IZOLA BANK

PILLAR 3 DISCLOSURES

2009

Company Registration Number: C 16343

Contents Page

1 Introduction

1.1 Background to Pillar 3 disclosures

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

Nature of Disclosures

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

The Annual Report of Izola Bank Limited has been filed with the MFSA Registry of Companies and the MFSA Banking Unit. These Pillar 3 disclosures refer to financial year ending 31st December 2009 and can be found on the Bank's website at http://www.izolabank.eu. As from financial year ending 31st December 2010 the disclosures will be published in the Annual Report.

The Bank has in place a formal policy to comply with the disclosure requirements laid down in Banking Rule BR/07/2009. The Directors, after due consideration of the size and complexity of the Bank, do not feel it necessary to produce Pillar 3 disclosures more frequently than annually.

Banking Rule BR/07/2009 requirements are incorporated in this document if they are deemed relevant for the Bank and have not been disclosed elsewhere, in particular in the Bank's Annual Report for 2009.

The disclosures are not subject to an external audit except where they are equivalent to those prepared under IFRS requirements in the Bank's Annual Report. The Bank's management is responsible for the verification of these Pillar 3 disclosures. They are also subject to review and verification by the Bank's Audit Committee.

2 Risk Management Objectives and Policies

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

Business risk

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

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

Concentration risk

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

The Bank recognizes that credit concentration risk is present in the Bank's factoring business in view of the fact that factored debtors are active in the property, building and construction sector. Credit concentration risk is mitigated by the Group's vast experience in this sector and local and in depth knowledge of the customer base. The Bank is fully able to take advantage of this experience and local knowledge.

2 Risk Management Objectives and Policies (continued)

Operational risk

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

Interest rate risk in the non-trading book

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

3 Board and Committee Structure

The Bank's Board of Directors comprises 3 executive directors and 6 non-executive directors. In addition to the Board and Board Committee, there are two Board appointed committees, the Credit Committee and the Audit Committee, which report directly to the Board.

Board Committee

Composition: The Board Committee comprises four directors.

Main Functions: The Board Committee performs and executes the authorisation powers normally attributed to the Board except for policy decisions.

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

Credit Committee

Composition: A minimum of 2 non-executive directors

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

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

3 Board and Committee Structure (continued)

Audit Committee

Composition: A minimum of 2 non-executive directors

Main Functions: The Committee provides independent review, monitoring and assessment of:

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

Frequency: The Committee meets at least three times a year

4 Own Funds

During the year ended 31st December 2009, the Bank complied with all of the externally imposed capital requirements to which it was subject.

The following table summarises the composition of the Bank's regulatory capital as reported to the MFSA as at 31st December 2009.

Table 3.1 Capital Resources as reported to MFSA as at 31 December 2009

BR03 Ref		Note	As at 31/12/2009 € 000s
1.0.0	**ORIGINAL OWN FUNDS**		
1.1.1	Ordinary shares	i	4,000
1.1.6	Profit and loss account	ii	55
1.1.7	Interim profits (eligible for inclusion)	iii	1,398
1.1.10	Capital Contribution	iv	7,449
1.2.0	**Deductions**		**0**
1.2.11	**Total Original Own Funds**		**12,902**
2.0.0	**ADDITIONAL OWN FUNDS**		**0**
2.3.3.1	Revaluation reserves	v	640
2.1.9	General provision for bad and doubtful debts		55
2.2.0	**Total Additional Own Funds**		**695**
3.0.0	**TOTAL GROSS OWN FUNDS**		**13,597**
4.0.0	**SUPPLEMENTARY OWN FUNDS**		0
4.2.0	**Deductions**		0
4.3.0	**Total Supplementary Own Funds**		**0**
5.0.0	Deduction of holdings in other credit/financial institution		0
6.0.0	**TOTAL OWN FUNDS**		**13,597**

4 Own Funds (continued)

Composition of Own Funds

i. Ordinary Shares: At 31 December 2009, the authorised and issued share capital comprised 160,000 ordinary shares of EUR25 each. All shares in issue are fully paid up. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings of the bank.

ii. Profit and Loss Account: this includes the balance available for distribution to the shareholders.

iii. Interim profits: this includes the balance available for distribution to the shareholders.

iv. Capital Contribution: this represents a contribution, to the distributable reserves of the Bank, by the shareholders.

v. Revaluation Reserve: this represents reserves arising from the revaluation of tangible fixed assets.

5 Capital Adequacy

5.1 Internal Capital Adequacy Assessment Process (ICAAP)

ICAAP Methodology

The Bank's latest ICAAP report is based on 31st December 2008 figures.

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

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

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

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

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

5.2 Credit Risk Capital Requirements by Standardised Approach Exposure Class

Table 5.1 Capital Requirement by exposure class as at 31 December 2009

	Capital Requirement € 000s
Central Government or Central Banks	0
Corporates	625
Institutions	180
Other	214
Total	**1,019**

5 Capital Adequacy (continued)

5.3 Market Risk Capital Requirement

The market risk capital requirement of the Bank is not significant, comprising a foreign exchange risk charge of €1,860.

5.4 Operational Risk Capital Requirement

The gross income registered by the Bank in 2007, 2008 and 2009 amounted to EUR2,490,671, EUR2,144,979 and EUR2,441,822 respectively. The operational risk capital requirement for 2009 amounted to EUR353,874.

6 Credit Risk

6.1 Credit risk

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

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

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

Impaired factored receivables

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

Table 6.1 Allowance for impairment on factored receivables

	2009 EUR	2008 EUR
Factored receivables - gross	**5,393,564**	4,409,380
Collectively determined	**5,393,564**	4,409,380
Allowance for impairment	**54,646**	46,862

Past due but not impaired

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

At 31 December 2009, 15% of the bank's factored receivables were past due but not impaired.

Table 6.2 Neither past due nor impaired loans and securities

	2009 EUR	2008 EUR
Loans and advances to customers	**21,140,261**	15,030,861
Loans and advances to banks	**11,219,096**	9,788,398
Investment securities	**28,945,952**	26,307,844
	61,305,309	51,127,103

6 Credit Risk (continued)

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

Allowances for impairment

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

	2009 EUR	2008 EUR
Factored receivables		
Collective allowance for impairment	**54,646**	46,862

Table 6.3 Total period end and average exposures after individual impairment and prior to credit risk mitigation by exposure class

	Exposure as at 31/12/2009 € 000s	Average Exposure for period to 31/12/2009 € 000s
Central Government or Central Banks	2,345	1,862
Corporates	53,585	61,525
Institutions	11,220	6,913
Other	3,323	3,107
Total	**70,473**	**73,408**

Table 6.4 Geographic distribution of exposure classes

	Malta € 000s	Europe € 000s	Rest of the World € 000s	Total € 000s
Central Government or Central Banks	2,345	-	-	2,345
Corporates	-	53,583	2	53,585
Institutions	156	7,957	3,107	11,220
Other	2,097	1,058	168	3,323
Total	**4,598**	**62,598**	**3,277**	**70,473**

Table 6.5 Distribution of the exposures by industry/counterparty type

	Central Government or Central Banks € 000s	Corporates € 000s	Institutions € 000s	Other € 000s	Total € 000s
Monetary Financial Institutions	2,345	-	11,220	1	13,566
Manufacturing	-	14,515	-	82	14,597
Wholesale and retail trade	-	20,917	-	825	21,742
Real estate, renting and business activities	-	6,154	-	214	6,368
Construction	-	10,676	-	27	10,703
Education	-	6	-	2	8
Other	-	1,317	-	2,172	3,489
Total	**2,345**	**53,585**	**11,220**	**3,323**	**70,473**

6 Credit Risk (continued)

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

Table 6.6 Residual Maturity Breakdown of the exposures

	< 1 year € 000s	1 – 5 years € 000s	> 5 years € 000s	Total € 000s
Central Government or Central Banks	2,345	-	-	2,345
Corporates	36,223	8,617	8,745	53,585
Institutions	11,220	-	-	11,220
Other	3,323	-	-	3,323
Total	**53,111**	**8,617**	**8,745**	**70,473**

6.4 Past Due Exposures and Impaired Assets

Table 6.7 Impaired, past due exposures and provisions by industry sector

Standardised exposure classes	Individual & collective provision € 000s	Charged to income statement in the year ended 31 December 2009 € 000s
Central Government or Central Banks	-	-
Corporates	55	8
Institutions	-	-
Other	-	-
Total	**55**	**8**

Table 6.8 Impaired, past due exposures and provisions by geographic area

Standardised exposure classes	Individual & collective provision € 000s	Charged to income statement in the year ended 31 December 2009 € 000s
Malta	-	-
Europe	55	8
Rest of the World	-	-
Total	**55**	**8**

Table 6.9 Movement in allowances for impaired and past due exposures and provisions

	Individual & collective provision € 000s
Opening balance	47
Amounts written off	-
Charged to income statement	8
Closing balance	**55**

7 Standardised Approach to Credit Risk

7.1 Exposure to Institutions

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

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

Table 7.1 Institutions

Credit Quality Step	Risk Weight	Banking Regulation	Exposure € 000s	Exposure After CRM € 000s
1	20%	Fitch AAA to AA -	11,220	11,220

7.2 Exposure to Central Goverment and Central Bank

Exposures to central government and central bank denominated and funded in the domestic currency of the central government and central bank are assigned a risk weight of 0% in line with BR/04/2007 (Appendix 2).

Table 7.1 Central Government and Central Bank

Credit Quality Step	Risk Weight	Banking Regulation	Exposure € 000s	Exposure After CRM € 000s
1	0%	BR/04/2007	2,345	2,345

7.3 Corporates

Corporate exposures have a 0% risk weighting as they are cash secured.

Table 7.3 Corporates

Credit Quality Step	Risk Weight	Banking Regulation	Exposure € 000s	Exposure After CRM € 000s
1	0%	BR/04/2007	45,819	0

8 Market Risk

8.1 Market Risk

Market risk is disclosed in note 4.5 of the Annual report of 2009.

8.2 Liquidity Risk

Liquidity risk is disclosed in note 4.6 of the Annual Report of 2009.

8.3 Foreign exchange risk

Foreign exchange risk is disclosed in note 4.5.2 of the Annual Report of 2009.

9 Operational Risk

Operational risk is disclosed in note 4.2 and 4.7 of the Annual Report of 2009.

10 Exposure To Interest Rate Risk In The Non-Trading Book

Interest risk is disclosed in note 4.5.1 of the Annual Report of 2009.

11 Credit Risk Mitigation

11.1 Collateral

Analysis of collateral is disclosed in Note 4.4.3 of the Annual Report 2009.

***Table 11.1** Exposure value covered by eligible financial collateral*

	€ 000s
Central Government or Central Banks	-
Corporates	45,021
Institutions	-
Other	-
Total	**45,021**

12 Conclusion

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

In the event that a user of this disclosure document should require further explanation on the disclosures given, application should be made in writing to The Financial Controller, Izola Bank Limited, 53/58 East Street, Valletta VLT 1251, Malta.

IZOLA BANK

Izola Bank p.l.c.
53/58, East Street,
Valletta VLT 1251
Malta.

T: +356 21 241 258
F: +356 21 241 250

info@izolabank.eu
www.izolabank.eu