	20,859	50,157
Depreciation for the period		1,437	3,938	1,660	7,035
31 December 2017		15,570	19,103	22,519	57,192
Depreciation for the year		948	3,308	1,380	5,636
Accumulated depreciation on assets retired from active use		(424)	(5,617)	(5,516)	(11,557)
Disposals		(463)	-	-	(463)
31 December 2018		15,631	16,794	18,383	50,808
Carrying amount at:					
31 December 2017		**86,096**	**12,135**	**6,817**	**105,048**
31 December 2018		**99,648**	**12,352**	**6,978**	**118,978**

Notes to the financial statements 31 December 2018 (continued)

21. PROPERTY AND EQUIPMENT (continued)

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
Carrying amount of land and buildings occupied for own use	94,398	86,042	94,452	86,096
Future capital expenditure:				
- contracted but not provided for in the financial statements	4,617	4,886	4,617	4,886
- authorised by the directors but not contracted for	21,600	15,874	21,600	15,874

Land and buildings are revalued by professionally qualified architects in accordance with the policy documented in Note 1. The carrying amounts of land and buildings that would have been included in the financial statements had these assets been carried at cost less accumulated depreciation are:
2018: Group and Bank €53.6 million (2017: Group €52.1 million and the Bank: €51.9 million).

Property valuations are mainly valued using the 'comparative investment approach' whereby market value is arrived at by capitalising at an appropriate yield rate, the annual income produced, should the property be leased out to third parties. The income is arrived at by analysing a number of estate agent listings for comparative properties and determining a mean rental value rate. The valuation techniques were consistent with those applied for the year ended 31 December 2017.

During the year ended 31 December 2018, revaluation on land and buildings amounted to €12.8 million out of which €6.1 million related to revaluation on 'Assets held for realisation' which were reclassified to 'Property and equipment' as at 31 December 2017. The remaining revaluation of €6.7 million relates to property which is revalued by the Bank on a regular basis in accordance with the Group's accounting policies.

Property fair value measurement is classified as Level 3. Significant unobservable inputs used in the valuation of these properties is the rental income for office space and the percentage capitalisation rate which indicates the multiplier relationship between Net Rental Income and Property Value. Further details about these significant inputs are summarised in the table below:

	Significant unobservable input	Narrative sensitivity
Buildings in Commercial Area	Price per square metre, ranging from €115/sqm to €985/sqm	The higher the price per square metre the higher the fair value
	Capitalisation rate, ranging from 5.5% to 5.75%	The higher the capitalisation rate the lower the fair value
Buildings in Residential Area	Price per square metre, ranging from €125/sqm to €180/sqm	The higher the price per square metre the higher the fair value
	Capitalisation rate of 5.75%	The higher the capitalisation rate the lower the fair value

Notes to the financial statements 31 December 2018 (continued)

22. DEFERRED TAX

Deferred taxation is analysed as follows:

	The Group 2018 €000	The Group 2017 €000	The Bank 2018 €000	The Bank 2017 €000
Net deferred tax asset arising on:				
Fair value movement of financial instruments	281	(1,793)	281	(1,793)
Impairment allowances	44,356	58,298	44,356	58,298
Allowance for employee benefits	5,814	7,111	5,814	7,111
Excess of capital allowances over depreciation	(8,292)	(5,469)	(8,292)	(5,469)
Defined benefit plans	3,360	2,070	3,360	2,070
Provisions	26,250	-	26,250	-
	71,769	60,217	71,769	60,217
Deferred tax liability arising on:				
Property revaluation	5,743	4,519	5,743	4,519

The Group and the Bank

	At 31 December 2017 €000	Recognised in profit or loss €000	Recognised in equity €000	IFRS 9 adoption €000	At 31 December 2018 €000
Movement in temporary differences relating to:					
Fair value movement of financial instruments (on adoption of IFRS 9)	(1,793)	-	-	2,074	281
Impairment allowances	58,298	(16,610)	-	2,668	44,356
Allowance for employee benefits	7,111	(1,297)	-	-	5,814
Excess of capital allowances over depreciation	(5,469)	(2,823)	-	-	(8,292)
Defined benefit plans	2,070	-	1,290	-	3,360
Property revaluation	(4,519)	-	(1,224)	-	(5,743)
Other temporary differences	-	26,250	-	-	26,250
	55,698	5,520	66	4,742	66,026

The Group and the Bank

	At 30 September 2016 €000	Recognised in profit or loss €000	Recognised in equity €000	IFRS 9 adoption €000	At 31 December 2017 €000
Movement in temporary differences relating to:					
Fair value movement of financial instruments	(4,221)	315	2,113	-	(1,793)
Impairment allowances	66,947	(8,649)	-	-	58,298
Allowance for employee benefits	6,960	151	-	-	7,111
Excess of capital allowances over depreciation	(4,563)	(906)	-	-	(5,469)
Defined benefit plans	2,075	-	(5)	-	2,070
Property revaluation	(4,318)	-	(201)	-	(4,519)
	62,880	(9,089)	1,907	-	55,698

The Group's deferred tax assets and liabilities on the statement of financial position have not been off-set to the extent that there is no legally enforceable right of set-off with the tax authorities.

Notes to the financial statements 31 December 2018 (continued)

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
23. PREPAYMENTS AND ACCRUED INCOME				
Accrued income	-	33,144	-	33,144
Prepayments	10,314	6,241	8,851	7,173
	10,314	39,385	8,851	40,317

During the current financial year interest receivable accrued of €30.3 million has been reclassifed from Prepayments and Accrued Income to the respective financial assets categories namely Financial assets at fair value through profit or loss, Investments and Loans and Advances to customers at amortised cost as applicable. Prior year figures have not been restated. Refer to Significant accounting policies - Note 1.1 Basis of Preparation.

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
24. AMOUNTS OWED TO BANKS				
Term deposits	73,380	119,734	73,380	119,734
Repayable on demand	72,641	72,462	72,641	72,462
	146,021	192,196	146,021	192,196

During the current financial year interest payable accrued of €0.2 million has been reclassifed from Accruals and Deferred Income to Amounts Owed to Banks. Prior year figures have not been restated. Refer to Significant accounting policies - Note 1.1 Basis of Preparation.

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
25. AMOUNTS OWED TO CUSTOMERS				
Term deposits	1,791,042	1,750,910	1,791,042	1,750,910
Repayable on demand	8,623,866	8,349,715	8,626,957	8,351,254
	10,414,908	10,100,625	10,417,999	10,102,164

During the current financial year interest payable accrued of €7.6 million has been reclassifed from Accruals and Deferred Income to Amounts Owed to Customers. Prior year figures have not been restated. Refer to Significant accounting policies - Note 1.1 Basis of Preparation.

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
26. DEBT SECURITIES IN ISSUE				
4.80% Euro debt securities	-	55,400	-	55,400
4.25% Euro debt securities	40,197	40,000	40,197	40,000
	40,197	95,400	40,197	95,400

The 4.8% Euro unsubordinated bonds matured during the current financial year and were redeemed at par on 27 August 2018.

The 4.25% Euro unsubordinated bonds are redeemable at par on 17 May 2019 and are listed on the Malta Stock Exchange. The fair value of these unsecured bonds as at 31 December 2018 is €40.2 million (2017: €41.5 million).

During the current financial year interest payable accrued of €197,391 has been reclassifed from Accruals and Deferred Income to Debt Securities in Issue. Prior year figures have not been restated. Refer to Significant accounting policies - Note 1.1 Basis of Preparation.

Notes to the financial statements 31 December 2018 (continued)

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
27. OTHER LIABILITIES				
Post employment and termination liabilities (see note 35)	26,302	26,229	26,302	26,229
Cash collateral for commitments	55,574	50,912	55,574	50,912
Deposits from companies in formation	4,941	3,520	4,941	3,520
Bills payable	36,024	39,511	36,024	39,511
Accruals and deferred income	25,272	26,158	25,272	26,158
Payment orders outwards	23,572	16,532	23,572	16,532
Other	24,736	32,889	24,519	32,566
	196,421	195,751	196,204	195,428
28. ACCRUALS AND DEFERRED INCOME				
Accrued interest	-	11,958	-	11,958
Other	539	493	-	-
	539	12,451	-	11,958

During the current financial year, interest accrued has been reclassified from Accruals and Deferred Income to Amounts owed to customers, Amounts owed to banks, Debt Securities, Subordinated Liabilities and other Financial Liabilities as applicable. Prior year figures have not been restated. Refer to Significant accounting policies - Note 1.1 Basis of Preparation.

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
29. DERIVATIVES DESIGNATED FOR HEDGE ACCOUNTING				
Derivative financial instruments designated as fair value hedges	10,206	12,053	10,206	12,053

During the current financial year interest payable accrued of €0.3 million has been reclassifed from Accrued and Deferred Income to Derivatives Designated for Hedge Accounting. Prior year figures have not been restated. Refer to Significant accounting policies - Note 1.1 Basis of Preparation.

The above comprise interest rate swaps.

The notional amount of the over-the-counter interest rate swaps stated above at fair value, amount to €61.8 million (2017: €59.2 million). The remaining life of these instruments is more than 1 year.

Notes to the financial statements 31 December 2018 (continued)

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
30. SUBORDINATED LIABILITIES				
5.35% Euro subordinated unsecured bonds	50,118	50,000	50,118	50,000
4.80% Euro subordinated unsecured bonds	70,993	70,000	70,993	70,000
3.50% Euro subordinated unsecured bonds	113,130	111,591	113,130	111,591
	234,241	231,591	234,241	231,591

During the current financial year interest payable accrued of €2.6 million has been reclassifed from Accruals and Deferred Income to Subordinated Liabilities. Prior year figures have not been restated. Refer to Significant accounting policies - Note 1.1 Basis of Preparation.

The 5.35% Euro subordinated bonds are redeemable at par on 15 June 2019 and are listed on the Malta Stock Exchange. The fair value of these unsecured bonds as at 31 December 2018 is €50.0 million (2017: €51.4 million).

The 4.8% Euro subordinated bonds are redeemable at par on 15 March 2020 and are listed on the Malta Stock Exchange. The fair value of these unsecured bonds as at 31 December 2018 is €70.6 million (2017: €72.2 million).

The 3.5% Euro subordinated bonds are redeemable at par on 8 August 2030 and are listed on the Malta Stock Exchange. The fair value of these unsecured bonds as at 31 December 2018 is €111.5 million (2017: €111.8 million).

	The Bank	
	2018	2017
31. SHARE CAPITAL AND SHARE PREMIUM	€000	€000
Share capital		
Authorised:		
1,000,000,000 Ordinary shares of €1.00 each	1,000,000	1,000,000
(2017: 1,000,000,000 Ordinary shares of €1.00 each)		
Issued and paid up:		
530,772,000 Ordinary shares of €1.00 each fully paid	530,772	525,000
(2017: 525,000,000 Ordinary shares of €1.00 each fully paid)		

During the financial year ended 31 December 2017 the Bank increased its authorised share capital from €500 million to €1 billion as approved by its shareholders during the Extraordinary General Meeting held on 27 July 2017.

On 16 January 2017 the Bank made a bonus issue of 30 million fully paid ordinary shares of a nominal value of €1.00 per share, representing one bonus share for every 13 shares held, thereby increasing the issued share capital from 390 million shares to 420 million shares, resulting in a paid up capital of €420 million. Furthermore, pursuant to Company Announcement No 325, the Bank announced that 105,000,000 new ordinary shares, resulting from the Rights Issue, have been admitted to the Official List and commenced trading with effect from 22 December 2017.

During the financial year ended 31 December 2018 ordinary share capital increased by €5,772,000 (5,772,000 shares at €1.00) as a result of the scrip dividend programme.

	The Bank	
	2018	2017
Share Premium	€000	€000
Share Premium	49,277	45,427

During the financial year ended 31 December 2018, as a result of the scrip dividend mentioned above, share premium account increased by 0.667c per share, for the 5,772,064 new ordinary shares.

Notes to the financial statements 31 December 2018 (continued)

32. OTHER RESERVES

Retained Earnings

Retained earnings represent the profits retained over the years and primarily comprise the profit attributable to equity holders after deducting dividends paid and transfers to share capital in respect of the scrip dividend. This reserve includes the amount held in respect of General Banking Reserves.

General Banking Reserves

The revised Banking Rule 09 requires banks in Malta to hold additional reserves for general banking risks against non-performing loans. This reserve is required to be funded from planned dividend. As at the reporting date this reserve amounts to €6.3 million (2017: €4.7 million).

Revaluation Reserves

Revaluation reserves represent fair value movements on land and buildings and financial assets at FVOCI (2017: available-for-sale investments) net of tax, which are recognised in Other Comprehensive Income.

	The Group	The Bank
	€000	€000
On land and buildings:		
30 September 2016	27,428	27,428
Property revaluation	2,005	2,005
Deferred tax and effect of changes in property tax rates	(201)	(201)
31 December 2017	29,232	29,232
Property revaluation	12,762	12,762
Deferred tax and effect of changes in property tax rates	(1,276)	(1,276)
Release of surplus on sale of property, net of tax	(462)	(462)
31 December 2018	**40,256**	**40,256**
On available-for-sale investments:		
30 September 2016	7,904	7,792
Fair value adjustments	1,379	1,379
Transfer to profit or loss on disposal	(7,443)	(7,443)
Deferred tax	2,122	2,122
31 December 2017	3,962	3,850
On fair value through other comprehensive income:		
31 December 2017	3,962	3,850
Adjustments on initial application of IFRS 9	14,728	14,728
Tax thereon	(5,155)	(5,155)
Adjusted balance at 1 January 2018	13,535	13,423
Fair value adjustments	(3,863)	(3,863)
Transfer to retained earnings on disposal	(1,917)	(1,917)
Tax thereon	2,023	2,023
31 December 2018	**9,778**	**9,666**
Total	**50,034**	**49,922**

Notes to the financial statements 31 December 2018 (continued)

33. PROVISIONS AND CONTINGENCIES

Provisions	Financial guarantees and loan commitments provisions €000	Custody and trust litigation provision €000	Other litigation provision €000	Total €000
Carrying amount at 1 January 2018	-	-	2,000	2,000
Adjustments on initial application of IFRS 9	23,016	-	-	23,016
Adjusted balance at 1 January 2018	23,016	-	2,000	25,016
Movement	(4,249)	75,000	-	70,751
Carrying amount at 31 December 2018	**18,767**	**75,000**	**2,000**	**95,767**

	The Group		The Bank	
	2018	2017	2018	2017
Contingencies	€000	€000	€000	€000
Acceptances and endorsements	2,862	3,191	2,862	3,191
Guarantees	304,310	223,625	304,310	223,625
Provision for default on forward contracts	5,815	7,133	5,815	7,133
Other contingent liabilities	22,418	19,902	22,418	19,902
	335,405	**253,851**	**335,405**	**253,851**

Financial guarantee contracts and loan commitments provision

The amount in respect of financial guarantee contracts and loan commitments issued represent the expected credit loss as at 31 December 2018. The amount charged to opening retained earnings on initial application of IFRS 9 is €14.9 million (net of tax) for financial guarantees and loan commitments issued.

Contingent liabilities

Contingent liabilities are backed by corresponding obligations from third parties.

Bank of Valletta is a party to legal proceedings arising out of its normal business operations. Matters arising from a set of similar circumstances can give rise to either a provision or a contingent liability, depending on the relevant facts and circumstances. The recognition of provisions and the disclosure of contingent liabilities in relation to such matters involves critical accounting estimates and judgments and is determined in accordance with the relevant accounting policies described in Note 1 (1.25.5). Except as disclosed hereunder, it is not practicable to provide an aggregate estimate of potential liability for the Bank's other legal proceedings as a class of contingent liabilities.

Litigation and claims provisions

The significant developments in the principal legal outstanding cases in relation to La Valette Multi Manager Property Fund, custody and trusts are disclosed below:

Deiulemar Trust

In November 2014, court action was instituted against the Bank by the curator of a failed group while under the trust of the Bank, by virtue of which a claim of €363 million was made. While the case has not as yet started to be heard, over the last three years there were various actions by the curator, the latest being a request for a precautionary warrant of seizure, in respect of which the Italian court has reserved its decision. On March 2018, the Italian Tribunal of Torre Annunziata upheld the issue of the precautionary warrant against the Bank for the sum of €363 million. Although the amount of the warrant does not necessarily reflect Bank of Valletta's potential financial exposure, the Bank pledged financial instruments in favour of the Italian Bank Intesa San Paolo and initiated legal action for the suspension of the garnishee. In May 2018, the Italian Tribunal declined the Bank's request for suspension and later in July the Tribunal also rejected the Bank's appeal. Following these events the Bank is seeking to protect its "right to a fair hearing" before an independent and impartial judiciary and is thus considering options to invoke certain Italian legal provisions (art 51) regarding constitutional legitimacy as well as to have recourse to the European Court of Human Rights (CEDU).

La Valette Multi Manager Property Fund (LVMMPF)

Proceedings in front of the Office of the Arbiter for Financial Services (OAFS) were instituted by a number of investors in the defunct La Vallette Multi Manager Property Fund against Financial Service Providers (FSPs), namely the Bank, the fund manager (a subsidiary of the BOV Group) and the SICAV. On 23 February 2018, the arbiter found in favour of the claimants and ordered the FSPs, in solidum between them, to pay the complainants the sum of €3.4 million, together with legal interest from the date when each complainant filed his claim before OAFS up to date of effective payment and also together with legal costs. On 14 March 2018, the Group filed an appeal before the Court of Appeal (Inferior Jurisdiction) from the before mentioned decision. Judgement on the appeal is expected on 30 April 2019.

Notes to the financial statements 31 December 2018 (continued)

33. PROVISIONS AND CONTINGENCIES (continued)

Falcon Fund SICAV
The Bank has received a claim from Hammaeskiold & Co as legal representatives of the Swedish Pension Agency (SPA), being the sole investor in the Falcon Fund SICAV (FFS). The damages claimed to have been suffered by SPA amount to at least SEK 740 million (equivalent to €73 million). While no court proceedings have yet been initiated, SPA has indicated their intention to do so. The amount of the claim does not necessarily reflect Bank of Valletta's potential financial exposure if a ruling were to be made against it on this matter.

Due to the uncertainties inherent in such matters, provisions on the above principal cases are based on the best information available at the reporting date and the ultimate settlement could be higher or lower depending on the outcome whilst the timing of the outflow of economic resources is uncertain. During the year ended 31 December 2018 a litigation provision of €75 million was recognised in the statements of profit or loss. No amount was utilised during the year.

34. COMMITMENTS

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
Documentary credits	60,212	87,707	60,212	87,707
Undrawn formal standby facilities, credit facilities and other commitments to lend	1,796,548	1,746,399	1,796,548	1,746,399
Capital expenditure contracted but not provided for in the financial statements	18,818	19,074	18,818	19,074
Commitments to financial institutions	5,814	5,011	5,814	5,011
	1,881,392	1,858,191	1,881,392	1,858,191

35. POST EMPLOYMENT AND TERMINATION LIABILITIES

The Group's and the Bank's major post-employment benefit plan (the "plan") applies to eligible individuals. The benefits provided to the individuals in terms of the plan are computed on a specified formula which takes into consideration, amongst other things, the employees' salary on retirement and the pension entitlement in terms of Maltese law. The provision is computed in accordance with the accounting policy for post-employment benefit plans.

This provision represents the Group's and the Bank's obligation:
- (i) discounted to the net present value at the rate which has been determined by reference to market yields at the end of the reporting period on Malta government bonds (the Directors consider this to be an appropriate proxy to a high quality corporate bond);
- (ii) after considering the life expectancy of such employees based on the latest publicly available mortality tables;
- (iii the expected terminal salaries; and
- (iv) the Bank's expectations of the employees' retirement date.

The Group and the Bank also operate an early retirement scheme whereby accepted applicants are given a lump sum payment of three times their terminal salary, or are paid two thirds of their terminal salary on a monthly basis until reaching retirement age. Furthermore, the Group and the Bank make payments to certain eligible employees in consideration of the liquidation of a defunct pension scheme.

The movement in the plans is analysed as follows:

	The Group and the Bank	
Post Employment and Termination Liabilities	2018	2017
	€000	€000
Present value at 1 January/1 October	26,229	25,813
Payments effected	(4,259)	(3,232)
Recognised in profit or loss:		
- Interest expense	(249)	(98)
- Terminal benefits	804	3,761
Remeasurement of actuarial gains/(losses) recognised in other comprehensive income resulting from:		
- Experience adjustments	(309)	(79)
- Changes in financial assumptions	-	(109)
- Changes in demographic assumptions	4,086	173
Present value at 31 December	26,302	26,229

Notes to the financial statements 31 December 2018 (continued)

35. POST EMPLOYMENT AND TERMINATION LIABILITIES (continued)

The year-end obligation in relation to the plan is mainly in relation to retired employees.

The plan exposes the Group and the Bank to the following main risks:
(i) interest risk, since a decrease in market yields will increase the plan liability; and
(ii) longevity risk, since an increase in the life expectancy of the plan participants will increase the plan liability.

The significant actuarial assumptions applied by the Group and the Bank in respect of the plan were as follows:

	The Group and the Bank	
	2018	2017
Discount rates	0.5%	0.4%
Life expectancy (years):		
Males	81	78
Females	85	83

The Group and the Bank are providing sensitivity analysis in connection with each significant actuarial assumption applied in respect of the plan. These analysis are prepared as of the end of the reporting period, showing how the liability would have been affected by hypothetical changes in the relevant actuarial assumptions that were reasonably possible at that date, while holding all other assumptions constant. The analysis presented below are for illustrative purposes only and may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another. In presenting the sensitivity analysis, the present value of the obligation has been calculated using the projected unit credit method at the end of the reporting period. The amounts generated from the analysis represent forward-looking estimates and hence, actual results in the future may differ materially from those projected results. In accordance with the transitional provisions in the revised IAS 19, the Group and the Bank have not disclosed comparative information in this respect.

- If the discount rate is 100 basis points higher (lower) with all other assumptions held constant, the defined benefit obligation decreases by €1.6 million (increases by €1.7 million)
- If the life expectancy increases (decreases) by two years for both men and women with all other assumptions held constant, the defined benefit obligation increases by €3.4 million (decreases by €3.4 million).

The weighted average duration of the liability in respect of the plan at 31 December 2018 is 12 years (2017: 9.5 years).

The Bank does not fund these pensions by assigning specific assets as there is sufficient liquidity to meet the required payments as these arise.

36. NOTES TO THE CASH FLOW STATEMENTS	Note	The Group		The Bank	
		2018	2017	2018	2017
		€000	€000	€000	€000
Cash	13	60,287	56,149	60,287	56,149
Treasury bills (with original maturity of less than 3 months)		74,066	-	74,066	-
Money at call and short notice		3,630,899	3,414,190	3,630,899	3,414,190
Amounts owed to banks		(138,393)	(191,732)	(138,393)	(191,732)
Cash and cash equivalents included in the statements of cash flow		**3,626,859**	**3,278,607**	**3,626,859**	**3,278,607**
Balances with contractual maturity of more than 3 months		18,571	32,485	18,571	32,485
		3,645,430	3,311,092	3,645,430	3,311,092
Equivalent items reported in the statement of financial position:					
Balances with Central Bank of Malta, Treasury bills and cash (excluding Reserve Deposit)		146,518	71,905	146,518	71,905
Loans and advances to banks		3,644,933	3,431,383	3,644,933	3,431,383
Amounts owed to banks		(146,021)	(192,196)	(146,021)	(192,196)
		3,645,430	3,311,092	3,645,430	3,311,092

Notes to the financial statements 31 December 2018 (continued)

37. RELATED PARTY TRANSACTIONS

During the current year and prior period, the Group and the Bank entered into transactions during the course of their normal business, with equity-accounted investees, subsidiaries, the Government of Malta ("The Government") (which has a 25% holding in the Bank), Government related entities, key management personnel, and other related parties. Government related entities are those where, in the opinion of the Bank, the Government is either deemed to exercise control, that is, it has the power to govern the financial and operating policies of the entity or linked to the Government but not controlled by the Government.

Key management personnel includes the Chairman, Directors, the members of the Management Board and their respective spouses, spousal equivalent and dependants. Other related parties are those companies over which the key management personnel hold control or significant influence (directorship).

Transactions with related parties are made on an arm's length basis.

The Bank also entered into related party transactions on an arm's length basis with its subsidiaries and equity-accounted investees. Transactions between the Bank and its subsidiaries have been eliminated on consolidation.

The amounts due to or from related parties are settled in cash and the amount of related party transactions and outstanding balances at the reporting date are disclosed below:

The Group	2018 12 months to Dec 2018 Related party transactions €000	Total activity/ balance €000	% of total	2017 15 months to Dec 2017 Related party transactions €000	Total activity/ balance €000	% of total
Interest and similar income: - on loans and advances, balances with Central Bank of Malta and treasury bills						
The Government	1,990			2,182		
Government related entities	13,766			18,305		
Key management personnel	37			66		
Other related parties	94			119		
	15,887	165,177	10%	20,672	198,997	10%
Interest and similar income: - on debt and other fixed income instruments						
The Government	10,548	48,719	22%	23,031	60,197	38%
Interest expense						
Equity-accounted investees	575			641		
The Government	12,242			11,878		
Government related entities	904			320		
Key management personnel	22			38		
Other related parties	1			-		
	13,744	57,350	24%	12,877	76,247	17%
Fee and commission income						
Equity-accounted investees	5,772			7,291		
The Government	168			208		
Government related entities	399			452		
Key management personnel	4			5		
Other related parties	23			15		
	6,366	92,368	7%	7,971	98,787	8%

Notes to the financial statements 31 December 2018 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

	2018 12 months to Dec 2018 Related party balances €000	Total activity/ balance €000	% of total	2017 15 months to Dec 2017 Related party balances €000	Total activity/ balance €000	% of total
Employee compensation and benefits						
Key management personnel	1,501	65,696	2%	1,668	79,750	2%
General administrative expenses						
Equity-accounted investees	74			135		
Key management personnel	44			39		
Other related parties	71			4		
	189	54,596	0%	178	59,463	0%
Movement in impairment allowances						
The Government	(28)			(11)		
Government related entities	(9,549)			(730)		
Key management personnel	7			-		
Other related parties	(12)			(5)		
	(9,582)	(10,816)	89%	(746)	(6,227)	12%
Balances with Central Bank of Malta, treasury bills and cash						
The Government	186,012	246,299	76%	103,535	159,684	65%
Financial assets at fair value through profit or loss						
The Government	21,989	206,206	11%	33,680	326,291	10%
Investments						
The Government	483,626	3,314,955	15%	562,772	3,374,541	17%
Loans and advances to customers (net)						
The Government	53,494			58,273		
Government related entities	429,532			429,657		
Key management personnel	2,992			3,530		
Other related parties	1,159			1,955		
	487,177	4,362,983	11%	493,415	4,162,032	12%
Loans and advances to banks						
The Government	3,154,289	3,644,933	87%	2,906,971	3,431,383	85%
Impairment allowances						
The Government	(107)			(135)		
Government related entities	(1,529)			(11,078)		
Key management personnel	(7)			-		
Other related parties	(3)			(15)		
	(1,646)	(107,063)	2%	(11,228)	(166,200)	7%

Notes to the financial statements 31 December 2018 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

	2018 12 months to Dec 2018 Related party balances €000	Total activity/ balance €000	% of total	2017 15 months to Dec 2017 Related party balances €000	Total activity/ balance €000	% of total
Amounts owed to customers						
Equity-accounted investees	193,624			218,070		
The Government	221,198			218,844		
Government related entities	153,534			105,252		
Key management personnel	5,716			4,789		
Other related parties	9,338			3,817		
	583,410	10,414,908	6%	550,772	10,100,625	5%
Total Assets less Liabilities						
Equity-accounted investees	(193,624)			(218,070)		
The Government	3,678,105			3,446,252		
Government related entities	274,469			313,327		
Key management personnel	(2,731)			(1,259)		
Other related parties	(8,182)			(1,877)		
	3,748,037			3,538,373		
Commitments						
Equity-accounted investees	301			396		
The Government	20,250			48,075		
Government related entities	120,388			111,689		
Key management personnel	339			683		
Other related parties	6,124			1,126		
	147,402	1,881,392	8%	161,969	1,858,191	9%

The Bank

	2018 Related party balances €000	Total activity/ balance €000	% of total	2017 Related party balances €000	Total activity/ balance €000	% of total
Interest and similar income: - on loans and advances, balances with Central Bank of Malta and treasury bills						
The Government	1,990			2,182		
Government related entities	13,766			18,305		
Key management personnel	13			10		
Other related parties	26			97		
	15,795	165,177	10%	20,594	198,997	10%
Interest and similar income: - on debt and other fixed income instruments						
The Government	10,548	48,719	22%	23,031	60,197	38%
Interest expense						
Equity-accounted investees	575			641		
Subsidiaries	2			2		
The Government	12,242			11,878		
Government related entities	904			320		
Key management personnel	21			38		
	13,744	57,350	24%	12,879	76,247	17%

Notes to the financial statements 31 December 2018 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

The Bank	2018 12 months to Dec 2018 Related party balances €000	Total activity/ balance €000	% of total	2017 15 months to Dec 2017 Related party balances €000	Total activity/ balance €000	% of total
Fee and commission income						
Equity-accounted investees	5,772			7,291		
Subsidiaries	2,120			2,654		
The Government	168			208		
Government related entities	399			452		
Key management personnel	3			3		
Other related parties	2			2		
	8,464	83,346	10%	10,610	87,587	12%
Dividend income						
Equity-accounted investees	9,699			6,869		
Subsidiaries	2,054			8,888		
	11,753	12,828	92%	15,757	17,682	89%
Employee compensation and benefits						
Key management personnel	1,321	63,043	2%	1,595	76,507	2%
General administrative expenses						
Equity-accounted investees	74			135		
Key management personnel	57			31		
Other related parties	25			4		
	156	53,093	0%	170	57,806	0%
Movement in impairment allowances						
The Government	(28)			(11)		
Government related entities	(9,549)			(730)		
Key management personnel	7			-		
Other related parties	(12)			11		
	(9,582)	(10,816)	89%	(730)	(6,227)	12%
Balances with Central Bank of Malta, treasury bills and cash						
The Government	186,012	246,299	76%	103,535	159,684	65%
Financial assets at fair value through profit or loss						
The Government	21,988	205,227	11%	33,680	325,316	10%
Investments						
The Government	483,626	3,314,955	15%	562,772	3,374,541	17%
Loans and advances to customers (net)						
The Government	53,494			58,273		
Government related entities	429,532			429,657		
Key management personnel	2,392			2,321		
Other related parties	328			1,729		
	485,746	4,362,983	11%	491,980	4,162,032	12%
Loans and advances to banks						
The Government	3,154,289			2,906,971		
Other related parties	8,403			-		
	3,162,692	3,644,933	87%	2,906,971	3,431,383	85%

Notes to the financial statements 31 December 2018 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

The Bank	2018 12 months to Dec 2018 Related party balances €000	Total activity/ balance €000	% of total	2017 15 months to Dec 2017 Related party balances €000	Total activity/ balance €000	% of total
Impairment allowances						
The Government	(107)			(135)		
Government related entities	(1,529)			(11,078)		
Key management personnel	(7)			-		
Other related parties	-			(12)		
	(1,643)	(107,063)	2%	(11,225)	(166,200)	7%
Other assets						
Subsidiaries	1,983	95,586	2%	172	115,785	0%
Amounts owed to customers						
Equity-accounted investees	193,624			218,070		
Subsidiaries	3,091			1,539		
The Government	221,198			218,844		
Government related entities	153,534			105,252		
Key management personnel	4,521			3,968		
Other related parties	2,801			443		
	578,769	10,417,999	6%	548,116	10,102,164	5%
Total Assets less Liabilities						
Equity-accounted investees	(193,624)			(218,070)		
Subsidiaries	(1,108)			(1,367)		
The Government	3,678,104			3,446,252		
Government related entities	274,469			313,327		
Key management personnel	(2,136)			(1,647)		
Other related parties	(2,473)			1,274		
	3,753,232			3,539,769		
Commitments						
Equity-accounted investees	301			396		
The Government	20,250			48,075		
Government related entities	120,388			111,689		
Key management personnel	306			521		
Other related parties	1,623			1,045		
	142,868	1,881,392	8%	161,726	1,858,191	9%

Notes to the financial statements 31 December 2018 (continued)

37. RELATED PARTY TRANSACTIONS (continued)

	The Group		The Bank	
	2018	2017	2018	2017
	€000	€000	€000	€000
All outstanding balances are secured except for the following:				
Loans and advances to customers:				
- Key management personnel	118	144	106	132
- Other related parties	243	159	-	-
	361	303	106	132
Details of guarantees received are disclosed below:				
Loans and advances to customers:				
- Amounts guaranteed by The Government	471,540	485,278	471,540	485,278

Loans to and commitments on behalf of directors and other key management personnel (including connected persons):

	The Group		The Bank	
	Loans and advances	Commitments	Loans and advances	Commitments
	€000	€000	€000	€000
Directors				
At 1 October 2016	488	196	306	131
Additions	1,634	210	496	91
	2,122	406	802	222
Less reductions/repayments	(153)	(73)	(42)	(52)
At 31 December 2017	1,969	333	760	170
Additions	64	68	9	33
	2,033	401	769	203
Less reductions/repayments	(735)	(301)	(71)	(136)
At 31 December 2018	1,298	100	698	67
Other key management personnel				
At 1 October 2016	1,024	296	1,024	296
Additions	691	194	691	194
	1,715	490	1,715	490
Less reductions/repayments	(154)	(139)	(154)	(139)
At 31 December 2017	1,561	351	1,561	351
Additions	257	236	257	220
	1,818	587	1,818	571
Less reductions/repayments	(125)	(348)	(124)	(332)
At 31 December 2018	1,693	239	1,694	239

The above facilities do not involve more than the normal risk of repayment or present other unfavourable features and were made in the ordinary course of business on substantially the same terms as for comparable transactions with persons of a similar standing, or where applicable, other employees.

Notes to the financial statements 31 December 2018 (continued)

38. SEGMENTAL INFORMATION BY CLASSES OF BUSINESS

The Group's reportable segments are shown in the table below.

Reportable segments	Operations
Personal Banking & Wealth Management	Loans and other transactions and balances with retail customers, including wealth and asset management related activities
Corporate Banking	Loans and other transactions and balances with corporate customers
Proprietary Investments	Funding and centralised risk management activities through borrowings and issues of debt securities
Liquidity Management	Investments in liquid assets such as short-term placements and corporate and government debt securities

Interest income is the main revenue generating activity for all segments. The customer-oriented segments also have income derived from fees and commissions and earnings arising on foreign exchange transactions.

This segment information covers a twelve month period from 1 January 2018 to 31 December 2018. The comparative period is the fifteen month period from 1 October 2016 to 31 December 2017.

	Personal Banking & Wealth Management		Corporate Banking		Proprietary Investments		Liquidity Management		Total Reportable Segments	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
	€000	€000	€000	€000	€000	€000	€000	€000	€000	€000
Interest income	73,978	88,242	89,733	109,865	48,533	60,094	1,652	993	213,896	259,194
Interest expense	(5,305)	(7,291)	(5,987)	(8,379)	(7,363)	(9,551)	(38,695)	(51,026)	(57,350)	(76,247)
Fee and commission income	56,676	66,901	21,456	22,448	1,194	619	13,042	8,819	92,368	98,787
Fee and commission expense	(10,612)	(11,656)	(139)	(207)	-	-	(480)	(635)	(11,231)	(12,498)
Trading income	287	636	11,022	14,953	-	7,023	5,654	8,162	16,963	30,774
Gain/(Loss) from financial assets	-	-	-	-	2,045	(1,462)	-	-	2,045	(1,462)
Other income	-	-	-	-	1,075	1,925	-	-	1,075	1,925
Depreciation and amortisation	(5,515)	(6,699)	(1,644)	(1,962)	(431)	(55)	(2,716)	(3,322)	(10,306)	(12,038)
Other costs	(57,183)	(69,105)	(18,747)	(21,864)	(4,004)	(5,541)	(40,358)	(42,703)	(120,292)	(139,213)
Impairment reversal	2,135	878	8,034	5,349	647	-	-	-	10,816	6,227
Operating profit/(loss) before litigation provision	54,461	61,906	103,728	120,203	41,696	53,052	(61,901)	(79,712)	137,984	155,449
Litigation provision	(75,000)	-	-	-	-	-	-	-	(75,000)	-
Operating (loss)/profit before share of results of equity-accounted investees	(20,539)	61,906	103,728	120,203	41,696	53,052	(61,901)	(79,712)	62,984	155,449
Group share of results after tax of equity-accounted investees	-	-	-	-	8,214	19,287	-	-	8,214	19,287
Group profit before taxation for the year/period									71,198	174,736

Notes to the financial statements 31 December 2018 (continued)

38. SEGMENTAL INFORMATION BY CLASSES OF BUSINESS (continued)

	Personal Banking & Wealth Management		Corporate Banking		Proprietary Investments		Liquidity Management		Total Reportable Segments	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
	€000	€000	€000	€000	€000	€000	€000	€000	€000	€000
ASSETS	2,251,668	2,123,830	2,325,771	2,263,501	3,408,610	3,599,146	3,891,231	3,591,017	11,877,280	11,577,494
Property and equipment and Intangible assets	-	-	-	-	134,903	100,334	-	-	134,903	100,334
Additions to property and equipment and intangible assets	-	-	-	-	26,295	33,341	-	-	26,295	33,341
Carrying value of equity-accounted investees	-	-	-	-	108,510	109,461	-	-	108,510	109,461
Total Assets	2,251,668	2,123,830	2,325,771	2,263,501	3,678,318	3,842,282	3,891,231	3,591,017	12,146,988	11,820,630
LIABILITIES										
Total Liabilities	2,453,189	2,236,426	2,726,077	2,681,112	3,561,412	3,747,437	2,412,177	2,193,568	11,152,855	10,858,543

The revenue which is reported above represents revenue generated from external customers. There were no inter-segment revenue during the year/period (2017: nil).

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 1. Segment's operating profit represents the profit earned by each segment.

There are no material activities which are carried out outside Malta.

39. FINANCIAL RISK MANAGEMENT

39.1 Use of financial instruments

By their nature, the Group's activities are principally related to the use of financial instruments including derivatives. The Group accepts deposits from customers at both fixed and floating rates and for various periods, and seeks to earn interest margins by investing these funds in high-quality assets. The Group seeks to increase these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

The Group also seeks to increase its interest margins through lending to commercial and retail borrowers with a range of credit standings. Such exposures involve both on-balance sheet loans and advances, as well as guarantees and other commitments such as performance and other bonds and letters of credit.

The Board places trading limits on the level of exposure that can be taken in relation to both overnight and intra-day market positions. Foreign exchange and interest rate exposures are normally offset by entering into counterbalancing positions, thereby controlling the variability in the net cash amounts required to liquidate market positions.

Given that the difference between the Group and the Bank balances in respect of financial instruments, and the corresponding effect on the statement of profit or loss and other comprehensive income and reserves in respect thereof, are not material, references in this note to the Group are to be construed as references to the Bank, unless otherwise stated.

The principal areas of financial risk are detailed overleaf:

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2 Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation.

Financial assets which could potentially expose the Group to credit risk, mainly include balances with Central Bank of Malta, treasury bills and cash, derivative financial assets, debt and other fixed income instruments, and loans and advances to banks and customers.

39.2.1 Credit risk management and exposure

(i) Loans and advances

The purpose of credit risk management is to keep credit risk exposure to a permissible level relative to capital, to maintain the soundness of assets, and to ensure returns commensurate with risk. This leads to a loan portfolio that achieves high returns on capital and assets.

Credit risk is managed and controlled throughout the Bank on the basis of established credit processes, and within a framework of credit policy and delegated authorities based on responsibility, skill and experience.

Credit grading and monitoring systems are in place to accommodate the early identification and management of deterioration in loan quality. In addition, the credit management process is underpinned by an independent system of credit review.

Credit risk analysis is carried out on two levels: the single name; and the bank's lending portfolio review. The Bank uses a number of tools to limit its exposure to undue credit risk. These include the application of:

- High-level credit policies designed to ensure a balanced and managed approach to the identification and mitigation of credit risk;
- Lending guidelines defining the responsibilities of lending officers that seek to provide a disciplined and focused benchmark for credit decisions;
- Independent reviews of credit exposures;
- Sector caps, encompassing both industry and specific product types, to communicate the Board's risk appetite for specific types of business;
- Establishment and maintenance of large exposures and provisioning policies in accordance with regulatory reporting requirements; and
- Communication and provision of general guidance on all credit-related risk issues, including regulatory changes to promote consistent and best practice throughout the Bank.

Where possible the Bank aims to reduce and control risk concentrations. Broadly stated, concentration results when the Bank has a high level of exposure to a single or related group of borrowers, credit exposures secured by a single security, or credit exposures with common characteristics within an industry, such that adverse developments in this exposure would be damaging to the Bank.

Given the size and nature of the domestic financial sector and the local economy, the Bank is exposed to concentration risk in its credit business. The Bank has systems in place to identify material concentrations in the loan portfolio, and to ensure adherence to prudential limits set by the Board of Directors and/or the regulators to single borrowers or groups of related borrowers and other significant risk concentrations. The CEO and the Board of Directors are regularly informed on the concentration of the Bank's portfolio.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1 Credit risk management and exposure (continued)

The following industry concentrations in connection with loans and advances to banks and customers are considered significant:

	The Group	
	2018	2017
	€000	€000
Agriculture	5,338	5,465
Fishing	14,216	27,180
Mining and quarrying	502	820
Manufacturing	191,944	176,536
Electricity, gas, steam and air conditioning supply	113,219	114,550
Water supply, sewerage waste management and remediation activities	2,071	19,942
Construction	203,666	178,918
Wholesale and retail trade	354,329	332,685
Transportation and storage	158,425	215,520
Accommodation and food service activities	175,503	182,322
Information and communication	32,102	32,298
Financial and insurance activities	411,068	400,248
Real estate activities	398,023	384,725
Professional, scientific and technical activities	98,502	97,864
Administrative and support service activities	49,592	48,247
Public administration and defence, compulsory social security	35,057	30,014
Education	16,121	14,848
Human health and social work activities	48,698	33,510
Arts, entertainment and recreation	27,490	27,608
Other services activities	13,497	11,548
Households and individuals	2,255,793	2,135,957
Loans and advances to customers	4,605,156	4,470,805
Loans and advances to banks	3,644,933	3,431,383
	8,250,089	**7,902,188**

2017 figures have been restated to conform with current year's presentation which is in line with Finrep reporting.

(ii) Other financial assets

The credit risk in respect of other financial assets is mitigated through limits set in the Treasury Management Policy. The Bank assigns limits on the level of credit risk undertaken in relation to any single counterparty or sovereign exposure in accordance with external ratings based on Fitch's ratings or on those of other major rating agencies.

Changes in credit ratings are monitored on a daily basis and are subject to frequent review, when considered necessary. The limits on the level of credit risk are reviewed consistently and approved by the Board of Directors at regular intervals. Actual exposures are monitored against limits on an on going basis. The Bank enters into security transactions only with such authorised counterparties and it invests only in securities or paper with credit quality within specific parameters stated in the Treasury Management Policy.

The level of concentration in respect of other significant financial assets is disclosed in the remaining notes to the financial statements.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1 Credit risk management and exposure (continued)

(ii) Other financial assets (continued)

Collateral and other credit enhancements

Credit risk mitigation is one of the key elements of the Group's credit policy. This includes the requirement to obtain collateral, depending on the nature of the proposal, as set out in the Bank's policies and procedures. The nature and level of collateral required depends on a number of factors, including, but not limited to the amount of the exposure, the type of facility provided, the term of the facility, the amount of the counterparty's contribution and an evaluation of the level of the credit risk or probability of default involved (see note 39.2.1.5).

Settlement Risk

The Group's activity may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to failure of a company to honour its obligations to deliver cash, securities or other assets as contractually agreed. Settlement risk in respect of security transactions is mitigated through settlement limits assigned to counterparties based on external credit ratings or by effecting payment on a delivery versus payment (DVP) basis.

Sovereign Debt

Sovereign risk refers to the risk that a government may default on its obligations, and includes refinancing risk related to the inability to raise capital to repay maturing bonds. The Group monitors sovereign risks through sovereign credit ratings issued by credit rating agencies which include Fitch, Moody's, and S&P. The Treasury Management Policy seeks to mitigate sovereign risk, whether directly or indirectly through exposures to corporate and financial institutions domiciled therein, through investment limits assigned on the basis of the long-term credit rating of such sovereigns. This is further supplemented by in depth economic reviews undertaken periodically and assessments of the fiscal, economic and socio-political aspects upon which such limits are accordingly aligned.

39.2.1.1 Credit Quality

(i) Debt securities and other bills by rating agency (Fitch) designation

The Group	Balances with CBM and Treasury Bills €000	Debt Securities €000	Loans and Advances to Banks €000	Derivatives €000	Total €000
As at 31 December 2018					
AAA	-	554,918	3,179,094	-	3,734,012
AA- to AA+	-	777,283	102,776	678	880,737
A- to A+	186,012	1,705,710	262,775	3,273	2,157,770
BBB- to BBB+	-	280,981	30,252	-	311,233
Lower than BBB-	-	11,464	13,966	-	25,430
Unrated	-	5,103	56,070	440	61,613
	186,012	**3,335,459**	**3,644,933**	**4,391**	**7,170,795**
As at 31 December 2017					
AAA	-	255,936	3,052,394	-	3,308,330
AA- to AA+	-	588,077	20,149	422	608,648
A- to A+	103,535	2,294,539	202,108	5,068	2,605,250
BBB- to BBB+	-	314,611	133,953	542	449,106
Lower than BBB-	-	17,781	7,187	-	24,968
Unrated	-	9,716	15,592	1,458	26,766
	103,535	**3,480,660**	**3,431,383**	**7,490**	**7,023,068**

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1 Credit risk management and exposure (continued)

39.2.1.1 Credit Quality (continued)

The tables below analyse debt securities by sector, classification and residency.

Sector

	The Group and The Bank		
	Amortised cost	FVOCI	FVTPL
2018	€000	€000	€000
Banks	1,395,572	5,073	4,460
Central Banks	-	-	-
Government	1,352,838	64,930	35,173
Public	-	72,904	-
Others	404,509	-	-
	3,152,919	142,907	39,633

	The Group and The Bank		
	Held-to-maturity	Available-for-sale	FVTPL
2017	€000	€000	€000
Banks	1,580,843	-	28,811
Government	1,008,633	66,079	64,340
Public	-	73,249	-
Others	640,439	-	18,266
	3,229,915	139,328	111,417

Residency

	The Group and The Bank		
	Amortised cost	FVOCI	FVTPL
2018	€000	€000	€000
Malta	421,947	137,834	21,989
Monetary Union member states	1,205,379	-	13,184
Rest of the world	1,525,593	5,073	4,460
	3,152,919	142,907	39,633

	The Group and The Bank		
	Held-to-maturity	Available-for-sale	FVTPL
2017	€000	€000	€000
Malta	496,691	139,328	38,398
Monetary Union member states	1,029,653	-	39,090
Rest of the world	1,703,571	-	33,929
	3,229,915	139,328	111,417

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

(ii) Loans and advances to customers analysed into performing and non-performing exposures

Total Gross/Forborne Exposures	The Group Total 2018 €000	The Group of which Forborne 2018 €000
Performing		
Stage 1	4,063,331	-
Stage 2	298,277	16,263
	4,361,608	16,263
Non-performing		
Stage 3	243,548	101,761
	243,548	101,761
Total Gross/Forborne Exposures	4,605,156	118,024

	The Group Total 2017 €000	The Group of which Forborne 2017 €000
Performing		
Neither past due nor impaired	4,156,498	35,863
Past due < 90 days, but not impaired	32,088	1,242
	4,188,586	37,105
Non-performing		
Past due > 90 days, but not impaired	96,720	39,212
Impaired	185,499	91,553
	282,219	130,765
Total Gross/Forborne Exposures	4,470,805	167,870

Gross Forborne Exposures are analysed as follows:

	Modification in Terms 2018 €000	Refinancing 2018 €000	Modification in Terms 2017 €000	Refinancing 2017 €000
Performing				
Personal	2,898	181	3,483	338
Business	10,877	2,307	31,560	1,724
	13,775	2,488	35,043	2,062
Non-performing				
Personal	20,371	242	27,166	654
Business	77,049	4,099	99,357	3,588
	97,420	4,341	126,523	4,242

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

The movement in forebearance activity during the period is as follows:

	Loans & Advances	
	2018	**2017**
	12 months	**15 months**
	€000	**€000**
1 January	167,870	209,822
Additions	21,763	15,907
Retired from forborne	(71,609)	(57,859)
31 December	118,024	167,870

(iii) Analysis of past due balances

Past due up to 29 days	104,598	63,058
Past due 30 - 59 days	21,681	15,821
Past due 60 - 89 days	2,824	5,754
	129,103	84,633

Analysis of past due balances comprise all loan exposures (including forborne exposures).

A financial asset is past due when a counterparty has failed to make a payment when contractually due.

Defaulted gross loans by segment:		
Business	193,524	148,733
Personal	50,024	36,766
	243,548	**185,499**

Defaulted facilities are those credit facilities with payments of interest and/or capital overdue by 90 days or more or where the Group has reasons to doubt the eventual recoverability of funds. A variety of types of collateral are accepted including property, securities, cash, guarantees and insurance, as disclosed in note 39.2.1.5.

Information about impairment allowances is disclosed in note 39.2.1.2 in respect of the Group's exposures as at 31 December 2018, and in note 39.2.2.3 in respect of the Group's exposures as at 31 December 2017.

39.2.1.2 Expected credit loss measurement

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:
- A financial instrument that is not credit-impaired on initial recognition is classified in Stage 1 and has its credit risk continuously monitored by the Group.
- If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to Stage 2 but is not yet deemed to be credit-impaired. Refer to note 39.2.1.2.1 for a description of how the Group determines when a significant increase in credit risk has occurred.
- If the financial instrument is credit-impaired, the financial instrument is then moved to Stage 3. Refer to note 39.2.1.2.2 for a description of how the Group defines credit-impaired and default.
- Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 and 3 have their ECL measured based on expected losses on a lifetime bases. Refer to note 39.2.1.2.4 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.
- A pervasive concept in measuring ECL in accordance with IFRS 9 is that it should consider forward-looking information. Note 39.2.1.2.5 includes an explanation of how the Group has incorporated this in its ECL models.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1.2 Expected credit loss measurement (continued)

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

Change in credit quality since initial recognition

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

39.2.1.2.1 Significant increase in credit risk

With the exception of instruments measured at FVTPL, exposures with low credit risk at the reporting date and any originated credit-impaired financial assets (note 39.2.1.2.2), the Group assesses whether financial instruments have experienced a significant increase in credit risk since initial recognition.

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

In the case of the Group's advances portfolio, the objective of the assessment is to identify whether a significant increase in credit risk has occurred for an exposure by comparing:

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

The Group allocates each exposure to a credit risk grade based on a variety of data that is determined to be predictive of the risk of default and applying experienced credit judgement. Credit risk grades are defined using qualitative and quantitative factors that are indicative of risk of default. These factors vary depending on the nature of the exposure and the type of borrower.

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

Stage	Internal rating
1	1 - 3
2	4 - 5
3	6 - 11

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

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1.2.1 Significant increase in credit risk (continued)

Commercial exposures	Personal exposures	All exposures
• Information obtained during periodic review of customer files - e.g. audited financial statements, management accounts, budgets and projections. Examples of areas of particular focus are: gross profit margins, financial leverage ratios, debt service coverage, compliance with covenants, quality of management, senior management changes • Actual and expected significant changes in the political, regulatory and technological environment of the borrower or in its business activities	• Internally collected data on customer behaviour -e.g. utilisation of credit card facilities • Affordability metrics	• Payment record - this includes overdue status as well as a range of variables about payment ratios • Utilisation of the granted limit • Requests for and granting of forbearance • Existing and forecast changes in business • Financial and economic conditions

The Group applies the low credit risk simplification for all investments which are of an investment grade, which comprises the vast majority of its treasury portfolio. The Group accordingly only assesses SICR for investments in those debt securities which are rated as sub-investment grade. For sub-investment grade securities, the Group considers a security to have experienced a significant increase in credit risk if the security has been the subject to a credit rating downgrade since initial recognition.

39.2.1.2.2 Definition of default and credit impaired

The Group considers financial assets in the advances portfolio to be in default when:

- the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as realising security (if any is held); or
- the borrower is past due more than 90 days on any material credit obligation to the Group.

Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit lower than the current amount outstanding.

In assessing whether a borrower is in default, the Group considers indicators that are:

- qualitative – e.g. breaches of covenant;
- quantitative – e.g. overdue status and non-payment on another obligation of the same issuer to the Group; and
- based on data developed internally and obtained from external sources.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

The definition of default aligns with that applied by the Group for regulatory capital purposes.

At each reporting date, the Group assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is ‘credit-impaired’ when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

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

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

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

In the case of the treasury portfolio, the Group considers investments in debt instruments to be in default when a payment, including a coupon payment, is missed.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1.2.3 Cure rate

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

A foreborne instrument is considered to no longer be in default when it no longer meets any of the criiteria for a consecutive period of twelve months.

The Group's experience is that defaulted debt investments within the treasury portfolio do not cure given that a security's default mechanism is triggered when a security's issuer misses a coupon payment. Any new instruments which the Group receives as part of an eventual debt restructuring exercise is considered to be a new instrument altogether.

39.2.1.2.4 Measuring ECL

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

- The PD represents the likelihood of a borrower defaulting on its financial obligation (as per "Definition of default and credit-impaired" above), either over the next 12 months (12M PD), or over the remaining lifetime (Lifetime PD) of the obligation.
- EAD is based on the amounts the Group expects to be owed at the time of default, over the next 12 months (12M EAD) or over the remaining lifetime (Lifetime EAD). For example, for a revolving overdraft, the Group includes the current drawn balance plus any further amount that is expected to be drawn up to the current contractual limit by the time of default, should it occur.
- LGD represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counter party, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD). LGD is calculated on a 12 month or lifetime basis, where 12-month LGD is the percentage of loss expected to be made if the default occurs in the next 12 months and Lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

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

These parameters are generally derived from internally developed statistical models and other historical data. They are adjusted to reflect forward-looking information as described in note 39.2.1.2.5.

PD estimates are estimates at a certain date, which are calculated based on statistical rating models, and assessed using rating tools tailored to the various categories of counterparties and exposures. These statistical models are based on internally compiled data comprising both quantitative and qualitative factors. Where it is available, market data may also be used to derive the PD for large corporate counterparties. If a counterparty or exposure migrates between rating classes, then this will lead to a change in the estimate of the associated PD. PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates.

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

The Group estimates LGD parameters on its advances portfolio based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset. For loans secured by retail property, LTV ratios are a key parameter in determining LGD. In the case of the Group's treasury portfolio, the Group lacks historical experience of defaults, and accordingly makes use of the LGD parameters set out by the Bank for International Settlements.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1.2.4 Measuring ECL (continued)

As described above, and subject to using a maximum of a 12-month PD for financial assets for which credit risk has not significantly increased, the Group measures ECL considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk, even if, for risk management purposes, the Group considers a longer period. The maximum contractual period extends to the date at which the Group has the right to require repayment of an advance or terminate a loan commitment or guarantee.

However, for retail overdrafts and credit card facilities that include both a loan and an undrawn commitment component, the Group measures ECL over a period longer than the maximum contractual period if the Group's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Group's exposure to credit losses to the contractual notice period. These facilities do not have a fixed term or repayment structure and are managed on a collective basis. The Group can cancel them with immediate effect but this contractual right is not enforced in the normal day-to-day management, but only when the Group becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Group expects to take and that serve to mitigate ECL. These include a reduction in limits, cancellation of the facility and/or turning the outstanding balance into a loan with fixed repayment terms.

39.2.1.2.5 Forward-looking information

The assessment of SICR and the calculation of ECL both incorporate forward-looking information. The Group has performed historical analysis and identified the key economic variables impacting credit risk and expected credit losses for each portfolio.

These economic variables and their associated impact on the PD, EAD and LGD vary by financial instrument. Forecasts of these economic variables (the "base economic scenario") are calculated using statistical models and forecasts are obtained for all maturities to which the Bank has exposure. Macro factors that are found to be statistically significant for all portfolios are forecasted using a vector autoregressive model (VAR). On an annual basis, as part of the model recalibration exercise an assessment is carried out to ensure that these economic variables are still statistically significant.

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

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

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1.2.6 Critical estimates

The most significant key macroeconomic variables used for the ECL estimate as at 31 December 2018 are set out below. The scenarios "base", "upside" and "downside" were used for all loan portfolios.

		2019	2020	2021	2022	2023
GDP Growth rate	**Base**	0.73%	1.25%	1.29%	1.27%	1.24%
	Range of forecasts for alternative scenarios	1.4 - 0.08%	2.03 - 0.45%	2.11 - 0.45%	2.09 - 0.45%	2.05 - 0.40%
Housing index	**Base**	1.43%	0.29%	0.98%	0.76%	0.84%
	Range of forecasts for alternative scenarios	-0.86 - 3.64%	-2.35 - 3.03%	-1.79 - 3.65%	-1.95 - 3.70%	-1.86 - 3.67%
Inflation rate	**Base**	2.59%	1.39%	1.72%	1.64%	1.73%
	Range of forecasts for alternative scenarios	2.18 - 2.99%	0.64 - 2.20%	0.88 - 2.54%	0.76 - 2.46%	0.86 - 2.60%
Interest rate	**Base**	0.00%	0.00%	0.01%	-0.01%	0.00%
	Range of forecasts for alternative scenarios	0.00 - 0.00%	0.00 - 0.09%	0.00 - 0.20%	0.00 - 0.15%	0.00 - 0.18%
Money supply	**Base**	2.83%	3.71%	4.12%	3.57%	3.72%
	Range of forecasts for alternative scenarios	4.85 - 0.75%	5.89 - 1.50%	6.51 - 1.65%	6.04 - 1.11%	6.15 - 1.23%
Trade ratio	**Base**	89.36%	14.16%	79.78%	29.57%	73.28%
	Range of forecasts for alternative scenarios	-127.65 - 310.07%	-225.15 - 247.96%	-175.93 - 331.61%	-241.27 - 307.09%	-188.79 - 349.16%
Unemployment rate	**Base**	-0.09%	0.02%	-0.15%	-0.05%	-0.11%
	Range of forecasts for alternative scenarios	-0.20 - 0.03%	-0.17 - 0.22%	-0.37 - 0.09%	-0.20 - 0.19%	0.00 - 0.14%

Other forward-looking considerations not incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also been considered, but are not deemed to have a material impact. This is reviewed and monitored for appropriateness on a quarterly basis.

39.2.1.2.7 Grouping by shared risk characteristics

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics that include:

- instrument type;
- credit risk gradings;
- collateral type;
- LTV ratio for retail mortgages;
- date of initial recognition;
- remaining term to maturity;
- industry; and
- geographic location of the borrower.

The groupings are subject to regular review to ensure that exposures within a particular group remain appropriately homogeneous.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1.2.7 Grouping by shared risk characteristics (continued)

For portfolios in respect of which the Group has limited historical data, external benchmark information is used to supplement the internally available data. The portfolios for which external benchmark information represents a significant input into measurement of ECL are as follows.

	Exposure	External benchmark used LGD
Investments in debt securities within the treasury portfolio	€ 3,296,334	11% - 61% Bank for International Settlements parameters

39.2.1.3 Gross carrying amount and exposure to credit risk as at 31 December 2018

The following table sets out information about the credit quality of financial assets measured at amortised cost, FVOCI debt investments. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

Explanation of the terms: 12-month ECL, lifetime ECL and credit-impaired are included in Note 39.2.1.2.

	Stage 1 12-month ECL	Stage 2 Lifetime ECL not credit-Impaired	Stage 3 Lifetime ECL credit-Impaired	Purchased credit-Impaired	Total
	€000	€000	€000	€000	€000
Loans and advances to banks at amortised cost					
AAA	3,154,289	-	-	-	3,154,289
AA- to AA+	32,228	-	-	-	32,228
A- to A+	165,710	-	-	-	165,710
Lower than A-	490	13,970	-	-	14,460
Unrated	-	-	-	-	-
	3,352,717	13,970	-	-	3,366,687
Loss allowance	(3)	(3)	-	-	(6)
Carrying amount	3,352,714	13,967	-	-	3,366,681
Loans and advances to customers at amortised cost					
Grades 1-3	3,928,221	45,687	1,705	-	3,975,613
Grades 4-5	-	252,591	3,188	-	255,779
Grades 6-11	-	-	238,654	-	238,654
	3,928,221	298,278	243,547	-	4,470,046
Loss allowance	(9,210)	(18,345)	(79,508)	-	(107,063)
Carrying amount	3,919,011	279,933	164,039	-	4,362,983

Facilities under probation may result in an ECL stage which does not represent their internal grading.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1.3 Gross carrying amount and exposure to credit risk as at 31 December 2018 (continued)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL not credit-Impaired	Stage 3 Lifetime ECL credit- Impaired	Purchased credit-Impaired	Total
	€000	€000	€000	€000	€000
Investments in debt securities					
AAA	554,918	-	-	-	554,918
AA- to AA+	772,914	-	-	-	772,914
A- to A+	1,675,570	3,116	-	-	1,678,686
Lower than A-	273,283	11,464	-	-	284,747
Unrated	-	5,069	-	-	5,069
	3,276,685	19,649	-	-	3,296,334
Loss allowance	(382)	(126)	-	-	(508)
Carrying amount	3,276,303	19,523	-	-	3,295,826

39.2.1.4 Maximum exposure to credit risk on FVTPL securities, financial guarantees and loan commitments

Maximum exposure
The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the maximum exposure to credit risk without taking account of the value of any collateral obtained, except as disclosed below:

Financial guarantees
The maximum exposure to credit risk is the full amount that the Group would have to pay if the guarantees are called upon (note 33).

Loan commitments
The maximum exposure to credit risk arising on loan commitments and other credit related commitments that are irrecoverable over the life of the respective facilities is the full amount of the committed facilities (note 34).

The following table contains an analysis of the maximum credit risk exposure from financial assets not subject to impairment (i.e. FVTPL):

	Maximum exposure to credit risk	
	2018	2017
	€000	€000
Financial assets mandatorily measured at FVTPL:		
- Debt securities	7,778	-
	7,778	-
Financial assets designated at fair value:		
- Debt securities	31,855	111,417
- Loans and advances to customers	135,110	142,573
	166,965	**253,990**
	174,743	**253,990**
Derivatives financial instruments	4,391	7,490

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1.5 Collateral

The Group employs a range of policies and practices to mitigate credit risk. The most common of these is accepting collateral for funds advanced. The Group has internal policies on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets such as premises, inventory and accounts receivable;
- Charges over financial instruments such as debt securities and equities; and
- Margin agreement for derivatives, for which the Group has master netting agreements imposed by way of law.

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

Collateral held as security for financial assets other than loans and advances depends on the nature of the instrument. Debt securities, treasury and other eligible bills are generally unsecured, with the exception of asset-backed securities and similar instruments, which are secured by portfolios of financial instruments. Derivatives are also collateralised.

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

A portion of the Group's financial assets originated by the mortgage business has sufficiently low 'loan to value' (LTV) ratios, which results in no loss allowance being recognised in accordance with the Group's expected credit loss model. The carrying amount of such financial assets is €587.3 million as at 31 December 2018.

Security values are reviewed on a regular basis and are also re-assessed at time of default if it is found that the carrying value of the collateral item could have materially changed since last valuation. The Bank calculates the value of collateral as the market value less a haircut, with the latter representing a conservative estimate of the costs to sell and the potential loss of value in a forced sale scenario. For financial instruments, haircuts are calculated according to the risk profile of each individual security and depend on a number of variables including price volatility and liquidity/marketability of the instrument.

The table below shows the financial effect and main types of collateral held against the Group's customer loan exposures:

The Group

As at 31 December 2018

	Loans and advances to customers	Undrawn credit facilities and other commitments to lend
	€000	€000
Loans collateralised by:		
Prime bank guarantees	1,004	392
Cash or quasi cash	109,593	42,754
Guarantees and/or letters of comfort issued by the Malta Government, the Central Bank of Malta or Public agencies	471,762	184,041
Residential property	1,946,718	759,447
Commercial property	1,118,414	436,312
Personal guarantees and others	220,272	85,932
	3,867,763	**1,508,878**

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1.5 Collateral (continued)

The Group
As at 31 December 2017

	Loans and advances to customers	Undrawn credit facilities and other commitments to lend
	€000	€000
Loans collateralised by:		
Prime bank guarantees	1,464	572
Cash or quasi cash	152,259	59,476
Guarantees and/or letters of comfort issued by the Malta Government, the Central Bank of Malta or Public agencies	509,939	199,192
Residential property	1,804,873	705,020
Commercial property	1,032,465	403,302
Personal guarantees and others	232,148	90,681
	3,733,148	**1,458,243**

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

The Group
As at 31 December 2018

	Gross carrying amount	Impairment allowance	Net carrying amount	Fair value of collateral held post haircut
	€000	€000	€000	€000
Credit-impaired assets				
Loans to individuals:				
- Personal Loans	4,570	(2,645)	1,925	2,064
- Home Loans	43,740	(7,796)	35,944	34,726
- Personal Overdrafts	999	(531)	468	963
- Credit Cards	715	(712)	3	-
Loans to corporate entities:				
- Business Loans	128,690	(45,693)	82,997	99,408
- Business Overdrafts	63,674	(20,980)	42,694	54,595
- Encroachments	1,159	(1,151)	8	-
Total credit-impaired assets	243,547	(79,508)	164,039	191,756

Fair value of collateral refers to value adjusted collateral.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.1.5 Collateral (continued)

Residential lending

The table below stratifies credit exposures, covered by residential property, to retail customers by ranges of loan-to-value ('LTV'). LTV is calculated as the ratio of the gross amount of loan or the amount committed for loan commitments to the value of the collateral. The gross amounts exclude any impairment allowances. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for these loans is based on the collateral value at origination updated based on changes in house price indices.

Residential lending and commitments for residential lending	2018	2017
	€000	€000
Less than 25%	146,309	166,444
25% to 50%	456,424	504,234
51% to 75%	856,469	815,181
76% to 90%	918,239	1,040,848
	2,377,441	2,526,707

The following table shows the distribution of LTV ratios for the Group's mortgage credit-impaired portfolio

Residential lending and commitments for residential lending	Credit Impaired (Gross carrying amount)
	2018
	€000
Lower than 25%	3,230
25% to 50%	9,013
51% to 75%	11,833
76% to 90%	20,866
Total	44,942

39.2.2 The expected credit loss provision and write-offs of exposures as at 31 December 2018

39.2.2.1 Reconciliation of ECL

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

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit- impaired in the period, and the consequent "step up" (or "step down") between 12-month and Lifetime ECL. Changes in the staging allocation of balances existing at 1 January 2018 (and associated ECL changes) are presented in "transfers to/(from)", whereas subsequent changes in the staging allocation of new assets originated during the year are presented in "new financial assets originated";
- Additional allowances for new financial instruments recognised during the period, as well as releases for financial instruments de-recognised in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;
- Impacts on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Financial assets derecognised during the period and write-offs of allowances related to assets that were written off during the period (see note 39.2.2.4)

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.2 The expected credit loss provision and write-offs of exposures as at 31 December 2018 (continued)

39.2.2.1 Reconciliation of ECL (continued)

Allowances	Stage 1 12-month ECL €000	Stage 2 Lifetime ECL €000	Stage 3 Lifetime ECL €000	Total €000
Total allowances at 1 January 2018	**11,252**	**26,813**	**111,556**	**149,621**
Home Loans				
Allowances at 1 January 2018	2,149	1,682	8,627	**12,458**
Transfer to/(from):				
Stage 1	(8)	176	600	**768**
Stage 2	5	(488)	231	**(252)**
Stage 3	1	60	(137)	**(76)**
New financial assets originated *	404	174	229	**807**
Financial assets that have been derecognised	(242)	(208)	(237)	**(687)**
Write-offs	-	-	(797)	**(797)**
Changes to model assumptions and methodologies	(608)	(155)	(2)	**(765)**
Other movements	(243)	(83)	(718)	**(1,044)**
Allowances on home loans at 31 December 2018	1,458	1,158	7,796	**10,412**
Personal				
Allowances at 1 January 2018	1,084	757	2,432	**4,273**
Transfer to/(from):				
Stage 1	(8)	127	586	**705**
Stage 2	2	(77)	99	**24**
Stage 3	-	20	(71)	**(51)**
New financial assets originated *	344	77	520	**941**
Financial assets that have been derecognised	(160)	(36)	(296)	**(492)**
Write-offs	-	-	(14)	**(14)**
Changes to model assumptions and methodologies	(198)	(42)	-	**(240)**
Other movements	(229)	(375)	(81)	**(685)**
Allowances on personal at 31 December 2018	835	451	3,175	**4,461**
Credit Cards				
Allowances at 1 January 2018	1,785	2,815	812	**5,412**
Transfer to/(from):				
Stage 1	(153)	394	87	**328**
Stage 2	112	(567)	125	**(330)**
Stage 3	3	17	(140)	**(120)**
New financial assets originated *	89	24	4	**117**
Financial assets that have been derecognised	(59)	(110)	(165)	**(334)**
Write-offs	-	-	-	**-**
Changes to model assumptions and methodologies	(477)	(143)	(2)	**(622)**
Other movements	376	(1,324)	-	**(948)**
Allowances on credit cards at 31 December 2018	1,676	1,106	721	**3,503**
Business				
Allowances at 1 January 2018	6,234	21,559	99,685	**127,478**
Transfer to/(from):				
Stage 1	(273)	1,449	5,097	**6,273**
Stage 2	50	(6,848)	2,386	**(4,412)**
Stage 3	6	228	(1,588)	**(1,354)**
New financial assets originated *	2,909	5,828	883	**9,620**
Financial assets that have been derecognised	(779)	(4,894)	(7,498)	**(13,171)**
Write-offs	-	-	(33,356)	**(33,356)**
Changes to model assumptions and methodologies	(991)	(643)	(851)	**(2,485)**
Other movements	(1,915)	(1,049)	3,058	**94**
Allowances on business at 31 December 2018	5,241	15,630	67,816	**88,687**
Total allowances at 31 December 2018	**9,210**	**18,345**	**79,508**	**107,063**

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.2 The expected credit loss provision and write-offs of exposures as at 31 December 2018 (continued)

39.2.2.1 Reconciliation of ECL (continued)

Provisions	Stage 1 12-month ECL €000	Stage 2 Lifetime ECL €000	Stage 3 Lifetime ECL €000	Total €000
Total Provisions at 1 January 2018	**3,995**	**4,791**	**14,230**	**23,016**
Home Loans				
Provisions at 1 January 2018	421	259	612	**1,292**
Transfer to/(from):				
Stage 1	(2)	-	5	**3**
Stage 2	-	(17)	11	**(6)**
Stage 3	-	-	(70)	**(70)**
New financial assets originated *	35	144	-	**179**
Financial assets that have been derecognised	(73)	(33)	(215)	**(321)**
Write-offs	-	-	(36)	**(36)**
Changes to model assumptions and methodologies	(151)	(51)	(8)	**(210)**
Other movements	133	58	91	**282**
Provisions on home loans at 31 December 2018	363	360	390	**1,113**
Personal				
Provisions at 1 January 2018	60	12	167	**239**
Transfer to/(from):				
Stage 1	(2)	14	6	**18**
Stage 2	-	(1)	-	**(1)**
Stage 3	-	-	(11)	**(11)**
New financial assets originated *	50	47	21	**118**
Financial assets that have been derecognised	(17)	(1)	(69)	**(87)**
Write-offs	-	-	-	**-**
Changes to model assumptions and methodologies	(15)	(7)	(2)	**(24)**
Other movements	(14)	(3)	(8)	**(25)**
Provisions on personal at 31 December 2018	62	61	104	**227**
Credit Cards				
Provisions at 1 January 2018	390	29	14	**433**
Transfer to/(from):				
Stage 1	(15)	14	6	**5**
Stage 2	12	(17)	3	**(2)**
Stage 3	1	-	(4)	**(3)**
New financial assets originated *	28	1	-	**29**
Financial assets that have been derecognised	(21)	(4)	(4)	**(29)**
Write-offs	-	-	-	**-**
Changes to model assumptions and methodologies	(115)	(6)	-	**(121)**
Other movements	108	5	-	**113**
Provisions on credit cards at 31 December 2018	388	22	15	**425**
Business				
Provisions at 1 January 2018	3,124	4,491	13,437	**21,052**
Transfer to/(from):				
Stage 1	(23)	16	482	**475**
Stage 2	11	(834)	15	**(808)**
Stage 3	-	-	(31)	**(31)**
New financial assets originated *	1,665	5,736	-	**7,401**
Financial assets that have been derecognised	(770)	(600)	(816)	**(2,186)**
Write-offs	-	-	(17)	**(17)**
Changes to model assumptions and methodologies	(660)	(362)	(420)	**(1,442)**
Other movements	(242)	(4,147)	(3,053)	**(7,442)**
Provisions on business at 31 December 2018	3,105	4,300	9,597	**17,002**
Total Provisions at 31 December 2018	**3,918**	**4,743**	**10,106**	**18,767**

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.2 The expected credit loss provision and write-offs of exposures as at 31 December 2018 (continued)

39.2.2.2 Contributors to changes in provision

Significant changes in the gross carrying amount of financial assets that contributed to changes in the loss allowance were as follows:

- Gross loans and advances increased by 3% during the year. The high volume of new loans originated during the period, aligned with the Group's organic growth objective, increased the loss allowance by €11.5 million.
- There were no significant changes to the modification of facility contracts following renegotiation with customers facing financial difficulties.
- The write-off of loans with a total gross carrying amount of €46.9 million resulted in the reduction of the Stage 3 expected credit losses by €34.2 million.

The following tables further explains changes in the gross carrying amount of the loan portfolio to help explain their significance to the changes in the loss allowance for the same portfolio as discussed above:

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	€000	€000	€000	€000
Total Gross Carrying Amount at 1 January 2018	**3,940,225**	**249,576**	**281,004**	**4,470,805**
Home Loans				
Gross carrying amount as at 1 January 2018	1,834,094	42,461	45,622	**1,922,177**
Transfer to/(from):				
Stage 1	(10,644)	7,281	3,349	**(14)**
Stage 2	7,820	(9,788)	1,573	**(395)**
Stage 3	376	1,828	(2,177)	**27**
New financial assets originated *	366,156	2,906	1,411	**370,473**
Financial assets that have been derecognised	(159,387)	(5,195)	(3,639)	**(168,221)**
Write-offs	-	-	(2,330)	**(2,330)**
Other changes in carrying amount	(74,001)	(1,450)	(70)	**(75,521)**
Home loans gross carrying amount as at 31 December 2018	**1,964,414**	**38,043**	**43,739**	**2,046,196**
Personal				
Gross carrying amount as at 1 January 2018	150,304	6,947	4,673	**161,924**
Transfer to/(from):				
Stage 1	(1,541)	829	718	**6**
Stage 2	758	(1,234)	242	**(234)**
Stage 3	20	68	(127)	**(39)**
New financial assets originated *	50,029	1,310	769	**52,108**
Financial assets that have been derecognised	(27,230)	(899)	(490)	**(28,619)**
Write-offs	-	-	(830)	**(830)**
Other changes in carrying amount	(24,394)	(1,467)	607	**(25,254)**
Personal gross carrying amount as at 31 December 2018	**147,946**	**5,554**	**5,562**	**159,062**

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.2 The expected credit loss provision and write-offs of exposures as at 31 December 2018 (continued)

39.2.2.2 Contributors to changes in provision (continued)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Total
	€000	€000	€000	€000
Credit cards				
Gross carrying amount as at 1 January 2018	42,579	8,264	787	**51,630**
Transfer to/(from):				
Stage 1	(4,035)	4,697	133	**795**
Stage 2	3,356	(4,073)	173	**(544)**
Stage 3	82	109	(215)	**(24)**
New financial assets originated *	2,110	273	4	**2,387**
Financial assets that have been derecognised	(1,478)	(513)	(186)	**(2,177)**
Other changes in carrying amount	939	49	25	**1,013**
Credit cards gross carrying amount as at 31 December 2018	**43,553**	**8,806**	**721**	**53,080**
Business				
Gross carrying amount as at 1 January 2018	1,913,248	191,905	229,921	**2,335,074**
Transfer to/(from):				
Stage 1	(65,771)	55,556	9,020	**(1,195)**
Stage 2	15,969	(25,771)	7,004	**(2,798)**
Stage 3	1,187	2,938	(6,897)	**(2,772)**
New financial assets originated *	213,880	49,019	2,917	**265,816**
Financial assets that have been derecognised	(138,131)	(49,196)	(19,993)	**(207,320)**
Write-offs	-	-	(43,708)	**(43,708)**
Other changes in carrying amount	(32,964)	21,424	15,261	**3,721**
Business gross carrying amount as at 31 December 2018	1,907,418	245,875	193,525	**2,346,818**
Total Gross carrying amount as at 31 December 2018	4,063,331	298,278	243,547	4,605,156
Less Allowances	(9,210)	(18,345)	(79,508)	(107,063)
Net Loans and Advances to customers	**4,054,121**	**279,933**	**164,039**	**4,498,093**

Gross carrying amount comprises of loans and advances to customers at amortised cost and loans and advances to customers designated as fair value through profit or loss.

*This includes financial assets originating during the year that:
- are not in Stage 1 due to the Pull effect policy in line with EBA technical standard on Non Performing and forbearance; or
- have experienced significant increase in credit risk during the year and are still under probation.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.2 The expected credit loss provision and write-offs of exposures as at 31 December 2018 (continued)

39.2.2.2 Contributors to changes in provision (continued)

Impairment Allowances on Total/Forborne Exposures

	The Group	
	Total	of which Forborne
	2018	2018
	€000	€000
Performing		
Stage 1	9,210	-
Stage 2	18,345	1,816
	27,555	1,816
Non-performing		
Stage 3	79,508	33,330
	79,508	33,330
Total Impairment Allowances	107,063	35,146

39.2.2.3 Incurred credit loss measurement prior to 1 January 2018

Impairment Allowances on Total/Forborne Exposures	The Group	
	Total	of which Forborne
	2017	2017
	€000	€000
Performing		
Neither past due nor impaired	32,092	2,312
Past due < 90 days, but not impaired	1,196	87
	33,288	2,399
Non-performing		
Past due > 90 days, but not impaired	31,261	8,398
Impaired	101,651	54,746
	132,912	63,144
Total Impairment Allowances	166,200	65,543

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.2 The expected credit loss provision and write-offs of exposures as at 31 December 2018 (continued)

39.2.2.3 Incurred credit loss measurement prior to 1 January 2018 (continued)

The Movement in allowance accounts for loans and advances to customers are as follows:

	The Group Allowances 2018 €000
Change in allowances for uncollectability:	
At 1 January	166,200
Impact on adoption of IFRS 9	(16,579)
Additions	37,616
Reversals	(80,174)
At 31 December	107,063

	The Group	
	Individually assessed allowances 2017 15 months €000	Collective allowances 2017 15 months €000
Change in allowances for uncollectability:		
At 1 October	170,776	14,936
Additions	55,134	3,251
Reversals	(75,912)	(1,985)
	(20,778)	1,266
At 31 December	149,998	16,202

Interest income recognised during the year ended 31 December 2018 in respect of forborne assets amounted to €6.5 million (2017: €8.8 million).

39.2.2.4 Write-off policy

Loans and debt securities are written off in full when there is no realistic prospect of recovery. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts. However, financial assets that are written off could be subject to enforcement activities in order to comply with the Group's procedures for recovery of amounts due.

39.2.2.5 Contractual amounts outstanding on assets that were written off

The contractual amount outstanding on financial assets that were written off during the year ended 31 December 2018 and that are still subject to enforcement activity is €46.9 million.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.2.3 Modification of financial assets' terms

The contractual terms of a loan may be modified for a number of reasons, including changing market conditions, customer retention and other factors not related to a current or potential credit deterioration of the customer. An existing loan whose terms have been modified may be derecognised and the renegotiated loan recognised as a new loan at fair value in accordance with the accounting policy set out in Note 1.4.2.

When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects comparison of:

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

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

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired (see Note 39.2.1.2.2). A customer needs to demonstrate consistently good payment behaviour over a period of 12 months before the exposure is no longer considered to be credit-impaired in default or a period of 3 months before the exposure's PD is considered to have decreased such that the loss allowance reverts to being measured at an amount equal to 12-month ECL.

During the current financial year there were no significant modification of financial assets.

39.2.4 Equity instruments designated as at FVOCI

At 1 January 2018, the Group designated certain investments shown in the following table as equity securities as at FVOCI. In 2017, these investments were generally classified and measured at FVTPL. The fair value of these investments as at 31 December 2018 and the dividend income recognised during the year is detailed below.

	Fair value	Dividend income recognised
	2018	2018
	€000	€000
Local Other	17,411	240
Local Banks	166	11
Local Public	1,552	62
	19,129	313

During the current financial year a number of equity instruments were sold in line with the Bank's risk appetite strategy. The fair value of these equity instruments upon disposal was €12.3 million. Transfers of cumulative gains within equity amounted to €1.9 million.

39.3 Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value. The Group monitors and manages this risk by maintaining sufficient cash and, where possible, financial assets for which there is a liquid market and that are readily saleable to meet liquidity needs. The Group is exposed to daily calls on its available cash resources from overnight deposits, current and call deposits, maturing term deposits, loan drawdowns, guarantees and from margin and other calls on cash-settled derivatives. In order to ensure that maturing funds are always available to meet expected demand for cash, the Board sets parameters within which maturities of assets and liabilities may be mismatched. Unmatched positions potentially enhance profitability, but also increase the risk of losses. In addition, the Group manages its risk to a shortage of funds by monitoring forecast and actual cashflows, by monitoring the availability of raising funds to meet commitments associated with financial instruments and by holding financial assets which are expected to generate cash inflows that will be available to meet cash outflows on liabilities.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

The table below analyses Group financial liabilities into relevant maturity groupings, based on the remaining period at the reporting date to the contractual maturity date. The balances in this table will not agree directly to the balances in the statement of financial position as the table incorporates all cash flows, on an undiscounted basis, related to both principal as well as those associated with all future coupon payments. Furthermore, loan commitments do not meet the criteria for recognition in the statement of financial position.

Financial liabilities at fair value through profit or loss and derivatives designated for hedge accounting, disclosed below, represent amounts for which net cash flows are exchanged.

The Group	Due within 3 months	Due between 3 & 12 months	Due between 1 & 5 years	Due after 5 years	Gross nominal outflow	Carrying amount
At 31 December 2018	**€000**	**€000**	**€000**	**€000**	**€000**	**€000**
Financial liabilities at fair value through profit or loss	1,394	2,704	7,073	2,413	13,584	8,812
Amounts owed to banks	146,560	8	-	-	146,568	146,021
Amounts owed to customers	9,096,232	924,826	404,546	3,857	10,429,461	10,414,908
Debt securities in issue	-	1,700	40,850	-	42,550	40,197
Subordinated liabilities	3,633	54,970	87,303	138,931	284,837	234,241
Derivatives designated for hedge accounting	433	1,086	5,162	5,162	11,843	10,206
Other financial liabilities	267,748	1,202	7,397	13,784	290,131	298,470
	9,516,000	**986,496**	**552,331**	**164,147**	**11,218,974**	**11,152,855**
Loan commitments	1,796,548					
At 31 December 2017						
Financial liabilities at fair value through profit or loss	1,390	2,475	7,517	2,952	14,334	11,957
Amounts owed to banks	192,591	8	-	-	192,599	192,196
Amounts owed to customers	8,894,632	976,064	306,336	3,139	10,180,171	10,100,625
Debt securities in issue	1,330	58,430	40,850	-	100,610	95,400
Subordinated liabilities	3,633	6,308	142,000	142,836	294,777	231,591
Derivatives designated for hedge accounting	593	1,312	6,004	7,450	15,359	12,053
Other financial liabilities	180,812	4,747	9,598	10,470	205,627	214,721
	9,274,981	**1,049,344**	**512,305**	**166,847**	**11,003,477**	**10,858,543**
Loan commitments	1,746,399					

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

Assets available to meet these liabilities, and to cover outstanding commitments, include balances with Central Bank of Malta, treasury bills and cash, cheques in course of collection, loans to banks and to customers and marketable securities and undrawn credit lines.

The table below analyses the assets and liabilities that are recognised in the statement of financial position into relevant maturity groupings, based on the remaining period at the reporting date to their contractual maturity date.

The Group	Less than 3 months	Between 3 months and 1 year	Between 1 and 5 years	More than 5 years	Other	Carrying amount
	€000	€000	€000	€000	€000	€000
At 31 December 2018						
Assets						
Balances with Central Bank of Malta, treasury bills and cash	76,021	10,210	-	-	160,068	**246,299**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	4,383	1,067	34,092	91	-	**39,633**
- Equity and other non-fixed income instruments	-	-	-	-	27,072	**27,072**
- Loans and advances	-	-	-	135,110	-	**135,110**
- Derivative financial instruments	4,186	60	145	-	-	**4,391**
Investments						
- Debt and other fixed income financial instruments						
- FVOCI	-	5,073	51,243	86,591	-	**142,907**
- Amortised cost	211,526	614,046	1,898,086	429,261	-	**3,152,919**
- Equity and other non-fixed income instruments						
- FVOCI	-	-	-	-	19,129	**19,129**
Loans and advances to banks	3,628,719	-	-	-	16,214	**3,644,933**
Loans and advances to customers	510,465	36,694	153,070	3,662,754	-	**4,362,983**
Investments in equity-accounted investees	-	-	-	-	108,510	**108,510**
Other assets	-	-	-	-	263,102	**263,102**
	4,435,300	**667,150**	**2,136,636**	**4,313,807**	**594,095**	**12,146,988**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	2,161	109	2,765	3,777	-	**8,812**
Amounts owed to banks	110,008	36,013	-	-	-	**146,021**
Amounts owed to customers	9,100,245	915,990	395,050	3,623	-	**10,414,908**
Debt securities in issue	-	40,197	-	-	-	**40,197**
Other liabilities	-	-	-	-	298,470	**298,470**
Derivatives designated for hedge accounting	-	-	368	9,838	-	**10,206**
Subordinated liabilities	-	50,118	70,993	113,130	-	**234,241**
Equity holders of the Bank	-	-	-	-	994,133	**994,133**
	9,212,414	**1,042,427**	**469,176**	**130,368**	**1,292,603**	**12,146,988**

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

The Group At 31 December 2017	Less than 3 months €000	Between 3 months and 1 year €000	Between 1 and 5 years €000	More than 5 years €000	Other €000	Carrying amount €000
Assets						
Balances with Central Bank of Malta, treasury bills and cash	4,503	-	-	-	155,181	**159,684**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	8,248	16,422	71,422	15,325	-	**111,417**
- Equity and other non-fixed income instruments	-	-	-	-	64,811	**64,811**
- Loans and advances	-	-	-	142,573	-	**142,573**
- Derivative financial instruments	6,889	472	87	42	-	**7,490**
Investments						
- Debt and other fixed income financial instruments						
- FVOCI	-	-	48,635	90,693	-	**139,328**
- Amortised cost	158,210	620,614	2,338,395	112,696	-	**3,229,915**
- Equity and other non-fixed income instruments						
- FVOCI	-	-	-	-	5,298	**5,298**
Loans and advances to banks	3,411,769	12,001	-	-	7,613	**3,431,383**
Loans and advances to customers	538,307	44,084	365,246	3,214,395	-	**4,162,032**
Investments in equity-accounted investees	-	-	-	-	109,461	**109,461**
Other assets	-	-	-	-	257,238	**257,238**
	4,127,926	**693,593**	**2,823,785**	**3,575,724**	**599,602**	**11,820,630**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	4,035	1,682	3,223	3,017	-	**11,957**
Amounts owed to banks	154,544	37,652	-	-	-	**192,196**
Amounts owed to customers	8,857,595	957,285	285,745	-	-	**10,100,625**
Debt securities in issue	-	55,400	40,000	-	-	**95,400**
Other liabilities	-	-	-	-	214,721	**214,721**
Derivatives designated for hedge accounting	-	-	379	11,674	-	**12,053**
Subordinated liabilities	-	-	120,000	111,591	-	**231,591**
Equity holders of the Bank	-	-	-	-	962,087	**962,087**
	9,016,174	**1,052,019**	**449,347**	**126,282**	**1,176,808**	**11,820,630**

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

The Bank

At 31 December 2018	Less than 3 months €000	Between 3 months and 1 year €000	Between 1 and 5 years €000	More than 5 years €000	Other €000	Carrying Amount €000
Assets						
Balances with Central Bank of Malta, treasury bills and cash	76,021	10,210	-	-	160,068	**246,299**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	4,383	1,067	34,092	91	-	**39,633**
- Equity and other non-fixed income instruments	-	-	-	-	26,093	**26,093**
- Loans and advances	-	-	-	135,110	-	**135,110**
- Derivative financial instruments	4,186	60	145	-	-	**4,391**
Investments						
- Debt and other fixed income financial instruments						
- fair value through other comprehensive income	-	5,073	51,243	86,591	-	**142,907**
- measured at amortised cost	211,526	614,046	1,898,087	429,260	-	**3,152,919**
- Equity and other non-fixed income instruments						
- fair value through other comprehensive income	-	-	-	-	19,129	**19,129**
Loans and advances to banks	3,628,719	-	-	-	16,214	**3,644,933**
Loans and advances to customers	510,465	36,694	153,070	3,662,754	-	**4,362,983**
Investments in equity-accounted investees and subsidiaries	-	-	-	-	59,100	**59,100**
Other assets	-	-	-	-	260,942	**260,942**
	4,435,300	**667,150**	**2,136,637**	**4,313,806**	**541,546**	**12,094,439**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	2,161	109	2,765	3,777	-	**8,812**
Amounts owed to banks	110,008	36,013	-	-	-	**146,021**
Amounts owed to customers	9,103,336	915,990	395,050	3,623	-	**10,417,999**
Debt securities in issue	-	40,197	-	-	-	**40,197**
Other liabilities	-	-	-	-	297,714	**297,714**
Derivatives designated for hedge accounting	-	-	368	9,838	-	**10,206**
Subordinated liabilities	-	50,118	70,993	113,130	-	**234,241**
Equity holders of the Bank	-	-	-	-	939,249	**939,249**
	9,215,505	**1,042,427**	**469,176**	**130,368**	**1,236,963**	**12,094,439**

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

The Bank

At 31 December 2017	Less than 3 months €000	Between 3 months and 1 year €000	Between 1 and 5 years €000	More than 5 years €000	Other €000	Carrying amount €000
Assets						
Balances with Central Bank of Malta, treasury bills and cash	4,503	-	-	-	155,181	**159,684**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	8,248	16,422	71,422	15,325	-	**111,417**
- Equity and other non-fixed income instruments	-	-	-	-	63,836	**63,836**
- Loans and advances	-	-	-	142,573	-	**142,573**
- Derivative financial instruments	6,889	472	87	42	-	**7,490**
Investments						
- Debt and other fixed income financial instruments						
- available-for-sale	-	-	48,635	90,693	-	**139,328**
- held-to-maturity	158,210	620,614	2,338,395	112,696	-	**3,229,915**
- Equity and other non-fixed income instruments						
- available-for-sale	-	-	-	-	5,298	**5,298**
Loans and advances to banks	3,411,768	12,001	-	-	7,614	**3,431,383**
Loans and advances to customers	538,307	44,084	365,246	3,214,395	-	**4,162,032**
Investments in equity-accounted investees and subsidiaries	-	-	-	-	59,100	**59,100**
Other assets	-	-	-	-	255,258	**255,258**
	4,127,925	**693,593**	**2,823,785**	**3,575,724**	**546,287**	**11,767,314**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	4,035	1,682	3,223	3,017	-	**11,957**
Amounts owed to banks	154,543	37,653	-	-	-	**192,196**
Amounts owed to customers	8,859,134	957,285	285,745	-	-	**10,102,164**
Debt securities in issue	-	55,400	40,000	-	-	**95,400**
Other liabilities	-	-	-	-	213,905	**213,905**
Derivatives designated for hedge accounting	-	-	379	11,674	-	**12,053**
Subordinated liabilities	-	-	120,000	111,591	-	**231,591**
Equity holders of the Bank	-	-	-	-	908,048	**908,048**
	9,017,712	**1,052,020**	**449,347**	**126,282**	**1,121,953**	**11,767,314**

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

Banking Rule 07 transposing the provisions of the EBA Guidelines on Disclosures of Encumbered and Unencumbered Assets (EBA/GL/2014/03) requires disclosure on asset encumbrance. The Group is in compliance with the contents thereof.

This disclosure provides details of available and unrestricted assets that could be used to support potential future funding and collateral needs. An asset is considered as encumbered when it has been pledged as collateral against an existing liability, and as a result is no longer available to the Group to secure funding, satisfy collateral needs or be sold to reduce the funding requirement.

This disclosure is limited to assets available for central bank refinancing and securities that are transferable and is not designed to identify assets which would be available to meet the claims of creditors or to predict assets that would be available to creditors in the event of a resolution or bankruptcy.

Asset Encumbrance

	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
	€000	€000	€000	€000
The Group				
As at 31 December 2018				
Equity instruments	-	-	46,201	46,201
Debt securities	485,349	493,951	2,850,110	2,951,820
Loan and advances	-	-	8,242,807	-
Other assets	-	-	522,521	-
	485,349	**493,951**	**11,661,639**	**2,998,021**
The Group				
As at 31 December 2017				
Equity instruments	-	-	70,109	70,109
Debt securities	209,084	214,254	3,271,576	3,305,840
Loan and advances	-	-	7,835,019	-
Other assets	-	-	434,842	-
	209,084	**214,254**	**11,611,546**	**3,375,949**
The Bank				
As at 31 December 2018				
Equity instruments	-	-	45,222	45,222
Debt securities	485,349	493,951	2,850,110	2,951,820
Loan and advances	-	-	8,242,807	-
Other assets	-	-	470,951	-
	485,349	**493,951**	**11,609,090**	**2,997,042**
The Bank				
As at 31 December 2017				
Equity instruments	-	-	69,134	69,134
Debt securities	209,084	214,254	3,271,576	3,305,840
Loan and advances	-	-	7,835,019	-
Other assets	-	-	382,501	-
	209,084	**214,254**	**11,558,230**	**3,374,974**

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.3 Liquidity risk (continued)

Asset Encumbrance (continued)

The Group does not encumber any of the collateral received or any of its debt securities issued.

As at 31 December 2018, the Bank has an outstanding liability with regards to significant claims associated with encumbered assets.

As at 31 December 2017, the Group and the Bank did not have any outstanding liabilities associated with encumbered assets.

The Group and the Bank undertake the following:
(i) Pledging of debt securities against the provision of credit lines by the Central Bank of Malta;
(ii) Pledging of debt securities in favour of the Depositor Compensation Scheme; and
(iii) Pledging of assets in favour of the Italian bank Intesa San Paolo against the precautionary warrant of seizure in respect of Deilumar Trust. This amount does not necessarily reflect BOV's potential financial exposure.

39.4 Market risk

Market Risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: interest rate risk, currency risk and other price risk. It arises in all areas of the Group's activities and is managed by a variety of different techniques as detailed below.

The objective of the Group is to manage and control market risk exposures in order to optimise return on risk while maintaining a market profile consistent with the Bank's status as a leading Bank in providing financial products and services.

The market risk appetite is articulated in the Treasury Management Policy. It is defined as the quantum and composition of market risk that the Bank is currently exposed to and the direction in which the Bank desires to manage this risk. Market risk is managed through limits set in the Treasury Management Policy. The Policy is reviewed by Treasury department in co-ordination with Risk Management department and is approved by the Asset Liability Management Committee (ALCO) and the Board of Directors.

39.4.1 Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument would fluctuate because of changes in market interest rates.

The Group is exposed to fair value interest rate risk arising from financial assets and liabilities with fixed interest rates and to cash flow interest rate risk arising from financial assets and liabilities with floating interest rates. The Group is not directly exposed to interest rate risk on investment in equity instruments. The Group uses interest rate swaps to hedge the interest rate risk of certain financial instruments.

The analysis of interest rate risk has evolved from assessing the sensitivity of the treasury portfolio, using a modified duration method, to a more comprehensive methodology. The latter approach covers all interest sensitive assets and liabilities, as well as off-balance sheet items; this effectively widens the analysis and enables the stressing of various movements in the yield curve.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.4 Market risk (continued)

39.4.1 Interest rate risk (continued)

The tables below depict the movement of stressed yield curves and the changes in the Report Equity and Net Interest Income to such movement. For further information related to the measurement of interest rate risk can be found in the Capital & Risk Management Report section 7.2.1.

	Basis points	Direction
Parallel Shock Up	200	Up
Parallel Shock Down	200	Down
Short Rates Up	250	Up
Short Rates Down	250	Down
Steepener	250	Short Rates Down
	100	Long Rates Up
Flattener	250	Short Rates Up
	100	Long Rates Down

	Parallel Shock Up	Parallel Shock Down	Short Rates up	Short Rates Down	Steepener	Flattener
	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
Sensitivity of reported equity to interest rate movements						
2018						
At 31 December	26	5	11	(13)	(14)	1
Average for the period	26	20	30	10	-	25
Maximum for the period	56	40	57	34	28	52
Minimum for the period	(1)	-	11	(13)	(14)	1
2017						
At 31 December	37	(8)	27	(4)	(1)	18
Average for the period	30	(8)	23	(4)	(4)	15
Maximum for the period	37	-	27	-	(1)	18
Minimum for the period	25	(16)	20	(7)	(6)	12

	Parallel Shock Up	Parallel Shock Down
Sensitivity of projected net interest income to interest rate movements	€ millions	€ millions
2018		
At 31 December	210	(67)
Average for the period	93	(102)
Maximum for the period	210	(67)
Minimum for the period	(3)	(167)
2017		
At 31 December	10	(104)
Average for the period	6	(104)
Maximum for the period	10	(103)
Minimum for the period	3	(104)

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.4 Market risk (continued)

39.4.1 Interest rate risk (continued)

Interest rate repricing gap

The table below summarises the Group's exposure to interest rate risk. Included in the table are Group assets and liabilities, including derivative financial instruments which are principally used to reduce exposure to interest rate risk, categorised by repricing date.

The Group's assets and liabilities are set to reprice as follows:

	Up to 1 Month €000	3 months or less but over 1 month €000	1 year or less but over 3 months €000	Over 1 year €000	Others €000	Total €000
ASSETS						
Balances with Central Bank of Malta, treasury bills and cash	99,780	76,024	10,207	-	60,288	**246,299**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	-	4,382	8,803	26,356	92	**39,633**
- Equity and other non- fixed income instruments	-	-	-	-	27,072	**27,072**
- Loans and advances	135,110	-	-	-	-	**135,110**
- Derivative financial instruments	-	-	-	-	4,391	**4,391**
Investments						
- Debt and other fixed income financial instruments						
- measured at FVOCI	-	(2)	5,073	137,836	-	**142,907**
- measured at amortised cost	541,970	1,076,507	265,673	1,268,769	-	**3,152,919**
- Equity and other non-fixed income instruments						
- measured at FVOCI	-	-	-	-	19,129	**19,129**
Loans and advances to banks	3,360,135	8,744	-	-	276,054	**3,644,933**
Loans and advances to customers	4,053,971	-	-	309,012	-	**4,362,983**
Investments in equity-accounted investees	-	-	-	-	108,510	**108,510**
Other assets	-	-	-	-	263,102	**263,102**
Total 2018	**8,190,966**	**1,165,655**	**289,756**	**1,741,973**	**758,638**	**12,146,988**
Total 2017	7,916,556	1,342,914	398,864	1,309,756	852,540	11,820,630
LIABILITIES and EQUITY						
Financial liabilities at fair value through profit or loss	1,034	1,985	3,415	-	2,378	**8,812**
Amounts owed to banks	37,336	36,012	-	-	72,673	**146,021**
Amounts owed to customers	6,045,768	262,265	904,745	378,758	2,823,372	**10,414,908**
Debt securities in issue	-	-	40,197	-	-	**40,197**
Other liabilities	-	-	-	-	298,470	**298,470**
Derivatives designated for hedge accounting	-	368	9,838	-	-	**10,206**
Subordinated liabilities	-	-	50,125	184,116	-	**234,241**
Equity holders of the Bank	-	-	-	-	994,133	**994,133**
Total 2018	**6,084,138**	**300,630**	**1,008,320**	**562,874**	**4,191,026**	**12,146,988**
Total 2017	5,937,323	289,894	1,019,745	566,277	4,007,391	11,820,630
Interest rate swaps - 2018	**47,084**	**56,445**	**94,564**	**(198,094)**	**-**	
Interest rate swaps - 2017	77,564	71,830	134,043	(283,437)	-	
Gap - 2018	**2,153,912**	**921,470**	**(624,000)**	**981,005**	**-**	
Gap - 2017	2,056,797	1,124,850	(486,838)	460,042	-	
Cumulative Gap - 2018	**2,153,912**	**3,075,382**	**2,451,382**	**3,432,387**	**-**	
Cumulative Gap - 2017	2,056,797	3,181,647	2,694,809	3,154,851	-	

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.4 Market risk (continued)

39.4.2 Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Board of Directors sets limits on the level of exposure by currency and in total, which levels are monitored daily.

The following table summarises the Group's exposure to foreign currency exchange rate risk at the reporting date. Included in the table are the Group's assets and liabilities at carrying amounts, analysed into relevant currency groupings.

The Group 31 December 2018	EUR €000	USD €000	GBP €000	AUD €000	Other Currencies €000	Total €000
Assets						
Balances with Central Bank of Malta, treasury bills and cash	242,045	1,489	1,986	86	693	**246,299**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	35,191	4,193	44	203	2	**39,633**
- Equity and other non-fixed income instruments	19,585	7,090	397	-	-	**27,072**
- Loans and advances	135,110	-	-	-	-	**135,110**
- Derivative financial instruments	3,200	868	174	-	149	**4,391**
Investments						
- measured at FVOCI	70,003	72,904	-	-	-	**142,907**
- amortised	2,230,724	490,031	212,223	179,123	40,818	**3,152,919**
- Equity and other non-fixed income instruments						
- measured at FVOCI	19,129	-	-	-	-	**19,129**
Loans and advances to banks	3,300,818	122,756	101,996	14,427	104,936	**3,644,933**
Loans and advances to customers	4,317,432	29,763	14,838	-	950	**4,362,983**
Other assets	372,236	(750)	104	-	22	**371,612**
	10,745,473	**728,344**	**331,762**	**193,839**	**147,570**	**12,146,988**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	7,288	1,320	153	-	51	**8,812**
Amounts owed to banks	43,721	59,008	9,509	27,696	6,087	**146,021**
Amounts owed to customers	9,251,190	668,990	296,182	58,493	140,053	**10,414,908**
Debt securities in issue	40,197	-	-	-	-	**40,197**
Other liabilities	195,879	(924)	(1,175)	266	8,657	**202,703**
Derivatives held for hedge accounting	368	9,838	-	-	-	**10,206**
Subordinated liabilities	234,241	-	-	-	-	**234,241**
Equity	988,989	31,352	(84)	(39)	(26,085)	**994,133**
Provision	-	-	-	-	95,767	**95,767**
	10,761,873	**769,584**	**304,585**	**86,416**	**224,530**	**12,146,988**

	USD	GBP	AUD	Other Currencies
Net on balance sheet financial position	(41,240)	(27,177)	107,423	(76,960)
Notional amount of derivative instruments	10,035	(29,585)	(108,070)	6,766
Net open position	(31,205)	(2,408)	(647)	(70,194)

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.4 Market risk (continued)

39.4.2 Currency risk (continued)

The Group 31 December 2017	EUR €000	USD €000	GBP €000	AUD €000	Other Currencies €000	Total €000
Assets						
Balances with Central Bank of Malta, treasury bills and cash	157,059	1,089	933	86	517	**159,684**
Financial assets at fair value through profit or loss						
- Debt and other fixed income instruments	92,132	17,581	40	1,663	3	**111,419**
- Equity and other non-fixed income instruments	59,595	744	2,592	-	1,878	**64,809**
- Loans and advances	142,573	-	-	-	-	**142,573**
- Derivative financial instruments	42	5,097	304	2,011	36	**7,490**
Investments						
- available-for-sale	66,079	73,249	-	-	-	**139,328**
- held-to-maturity	2,037,921	697,554	231,473	184,414	78,553	**3,229,915**
- Equity and other non-fixed income instruments						
- available-for-sale	-	5,298	-	-	-	**5,298**
Loans and advances to banks	3,040,077	89,554	90,147	19,336	192,269	**3,431,383**
Loans and advances to customers	4,104,307	38,036	18,726	-	963	**4,162,032**
Other assets	363,092	2,154	614	730	109	**366,699**
	10,062,877	**930,356**	**344,829**	**208,240**	**274,328**	**11,820,630**
Liabilities and Equity						
Financial liabilities at fair value through profit or loss	6,976	3,099	526	637	719	**11,957**
Amounts owed to banks	50,897	126,224	7,919	1,660	5,496	**192,196**
Amounts owed to customers	8,742,634	744,239	330,133	61,528	222,091	**10,100,625**
Debt securities in issue	95,400	-	-	-	-	**95,400**
Other liabilities	198,467	9,113	4,130	1,392	1,619	**214,721**
Derivatives designated for hedge accounting	380	11,761	(64)	(24)	-	**12,053**
Subordinated liabilities	231,591	-	-	-	-	**231,591**
Equity	965,761	(4,094)	21,667	736	(21,983)	**962,087**
	10,292,106	**890,342**	**364,311**	**65,929**	**207,942**	**11,820,630**

	USD	GBP	AUD	Other Currencies
Net on balance sheet financial position	40,014	(19,482)	142,311	66,386
Notional amount of derivative instruments	(42,667)	(497)	(141,198)	(43,230)
Net open position	(2,653)	(19,979)	1,113	23,156

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.4 Market risk (continued)

39.4.3 Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The Group is exposed to equity price risks arising from the holding of equity instruments classified either as available for sale or at fair value through profit or loss.

The carrying amounts of financial instruments at the reporting date which could potentially subject the Group to equity price risk are disclosed in the notes to the financial statements.

This risk is monitored and managed by the Risk management function of the Bank, as disclosed in more detail above.

39.5 Transferred financial assets that are not derecognised in their entirety

	The Group and the Bank	
	2018	2017
	€000	€000
Debt securities classified as		
- amortised cost	52,135	-
- held-to-maturity	-	37,655
	52,135	37,655
Amounts owed to banks	52,135	37,655

These transactions are covered by the TBMA/ISMA Global Repurchase Master Agreement ("the Agreement") and involve the sale of financial assets with a simultaneous agreement to repurchase them at a pre-determined price at a future date. The securities sold comprise financial assets at fair value through profit and loss and investment securities. The counterparty's liability is included in amounts owed to banks. The Group and the Bank continue to recognise the transferred assets since all the risks and rewards of the assets will be substantially retained in a manner that does not result in the transferred assets being derecognised for accounting purposes.

Each party to a transaction is subject to the events of default listed in the Agreement. In the event that any of the events of default is/are triggered, transactions are immediately terminated. Consequently, performance of the respective obligations of the parties with respect to the delivery of securities, the payment of the repurchase prices for any equivalent securities and the repayment of any cash margin shall become due and payable.

39.6 Fair value of financial instruments

The Group's accounting policy for determining the fair value of financial instruments is described in notes 1.3, 1.20 and 1.25 to these Financial Statements.

For financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly. This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3 inputs are unobservable inputs for the asset or liability. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instruments' valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

For assets and liabilities that are recognised in the financial statements at fair value on a recurring basis, the Group and the Bank determine when transfers are deemed to have occurred between Levels in the hierarchy at the end of each reporting period.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.6 Fair value of financial instruments (continued)

Bases of valuing financial assets and liabilities measured at fair value

	Fair value measurement			
	Level 1 €000	Level 2 €000	Level 3 €000	Total €000
The Group				
At 31 December 2018				
Assets				
Financial assets at fair value through profit or loss				
- debt and other fixed income instruments	35,264	4,369	-	39,633
- equity and other non-fixed income instruments	5,056	12,042	9,974	27,072
- loans and advances	-	135,110	-	135,110
- derivative financial instruments	-	4,391	-	4,391
Investments				
Debt and other fixed income instruments				
- FVOCI	70,003	72,904	-	142,907
Equity and other non-fixed income instruments				
- FVOCI	9,982	9,147	-	19,129
	120,305	**237,963**	**9,974**	**368,242**
Liabilities				
Financial liabilities at fair value through profit or loss	-	8,812	-	8,812
Derivatives designated for hedge accouting	-	10,206	-	10,206
	-	**19,018**	**-**	**19,018**
The Group				
At 31 December 2017				
Assets				
Financial assets at fair value through profit or loss				
- debt and other fixed income instruments	99,015	12,402	-	111,417
- equity and other non-fixed income instruments	36,501	23,193	5,117	64,811
- loans and advances	-	142,573	-	142,573
- derivative financial instruments	-	7,490	-	7,490
Investments				
Debt and other fixed income instruments				
- available-for-sale	66,079	73,249	-	139,328
Equity and other non-fixed income instruments				
- available-for-sale	-	-	5,298	5,298
	201,595	**258,907**	**10,415**	**470,917**
Liabilities				
Financial liabilities at fair value through profit or loss	-	11,957	-	11,957
Derivatives designated for hedge accounting	-	12,053	-	12,053
	-	**24,010**	**-**	**24,010**

During the period under review financial assets at fair value through profit or loss amounting to €0.4 million were transferred from Level 2 to Level 3 (2017: Level 2 to level 1 €0.8 million). The transfer from Level 2 to Level 3 was due to equities in liquidation as at the same date. During the same period no change in levels was made in financial assets classified as investments.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.6 Fair value of financial instruments (continued)

Control Framework

Fair values are subject to a control framework designed to ensure that they are either determined or validated by a function independent of the risk taker and that they are appropriately performed and reviewed by competent personnel. To this end, the determination of fair values is a process which is performed by Financial Markets and Investments and reviewed by Finance. Finance establishes the accounting policies and, in conjunction with Financial Markets and Investments, it establishes the procedures governing valuation, and is responsible for ensuring that they comply with all relevant accounting standards. The valuation techniques and procedures applied are subject to a process of due diligence, which process was duly approved by the Board and the Audit Committee and documented accordingly.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to valuation techniques, independent price determination or validation is utilised, to the extent practicable. In inactive markets, direct observation of a traded price may not be possible. In these circumstances, the Bank sources alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable. The factors which are mainly considered are the following:

- the extent to which prices may be expected to represent genuine traded or tradable prices;
- the degree of similarity between financial instruments;
- the degree of consistency between different sources;
- the process followed by the pricing provider to derive the data;
- the elapsed time between the date to which the market data relates and the end of the reporting period; and
- the manner in which the data was sourced.

In determining the fair values for financial instruments measured at fair value the credit risk adjustment for the counterparty, the Bank or both, as the case may be, is deemed to be immaterial and hence no adjustment to the fair value of financial Instruments at fair value through profit or loss was effected.

The Group calculates the credit risk adjustment by applying the probability of default of the counterparty to the expected positive exposure to the counterparty, and multiplying the result by the loss expected in the event of default. The calculation is performed over the life of the potential exposure.

Financial instruments at fair value through profit or loss and financial assets which are held for investment purposes as available-for-sale are carried at their fair value.

(i) Investments - Debt and other fixed income instruments
This category of asset is carried at amortised cost. Their fair value is disclosed separately in the respective note to the financial statements.

(ii) Loans and advances to customers
Loans and advances to customers are the largest financial asset held by the Group, and are reported net of allowances to reflect the estimated recoverable amounts. The carrying amount of loans and advances to customers is a reasonable approximation of fair value because these are re-priced to take into account changes in both benchmark rate and credit spreads. Their fair value measurement is a Level 2 input.

(iii) Loans and advances to banks, balances with Central Bank and Treasury Bills
The majority of these assets reprice or mature in less than 1 year. Hence their fair value is not deemed to differ materially from their carrying amount at the respective reporting dates.

(iv) Amounts owed to banks and customers
These liabilities are carried at amortised cost. The majority of these liabilities reprice or mature in less than 1 year. Hence their fair value is not deemed to differ materially from their carrying amount at the respective reporting dates. Their fair value measurement is a Level 2 input.

(v) Debt securities in issue and subordinated liabilities
These liabilities are carried at amortised cost. Their fair value is disclosed separately in the respective notes to the financial statements.

(vi) Other financial liabilities
The fair value of other financial liabilities is not deemed to differ materially from their carrying amount at the respective reporting dates.

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.6 Fair value of financial instruments (continued)

Bases of valuing financial assets and liabilities not measured at fair value

The following table provides an analysis of financial instruments that are not measured at fair value subsequent to initial recognition:

	Fair value measurement				Carrying
	Level 1 €000	Level 2 €000	Level 3 €000	Total €000	Amount €000
2018					
Financial assets					
Amortised	2,660,111	516,377	-	3,176,488	3,152,919
Financial liabilities					
Debt securities in issue	40,200	-	-	40,200	40,197
Subordinated liabilities	232,131	-	-	232,131	234,241
	272,331	-	-	272,331	274,438

	Fair value measurement				Carrying
	Level 1 €000	Level 2 €000	Level 3 €000	Total €000	Amount €000
2017					
Financial assets					
Held-to-maturity investments	2,643,695	625,651	-	3,269,346	3,229,915
Financial liabilities					
Debt securities in issue	97,454	-	-	97,454	95,400
Subordinated liabilities	235,328	-	-	235,328	231,591
	332,782	-	-	332,782	326,991

The reconciliation of Level 3 fair value measurements of financial instruments is disclosed below.

	Fair value through profit or loss		Fair value through other comprehensive income		
	Debt and other fixed income instruments €000	Equity and other non-fixed income instruments €000	Debt and other fixed income instruments €000	Equity and other non-fixed income instruments €000	Total €000
2018					
Opening balance	-	5,117	-	5,298	10,415
- in profit or loss	-	1,191	-	-	1,191
- in other comprehensive income	-	-	-	-	-
Purchases	-	-	-	-	-
Transfers		5,695	-	(5,298)	397
Sales	-	(2,029)	-	-	(2,029)
Closing balance	-	9,974	-	-	9,974

	Fair value through profit or loss		Available-for-sale investments		
	Debt and other fixed income instruments €000	Equity and other non-fixed income instruments €000	Debt and other fixed income instruments €000	Equity and other non-fixed income instruments €000	Total €000
2017					
Opening balance	-	5,678	-	3,583	9,261
- in profit or loss	-	(7)	-	1,715	1,708
Purchases	-	3,088	-	-	3,088
Sales	-	(3,642)	-	-	(3,642)
Closing balance	-	5,117	-	5,298	10,415

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.6 Fair value of financial instruments (continued)

The instruments classified within Level 3 comprise externally managed funds. Approximately 50% of the carrying amount represents funds with underlying investments which mainly comprise properties with the remaining 50% representing a European fund which invests in projects related to energy, climate change and infrastructure having 65% of its assets focused on new projects, with the remaining 35% focused on replacement, modernisation and capacity enhancement. The Bank has determined that the reported net asset value of these funds represents their fair value at the end of the reporting period. For one of the property funds, the Bank has adjusted the reported net asset value to take cognisance of factors which resulted in a lower fair value for the fund; in respect of another property fund, the fair value of the Bank's interest was determined to be nil in view of the fact that the value of the Fund's reported liabilities approximated the value of its reported assets. The net asset value of these funds was determined using statements or other information provided by the fund managers. The Bank considers that such valuations may rely significantly on the judgments and estimates made by the fund managers and given the level of subjectivity involved, these are included within level 3.

39.7 Capital risk management

The Group's capital management approach ensures a sufficient level of capitalisation to manage the risk exposures whilst supporting business growth and providing adequate returns to the shareholders. Risk capital management does not in any way substitute risk mitigation measures. It is vital that the structure of limits and thresholds should be able to prevent concentrations of risk from building up in such a way as to compromise a significant proportion of the Group's capital resources.

On 1 January 2014 the Capital Requirements Directive (CRD) and the Capital Requirements Regulations (CRR) came into effect, constituting the European implementation of the Basel capital and liquidity agreement of 2010. The Group has made the necessary changes in order to ensure that it is compliant with the Pillar I capital requirements set by the CRR. Other material risks are also allocated capital as part of the Internal Capital Adequacy Process (ICAAP) embedded in the Pillar II process. This process helps to measure with greater risk sensitivity the amount of regulatory capital which the Group requires to cover risks assumed in the course of its business, including risks not covered in Pillar I. The Board submitted the latest ICAAP capital document to the JST in April 2017.

Capital management is under the direct control of the Asset Liability Management Committee (ALCO). During the financial period, ALCO has monitored the adequacy of the Group's capital and gave strategic direction on the most efficient use of capital.

During the period under review and during the comparative period, there were no reported breaches in respect of the externally imposed capital requirements. The Group uses the Standardised Approach for credit risk, the Basic Indicator Approach for operational risk and the Base Method with respect to the Group's foreign exchange risk in line with CRR requirements.

The following table shows the components and basis of calculation of the Group's and the Bank's own funds.

	The Group €000	The Bank €000
Own funds		
Tier 1		
- Paid up capital instruments	530,772	530,772
- Share premium	49,277	49,277
- Retained earnings*	302,086	302,955
- Accumulated other comprehensive income	9,778	9,666
- Other reserves	40,256	40,256
- Funds for general banking risk	6,323	6,323
- Deductions:		
Other intangible assets	(42,043)	(42,043)
Depositor Compensation Scheme Reserve	(43,060)	(43,060)
Total Tier 1 Capital	853,389	854,146

**Retained earnings include current period profit which is subject to regulatory approval.*

Notes to the financial statements 31 December 2018 (continued)

39. FINANCIAL RISK MANAGEMENT (continued)

39.7 Capital risk management (continued)

	The Group €000	The Bank €000
Tier 2		
- Capital instruments and subordinated loans	133,016	133,016
Total Tier 2 Capital	133,016	133,016
Total Own Funds	986,405	987,162

Further information on the Group's and the Bank's capital adequacy ratios may be found in section 3.2 in the Capital and Risk Management report, which are subject to internal verification as set out in paragraph 1.1 of that report

39.8 Offsetting financial assets and financial liabilities

The derivative financial assets with a positive carrying amount and the derivative financial liabilities with a negative carrying amount do not meet the offsetting criteria in IAS 32 and hence they are presented separately in the Statement of Financial Position. These instruments are subject to the ISDA Master Agreement. The ISDA Master Agreement provides, amongst others, for the netting of termination values for purposes of determining a single lump-sum termination amount upon the insolvency of a counterparty. By virtue of the Set-off and Netting on Insolvency Act, 2003 (Chapter 459, Laws of Malta), the close-out netting provisions contained in the ISDA Master Agreement are valid and enforceable under Maltese law. The set-off provisions under the ISDA Master Agreement can be triggered where an event of default, credit event upon merger or any termination event has been declared.

The Bank also has in place credit support annexes "CSAs" with a number of its financial counterparties for purposes of the collateralisation of exposures between the Bank and its counterparties. The CSA is a schedule to the ISDA Master Agreement. By virtue of such CSAs, a party to a derivative that has an exposure to its counterpart, will post collateral to its counterpart to cover such exposure by way of an outright title transfer of such collateral. All CSAs that the Bank has in place are of a two-way nature.

In the case of non-financial counterparties, the Bank enters into pledging collateral arrangements with the counterparties, in favour of the Bank. Such pledging agreements are of a one-way nature, in favour of the Bank.

	The Group	
	2018 €000	2017 €000
Derivative financial assets		
Gross amounts of recognised financial assets	4,391	7,490
Net amounts of financial assets presented in the statement of financial position	4,391	7,490
Related amounts not set off in the statement of financial position:		
Financial instruments	(4,391)	(7,490)
Net amount	-	-

Financial liabilities subject to offsetting, enforcable master netting arrangements and similar agreements

	The Group 2018 €000	The Group 2017 €000
Derivative financial liabilities		
Gross amounts of recognised financial liabilities	19,018	24,010
Net amounts of financial liabilities presented in the statement of financial position	19,018	24,010
Related amounts not set off in the statement of financial position:		
Financial instruments	(4,391)	(7,490)
Financial collateral pledged	(22,909)	(27,325)
Net amount	(8,282)	(10,805)

Notes to the financial statements 31 December 2018 (continued)

40. ASSETS HELD FOR REALISATION

The assets held for realisation mainly comprise immovable properties that were held as collateral for outstanding loans, which properties were taken into the possession of the Bank following defaults by the counterparty. The Bank's policy is to dispose of such assets within a reasonable timeframe from the date of classification, unless events or circumstances which are beyond the Bank's control extend the period to complete the sale. Such assets meet the criteria for classification as non-current assets held for sale in accordance with IFRS 5. Assets not disposed of during the reasonable timeframe are reclassified to PPE.

During the period ended 31 December 2017, €7.5 million in Assets held for realisation were reclassified to Property and equipment (note 21).

41. TRUST ACTIVITIES

The Group acts as trustee and provides trust activities that result in the holding and placing of assets on behalf of third parties. Trust assets are not assets of the Group and therefore they are not included in its Statement of Financial Position.

Income derived from trust assets is excluded from revenue. Fees arising from the rendering of trustee services are recognised in the Group's profit or loss.

At 31 December 2018, the total assets held by the Group on behalf of its customers amounted to €126.8 million (2017: €173.8 million).

Details on significant claims related to trusts are given in Note 33.

42. REGULATORY COMPENSATION SCHEMES

As at 31 December 2018, no balances with Central Bank of Malta have been pledged in favour of the Depositor Compensation Scheme (refer to note 16).

In accordance with the provisions of the Investor Compensation Scheme Regulations, 2003, issued under the Investment Services Act, 1994, licence holders are required to transfer a variable contribution to an Investor Compensation Scheme Reserve and place the equivalent amount with a bank, pledged in favour of the Scheme. Alternatively licence holders can elect to pay the amount of variable contribution directly to the Scheme.

Bank of Valletta p.l.c. has elected to pay the amount of the variable contribution directly to the Scheme.

Regulatory contributions amounting to €10 million (2017: €8.3 million), included with administrative expenses, reflect the Group's annual obligations arising from the recent EU Directives on Deposit Guarantee Scheme and Single Resolution Fund.

43. EVENTS SUBSEQUENT TO THE FINANCIAL REPORTING DATE

On 13 February 2019, eleven unauthorised international outward payments, denominated in different currencies and totalling to an equivalent of Eur 12.9 million, were discovered by the Bank during a routine reconciliation process. An internal investigation concluded that such payments were the result of a cyber security breach. The Bank continues to conduct its investigation into the incident and has already taken steps to redimension the IT security framework. A number of initiatives have already been put in place. It is concurrently endeavouring to recover the funds remitted as a result of these unauthorised payments. Up to the date of publication, Eur 5.6 million have been or are in the process of being recovered, while legal proceedings have been initiated to recover a further Eur 4.4 million. The recoverability of the remaining Eur 2.9 million is considered to be doubtful, although the Bank is taking all necessary measures to recover its funds, including judicial actions. Other costs are expected to be incurred to cover expenses related directly or indirectly in the resolution of the incident. While such cost cannot, at this point, be reliably estimated, the Bank does not expect this to be a material amount. As a result of this incident, the Bank is not envisaging any impairment charges or the need to set amounts against litigation or other claims. Any amount that is deemed to be irrecoverable will be written off against future profits.

44. REGISTERED OFFICE

The registered and principal office of the Bank is 58, Triq San Żakkarija, Il-Belt Valletta, VLT1130, Malta.

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c.

1 Report on the Audit of the Financial Statements

Opinion

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

In our opinion, the accompanying financial statements:

(a) give a true and fair view of the financial position of the Bank and the Group as at 31 December 2018, and of their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU; and

(b) have been properly prepared in accordance with the provisions of the Companies Act, 1995 (Chapter 386, Laws of Malta) (the "Act") and the Banking Act, 1994 (Chapter 371, Laws of Malta) (the "Banking Act") and, additionally, specifically in relation to those of the Group, with the requirements of Article 4 of the Regulation on the application of IFRS as adopted by the EU.

Basis for opinion

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

Key audit matters

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

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

Impairment allowances on loans and advances to customers at amortised cost, including off-balance sheet elements of the allowance (Group and Bank)

Accounting policy notes 1.4.3 to the financial statements and notes 8, 17, 33, 34 and 39.2 for further disclosures.

'Expected credit loss allowance' on 'Loans and advances to customers at amortised cost' (Bank and Group: €4.4 billion) amounted to €107.1 million. 'Expected credit loss provision' on 'Off-balance sheet credit exposures' (Bank and Group: €2.1 billion) amounted to €18.8 million.

With effect from 1 January 2018, the Group adopted IFRS 9 *Financial Instruments*. That financial reporting standard requires the use of the expected credit loss ("ECL") model to measure impairment allowance on loan exposures, both on and off balance sheet. The calculation of the ECL involves a number of complex, judgemental and highly sensitive assumptions. Our main areas of audit focus in the Group's implementation of IFRS 9 were the following:

- IFRS 9 requires the Group to measure ECL on a forward-looking basis reflecting a range of estimates of future economic conditions. Significant management judgement is present in the selection of forward looking macroeconomic scenarios, the associated scenario probabilities and the material economic variables which drive the scenarios and the related weightings.
- The criteria selected by the Group to identify a significant increase in credit risk ('SICR') within the Group's ECL calculation determines whether a twelve month or lifetime provision is recorded, and is therefore another key area of judgement.
- Complex and inherently judgemental modelling techniques are used to estimate ECLs which involve determining 'Probabilities of Default' ("PD"), 'Loss Given Default' ("LGD") and 'Exposures at Default' ("EAD"). In particular, the PD models used in the loans and advances to customers represent the most significant judgemental element of the Group's ECL modelling approach, being the key drivers of the Group's ECL calculation.

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c. (continued)

Key audit matters (continued)

Impairment allowances on loans and advances to customers at amortised cost, including off-balance sheet elements of the allowance (Group and Bank) (continued)

— Qualitative adjustments to the model-driven ECL results are raised by the Group to address known impairment model limitations or emerging trends. Estimating those adjustments involves significant judgement.
— The carrying value of loans and advances to customers that are individually assessed as stage 3 (that is, credit impaired) requires the identification of loss events and an estimation of the impairment charge. The estimation of expected credit losses includes a range of estimates of future cash flows and valuation of collateral, which are inherently uncertain and judgemental.

The disclosures regarding the application of IFRS 9 are key to understanding the change from IAS 39 as well as explaining the key judgements made, as referred to in this key audit matter, and inputs used to generate the IFRS 9 ECL results.

Our response

- We have tested the design and implementation as well as the operating effectiveness of controls within the ECL process on loans and advances to customers. These included the:
  - sanctioning of facilities in line with the established authorisation limits as per the Group's credit policy;
  - automated control over downgrade of loan credit ratings upon delinquency;
  - monitoring control performed on delinquent personal facilities maintained across the Group; and
  - Provisions Committee bi-annual review of ECL movements, management overlays and other adjustments.

- We involved our own financial risk modelling specialists in evaluating the appropriateness of the Group's IFRS 9 impairment methodologies (including the SICR criteria used). We used our experience of the Group to independently assess PD, LGD and EAD assumptions. For a sample of models we assessed the reasonableness of the model predictions by comparing them against actual results. We made enquiries of the Group as to the reasons for any significant variations identified and assessed the reasonableness of the explanations provided.

- We involved our economics specialists to assist in assessing:
  - the appropriateness of the Group's methodology for determining the macroeconomic scenarios used and the reasonableness of the probability weightings applied to them; and
  - the key macroeconomic variables as well as the accuracy of macroeconomic data feeding the ECL model.

- In evaluating the Group's credit grading process, we performed detailed credit reviews on a sample of corporate exposures selected qualitatively on the basis of risk, including a sample of stage 3 loans and advances to customers. In performing those reviews, we:
  - considered relevant internal information available used in the Group's assessment and, where available, external data in relation to those exposures;
  - evaluated whether those exposures were graded in line with the Group's credit policy; and
  - determined whether a SICR was appropriately identified.

- On a sample of corporate loans and advances to customers, we:
  - performed testing over key data elements (EAD, PD and LGD) impacting the ECL calculations to assess the accuracy of information used;
  - evaluated the qualitative adjustments to key data elements in order to assess the reasonableness of such adjustments by challenging key assumptions, inspecting the calculation methodology and tracing back to source data; and
  - re-performed model calculations for accuracy.

- We assessed whether the disclosures in relation to IFRS 9 adequately explain the key judgements made and significant inputs used in the recognition of expected credit losses as at the beginning and end of the financial reporting period.

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

Litigation and claims (Group and Bank)

Accounting policy notes 1.15 and 1.25.5 to the financial statements and note 33 for further disclosures.

Litigation provision of €77,000,000 (2017: €2,000,000) shown as part of 'Provisions' on the face of 'Statements of financial position' and included within the 'Provisions and Contingencies' note, together with significant claims disclosures.

The Group is exposed to various litigation and claims, which may potentially have a material impact on the financial statements as a whole, and which are subject to varying degrees of complexity.

Significant judgement is involved in determining whether an obligation is a present obligation or a possible one. That assessment determines whether such obligation is recognised as a provision in the statement of financial position, or is disclosed in the notes as a contingent liability. In instances where the directors determine that there is a present obligation, estimating the extent of the future outflow of economic resources is subject to significant estimation uncertainty.

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c. (continued)

Key audit matters (continued)

Litigation and claims (Group and Bank) (continued)

When a liability is not recognised for a possible significant outflow of economic resources, but there is more than a remote likelihood of an adverse outcome, the related disclosure is key to understanding the risks and potential effects on the Group's financial statements.

Our response

We considered the assessment made by the Group's internal legal counsel, the CEO, Chief Finance Officer, Chief Risk Officer and the Chairman of the Board on the (i) status of such claims as well as the (ii) action being taken by the Group in relation to those claims.

Specifically for the significant claims, we were directly provided with written opinions by, and held discussions with, the Group's external legal counsel, and evaluated their views on the outcome of such claims. Additionally, we challenged the directors' best estimate of the provisions recognised by corroborating their responses directly with the Group's external legal advisors.

We assessed whether the financial statements, in relation to the significant claims adequately disclose the amount of provision, the potential liabilities and the significant uncertainties that exist.

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

IT Access Controls (Group and Bank)

Section 8.3 of the Capital and risk management report contained in the Annual Report (unaudited)

Information security risk disclosures included within the Capital and risk management report

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A significant component of the general IT Controls environment is access controls. The objective of those controls relates to the prevention of unauthorised employee access to the Group's applications, operating systems and data in financial reporting processes. An information security function within the Group, which encompasses employee user access, permission and vulnerability reviews ("information security reviews"), is still at its inception stage.

The extent of information security reviews may be impacted by shortage in resources employed by the Group and the number of ongoing IT projects, particularly the Core Banking Transformation project. This project requires significant input from all lines of business as, the directors expect it to be implemented towards the end of 2019.

As part of our audit strategy, we seek to place reliance on a number of IT systems supporting the Group's operations, considering the design, implementation and operating effectiveness of controls existent in those systems (including access controls). Nonetheless, our ability to rely on such controls becomes impaired when deficiencies in access controls over those systems are not mitigated.

Our response

We tested the design, implementation and operating effectiveness of the access controls, set out below, in those systems we deemed relevant for audit purposes:
— creation, modification and revocation of user access rights;
— systems administrator rights;
— adherence to the Bank's password complexity policy; and
— access to migrate application development.

Where the results of our procedures in relation to the above controls were inconclusive, we conducted an additional retrospective review, to evaluate whether, for those automated controls:
— system access granted to employees without prior formal authorisation, was still appropriate; and
— system access assigned to terminated employees was used prior to access rights being revoked.

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

Other information

The directors are responsible for the other information which comprises the:

— Contents and General Information;
— Board of Directors & Group Company Secretary;
— Chairman's Statement;
— Chief Executive Officer's Review;
— Management Board;
— Corporate Social Responsibility;
— Directors' Report;
— Capital and Risk Management Report;
— Corporate Governance Statement of Compliance;

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c. (continued)

Other information (continued)

— Remuneration Report;
— Nominations Report;
— The Group's five year summary; and
— Group's Financial Highlights in US dollars.

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

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

In connection with our audit of the financial statements, our responsibility is to read the other information, and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors for the financial statements

The directors are responsible for the preparation of financial statements that (a) give a true and fair view in accordance with IFRS as adopted by the EU, and (b) are properly prepared in accordance with the provisions of the Act and the Banking Act, and, additionally, specifically in relation to those of the Group, with the requirements of Article 4 of the Regulation on the application of IFRS as adopted by the EU. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

The directors are also responsible for overseeing the financial reporting process.

Auditors' responsibilities for the audit of the financial statements

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

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

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's and the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c. (continued)

Auditors' responsibilities for the audit of the financial statements (continued)

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's and the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company and/or the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

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

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

2 Opinion on the Directors' Report

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

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

Pursuant to article 179(3) of the Act, other than for the non-financial information that is exclusively required to be disclosed by paragraph 8 of the Sixth Schedule of the Act with respect to the Bank, and paragraph 11 of the Sixth Schedule of the Act with respect to the Group (and on which we report separately below in our 'Report on Other Legal and Regulatory Requirements'), we are also required to:

- express an opinion on whether the directors' report has been prepared in accordance with the applicable legal requirements; and

- state whether, in the light of the knowledge and understanding of the entity and its environment obtained in the course of our audit of the financial statements, we have identified material misstatements in the directors' report, giving an indication of the nature of any such misstatements.

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

In such regards:

- in our opinion, the directors' report has been prepared in accordance with the applicable legal requirements;

- we have not identified material misstatements in the directors' report; and

- we have nothing to report in relation to the statement on going concern.

Independent auditors' report to the Shareholders of Bank of Valletta p.l.c. (continued)

3 Report on Other Legal and Regulatory Requirements

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

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

- we were first appointed as auditors by the shareholders on 19 June 2015, and subsequently reappointed at the Company's general meetings for each financial year thereafter. The period of total uninterrupted engagement is four years;
- our opinion on our audit of the financial statements is consistent with the additional report to the audit committee required to be issued by the Audit Regulation (as referred to in the Act); and
- we have not provided any of the prohibited services as set out in the APA.

Matters on which we are required to report by the Act, specific to large undertakings which are public-interest entities and public-interest entities which are parent undertakings of a large group that (individually and on a consolidated basis, respectively) exceed the criterion of an average number of five hundred employees during the financial year

Pursuant to article 179(3) of the Act, we report as under matters not already reported upon in our 'Opinion on the Directors' Report:

The Directors' Report contains the information required by paragraph 8 of the Sixth Schedule, with respect to the Bank and paragraph 11 of the Sixth Schedule with respect to the Group.

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

Pursuant to article 31(3)(a), (b) and (c) of the Banking Act, in our opinion:

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

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

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

The Principals authorised to sign on behalf of KPMG on the audit resulting in this independent auditors' report are Noel Mizzi and Jonathan Bingham.

Noel Mizzi
Partner, for and on behalf of
KPMG
Registered Auditors,
Portico Building,
Marina Street,
Pietà PTA 9044,
Malta

Jonathan Bingham
Partner, for and on behalf of
KPMG LLP
Chartered Accountants,
15 Canada Square,
Canary Wharf,
London E14 5GL,
United Kingdom

15 March 2019

The Group's five year summary - extracted from the respective audited financial statements

A. STATEMENTS OF PROFIT OR LOSS

For the financials periods

	2018 12 months to Dec 2018 €000	2017 15 months to Dec 2017 €000	2016 12 months to Sep 2016 €000	2015 12 months to Sep 2015 €000	2014 12 months to Sep 2014 €000
Interest and similar income	213,896	259,194	214,258	215,612	212,925
Interest expense	(57,350)	(76,247)	(65,429)	(70,834)	(86,922)
Net interest income	156,546	182,947	148,829	144,778	126,003
Other operating income	101,220	117,526	101,756	102,093	83,802
Gain on Visa transaction	-	-	27,511	-	-
Other operating charges	(130,598)	(151,251)	(112,778)	(108,032)	(93,499)
Net impairment reversals/(losses)	10,816	6,227	(23,142)	(32,710)	(19,431)
Litigation Provision	(75,000)	-	-	-	-
Share of results of equity-accounted investees	8,214	19,287	3,730	11,786	7,227
Profit before tax	71,198	174,736	145,906	117,915	104,102
Income tax expense	(19,788)	(55,238)	(50,708)	(37,971)	(34,718)
Profit for the period	51,410	119,498	95,198	79,944	69,384
Attributable to:					
Equity holders of the Bank	51,410	119,498	94,742	79,378	68,945
Non-controlling interest	-	-	456	566	439
	51,410	119,498	95,198	79,944	69,384
Earnings per share	09c7	27c1	21c6	18c1	15c7

The earnings per share figures for the 12 months to December 2018 have been adjusted to reflect the increase in the number of ordinary shares following the scrip issue on 19 May 2018.

The earnings per share figures have been adjusted retrospectively to reflect the increase in the number of ordinary shares following capitalisation of retained earnings and a bonus issue which occurred on 16 January 2017 and a rights issue which occurred on 31 December 2017.

The Group's five year summary - extracted from the respective audited financial statements (continued)

B. STATEMENTS OF FINANCIAL POSITION

	2018	2017	2016	2015	2014
	€000	€000	€000	€000	€000
ASSETS					
Balances with Central Bank of Malta, treasury bills and cash	246,299	159,684	171,050	126,652	130,966
Investments and financial assets at fair value through profit or loss	3,521,161	3,700,832	4,128,702	3,793,827	2,950,011
Loans and advances to banks	3,644,933	3,431,383	2,098,439	1,656,346	1,045,988
Loans and advances to customers	4,362,983	4,162,032	4,001,656	4,001,839	3,861,532
Investments in equity-accounted investees	108,510	109,461	97,041	96,904	88,553
Property and equipment	161,198	133,675	102,846	102,523	99,759
Current tax	7,606	12,034	16,061	965	-
Deferred tax	71,769	60,217	67,188	86,654	78,550
Assets held for realisation	4,335	5,972	11,973	11,601	9,755
Other assets	7,880	5,955	4,818	2,990	7,659
Prepayments and accrued income	10,314	39,385	23,077	21,661	24,018
Total Assets	**12,146,988**	**11,820,630**	**10,722,851**	**9,901,962**	**8,296,791**
LIABILITIES					
Financial liabilities at fair value through profit or loss and derivatives held for hedging	19,018	24,010	40,976	60,278	81,812
Amounts owed to banks	146,021	192,196	250,155	197,760	86,579
Amounts owed to customers	10,414,908	10,100,625	9,181,047	8,559,731	7,119,530
Debt securities in issue	40,197	95,400	95,400	95,400	95,400
Current tax	-	-	-	-	16,090
Deferred tax	5,743	4,519	4,318	4,382	5,100
Other liabilities	196,421	195,751	173,988	172,905	130,168
Provisions	95,767	2,000	-	-	-
Accruals and deferred income	539	12,451	16,215	21,317	27,643
Subordinated liabilities	234,241	231,591	231,591	120,000	120,000
Total Liabilities	11,152,855	10,858,543	9,993,690	9,231,773	7,682,322
EQUITY					
Called up share capital	530,772	525,000	390,000	360,000	330,000
Share premium account	49,277	45,427	988	988	988
Revaluation reserve	50,034	33,194	35,332	35,217	29,136
Retained earnings	364,050	358,466	302,841	272,713	253,245
Total Equity attributable to equity holders of the Bank	994,133	962,087	729,161	668,918	613,369
Non-controlling interest	-	-	-	1,271	1,100
Total Equity	994,133	962,087	729,161	670,189	614,469
Total Liabilities and Equity	**12,146,988**	**11,820,630**	**10,722,851**	**9,901,962**	**8,296,791**
MEMORANDUM ITEMS					
Contingent liabilities	335,405	253,851	225,407	251,670	233,451
Commitments	1,881,392	1,858,191	1,590,156	1,612,122	1,647,091

The Group's five year summary - extracted from the respective audited financial statements (continued)

C. STATEMENTS OF CASH FLOWS

	2018 €000	2017 €000	2016 €000	2015 €000	2014 €000
Net cash from operating activities	251,776	1,020,077	768,054	1,124,108	766,887
Cash flows from investing activities					
Dividends received from equity shares	10,774	8,794	5,628	5,808	4,926
Interest received from investing securities	54,953	74,725	59,783	58,998	45,394
Acquisition of non-controlling interest	-	-	(5,000)	-	-
Purchase of equity investments	-	-	-	(100)	(200)
Proceeds from Visa transaction	-	-	22,042	-	-
Proceeds from sale of equity instruments	12,296	4,350	3,043	-	-
Net increase in investment securities	129,240	258,283	(388,362)	(853,476)	(692,500)
Purchase of property and equipment	(26,295)	(33,341)	(8,111)	(9,132)	(14,649)
Proceeds on disposal of property and equipment	2,000	-	598	-	8
Net cash from/(used in)investing activities	182,968	312,811	(310,379)	(797,902)	(657,021)
Cash flows from financing activities					
Proceeds from rights issue	-	149,439	-	-	-
Interest paid on debt securities and subordinated liabilities	(13,414)	(17,875)	-	-	-
Proceeds from issue of subordinated bonds	-	-	111,591	-	-
Repayment of debt securities	(55,400)	-	-	-	-
Dividends paid	(17,678)	(33,883)	(30,575)	(29,362)	(34,466)
Net cash (used in)/from financing activities	(86,492)	97,681	81,016	(29,362)	(34,466)
Increase in cash and cash equivalents	348,252	1,430,569	538,691	296,844	75,400

D. PERFORMANCE EXPRESSED IN RELATION TO AVERAGE TOTAL ASSETS AND AVERAGE CAPITAL EMPLOYED

	2018 %	2017 %	2016* %	2015 %	2014 %
Operating income to total assets	2.2	2.1	2.4	2.7	2.7
Operating expenses to total assets	1.1	1.1	1.1	1.2	1.2
Profit before tax to total assets	0.6	1.2	1.1	1.3	1.3
Profit before tax to capital employed	7.3	16.5	16.9	18.4	17.5
Profit attributable to equity holders to total assets	0.4	0.8	0.7	0.9	0.9
Profit attributable to equity holders to capital employed	5.3	11.3	11.0	12.4	11.6

Ratios exclude gain on Visa transaction.

Group Financial Highlights in US dollars 31 December 2018

The following figures were converted from Euro to US Dollars using the rate of exchange ruling on 31 December 2018. The rate used was €1 = US$ 1.1453. This does not reflect the effect of the change in the rate of exchange since 31 December 2017 which was €1 = US$ 1.1986.

	2018	2017
	US$000	US$000
Net income attributable to equity holders of the Bank	58,880	143,230
Net income per share	11c	33c
Gross dividend paid	48,103	62,481
Net dividend paid	31,267	40,612
Gross dividend per share	9c	14c
Total assets	13,911,945	14,168,207
Liquid funds	282,086	191,397
Investments and financial assets at fair value through profit or loss	4,032,786	4,435,817
Advances	9,171,466	9,101,467
Investments in equity-accounted investees	124,277	131,200
Share capital	607,893	629,265
Capital reserves	113,741	94,235
Retained earnings	416,946	429,657

Notes