

Annual Report &  
Financial Statements  
**2017**



**izola Bank**





**izola Bank**

Annual Report  
**2017**



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# Chairperson's Statement

For the Year Ended 31 December 2017

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I am pleased to present the Bank's results for the year ended 31 December 2017.

## Review of performance

During the year ended 31 December 2017, the Bank generated a profit before tax of €3,556,931 down 4% on 2016. Profit after tax was €2,261,404, in line with the previous year.

Net interest income decreased by 10% whilst net fee and commission income registered a 29% increase compared to the previous year. This is a result of growth in factoring activities. These were complemented by a 26% improvement in other operating income which is mainly comprised of gains on investment. As a result, total operating income improved by 15.8% over 2016.

Personnel expenses and other administrative expenses increased by 35% in the year under review. This increase was mainly due to increases in the staff complement of the Bank, additional insurance expenses incurred to cover a substantial portion of the credit risk arising from the Bank's factoring portfolio, increases in regulatory and compliance costs and increased marketing spend to support the growth in factoring business. As a result of these increases, the Bank's Cost-to-Income ratio rose to close the year at 46.2% (2016: 40.9%).

## Review of financial position

Total assets increased by 5% to €206,629,804 whereas total liabilities rose from €168,951,393 to €177,157,964 – an increase of 5%. Shareholders' equity amounted to €29,471,840 compared with €28,468,558 of a year earlier.

As at 31 December 2017, the Capital Adequacy Ratio of 26% and Liquidity Ratio of 70% were both well above European banking sector norms.

Net impairment allowances amounting to €349,741 were taken in 2017 compared to €28,431 in 2016. These allowances are mostly collective allowance due to the growth in the Bank's factoring and lending portfolio and are not related to any deterioration in credit quality of the Bank's assets. The current credit approval and monitoring structures have helped to ensure very good credit quality of factoring debtors with minimal losses. In fact, out of a total amount of €152,179,351 of net factoring turnover in 2017, the Bank has only incurred bad debts of €89,020 during the year.

## Looking ahead

The Bank is committed to continue seeking further growth in its factoring operations in Belgium, mainly through its online factoring services named Izola Factor launched in mid-2016, together with growth in domestic loans and advances to customers through niche lending.

## Conclusion

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



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

22 March 2018

The directors have prepared this report for Izola Bank p.l.c (“the Bank”) in accordance with Article 177 of the Companies Act 1995 (Chapter 386, Laws of Malta) (“the Act”) including the further provisions as set out in the sixth schedule of the Act, together with the financial statements of the Bank for the year ended 31 December 2017.

#### **Board of directors**

Mrs. Magdalena De Roeck (Chairperson)  
Ms. Caroline Van Marcke  
Mr. Joseph C. Caruana (i)  
Mr. Francis Gouder (i)  
Mr. Charles Hertogs (i)  
Mr. Guido Mizzi (i)  
Mr. Patrick H. Van Leynseele (i)

(i) independent directors

#### **Company secretary**

Mr. Calvin Bartolo

#### **Principal activities**

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

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

#### **Review of business developments, financial performance and future developments**

During the accounting period under review, the Bank continued growing its retail customer depositor base and continued building on the online factoring platform launched in the Belgian market in mid-2016. Initial customer feedback about this product during the first year of operation has been very encouraging.

The Bank reported a profit after tax of €2,261,404 for the year under review. Total assets stood at €206,629,804 as at year end. Other results may be referred to in the Statement of Financial Position and Statement of Profit or Loss and Other Comprehensive Income on pages 1 and 2 respectively.

The Bank also carried on developing niche lending services both in Malta and abroad and intends to continue building on this in the years ahead.

#### **Principal risks and uncertainties**

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

## Directors' Report

For the Year Ended 31 December 2017

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

### Directors' responsibilities

The Companies Act, 1995 (Chapter 386, Laws of Malta) (the 'Act') requires the directors of Izola Bank p.l.c. to prepare financial statements for each financial period which give a true and fair view of the financial position of the Bank as at the end of the financial year and of the profit or loss of the Bank for that period in accordance with the requirements of International Financial Reporting Standards as adopted by the EU.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy, at any time, the financial position of the Bank and to enable them to ensure that the financial statements have been properly prepared in accordance with the provisions of the Act and the Banking Act, 1994 (Chapter 371, Laws of Malta).

The directors are also responsible for safeguarding the assets of the Bank and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors, through oversight of management, are responsible to ensure that the Bank establishes and maintains internal control to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Management is responsible, with oversight by the directors, to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the Bank's business. This responsibility includes establishing and maintaining controls pertaining to the Bank's objective of preparing financial statements as required by the Act and managing risks that may give rise to material misstatements in those financial statements. In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud.

### Events occurring after reporting date

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



#### **Dividends and reserves**

The directors have proposed a final dividend of €2,150,000 in respect of 2017, representing a dividend per share of €5.375.

#### **Information pursuant to Listing Rule 5.64**

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

#### **Information pursuant to Listing Rule 5.70.1**

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

Further details can be found within note 29 of the Financial Statements.

#### **Going concern**

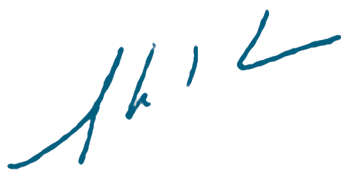
As required by Listing Rule 5.62, upon due consideration of the Bank's profitability, financial position, capital adequacy and solvency, the directors confirm the Bank's ability to continue operating as a going concern for the foreseeable future.

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

#### **Auditors**

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

Approved by the Board of Directors on 22 March 2018 and signed on its behalf by:



Mrs. Magdalena De Roeck  
Chairperson/Director



Mr. Guido Mizzi  
Director

#### **Registered Address**

53-58 East Street  
Valletta  
Malta  
Tel: +356 2124 1258

## Statement by the Directors

on the Financial Statements included in the Annual Report

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

Signed on behalf of the Board of Directors on 22 March 2018 by:



Mrs. Magdalena De Roeck  
Chairperson/Director



Mr. Guido Mizzi  
Director

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

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## **Introduction**

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

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

## **PART ONE - Compliance with the Code**

### **Principle 1: The Board**

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

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

### **Principle 2: Chairperson and Chief Executive**

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

### **Principle 3: Composition of the Board**

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

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

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

# Directors' Statement of Compliance

with the Code of Principles of Good Corporate Governance

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## Principle 4: Responsibilities of the Board

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

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

The Board delegates specific responsibilities to the following Committees:

### BOARD COMMITTEES

#### Board Committee

The Board Committee is composed of two directors and the CEO and meets on an ad hoc basis. The Board Committee acts in an advisory capacity to the Board.

	Meetings held: 1
<b>Members</b>	<b>Attended</b>
Mrs. Magdalena De Roeck (Chairperson)	1
Ms. Caroline Van Marcke	1
Mr. Andrew Mifsud	1

#### Audit Committee

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

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

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

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

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

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

Other Board members have a right to attend the meetings. The Head of Finance, Treasury and Compliance is responsible for the maintenance of internal controls and attends all meetings. The Head of IT, who is responsible for the maintenance of internal controls in relation to ICT, attends meetings when ICT-related topics are discussed. Both the internal and external auditors are also invited to attend meetings on an ad-hoc basis.

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

#### **Credit Committee**

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

<b>Members</b>	Meetings held: 4 <b>Attended</b>
Mr. Joseph Caruana (Chairman)	4
Mr. Francis Gouder	4
Mr. Andrew Mifsud	4

The Head of Credit and Risk attends meetings of the Credit Committee and acts as Secretary to the Committee.

#### **Management Committee**

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

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

The ALCO is composed of one independent non-executive director, the CEO, the Head of Finance, Treasury and Compliance and Finance Assistant Manager.

<b>Members</b>	Meetings held: 4 <b>Attended</b>
Mr. Andrew Mifsud (Chairman)	4
Mr. Francis Gouder	4
Mr. Calvin Bartolo	4
Mr. Karl Cachia	4

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

During the financial year 2017 the Board met four times. Notice of the dates of forthcoming meetings together with all board papers were circulated well in advance to the directors so that they had ample opportunity to consider the information and prepare for the next scheduled board meeting. After each board meeting and before the next meeting, minutes that faithfully record attendance and decisions were prepared and circulated to all directors.

# Directors' Statement of Compliance

with the Code of Principles of Good Corporate Governance

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## Principle 5: Board Meetings (Continued)

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

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

## Principle 6: Information and Professional Development

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

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

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

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

## Principle 8: Committees

As is permitted in terms of provision 8.A.2 of the Code, the Board carries out the tasks normally delegated to a Remuneration Committee since the remuneration of directors is not performance-related. More detailed information regarding remuneration is presented in the Remuneration Statement following this Statement of Compliance with the Code of Principles of Good Corporate Governance.

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

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

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

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

**Principle 11: Conflicts of Interest**

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

Each director has declared to the Bank, where applicable, his or her indirect beneficial interest in the share capital of the Bank.

**Principle 12: Corporate Social Responsibility**

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

# Directors' Statement of Compliance

with the Code of Principles of Good Corporate Governance

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## **PART TWO – Non-Compliance with the Code**

### **Principle 2 – Code Provision 2.3**

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

### **Principle 3 – Composition of the Board**

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

### **Principle 4 – Code Provision 4.2.7**

The Code Provision recommends that the Board should develop a succession policy for the future composition of the Board and particularly the executive component thereof, for which the Chairman should hold key responsibility. The Board does not have a succession policy in place for the future composition of the Board of Directors.

### **Principle 4 – Code Provision 4.3**

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

### **Principle 6 – Information and Professional Development**

Code Provision 6.4.4 recommends the CEO to establish a succession plan for senior management. The Board does not have a succession policy in place for senior management.

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

The Board does not consider it necessary to appoint a Committee to carry out an annual evaluation of its own performance and that of its Committees. This position will be reviewed in line with growth in future business and level of operational complexity.



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

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

**Listing Rule 5.97.4**

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

Approved by the Board of Directors on 22 March 2018 and signed on its behalf by:



Mrs. Magdalena De Roeck  
Chairperson/Director



Mr. Guido Mizzi  
Director

# Remuneration Report

For the Year Ended 31 December 2017

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## For the Year Ended 31 December 2017

As is permitted in terms of provision 8.A.2 of the Code, the Board carries out the tasks normally delegated to a Remuneration Committee since the remuneration of directors is not performance-related.

### Remuneration Policy

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

### Remuneration Statement

#### Executive Management

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

The terms and conditions of employment of senior management are set out in the respective indefinite contracts of employment. Senior management are not entitled to share options or profit sharing. There are no supplementary pension or early retirement schemes in place. Senior management are eligible for an annual salary increase and performance bonus.

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

Loans amounting to €270,000 was advanced to key management personnel as disclosed in note 29.3 to the financial statements.

There have been no significant changes in the Bank's remuneration policy for senior management during the year under review. During the course of 2018, the Bank intends to start offering all staff members, including senior management, home loans at a reduced rates and a contribution to a personal pension scheme.

Total emoluments of senior management for the year ended 31 December 2017 are as follows:

Fixed Remuneration	Variable Remuneration	Share Options	Others
€247,633	€98,984	None	Non-cash benefits referred to immediately above.

### Directors

As at 31 December 2017, the Board was composed of 7 non-executive directors.

The maximum annual aggregate emoluments that may be paid to the directors is approved by the shareholders in a General Meeting. This amount was fixed at an aggregate sum of €60,000 at the Annual General Meeting held on 4 April 2017.

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

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

Total emoluments of directors for the year ended 31 December 2017 are as follows:

<b>Fixed Remuneration</b>	<b>Variable Remuneration</b>	<b>Share Options</b>	<b>Others</b>
€46,000	None	None	None



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## **Independent Auditors' Report**

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

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

We are required, pursuant to Listing Rule 5.98, to express an opinion to the shareholders of Izola Bank p.l.c (the "Bank" or the "Company") on specific disclosures in the Annual Report which relate to the directors' corporate governance statement (the "Disclosures") for the year ended 31 December 2017.

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

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

### ***Responsibilities of the Directors***

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

### ***Auditors' responsibilities***

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

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

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

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

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



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## **Independent Auditors' Report (continued)**

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

### ***Auditors' responsibilities***

We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants, together with the ethical requirements that are relevant to our audit of the financial statements in accordance with the Accountancy Profession (Code of Ethics for Warrant Holders) Directive issued in terms of the Accountancy Profession Act (Chapter 281, Laws of Malta), 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 Company's corporate governance procedures or its risks and control procedures, nor on the ability of the Company to continue in operational existence. Our opinion in relation to the disclosures pursuant to Listing Rule 5.97.4 is based solely on our knowledge and understanding of the Company and its environment obtained in forming our opinion on the audit of the financial statements. We have not performed any procedures by way of audit, verification or review on the underlying information from which the disclosures required by Listing Rule 5.97.7 is derived.

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

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

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

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



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### Independent Auditors' Report (*continued*)

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

#### **Conclusion**

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

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

In our opinion:

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

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



**KPMG**  
Registered Auditors

22 March 2018

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

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# Statement of Financial Position

As at 31 December 2017

		2017	2016
ASSETS	Note	€	€
Cash and items in transit	27	2,587	2,084
Balances with Central Bank of Malta	27	1,948,344	10,351,518
Investments	13	57,213,412	66,925,325
Loans and advances to banks	14	20,079,499	31,788,316
Factored receivables	15	48,583,631	20,237,200
Other loans and advances to customers	16	65,524,805	61,350,109
Property and equipment	17	10,343,320	3,226,026
Intangible assets	18	1,634,529	1,560,192
Other assets	19	1,299,677	1,979,181
<b>Total assets</b>		<b>206,629,804</b>	<b>197,419,951</b>
LIABILITIES			
Balance owed to Central Bank of Malta		16,300,000	21,300,000
Amounts owed to customers	20	145,767,422	132,337,023
Debt securities issued	21	11,871,811	11,854,721
Deferred tax liabilities	22	724,009	1,579,636
Current tax payable		1,154,671	549,126
Accruals and deferred income	23	1,340,051	1,330,887
<b>Total liabilities</b>		<b>177,157,964</b>	<b>168,951,393</b>
EQUITY			
Called up share capital	24	10,000,000	10,000,000
Property revaluation reserve	24	2,657,412	961,468
Fair value reserve	24	876,876	2,663,593
Depositor compensation scheme reserve	24	354,523	238,387
Reserve for general banking risk	24	36	217
Capital contribution	24	12,532,675	11,436,521
Retained earnings	24	3,050,318	3,168,372
<b>Total equity attributable to equity holders of the Bank</b>		<b>29,471,840</b>	<b>28,468,558</b>
<b>Total liabilities and equity</b>		<b>206,629,804</b>	<b>197,419,951</b>
Memorandum items			
Commitments	25	60,202,304	42,580,312

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

The financial statements on pages 1 to 59 were approved by the Board of Directors on 22 March 2018 and signed on its behalf by:



Mrs. Magdalena De Roeck  
Director



Mr. Guido Mizzi  
Director



## Statement of Profit or Loss and Other Comprehensive Income

For the Year Ended 31 December 2017

	Note	2017 €	2016 €
Interest income and similar income			
- on loans and advances	5	<b>2,833,782</b>	<b>2,655,329</b>
- on debt securities		<b>1,492,274</b>	1,637,418
Interest expense and similar charges	6	<b>(2,544,779)</b>	(2,314,406)
<b>Net interest income</b>		<b>1,781,277</b>	1,978,341
Fee and commission income	7	<b>3,232,820</b>	2,499,484
Fee and commission expense	7	<b>(61,485)</b>	(61,108)
<b>Net fee and commission income</b>		<b>3,171,335</b>	2,438,376
Net trading gains		<b>14,615</b>	25,859
Other operating income	8	<b>2,135,004</b>	1,692,092
<b>Operating income</b>		<b>7,102,231</b>	6,134,668
Depreciation and amortisation	17 & 18	<b>(453,578)</b>	(353,378)
Impairment allowances	9	<b>(349,741)</b>	(28,431)
Personnel expenses	10.2	<b>(1,151,639)</b>	(930,754)
Other expenses	10.4	<b>(1,590,342)</b>	(1,106,967)
<b>Profit before income tax</b>	10	<b>3,556,931</b>	3,715,138
Income tax expense	11	<b>(1,295,527)</b>	(1,448,751)
<b>Profit for the year</b>		<b>2,261,404</b>	2,266,387
<b>Other comprehensive income, net of income tax</b>			
<b>Items that will not be reclassified to profit or loss</b>			
Transfer of depreciation on revaluation surplus net of deferred tax			
- retained earnings		<b>(13,503)</b>	12,153
- revaluation reserve		<b>13,503</b>	(12,153)
Property revaluation		<b>1,806,050</b>	-
Deferred tax adjustment on property revaluation		<b>(123,609)</b>	(74,569)
Reserve for general banking risk		<b>(181)</b>	-
Depositor compensation scheme reserve		<b>116,136</b>	-
		<b>1,682,441</b>	(74,569)
<b>Items that are or may be reclassified subsequently to profit or loss</b>			
Realised gains on disposals of available-for-sale debt securities, net of deferred tax		<b>(1,187,446)</b>	(967,588)
Change in fair value of available-for-sale financial assets, net of deferred tax		<b>(599,271)</b>	610,747
		<b>(1,786,717)</b>	(356,841)
<b>Other comprehensive income for the year, net of income tax</b>		<b>(104,276)</b>	(431,410)
<b>Total comprehensive income for the year</b>		<b>2,157,128</b>	1,834,977
<b>Earnings per share</b>	12	<b>5.65</b>	5.67

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

## Statement of Changes in Equity

For the Year Ended 31 December 2017

	Share Capital €	Property revaluation reserve €	Fair value reserve €	Depositor compensation scheme reserve €	Capital contribution €	Reserve for general banking risk €	Retained earnings €	Total €
<b>Balance at 1 January 2017</b>	10,000,000	961,468	2,663,593	238,387	11,436,521	217	3,168,372	28,468,558
Profit for year	-	-	-	-	-	-	2,261,404	2,261,404
<b>Other comprehensive income, net of tax</b>								
Transfer from retained earnings	-	13,503	-	116,136	-	(181)	(129,458)	-
Revaluation surplus	-	1,806,050	-	-	-	-	-	1,806,050
Transfer of depreciation on revaluation surplus	-	-	-	-	-	-	-	-
Realised gains on disposals of available-for-sale debt securities	-	-	(1,826,840)	-	-	-	-	(1,826,840)
Change in fair value of available-for-sale financial assets	-	-	(916,279)	-	-	-	-	(916,279)
Deferred tax thereon	-	(123,609)	956,402	-	-	-	-	832,793
Total other comprehensive income, net of tax	-	1,695,944	(1,786,717)	116,136	-	(181)	(129,458)	(104,276)
<b>Total comprehensive income for the year</b>	-	1,695,944	(1,786,717)	116,136	-	(181)	2,131,946	2,157,128
<b>Transactions with equity holders, recognised directly in equity</b>								
<b>Contributions by and distributions to equity Holders</b>								
Dividends to equity holders (note 24.8)	-	-	-	-	-	-	(2,250,000)	(2,250,000)
Contributions paid by equity holders	-	-	-	-	1,096,154	-	-	1,096,154
<b>Total contributions by and distribution to equity holders</b>	-	-	-	-	1,096,154	-	(2,250,000)	(1,153,846)
<b>Balance at 31 December 2017</b>	10,000,000	2,657,412	876,876	354,523	12,532,675	36	3,050,318	29,471,840

## Statement of Changes in Equity

For the Year Ended 31 December 2017

	Share Capital €	Property revaluation reserve €	Fair value reserve €	Depositor compensation scheme reserve €	Capital contribution €	Reserve for general banking risk €	Retained earnings €	Total €
<b>Balance at 1 January 2016</b>	10,000,000	1,048,190	3,020,434	238,387	10,482,904	217	2,889,832	27,679,964
Profit for year	-	-	-	-	-	-	2,266,387	2,266,387
<b>Other comprehensive income, net of tax</b>								
Transfer of depreciation on revaluation surplus	-	(12,153)	-	-	-	-	12,153	-
Realised gains on disposals of available-for-sale debt securities	-	-	(1,416,706)	-	-	-	-	(1,416,706)
Change in fair value of available-for-sale financial assets	-	-	856,818	-	-	-	-	856,818
Deferred tax thereon	-	(74,569)	203,047	-	-	-	-	128,478
Total other comprehensive income, net of tax	-	(86,722)	(356,841)	-	-	-	12,153	(431,410)
<b>Total comprehensive income for the year</b>	-	(86,722)	(356,841)	-	-	-	2,278,540	1,834,977
<b>Transactions with equity holders, recognised directly in equity</b>								
<b>Contributions by and distributions to equity holders</b>								
Dividends to equity holders (note 24.8)	-	-	-	-	-	-	(2,000,000)	(2,000,000)
Contributions paid by equity holders	-	-	-	-	953,617	-	-	953,617
<b>Total contributions by and distribution to equity holders</b>	-	-	-	-	953,617	-	(2,000,000)	(1,046,383)
<b>Balance at 31 December 2016</b>	10,000,000	961,468	2,663,593	238,387	11,436,521	217	3,168,372	28,468,558

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

## Statement of Cash Flows

For the Year Ended 31 December 2017

	Note	2017 €	2016 €
<b>Cash flows from operating activities</b>			
Interest and commission receipts		8,669,021	5,239,822
Interest and commission payments		(2,196,268)	(1,701,842)
Payments to employees and suppliers		(1,906,617)	(2,648,578)
Cash from operations before changes in operating assets/liabilities		4,566,136	889,402
Increase/(decrease) in operating assets:			
- loans and advances to customers		(1,268,188)	1,960,572
- factored receivables		(28,578,468)	(447,041)
- other receivables		(2,934,587)	(4,944,477)
Increase/(decrease) in operating liabilities:			
- amounts owed to customers		10,747,328	25,075,787
- amounts owed to Central Bank of Malta		(5,000,000)	(400,000)
Net cash generated from operating activities before income tax	26	(22,467,779)	22,134,243
Income tax paid		(712,816)	(993,419)
<b>Net cash (used in)/from operating activities</b>		<b>(23,180,595)</b>	<b>21,140,824</b>
<b>Cash flows from investing activities</b>			
Payments to acquire property, equipment and intangible assets		(5,839,157)	(852,138)
Proceeds from disposals of investments		21,170,143	7,353,517
Payments to acquire investments		(12,604,899)	(20,884,368)
Interest received from investments		1,524,330	1,625,085
Dividend received		262,536	227,943
<b>Net cash from/(used in) investing activities</b>		<b>4,512,953</b>	<b>(12,529,961)</b>
<b>Cash flow from financing activities</b>			
Dividends paid to shareholders		(2,000,000)	(2,000,000)
Capital contributed by shareholders		1,096,154	953,617
Interest paid on debt securities		(540,000)	(540,000)
<b>Net cash used in financing activities</b>		<b>(1,443,846)</b>	<b>(1,586,383)</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(20,111,488)</b>	<b>7,024,480</b>
Cash and cash equivalents at beginning of year		42,141,918	35,117,438
<b>Cash and cash equivalents at end of year</b>	27	<b>22,030,430</b>	<b>42,141,918</b>

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

## Notes to the Financial Statements

For the Year Ended 31 December 2017

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**izola Bank**

# Notes to the Financial Statements

For the Year Ended 31 December 2017

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## 1 Reporting entity

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

## 2 Basis of preparation

### 2.1 Statement of compliance

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

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

### 2.2 Basis of measurement

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

### 2.3 Functional and presentation currency

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

### 2.4 Use of estimates and judgements

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

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

## 3 Significant accounting policies

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

### 3.1 Financial assets and financial liabilities

#### 3.1.1 Non-derivative financial assets and financial liabilities

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

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

#### *Financial assets*

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

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

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

Held-to-maturity investments are carried at amortised cost using the effective interest method, less any impairment losses (see note 3.1.6). A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available-for-sale, and would prevent the Bank from classifying investment securities as held to maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

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

# Notes to the Financial Statements

For the Year Ended 31 December 2017

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## 3 Significant accounting policies (continued)

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

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

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

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

Interest income is recognised in profit or loss using the effective interest method. Dividend income is recognised in profit or loss when the Bank becomes entitled to the dividend. Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss. Impairment losses are recognised in profit or loss (see note 3.1.6).

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

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

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

##### 3.1.1.3 Loans and receivables (including factored receivables)

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term. These include loans and advances to banks and to customers that are recognised on the day the cash is advanced to these borrowers, and factoring receivables. These loans and receivables are initially measured at fair value plus transaction costs that are directly attributable to the acquisition of the financial assets. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less impairment losses (see note 3.1.6).

##### Financial liabilities

The Bank classifies financial liabilities as measured at amortised cost (see note 3.6).



### 3 Significant accounting policies (continued)

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

##### 3.1.2 Derecognition

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

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

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

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

##### 3.1.3 Offsetting

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

##### 3.1.4 Amortised cost measurement

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

# Notes to the Financial Statements

For the Year Ended 31 December 2017

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## 3 Significant accounting policies (continued)

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

#### 3.1.5 Fair value measurement

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

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

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

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

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

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

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

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

### 3 Significant accounting policies (continued)

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

##### 3.1.6 Identification and measurement of impairment

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

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

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

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

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

# Notes to the Financial Statements

For the Year Ended 31 December 2017

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## 3 Significant accounting policies (continued)

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

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

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

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

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

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

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

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

### 3.2 Cash and cash equivalents

Cash and cash equivalents comprise notes and coins in hand, unrestricted balances held with the Central Bank of Malta and deposits with contractual maturities of less than three months from the acquisition date which are subject to an insignificant risk of changes in their fair value. Subsequent to initial recognition, cash and cash equivalents are carried at amortised cost in the statement of financial position.

## 3 Significant accounting policies (continued)

### 3.3 Property and equipment

#### 3.3.1 Recognition and measurement

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

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

#### 3.3.2 Revaluation surplus or deficit

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

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

#### 3.3.3 Subsequent costs

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

#### 3.3.4 Depreciation

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

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

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

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

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

## Notes to the Financial Statements

For the Year Ended 31 December 2017

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### 3 Significant accounting policies (continued)

#### 3.4 Intangible assets - software

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

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

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

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

#### 3.5 Impairment of non-financial assets

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

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

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

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

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

#### 3.6 Deposits and debt securities issued

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

### 3 Significant accounting policies (continued)

#### 3.7 Interest

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability.

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

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

#### 3.8 Fees and commission

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

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

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

#### 3.9 Foreign currency transactions

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

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into the functional currency at foreign exchange rates ruling at the dates the fair values were determined.

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, which are recognised in other comprehensive income.

# Notes to the Financial Statements

For the Year Ended 31 December 2017

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## 3 Significant accounting policies (continued)

### 3.10 Operating lease payments

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

### 3.11 Employee benefits

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

### 3.12 Income tax

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

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

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

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

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

A deferred tax asset is recognised for temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### 3.13 Share Capital

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

### 3.14 Segment reporting

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



## 3 Significant accounting policies (continued)

### 3.15 New accounting standards

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

A number of new standards, amendments to standards and interpretations are not yet effective for annual periods beginning after 1 January 2017 and earlier application is permitted; however the Bank has not early applied the following new or amended standards in preparing these financial statements.

##### 3.15.1.1 IFRS 15 Revenue from Contracts with customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes.

IFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. Such standards have been adopted by the EU. Management has not identified any material impact on the Bank arising from the adoption of this IFRS.

##### 3.15.1.2 IFRS 16 Leases

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

##### 3.15.1.3 IFRS 9: Financial Instruments

The Bank will adopt the new standard on 1 January 2018 and in line with the requirements of IFRS 9, it will not restate the comparative financial information. The Bank has assessed the estimated impact that the initial application of IFRS 9 will have on its financial statements based on currently available information which may be subject to changes arising from further reasonable and supportable information being made available to the Bank in 2018.

#### *Classification and measurement*

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics. The standard contains three principal classification categories for financial assets: amortised cost, fair value through other comprehensive income ("FVOCI") and fair value through profit or loss ("FVTPL"). Under IFRS 9, derivatives embedded in contracts where the host is a financial asset are never bifurcated. Instead, the hybrid financial instrument as a whole is assessed for classification.

Based on its assessment, the Bank does not believe that the new classification requirements will have a material impact on its accounting for its loans and receivables (including factored receivables) and investments classified as available-for-sale.

# Notes to the Financial Statements

For the Year Ended 31 December 2017

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## 3 Significant accounting policies (continued)

### 3.15 New accounting standards (continued)

#### 3.15.1 New standards and interpretations endorsed by the EU but not yet effective (continued)

##### 3.15.1.3 IFRS 9: Financial Instruments (continued)

###### *Impairment*

IFRS 9 replaces the 'incurred loss' model in IAS 39: Financial Instruments – Recognition and Measurement with a forward-looking 'expected credit loss' ("ECL") model. The new impairment model will apply to financial assets measured at amortised cost or FVOCI, except for investments in equity instruments. A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Evaluating banks with similar financial assets for the purposes of measuring ECL.

The Bank has estimated that the application of IFRS 9's impairment requirements at 1 January 2018 will not result in a material change in the level of impairment provisions. The Bank's estimate is based on an evaluation of its factored receivables and loans and advances, recognised on the Bank's statement of financial position, which have low probability of default and/or loss given default. The 2018 accounting policies, assumptions, judgements and estimation techniques employed are subject to change until the Bank finalises its first financial statements that include the date of initial application.

## 4 Financial risk management

### 4.1 Organisation

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

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

## 4 Financial risk management (*continued*)

### 4.2 Risk exposure

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

The main categories of risk are:

- *Credit risk*: Risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. It arises from the lending, treasury, factoring of receivables and investment activities undertaken by the Bank.
- *Market risk*: Risk of losses arising from unfavourable changes in the level and volatility of interest rates, foreign exchange rates or investment prices.
- *Liquidity risk*: Liquidity risk is divided into two categories:
  - *Market (product) liquidity risk*: risk of losses arising from difficulty in accessing a product or market at the required time, price and volume.
  - *Funding liquidity risk*: risk of losses arising from a timing mismatch between investing, placements and funds arising from activities resulting in obligations missing the settlement date or satisfied at higher than normal rates.
- *Operational risk*: Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of the Bank's operations.

### 4.3 Capital base

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

#### 4.3.1 Capital management

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

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

- Tier 1 capital, which includes ordinary share capital, capital contribution, retained earnings and accumulated other comprehensive income.
- Tier 2 capital consisting of collective impairment allowances.

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

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

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

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 4 Financial risk management (continued)

#### 4.3 Capital base (continued)

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

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

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

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

	2017	2016
	€	€
Tier 1 capital		
Ordinary share capital	10,000,000	10,000,000
Capital contribution	12,532,675	11,436,521
Retained earnings	3,050,318	3,168,371
Property revaluation reserve	2,657,412	961,468
Fair value movement reserve	876,876	2,663,593
Deductions related to intangible assets	(1,634,529)	(1,560,192)
Transitional provisions (unrealised gains)	(706,858)	(2,175,037)
	<b>26,775,894</b>	<b>24,494,724</b>
Tier 2 capital		
Collective impairment allowance	640,825	286,396
	<b>640,825</b>	<b>286,396</b>
<b>Total regulatory capital</b>	<b>27,416,719</b>	<b>24,781,120</b>

Further information on the Bank's capital adequacy ratios may be found in sections 3 and 4 of Appendix 1 – Pillar 3 disclosures as at 31 December 2017, which are subject to internal review by the Bank.

## 4 Financial risk management (continued)

### 4.4 Credit risk

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

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

At the reporting date, 73% (2016: 76%) of other loans and advances to customers and Nil% (2016: Nil%) of investments were cash secured, 5% (2016: 2%) of other loans and advances to customers were secured against property, whilst 2% (2016: 2%) of other loans and advances to customers were secured against shares in a local company.

#### 4.4.1 Maximum exposure to credit risk

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

- Financial assets recognised in the statement of financial position comprise balances with Central Bank of Malta, financial investments, factored receivables, and other loans and advances. The maximum exposure to credit risk of these financial assets equals their carrying amount.
- Commitments for factored receivables, overdrafts and credit cards - the maximum exposure to credit risk is the full amount of the committed facilities (note 25).

#### 4.4.2 Industry concentration

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

	2017		2016	
	€	%	€	%
Manufacturing	<b>8,594,354</b>	<b>13</b>	7,347,078	12
Wholesale and retail trade	<b>20,172,377</b>	<b>31</b>	12,607,848	21
Real estate, renting and business activities	<b>36,758,074</b>	<b>56</b>	41,395,183	67
	<b>65,524,805</b>	<b>100</b>	61,350,109	100

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 4 Financial risk management (continued)

#### 4.4 Credit risk (continued)

##### 4.4.3 Analysis of collateral

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

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

	Loans and advances to customers	
	2017	2016
	€	€
<i>Type of collateral</i>		
Deposits held with the Bank	<b>48,186,659</b>	47,047,256
Bills of exchange	<b>5,083,381</b>	-
Commercial real estate	<b>3,143,852</b>	1,150,000
Unlisted shares	<b>954,724</b>	978,000
	Factored receivables	
	2017	2016
	€	€
<i>Type of collateral</i>		
Motor vehicles	<b>22,388,627</b>	-

##### 4.4.4 Impaired factored receivables

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

	2017	2016
	€	€
Factored receivables - gross	<b>49,618,594</b>	21,040,126
Collectively determined	<b>49,111,716</b>	20,460,429
Collective allowance for impairment	<b>528,085</b>	223,229
Specific allowance for impairment	<b>506,878</b>	579,697
Total impaired factored receivables	<b>1,034,963</b>	802,926

## 4 Financial risk management (continued)

### 4.4 Credit risk (continued)

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

	2017	2016
	€	€
Loans and advances to customers	<b>57,185,841</b>	55,876,574
Loans and advances to banks	<b>20,079,499</b>	31,788,316
Investment securities	<b>57,213,412</b>	66,925,325
	<b>134,478,752</b>	154,590,215

#### 4.4.6 Past due but not impaired

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

As at 31 December 2017, 22% (2016: 39%) of the Bank's factored receivables were past due but not impaired. 18% of these became past due on 31 December 2017. A substantial amount of these past due receivables have been paid by the date of issue of these financial statements.

#### 4.4.7 Loans with renegotiated terms and forbearance

The Bank has adopted the additional accounting policies, in note 3.1.6, as requested by the European Securities and Markets Authority (ESMA) Public Statement on the Treatment of Forbearance Practices in IFRS Financial Statements of Financial Institutions.

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

During 2017 and 2016, there were no instances where the terms and conditions of a loan had to be renegotiated in response to perceived financial difficulties of a customer. Consequently, the Bank did not apply forbearance measures during the current and comparative year.

As at 31 December 2017, the Bank had renegotiated five (2016: three) loans amounting to €164,514 (2016: €12,902) due to delays in the projects being financed. The Bank recognised interest amounting to €495 on these loans in 2017 (2016: €389). The movements in renegotiated loans may be summarised as follows:

# Notes to the Financial Statements

For the Year Ended 31 December 2017

## 4 Financial risk management (continued)

### 4.4 Credit risk (continued)

#### 4.4.7 Loans with renegotiated terms and forbearance (continued)

	<b>Total</b>
	<b>€</b>
<b>At 1 January 2016</b>	67,839
Recognised impairment	-
Loans repaid	(67,839)
Renegotiated loans	12,902
<b>At 31 December 2016</b>	12,902
<b>At 1 January 2017</b>	<b>12,902</b>
Recognised impairment	-
Loans repaid	<b>(12,902)</b>
Renegotiated loans	<b>164,514</b>
<b>At 31 December 2017</b>	<b>164,514</b>

#### 4.4.8 Allowances for impairment

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

	<b>2017</b>	2016
	<b>€</b>	€
Factored receivables		
Collective allowance for impairment	<b>528,085</b>	223,229
Specific allowance for impairment	<b>506,878</b>	579,697

#### 4.4.9 Write-off policy

The Bank writes off a loan, security and/or factored receivable balance (and any related allowance for impairment losses) when management determines that the loan, security and/or factored receivable is uncollectible. This determination is reached after considering information such as occurrence of significant changes in the borrower/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. During the current year, amounts receivable of €89,020 (2016: €105,377) were written off by the Bank.

#### 4.4.10 Concentration risk

In addition to the industry concentration mentioned in note 4.4.2, the Bank monitors concentration of credit risk by sector and by geographic location. An analysis of concentrations of credit risk is shown on the next page.



## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 4 Financial risk management (continued)

#### 4.4 Credit risk (continued)

##### 4.4.10 Concentration risk (continued)

	Loans and advances to customers		Factored receivables		Loans and advances to banks		Investment securities	
	2017	2016	2017	2016	2017	2016	2017	2016
	€	€	€	€	€	€	€	€
Carrying amount	<b>65,524,805</b>	61,350,109	<b>48,583,631</b>	20,237,200	<b>20,079,499</b>	31,788,316	<b>57,213,412</b>	66,925,325
<b>Concentration by sector</b>								
Corporate	<b>64,445,135</b>	60,365,976	<b>26,222,590</b>	20,237,200	-	-	<b>12,879,052</b>	10,517,752
Private individuals	<b>1,079,670</b>	984,133	<b>22,361,041</b>	-	-	-	-	-
Banks	-	-	-	-	<b>20,079,499</b>	31,788,316	<b>810,751</b>	828,550
Sovereign	-	-	-	-	-	-	<b>26,771,878</b>	38,658,448
Equity	-	-	-	-	-	-	<b>16,751,731</b>	16,920,575
	<b>65,524,805</b>	61,350,109	<b>48,583,631</b>	20,237,200	<b>20,079,499</b>	31,788,316	<b>57,213,412</b>	66,925,325
<b>Concentration by location</b>								
Europe	<b>64,332,536</b>	59,939,853	<b>48,583,631</b>	20,237,200	<b>20,079,499</b>	31,788,316	<b>57,213,412</b>	66,925,325
USA	<b>1,192,269</b>	1,410,256	-	-	-	-	-	-

# Notes to the Financial Statements

For the Year Ended 31 December 2017

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## 4 Financial risk management (continued)

### 4.4 Credit risk (continued)

#### 4.4.10 Concentration risk (continued)

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

### 4.5 Market risk

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

Market risk for the Bank consists of three elements:

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

#### 4.5.1 Interest rate risk

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

# Notes to the Financial Statements

For the Year Ended 31 December 2017

## 4 Financial risk management (continued)

### 4.5 Market risk (continued)

#### 4.5.1 Interest rate risk (continued)

2017

	Carrying amount	Effective interest rate	Less than three months	Between three months and one year	Between one year and five years	More than five years	Others
	€	%	€	€	€	€	€
<b>Assets</b>							
Cash	2,587	-	-	-	-	-	2,587
Balances receivable from Central Bank of Malta	1,948,344	-0.4%	1,948,344	-	-	-	-
Investments:							
- Held-to-maturity debt securities	-	-	-	-	-	-	-
- Available-for-sale debt securities	40,461,681	3.5%	-	707,000	23,294,450	16,460,231	-
- Available-for-sale equities	16,751,731	-	-	-	-	-	16,751,731
Loans and advances to banks	20,079,499	-0.2%	20,079,499	-	-	-	-
Loans and advances to customers	65,524,805	3.9%	21,787,435	5,759,335	7,043,649	30,934,386	-
Factored receivables	48,583,631	-	-	-	-	-	48,583,631
Other assets	13,277,526	-	-	-	-	-	13,277,526
<b>Total assets</b>	<b>206,629,804</b>		<b>43,815,278</b>	<b>6,466,335</b>	<b>30,338,099</b>	<b>47,394,617</b>	<b>78,615,475</b>
<b>Liabilities</b>							
Balance owed to Central Bank of Malta	16,300,000	-	-	3,300,000	13,000,000	-	-
Amounts owed to customers	145,767,422	1.3%	82,198,758	17,174,812	41,938,745	4,455,107	-
Debt securities issued	11,871,811	4.6%	-	-	-	11,871,811	-
Current tax payable	1,154,671	-	-	1,154,671	-	-	-
Other liabilities	2,064,060	-	-	-	-	-	2,064,060
	177,157,964		82,198,758	21,629,483	54,938,745	16,326,918	2,064,060
<b>Equity</b>							
Issued capital	10,000,000	-	-	-	-	-	10,000,000
Property revaluation reserve	2,657,412	-	-	-	-	-	2,657,412
Depositors' compensation scheme Reserve	354,523	-	-	-	-	-	354,523
Fair value reserve	876,876	-	-	-	-	-	876,876
Retained earnings	3,050,318	-	-	-	-	-	3,050,318
Reserve for General Banking Risk	36	-	-	-	-	-	36
Capital contribution	12,532,675	-	-	-	-	-	12,532,675
	29,471,840		-	-	-	-	29,471,840
<b>Total liabilities and equity</b>	<b>206,629,804</b>		<b>82,198,758</b>	<b>21,629,483</b>	<b>54,938,745</b>	<b>16,326,918</b>	<b>31,535,900</b>
<b>Gap</b>			<b>(38,383,430)</b>	<b>(15,163,148)</b>	<b>(24,600,646)</b>	<b>31,067,699</b>	<b>47,079,575</b>
<b>Cumulative gap</b>			<b>(38,383,430)</b>	<b>(53,546,628)</b>	<b>(78,147,274)</b>	<b>(47,079,575)</b>	<b>-</b>

# Notes to the Financial Statements

For the Year Ended 31 December 2017

## 4 Financial risk management (continued)

### 4.5 Market risk (continued)

#### 4.5.1 Interest rate risk (continued)

2016

	Carrying amount €	Effective interest rate %	Less than three months €	Between three months and one year €	Between one year and five years €	More than five years €	Others €
<b>Assets</b>							
Cash	2,084	-	-	-	-	-	2,084
Balances receivable from Central Bank of Malta	10,351,518	-0.4%	10,351,518	-	-	-	-
Investments:							
- Available-for-sale debt securities	50,004,750	3.7%	1,532,250	5,177,470	13,751,650	29,543,380	-
- Available-for-sale equities	16,920,574	-	-	-	-	-	16,920,574
Loans and advances to banks	31,788,316	-0.2%	31,788,316	-	-	-	-
Loans and advances to customers	61,350,109	4.3%	16,940,346	9,913,344	5,413,419	29,083,000	-
Factored receivables	20,237,200	-	-	-	-	-	20,237,200
Other assets	6,765,399	-	-	-	-	-	6,765,399
<b>Total assets</b>	<b>197,419,951</b>		<b>60,612,430</b>	<b>15,090,814</b>	<b>19,165,069</b>	<b>58,626,380</b>	<b>43,925,258</b>
<b>Liabilities</b>							
Balance owed to Central Bank of Malta	21,300,000	0.02%	-	-	21,300,000	-	-
Amounts owed to customers	132,337,023	1.4%	74,720,462	24,144,093	29,152,573	4,319,895	-
Debt securities issued	11,854,721	4.6%	-	-	-	11,854,721	-
Current tax payable	549,126	-	-	-	-	-	549,126
Other liabilities	2,910,523	-	-	-	-	-	2,910,523
	<b>168,951,393</b>		<b>74,720,462</b>	<b>24,144,093</b>	<b>50,452,573</b>	<b>16,174,616</b>	<b>3,459,649</b>
<b>Equity</b>							
Issued capital	10,000,000	-	-	-	-	-	10,000,000
Property revaluation reserve	961,468	-	-	-	-	-	961,468
Depositors' compensation scheme Reserve	238,387	-	-	-	-	-	238,387
Fair value reserve	2,663,593	-	-	-	-	-	2,663,593
Retained earnings	3,168,372	-	-	-	-	-	3,168,372
Reserve for General Banking Risk	217	-	-	-	-	-	217
Capital contribution	11,436,521	-	-	-	-	-	11,436,521
	<b>28,468,558</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>27,679,964</b>
<b>Total liabilities and equity</b>	<b>197,419,951</b>		<b>74,720,462</b>	<b>24,144,093</b>	<b>50,452,573</b>	<b>16,174,616</b>	<b>31,928,207</b>
<b>Gap</b>			<b>(14,108,032)</b>	<b>(9,053,279)</b>	<b>(31,287,504)</b>	<b>42,451,764</b>	<b>11,997,050</b>
<b>Cumulative gap</b>			<b>(14,108,032)</b>	<b>(23,161,310)</b>	<b>(54,448,815)</b>	<b>(11,997,050)</b>	<b>-</b>

## 4 Financial risk management (continued)

### 4.5 Market risk (continued)

#### 4.5.1 Interest rate risk (continued)

##### 4.5.1.1 Interest rate profile

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

	2017	2016
	€	€
<b>Fixed rate instruments</b>		
Investments – Debt securities available-for-sale	<b>38,942,631</b>	48,472,500
Loans and advances to banks	<b>2,687,579</b>	2,679,759
Loans and advances to customers	<b>52,679,248</b>	49,634,791
Balance owed to Central Bank of Malta	<b>(16,300,000)</b>	(11,300,000)
Debt securities in issue	<b>(11,871,811)</b>	(11,854,721)
Amounts owed to customers	<b>(81,552,465)</b>	(68,746,079)
	<b>(15,414,818)</b>	8,886,250
<b>Variable rate instruments</b>		
Investments – Debt securities available-for-sale	<b>1,519,050</b>	1,532,250
Loans and advances to customers	<b>12,845,557</b>	11,715,318
Balance receivable from Central Bank of Malta	<b>1,948,344</b>	10,351,518
Balance owed to Central Bank of Malta	-	(10,000,000)
Loans and advances to banks	<b>17,391,920</b>	29,108,557
Amounts owed to customers	<b>(64,214,957)</b>	(63,590,943)
	<b>(30,510,086)</b>	(20,883,299)

# Notes to the Financial Statements

For the Year Ended 31 December 2017

## 4 Financial risk management (continued)

### 4.5 Market risk (continued)

#### 4.5.1 Interest rate risk (continued)

##### 4.5.1.2 Fair value sensitivity analysis for fixed rate instruments

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

A sudden increase of 50 basis points in the yield to maturity of the benchmark 10 year Malta Government Stock would lead to a decrease in value of available for sale investments amounting to €1,028,989. Such a decrease would be recognised in other comprehensive income and in equity. A decrease of 50 basis points in interest rates would have an equal but opposite effect on other comprehensive income and equity.

##### 4.5.1.3 Cash flow sensitivity analysis for variable rate instruments

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

	Impact on	
	Profit or Loss	Equity
	€	€
<b>2017</b>		
+ 50 basis points	<b>(151,697)</b>	<b>(151,697)</b>
- 50 basis points	<b>151,697</b>	<b>151,697</b>
<b>2016</b>		
+ 50 basis points	(162,993)	(162,993)
- 50 basis points	162,993	162,993

#### 4.5.2 Currency risk

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

## 4 Financial risk management (continued)

### 4.5 Market risk (continued)

#### 4.5.2 Currency risk (continued)

Exposure to foreign currencies is maintained at minimum levels and within the prescribed limits set by the Bank's Board of Directors. In the scenario whereby all foreign currencies fluctuate up or down by 20% against the Euro, the carrying amounts of financial assets and liabilities would fluctuate, up or down by €26,849 (2016: €33,572) respectively.

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

	Euro €	2017 Other currencies €	Total €	Euro €	2016 Other currencies €	Total €
<b>Financial assets</b>						
Cash	2,587	-	2,587	2,084	-	2,084
Investments:						
- Debt securities available-for-sale	40,461,681	-	40,461,681	50,004,750	-	50,004,750
- Equities available-for-Sale	16,751,732	-	16,751,732	16,920,575	-	16,920,575
Loans and advances to banks and balances receivable from Central Bank of Malta	21,449,042	578,801	22,027,843	41,167,708	972,127	42,139,834
Loans and advances to customers	64,332,536	1,192,269	65,524,805	59,939,853	1,410,256	61,350,109
Factored receivables	48,583,631	-	48,583,631	20,237,200	-	20,237,200
	<b>191,581,209</b>	<b>1,771,070</b>	<b>193,352,279</b>	188,272,170	2,382,383	190,654,553
<b>Financial liabilities</b>						
Balance owed to Central Bank of Malta	16,300,000	-	16,300,000	21,300,000	-	21,300,000
Debt securities issued	11,871,811	-	11,871,811	11,845,721	-	11,845,721
Amounts owed to customers	144,335,268	1,432,154	145,767,422	130,156,237	2,180,786	132,337,023
	<b>172,507,079</b>	<b>1,432,154</b>	<b>173,939,233</b>	163,310,958	2,180,786	140,798,867

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

# Notes to the Financial Statements

For the Year Ended 31 December 2017

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## 4 Financial risk management (continued)

### 4.5 Market risk (continued)

#### 4.5.3 Investment price risk

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

#### 4.5.4 Fair values of financial instruments

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

##### a. Valuation models

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

- Level 1: inputs that are quoted market prices (unadjusted) in active markets for identical instruments.
- Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- Level 3: inputs that are unobservable.

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

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

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

##### b. Valuation framework

The Bank's only assets which are measured at fair value are the investments in Malta Government Stocks, corporate bonds which are listed on the Malta Stock Exchange and investment collective schemes. These are classified as available-for-sale securities. The Head of Finance, Treasury and Compliance has overall responsibility for independently verifying the results of all fair value measurements.



## 4 Financial risk management (continued)

### 4.5 Market risk (continued)

#### 4.5.4 Fair values of financial instruments (continued)

##### c. Financial instruments measured at fair value – Fair value hierarchy

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

	Level 1 €	Level 2 €	Level 3 €	Total €
<b>31-Dec-17</b>				
Investments:				
- Debt securities available-for-sale	40,461,681	-	-	40,461,681
- Equity instruments available-for-sale	16,751,731	-	-	16,751,731
	<u>57,213,412</u>	<u>-</u>	<u>-</u>	<u>57,213,412</u>
Investments:				
- Debt securities available-for-sale	50,004,750	-	-	50,004,750
- Equity instruments available-for-sale	16,920,575	-	-	16,920,575
	<u>66,925,325</u>	<u>-</u>	<u>-</u>	<u>66,925,325</u>

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

This category of assets is carried at fair value. The instrument included in this category is quoted and its fair value has been determined by reference to the market price as at 31 December 2017.

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

The Bank has an interest in an unquoted equity investment as disclosed in note 13.3. No fair value disclosure is provided for this equity investment security that is measured at cost because its fair value cannot be reliably measured. This investment is neither redeemable nor transferable and there is no market for it. The Bank does not intend to dispose of this investment.

The Bank has also an interest in an open-ended investment fund as disclosed in note 13.3. This asset is carried at fair value and its fair value has been determined by reference to the net asset value of this security as at 31 December 2017.

# Notes to the Financial Statements

For the Year Ended 31 December 2017

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## 4 Financial risk management (continued)

### 4.5 Market risk (continued)

#### 4.5.4 Fair values of financial instruments (continued)

##### d. Financial instruments not measured at fair value

Except for debt securities issued, the carrying amount of all financial instruments not measured at fair value approximates their fair value. The fair value of the debt securities issued as at 31 December 2017 amounted to €12,690,000 (2016: €12,708,000) whilst its carrying amount was €11,871,811 (2016: €11,854,721). The fair value of financial instruments not measured at fair value was determined as follows:

##### *Loans and advances to banks and factored receivables*

This category of assets is reported net of impairment allowances to reflect the estimated recoverable amounts. Loans and advances to banks are repriceable within 3 months whilst factored receivables are all short-term in nature. The carrying amounts of these financial assets therefore approximate their fair values.

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

33% (2016: 18%) of loans and advances to customers mature within 3 months and hence, the carrying amounts of these financial assets approximate their fair values. 20% (2016: 33%) mature after more than three months and within five years. The other 47% (2016: 49%) mature after more than five years. These instruments are cash secured by amounts owed to customers held by the Bank. There were no significant changes in the market interest rates during the term of these advances. The fair values of these securities therefore approximate their respective carrying amount.

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

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

##### *Amounts owed to customers*

This category of liabilities is carried at amortised cost and amounts to €145,767,422 (2016: €132,337,023). 47% (2016: 8%) of the Bank's amounts owed to customers have a contractual repricing term of three months or less. The carrying value of these amounts approximates their fair values. In respect of other longer-term fixed-maturity deposits, which are repriceable upon their contractual maturity date, given the insignificant changes in market interest rates, the fair values of these liabilities approximate their respective carrying amount.

##### *Debt securities issued*

This category of liabilities is carried at amortised cost. The instrument included in this category is quoted and its fair value has been determined by reference to the market price as at 31 December 2017.

#### 4 Financial risk management (*continued*)

##### 4.6 Liquidity Risk

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

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

The Bank's liquidity risk management focuses on structuring both the asset and liability portfolio so as to maintain diversity of funding sources and a spread of asset and liability maturities. A significant proportion of deposits are pledged, which contributes to the reduction of liquidity risk.

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

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 4 Financial risk management (continued)

#### 4.6 Liquidity Risk (continued)

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

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

## 4 Financial risk management (continued)

### 4.6 Liquidity Risk (continued)

At 31 December 2016	Less than one month	Between one and three months	Between three months and one year	Between one and five years	More than five years	Total
	€	€	€	€	€	€
<b>Financial assets</b>						
Cash	2,084	-	-	-	-	2,084
Investments:						
Equity shares	16,900,422	-	-	-	20,153	16,920,574
Debt securities available-for-sale	50,004,750	-	-	-	-	50,004,750
Loans and advances to banks and balances receivable from Central Bank of Malta	42,139,834	-	-	-	-	42,139,834
Loans and advances to customers	15,023,238	700	5,919,913	7,619,160	33,014,302	61,577,312
Factored receivables	12,197,450	7,615,330	424,420	-	-	20,237,200
	<u>136,267,778</u>	<u>7,616,030</u>	<u>6,344,333</u>	<u>7,619,160</u>	<u>33,034,455</u>	<u>190,881,756</u>
<b>Financial liabilities</b>						
Balance owed to Central Bank of Malta	-	-	-	21,300,000	-	21,300,000
Amounts owed to customers	71,563,788	3,156,673	24,144,093	29,152,573	4,319,875	132,337,023
Debt securities issued	-	-	-	-	11,854,721	11,854,721
	<u>71,563,788</u>	<u>3,156,673</u>	<u>24,144,093</u>	<u>50,452,573</u>	<u>16,174,616</u>	<u>165,491,744</u>

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 4 Financial risk management (continued)

#### 4.6 Liquidity risk (continued)

##### 4.6.1 Exposure to liquidity risk

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

	2017	2016
<b>As at 31 December</b>	<b>70%</b>	117%
Average for the year	<b>85%</b>	109%
Maximum for the year	<b>104%</b>	131%
Minimum for the year	<b>70%</b>	93%

##### 4.6.2 Residual contractual maturities of financial liabilities

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

	Carrying amount	Gross nominal outflow	Repayable on demand	Between one and three months	Between three months and one year	Between one and five years	After more than five years
				€	€	€	€
<b>At 31 December 2017</b>							
Debt securities issued	11,871,811	(16,320,000)	-	-	(540,000)	(2,160,000)	(13,620,000)
Balance owed to Central Bank of Malta	16,300,000	(16,300,000)	-	-	(3,300,000)	(13,000,000)	-
Amounts owed to customers	145,767,422	(150,075,888)	(75,840,429)	(6,485,002)	(18,311,665)	(40,668,866)	(8,769,926)
	<b>173,939,233</b>	<b>(182,695,888)</b>	<b>(75,840,429)</b>	<b>(6,485,002)</b>	<b>(22,151,665)</b>	<b>(55,828,866)</b>	<b>(22,389,926)</b>
<b>At 31 December 2016</b>							
Debt securities issued	11,854,721	(16,860,000)	-	-	(540,000)	(2,160,000)	(14,160,000)
Balance owed to Central Bank of Malta	21,300,000	(21,311,278)	-	-	-	(21,311,278)	-
Amounts owed to customers	132,337,023	(136,152,707)	(71,563,912)	(2,819,449)	(24,698,299)	(31,833,455)	(5,237,592)
	<b>165,491,744</b>	<b>(174,323,985)</b>	<b>(71,563,912)</b>	<b>(2,819,449)</b>	<b>(25,238,299)</b>	<b>(55,304,733)</b>	<b>(19,397,592)</b>

#### 4 Financial risk management (*continued*)

##### 4.7 Operational Risks

###### *Management of operational risk*

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

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

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

A financial measurement of this risk is arrived at by the Bank for the purpose of allocating risk capital using the Basic Indicator Approach under the Capital Requirements Directive rules. The capital requirement for operational risk under this method was calculated at €964,387 as at 31 December 2017 (2016: €866,745).

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 5 Interest income on loans and advances

	2017	2016
	€	€
Interest income on loans and advances to banks	7,849	-
Interest income on loans and advances to customers	2,825,933	2,655,329
	<b>2,833,782</b>	<b>2,655,329</b>

### 6 Interest expense and similar charges

	Note	2017	2016
		€	€
Interest expense:			
On amounts owed to banks		3,933	8,677
On loans and advances to banks		113,282	38,784
On amounts owed to customers		1,870,475	1,709,856
On debts securities issued		540,000	540,000
		<b>2,527,690</b>	<b>2,297,317</b>
Amortisation of debt issuance costs	21	17,089	17,089
		<b>2,544,779</b>	<b>2,314,406</b>

### 7 Net fee and commission income

	2017	2016
	€	€
Account maintenance and other bank charges	493,089	493,202
Commissions from factoring services	2,739,731	2,006,282
<b>Fee and commission income</b>	<b>3,232,820</b>	<b>2,499,484</b>
SWIFT and bank charges	(61,485)	(61,108)
<b>Fee and commission expense</b>	<b>(61,485)</b>	<b>(61,108)</b>
<b>Net fee and commission income</b>	<b>3,171,335</b>	<b>2,438,376</b>



### 8 Other operating income

	2017	2016
	€	€
Dividend income	262,536	227,943
Net gain on disposal of available-for-sale investments	1,826,840	1,416,706
Rental income	45,628	47,443
	<b>2,135,004</b>	<b>1,692,092</b>

### 9 Impairment allowances

	2017	2016
	€	€
<b>Write-offs</b>		
Factored receivables	(89,020)	(105,377)
	<b>(89,020)</b>	<b>(105,377)</b>
<b>Net impairment provisions</b>		
Factored receivables		
- collective allowances	(304,856)	(17,509)
- specific allowances	72,819	168,125
Credit cards, overdrafts and other advances		
- collective allowances	(49,574)	(46,569)
- specific allowances	20,890	(27,101)
	<b>(260,721)</b>	<b>76,946</b>
<b>Impairment allowances</b>	<b>(349,741)</b>	<b>28,431</b>

The comparative amounts €28,431 has been restated to reflect the reclassification of amounts previously written-off of €105,377 from other expenses (Note 10.4) to impairment allowances (Note 9).

### 10 Profit before income tax

**10.1** Profit before income tax is stated after charging fees payable, exclusive of VAT, to the Bank's auditors during 2017 for:

	€
Auditors' remuneration	30,250
Other assurance services	1,300
Other non-audit services	36,738
	<b>68,288</b>

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 10 Profit before income tax (continued)

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

	2017	2016
	€	€
Directors' fees	46,000	42,000
Staff costs:		
- wages, salaries and allowances	1,046,515	843,799
- defined contribution social security costs	59,124	44,955
	<b>1,151,639</b>	<b>930,754</b>

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

	2017	2016
	No.	No.
Managerial	5	4
Supervisory and clerical	23	19
	<b>28</b>	<b>23</b>

10.4 Other expenses incurred by the Bank during the year are analyzed as follows:

	2016	2015
	€	€
IT hardware and software maintenance costs	417,384	297,459
Marketing expenses	248,692	105,121
Amortisation of premium on investments	230,248	227,154
Other	694,018	477,233
	<b>1,590,342</b>	<b>1,106,967</b>

## 11 Income tax expense

### 11.1 Total income tax expense

	Note	2017 €	2016 €
<b>Current tax expense</b>			
Current year		<b>(1,318,361)</b>	(1,255,972)
<b>Deferred tax</b>			
Origination and reversal of temporary differences	22	<b>22,834</b>	(192,779)
Total tax expense		<b>(1,295,527)</b>	(1,448,751)

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

	2017 €	2016 €
Profit before income tax	<b>3,556,931</b>	3,715,138
Income tax at the applicable tax rate of 35%	<b>(1,244,926)</b>	(1,300,298)
Income tax effect of:		
Depreciation charges not deductible by way of capital allowances	<b>(11,023)</b>	(25,173)
Non-taxable income	<b>346</b>	625
Change in unrecognised deductible temporary differences	<b>(39,924)</b>	(123,905)
Tax expense	<b>(1,295,527)</b>	(1,448,751)

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 12 Earnings per share

Earnings per share is calculated on the profit attributable to ordinary shareholders of the Bank for the year ended 31 December 2017 amounting to €2,261,404 (2016: €2,266,380) divided by 400,000 (2016: 400,000), being the equivalent number of ordinary shares in issue and ranking equally for dividend during the year.

### 13 Investments

**13.1** Investments comprise:

	<b>2017</b>	2016
	€	€
Available-for-sale debt securities	<b>40,461,681</b>	50,004,750
Available-for-sale equity instruments	<b>16,751,731</b>	16,920,575
	<b>57,213,412</b>	66,925,325

**13.2** Available-for-sale debt securities comprise Malta Government Stocks amounting to €26,771,878 (2016: €38,651,473) and local corporate bonds amounting to €13,689,802 (2016: €11,353,277). As at 31 December 2017, part of the Malta Government Stocks held by the Bank were pledged in favour of the Central Bank of Malta to cover the Bank's participation in the Euro-system financing operations, which amounted to €16,300,000 (2016: €21,300,000) at that date.

**13.3** Equity instruments available-for-sale comprise:

	<b>2016</b>	2015
	€	€
Unquoted equity holding	<b>20,153</b>	20,153
Collective investment schemes	<b>16,731,578</b>	16,900,422
	<b>16,751,731</b>	16,920,575

### 13 Investments (continued)

13.4 The movement in investments may be summarised as follows:

	Available-for-sale €
<b>At 1 January 2016</b>	<b>52,537,656</b>
Acquisitions	20,884,368
Disposals	(7,353,517)
Net fair value movement	856,818
<b>At 31 December 2016</b>	<b>66,925,325</b>
<b>At 1 January 2017</b>	<b>66,925,325</b>
Acquisitions	12,604,899
Disposals	(21,400,533)
Net fair value movement	(916,279)
<b>At 31 December 2017</b>	<b>57,213,412</b>

### 14 Loans and advances to banks

	2017	2016
	€	€
Repayable on call and at short notice	17,391,920	29,108,557
Term loans and advances	2,687,579	2,679,759
	<b>20,079,499</b>	<b>31,788,316</b>

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 15 Factored receivables

	2017	2016
	€	€
Receivables factored without recourse		
- Invoice factoring	<b>27,229,967</b>	21,040,126
- Bills of Exchange factoring	<b>22,388,627</b>	-
	<b>49,618,594</b>	21,040,126
Allowance for uncollectability:		
- Specific	<b>(506,878)</b>	(579,697)
- Collective	<b>(528,085)</b>	(223,229)
	<b>(1,034,963)</b>	(802,926)
	<b>48,583,631</b>	20,237,200

Factored receivables are stated net of deferred factoring income of €2,683,071 (2016: €176,920).

#### Allowances

	2017	2016
	€	€
<b>At 1 January</b>	<b>802,926</b>	953,542
Net increase/(decrease)	<b>232,037</b>	(150,616)
<b>At 31 December</b>	<b>1,034,963</b>	802,926

An allowance for uncollectability is provided against receivables factored without recourse.

### 16 Other loans and advances to customers

#### 16.1 Term loans and advances

		2017	2016
	Note	€	€
Term loans and advances		<b>3,670,462</b>	3,631,924
Term loans and advances to related parties	<b>29.3</b>	<b>53,515,379</b>	52,147,256
Credit cards and overdrafts		<b>8,338,964</b>	5,570,929
		<b>65,524,805</b>	61,350,109

**16.2** At 31 December 2017, €37,978,035 (2016: €35,680,869) of loans and advances to customers are expected to be recovered in excess of 12 months after the reporting date.

**16.3** Loans and advances to customers amounting to €47,531,269 (2016: €46,397,256) are cash secured by amounts owed to customers held by the Bank and no specific allowance for uncollectability is necessary.

**16.4** Credit card, overdraft balances and other advances are stated net of €112,740 (2016: €63,166) collective impairment provision and €143,146 (2016: €164,037) specific impairment provision.

## 17 Property and equipment

### 17.1

	Cost / Revalued amount		Cost		
	Total €	Premises and improvements €	Computer hardware €	Other equipment €	Motor vehicles €
<b>Cost/revalued amount</b>					
At 1 January 2016	4,136,969	3,014,855	519,771	557,736	44,607
Acquisitions	210,979	44,970	24,336	46,211	95,462
Disposal	(33,445)	-	-	-	(33,445)
<b>At 31 December 2016</b>	<b>4,314,503</b>	<b>3,059,825</b>	<b>544,107</b>	<b>603,947</b>	<b>106,624</b>
At 1 January 2017	4,314,503	3,059,825	544,107	603,947	106,624
Revaluation	1,806,050	1,806,050	-	-	-
Acquisitions	5,473,905	5,416,799	29,787	27,319	-
<b>At 31st December 2017</b>	<b>11,594,458</b>	<b>10,282,674</b>	<b>573,894</b>	<b>631,266</b>	<b>106,624</b>
<b>Depreciation</b>					
At 1 January 2016	986,935	132,370	391,337	423,759	39,469
Charge for year	134,987	63,057	35,570	26,987	9,373
Released on Disposal	(33,445)	-	-	-	(33,445)
<b>At 31 December 2016</b>	<b>1,088,477</b>	<b>195,427</b>	<b>426,907</b>	<b>450,746</b>	<b>15,397</b>
At 1 January 2017	1,088,477	195,427	426,907	450,746	15,397
Charge for year	162,661	70,253	37,923	35,393	19,092
<b>At 31st December 2017</b>	<b>1,251,138</b>	<b>265,680</b>	<b>464,830</b>	<b>486,139</b>	<b>34,489</b>
<b>Carrying amount</b>					
At 1 January 2016	3,150,034	2,882,485	128,434	133,977	5,138
At 31 December 2016	3,226,026	2,864,398	117,200	153,201	91,227
At 1 January 2017	3,226,026	2,864,398	117,200	153,201	91,227
<b>At 31 December 2017</b>	<b>10,343,320</b>	<b>10,016,994</b>	<b>109,064</b>	<b>145,127</b>	<b>72,135</b>

**17.2** The carrying amount of premises and improvements that would have been included in the financial statements had these assets not been revalued (see note 31.3.3) and had been carried at cost less depreciation is €7,009,072 (2016: €1,658,752).

**17.3** As at 31 December 2017, capital expenditure authorised but not contracted for amounted to €234,500 (2016: €290,900) and capital expenditure authorised and contracted for amounted to €Nil (2016: €4,793,250).

# Notes to the Financial Statements

For the Year Ended 31 December 2017

## 17 Property and equipment (continued)

### 17.4 Revaluation of premises

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

Valuations of properties held since prior years was revalued by an independent professionally qualified architect during 2017 in accordance with accounting policy 3.3.1. The valuation was principally done using the "investment income approach" whereby market value is derived by capitalising at an appropriate yield rate, the annual income produced, should the property be leased out to third parties. The income is arrived at by analysing a number of rental rates taking cognisance of the location of the property, its size, layout, and planning and energy performance considerations. Significant unobservable inputs used in the valuation of these properties is the rental income applied in the region of €33 per square metre per month for commercial premises, and the percentage capitalisation rate of 7% which indicates the multiplier relationship between Net Rental Income and Property Value.

The value of the new premises acquired during 2017 approximates its acquisition price.

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

## 18 Intangible assets

	<b>Computer software</b> €
<b>Cost</b>	
At 1 January 2016	2,187,479
Acquisitions	677,649
<b>At 31 December 2016</b>	<b>2,865,128</b>
At 1 January 2017	2,865,128
Acquisitions	365,252
<b>At 31 December 2017</b>	<b>3,230,380</b>
<b>Depreciation</b>	
At 1 January 2016	1,086,545
Charge for year	218,391
<b>At 31 December 2016</b>	<b>1,304,936</b>
At 1 January 2017	1,304,936
Charge for the year	290,915
<b>At 31 December 2017</b>	<b>1,595,851</b>
<b>Carrying amount</b>	
At 1 January 2016	1,100,934
At 31 December 2016	1,560,192
At 1 January 2017	1,560,192
<b>At 31 December 2017</b>	<b>1,634,529</b>



### 18 Intangible assets (continued)

As at 31 December 2017, capital expenditure authorised but not contracted for amounted to €648,703 (2016: €229,020) and capital expenditure authorised and contracted for amounted to €43,750 (2016: €179,950).

### 19 Other assets

	2017	2016
	€	€
Accrued income	1,213,623	1,288,199
Accounts receivable and prepayments	86,054	690,982
	<b>1,299,677</b>	<b>1,979,181</b>

Accrued income includes amounts due by related parties amounting to €687,800 (2016: €729,460).

### 20 Amounts owed to customers

	2017	2016
	€	€
Repayable on demand	67,919,911	63,590,946
Term deposits	77,847,511	68,746,077
	<b>145,767,422</b>	<b>132,337,023</b>

Amounts owed to customers include an amount of €52,976,668 (2016: €50,395,033) owed by the Bank to related parties.

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 21 Debt securities issued

	2017	2016
	€	€
Debt securities issued at amortised cost	<b>11,871,811</b>	11,854,721
At 1 January	<b>11,854,721</b>	11,837,631
Amortisation of debt issuance costs during the year	<b>17,090</b>	17,090
At 31 December	<b>11,871,811</b>	11,854,721

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

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

### 22 Deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets	Liabilities	Net	Assets	Liabilities	Net
	2017	2017	2017	2016	2016	2016
	€	€	€	€	€	€
Excess of capital allowances over depreciation	-	<b>(350,455)</b>	<b>(350,455)</b>	-	(276,633)	(276,633)
Collective impairment allowance	<b>224,288</b>	-	<b>224,288</b>	100,238	-	100,238
Specific impairment allowance	<b>232,913</b>	-	<b>232,913</b>	260,307	-	260,307
Revaluation of property	-	<b>(361,145)</b>	<b>(361,145)</b>	-	(237,536)	(237,536)
Fair value movements	-	<b>(469,610)</b>	<b>(469,610)</b>	-	(1,426,012)	(1,426,012)
	<b>457,201</b>	<b>(1,181,210)</b>	<b>(724,009)</b>	360,545	(1,940,181)	(1,579,636)

## 22 Deferred tax assets and liabilities (continued)

Movement in temporary differences relates to:

	At 1 January 2017	Recognised in profit or loss	Recognised in equity	At 31 December 2017
	€	€	€	€
Excess of capital allowances over depreciation	(276,633)	(73,822)	-	(350,455)
Collective impairment allowance	100,238	124,050	-	224,288
Specific impairment allowance	260,307	(27,394)	-	232,913
Revaluation of property	(237,536)	-	(123,609)	(361,145)
Fair value movements	(1,426,012)	-	956,402	(469,610)
	<u>(1,579,636)</u>	<u>22,834</u>	<u>832,793</u>	<u>(724,009)</u>

	At 1 January 2016	Recognised in profit or loss	Recognised in equity	At 31 December 2016
	€	€	€	€
Excess of capital allowances over depreciation	(110,785)	(165,848)	-	(276,633)
Collective impairment allowance	77,811	22,427	-	100,238
Specific impairment allowance	309,665	(49,358)	-	260,307
Revaluation of property	(162,967)	-	(74,569)	(237,536)
Fair value movements	(1,629,059)	-	203,047	(1,426,012)
	<u>(1,515,335)</u>	<u>(192,779)</u>	<u>128,478</u>	<u>(1,579,636)</u>

## 23 Accruals and deferred income

	2017	2016
	€	€
Accrued interest payable	<b>831,783</b>	961,787
Deferred income and other accrued expenses	<b>508,268</b>	369,100
	<u><b>1,340,051</b></u>	<u>1,330,887</u>

Accruals and deferred income include amounts due to related parties (see note 29.3) amounting to €106,026 (2016: €222,428).

# Notes to the Financial Statements

For the Year Ended 31 December 2017

## 24 Share capital and reserves

### 24.1 Share capital

	Ordinary shares	
	2017	2016
	No.	No.
On issue at 1 January:		
Issued for cash	54,762	54,762
Issued in lieu of dividend payment	345,238	345,238
On issue at 31 December – fully paid	400,000	400,000

At 31 December 2017, the authorised and issued share capital comprised 400,000 ordinary shares (2016: 400,000) of €25 each. At 31 December 2017, IBL I Limited and IBL T Limited, which are 100% indirect subsidiaries of VMKG PLLC (the ultimate parent), held 1% and 99% of the Bank's issued ordinary shares respectively.

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

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings of the Bank.

### 24.2 Capital contribution

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

### 24.3 Property revaluation reserve

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

### 24.4 Fair value reserve

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

### 24.5 Depositor compensation scheme reserve

The depositor compensation scheme reserve represents amounts set aside by the Bank from its retained earnings. As at 31 December 2017, a total amount of €354,523, (2016: €238,387) was placed with Central Bank of Malta by the Bank and pledged in favour of the Depositor Compensation Scheme.

### 24.6 Reserve for general banking risk

Banking Rule 09 (BR09) requires the Bank to hold a Reserve for General Banking Risk, calculated as a percentage of non-performing loans. This reserve is required to be funded from planned dividends. In this respect, the Bank has taken a reserve at the end of this year amounting to €36 (2016: €217).

### 24 Share capital and reserves (continued)

#### 24.7 Availability of reserves for distribution

	2017	2016
	€	€
Distributable	<b>15,582,993</b>	14,604,893
Non-distributable	<b>3,888,847</b>	3,863,665
	<b>19,471,840</b>	18,468,558

#### 24.8 Dividends

During the current year the Bank declared and paid a dividend amounting to €5.625 (2016: €5.00) per ordinary share that amounted to €2,250,000 (2016: €2,000,000).

After 31 December 2017, the directors proposed a dividend of €5.375 per ordinary share in respect of 2017 amounting to €2,150,000. The proposed dividends have not been provided for.

### 25 Commitments

	2017	2016
	€	€
Unutilised factoring, overdraft facilities and credit card commitments	<b>60,202,304</b>	42,580,312

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

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

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 26 Net cash generated from operating activities

	2017	2016
	€	€
Profit for the year	2,261,404	2,266,387
Adjustments for:		
Depreciation and amortisation	453,578	353,378
Income tax expense	1,295,527	1,448,751
Impairment allowances	260,721	(76,946)
Interest receivable on debt securities	(1,492,274)	(1,637,418)
Interest expense on debt securities	540,000	540,000
Realised gains on disposal of investments	(1,826,840)	(1,416,706)
Amortisation of premiums and discounts on available-for-sale securities	230,248	227,154
Amortisation of transaction costs on debts securities issued	17,090	17,089
Dividend income	(262,536)	(227,943)
	<b>1,476,918</b>	1,493,746
Changes in loans and advances to customers and other receivables	(4,202,775)	(2,983,905)
Changes in factored receivables	(28,578,468)	(447,041)
Changes in amounts owed to customers and to Central Bank of Malta	8,430,399	24,675,787
Changes in accruals and deferred income	406,147	(604,344)
	<b>(22,467,779)</b>	22,134,243

### 27 Cash and cash equivalents

	2017	2016
	€	€
Cash and items in transit	2,587	2,084
Balances with Central Bank of Malta	1,948,344	10,351,518
Loans and advances to banks with contractual maturity of three months or less	20,079,499	31,788,316
	<b>22,030,430</b>	42,141,918

Balances with Central Bank of Malta amounting to €354,523 (2016: €238,387) are pledged in favour of the Depositor Compensation Scheme.

### 28 Operating leases

The Bank had no operating lease agreements in force during the year ended 31 December 2017 (2016: nil).

## 29 Related parties

### 29.1 Identity of related parties and ultimate controlling party

Related parties are related by virtue of having common directors. The Bank's ultimate parent is VMKG PLLC, company number 0447.152.677.

The financial results and assets and liabilities of the Bank are included in the consolidated financial statements of VMKG PLLC, the registered office of which is Paepsemiaan, 28-30, 1070 Brussels, Belgium.

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

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

### 29.2 Related party transactions

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

	<b>2017</b>	2016
	€	€
Interest receivable and similar income	<b>2,203,424</b>	2,367,914
Fees and commissions receivable	<b>2,447,471</b>	2,386,091
Other operating income	<b>45,628</b>	47,443
	<hr/>	<hr/>
Interest expense	<b>542,070</b>	602,734
	<hr/>	<hr/>

## Notes to the Financial Statements

For the Year Ended 31 December 2017

### 29 Related parties (continued)

#### 29.3 Related party balances

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

	2017	2016
	€	€
<b>Assets</b>		
Loans and advances to customers	<b>53,515,379</b>	52,147,256
Prepayments and accrued income	<b>687,800</b>	729,460
<b>Liabilities</b>		
Amounts owed to customers	<b>52,976,668</b>	50,395,033
Debt securities issued to directors	<b>290,000</b>	290,000
Accruals and deferred income	<b>106,026</b>	224,428

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

#### 29.4 Transactions with key management personnel

	2017	2016
	€	€
Compensation to key management personnel	<b>345,059</b>	298,419
Loans advanced to key management personnel	<b>20,000</b>	-



### 30 Operating segments

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

#### 30.2 Geographical information

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

	2017	2016
	€	€
<b>Revenue</b>		
Malta	<b>2,194,720</b>	1,656,286
Belgium	<b>5,364,156</b>	5,135,945
	<b>7,558,876</b>	6,792,231
<b>Other assets</b>		
Malta – property, equipment and intangible assets	<b>11,977,849</b>	4,786,218

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

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



KPMG  
Portico Building  
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## Independent Auditors' Report

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

### 1. Report on the Audit of the Financial Statements

#### Opinion

We have audited the financial statements of Izola Bank p.l.c. (the "Bank" or the "Company"), which comprise the statement of financial position as at 31 December 2017, the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements:

- (a) give a true and fair view of the financial position of the Bank as at 31 December 2017, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU; and
- (b) have been properly prepared in accordance with the provisions of the Companies Act, 1995 (Chapter 386, Laws of Malta) (the "Act") and the Banking Act, 1994 (Chapter 371, Laws of Malta) (the "Banking Act").

#### Basis for Opinion

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

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## Independent Auditors' Report (*continued*)

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### **Key Audit Matters**

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

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

### **Identification of impairment of factored receivables**

*Accounting policy note 3.1.6 to the financial statements and note 15.*

Invoice factoring (€27,229,967) and Bills of Exchange factoring (€22,388,627) gross of allowances for uncollectability (collectively referred to as "factored receivables"), included within the factored receivables caption

The Bank acquires receivables which are factored without recourse. The Bank's process for identifying whether an impairment loss has occurred involves judgement, particularly for those receivables which are past due their contractual repayment date.

### *Our response*

- we assessed the design and implementation of the controls which monitor receipts from debtors in accordance with the applicable repayment terms in relation to factored receivables, and, additionally, specifically in relation to bills of exchange factoring, the operating effectiveness of that control.
- specifically for exposures with overdue factored receivables at the reporting date, we evaluated the timeliness of receipts against the contractual repayment dates to assess possible indicators of any unrecorded impairment.

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

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## Independent Auditors' Report *(continued)*

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### **Other Information**

The directors are responsible for the other information which comprises:

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

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

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.

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## **Independent Auditors' Report (continued)**

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

### ***Responsibilities of the directors for the financial statements***

The directors are responsible for the preparation of financial statements that (a) give a true and fair view in accordance with IFRS as adopted by the EU, and (b) are properly prepared in accordance with the provisions of the Act and the Banking Act, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The directors are 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.

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## Independent Auditors' Report *(continued)*

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

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

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Consider the extent of compliance with those laws and regulations that directly affect the financial statements, as part of our procedures on the related financial statement items. For the remaining laws and regulations, we make enquiries of directors and other management, and inspect correspondence with the regulatory authority, as well as legal correspondence. As with fraud, there remains a higher risk of non-detection of other irregularities (whether or not these relate to an area of law directly related to the financial statements), as these may likewise involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.

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## **Independent Auditors' Report (continued)**

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

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

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

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

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## Independent Auditors' Report (*continued*)

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

### 2. Opinion on the Directors' Report

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

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

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

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

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

In such regards:

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

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### **Independent Auditors' Report (continued)**

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

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

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

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

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

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

Pursuant to article 31(3)(a), (b) and (c) of the Banking Act, in our opinion:

- we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purpose of our audit;
- proper books of account have been kept by the Bank so far as appears from our examination thereof; and
- the Bank's financial statements are in agreement with the books of account.

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).

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### **Independent Auditors' Report (continued)**

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

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

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

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

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

**KPMG**  
Registered Auditors

22 March 2018

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### INTRODUCTION

#### *Background to Pillar 3 disclosures*

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

#### *Nature of Disclosures*

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

The Annual Report of Izola Bank p.l.c. has been filed with the MFSA Registry of Companies and the MFSA Banking Unit. These Pillar 3 disclosures refer to the financial year ended 31st December 2017 and have been included in the Annual Report for 2017.

The Bank has in place a formal policy to comply with the disclosure requirements laid down in Banking Rule BR/07/2017. The Directors, after due consideration of the size and complexity of the Bank, do not feel it necessary to produce Pillar 3 disclosures more frequently than annually.

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

### 1 RISK MANAGEMENT OBJECTIVES AND POLICIES

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

#### **Business risk**

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

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

#### **Concentration risk**

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

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

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

### Operational risk

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

### Interest rate risk in the non-trading book

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

## 2 BOARD AND COMMITTEES STRUCTURE

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

### Board Committee

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

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

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

### Credit Committee

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

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

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

### Audit Committee

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

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

The Committee provides independent review, monitoring and assessment of:

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

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

## 2 BOARD AND COMMITTEES STRUCTURE (continued)

### Asset and Liability Management Committee (ALCO)

**Composition:** This Committee is made up of a non-executive independent director, the Chief Executive Officer, the Head of Finance, Treasury and Compliance and a Finance, Treasury and Compliance Assistant Manager.

**Main Functions:** The ALCO:

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

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

## 3 OWN FUNDS

During the year ended 31 December 2017, the Bank complied with all of the externally imposed capital requirements to which it was subject. The following table summarises the composition of the Bank's regulatory capital as reported to the MFSA as at 31 December 2017.

	<b>2017</b> €
<b>Common Equity Tier 1 (CET1) Capital: instruments and reserves</b>	
Paid up capital instruments	22,532,675
Retained Earnings	3,050,318
Accumulated other comprehensive income (and other reserves)	3,534,288
	<b>29,117,281</b>
 <b>Common Equity Tier 2 (CET2) Capital: instruments and reserves</b>	
Collective provisioning	640,825
	<b>640,825</b>
 <b>Regulatory deductions and adjustments</b>	
Deductions related to intangible assets	(1,634,529)
Regulatory adjustments relating to unrealised gains	(706,858)
	<b>27,416,719</b>

### 3 OWN FUNDS *(continued)*

#### *Composition of Own Funds*

- i.* Ordinary Shares: At 31 December 2017, the authorised share capital comprised 400,000 ordinary shares of €25 each. All shares in issue are fully paid up. The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings of the Bank.
- ii.* Retained Profits: this includes the balance available for distribution to the shareholders.
- iii.* Capital Contribution: this represents a contribution by the shareholders to the distributable reserves of the Bank.
- iv.* Collective Provisioning: this represents a general provision against the Bank's unsecured lending.
- v.* Available-for-sale Financial Assets (AFS): this represents fair value movements on AFS assets, net of tax.
- vi.* Revaluation Reserve: this represents reserves arising from the revaluation of tangible fixed assets, net of tax.

### 4 CAPITAL ADEQUACY

#### **4.1 Internal Capital Adequacy Assessment Process (ICAAP)**

##### *ICAAP Methodology*

The Bank's latest ICAAP report is based on 31st December 2016 figures.

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

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

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

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

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

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

Table 4.1 Capital Requirement by exposure class as at 31 December 2017

	Capital Requirement
	€ 000s
Central Government or Central Banks	-
Corporates	4,360
Institutions	466
Retail	1,610
Other	1,043
<b>Total</b>	<b>7,479</b>

**4.3 Market Risk Capital Requirement**

The market risk capital requirement of the Bank is not significant, comprising a foreign exchange risk charge of €14,527.

**4.4 Operational Risk Capital Requirement**

The gross income registered by the Bank in 2017, 2016 and 2015 amounted to €7,102,231, €6,134,668 and €6,048,076 respectively. The operational risk capital requirement for 2017 amounted to €964,249.



## 4 CAPITAL ADEQUACY (continued)

## 4.5 Calculation of minimum capital requirement and risk-weighted assets

	Statement of financial position value <b>2017</b>	Risk weighted exposure <b>2017</b>	Capital requirement <b>2017</b>	Statement of financial position value 2016	Risk weighted exposure 2016	Capital requirement 2016
	€	€	€	€	€	€
<b>On balance sheet assets</b>						
Cash and items in transit	2,587	517	41	2,084	417	33
Balance with Central Bank of Malta	1,948,344	-	-	10,351,518	-	-
Investments	57,213,412	21,421,906	1,713,752	66,925,325	16,912,067	1,352,965
Loans and advances to banks	20,079,499	4,015,900	321,272	31,788,316	6,357,663	508,613
Factored receivables	48,583,631	39,937,418	3,194,993	20,237,200	20,237,200	1,618,976
Other loans and advances to customers	65,524,805	14,835,857	1,186,869	61,350,109	14,299,585	1,143,967
Property and equipment	10,343,320	10,343,320	827,466	3,226,026	3,226,026	258,082
Intangible assets	1,634,529	1,634,529	130,762	1,560,192	1,560,192	124,815
Prepayments and accrued income	1,299,677	1,299,677	103,974	1,979,181	989,590	79,167
	<b>206,629,804</b>	<b>93,489,124</b>	<b>7,479,129</b>	<b>197,419,951</b>	<b>63,582,740</b>	<b>5,086,618</b>
<b>Off balance sheet items</b>						
Commitments	<b>60,202,304</b>			<b>42,580,312</b>		
Credit risk capital requirement		93,489,124	7,479,129		63,582,740	5,086,618
Foreign exchange risk capital requirement		181,584	14,527		33,572	2,686
Operational risk capital requirement		12,053,113	964,249		10,834,313	866,745
Total capital requirement		<b>105,732,821</b>			<b>74,450,625</b>	
Own funds						
Total own funds	<b>27,416,719</b>			<b>24,781,120</b>		
Capital adequacy ratio			<b>26%</b>			<b>33%</b>

## 5 CREDIT RISK

### 5.1 Credit risk

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

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

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

#### *Impaired factored receivables*

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

Table 5.1 Allowance for impairment on factored receivables

	2017	2016
	€	€
Factored receivables – gross	<b>49,618,594</b>	21,040,126
Collectively determined	<b>49,111,716</b>	20,460,429
Collective allowance for impairment	<b>528,085</b>	223,229
Specific allowance for impairment	<b>506,878</b>	579,697

#### *Past due but not impaired*

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

As at 31 December 2017, 22% (2016: 39%) of the Bank's factored receivables were past due but not impaired. 18% of these became past due on 31 December 2017. A substantial amount of these past due receivables have been paid by the date of issue of these financial statements.

Table 5.2 Neither past due nor impaired loans and securities

	2017	2016
	€	€
Loans and advances to customers	<b>57,185,841</b>	55,876,574
Loans and advances to banks	<b>20,079,499</b>	31,788,316
Investment securities	<b>57,213,412</b>	66,925,325
	<b>134,478,752</b>	154,492,821

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

#### Allowances for impairment

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

	2017	2016
	€	€
Allowance for impairment on factored receivables	<b>1,034,963</b>	802,926

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

	Exposure as at 31/12/2017	Average Exposure for period to 31/12/2017
	€ 000s	€ 000s
Central Government or Central Banks	28,720	39,011
Corporates	119,596	109,208
Institutions	20,890	31,870
Retail	23,219	12,951
Other	14,204	23,277
<b>Total</b>	<b>206,629</b>	<b>216,317</b>

5 CREDIT RISK (Continued)

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

Table 5.4 Geographic distribution of exposure classes

	Malta	Europe	Rest of the World	Total
	€ 000s	€ 000s	€ 000s	€ 000s
Central Government or Central Banks	28,720	-	-	28,720
Corporates	20,961	97,443	1,192	119,596
Institutions	4,353	16,537	-	20,890
Retail	22,389	830	-	23,219
Other	12,744	1,460	-	14,204
<b>Total</b>	<b>89,167</b>	<b>116,270</b>	<b>1,192</b>	<b>206,629</b>

Table 5.5 Distribution of the exposures by industry/counterparty type

	Central Government or Central Banks	Corporates	Institutions	Retail	Other	Total
	€ 000s	€ 000s	€ 000s	€ 000s	€ 000s	€ 000s
Monetary Financial Institutions	1,948	-	20,890	-	-	22,838
Sovereigns	26,772	-	-	-	-	26,772
Manufacturing	-	8,913	-	-	-	8,913
Wholesale and retail trade	-	20,176	-	-	-	20,176
Real estate, renting and business activities	-	4,529	-	-	-	4,529
Construction	-	83,697	-	-	-	83,697
Households	-	-	-	23,219	-	23,219
Other	-	2,281	-	-	14,204	16,485
<b>Total</b>	<b>28,720</b>	<b>119,596</b>	<b>20,890</b>	<b>23,219</b>	<b>14,204</b>	<b>206,629</b>

Table 5.6 Residual Maturity Breakdown of the exposures

	< 1 year	1 – 5 years	> 5 years	Total
	€ 000s	€ 000s	€ 000s	€ 000s
Central Government or Central Banks	1,948	20,521	6,251	28,720
Corporates	81,555	7,107	30,934	119,596
Institutions	20,786	104	-	20,890
Retail	7,284	15,621	314	23,219
Other	14,204	-	-	14,204
<b>Total</b>	<b>125,777</b>	<b>43,353</b>	<b>37,499</b>	<b>206,629</b>

## 5 CREDIT RISK (Continued)

### 5.4 Past Due Exposures and Impaired Assets

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

Standardised exposure classes	Individual & collective provision	Charged to income statement in the year ended 31 December 2017
	€ 000s	€ 000s
Central Government or Central Banks	-	-
Corporates	1,291	(350)
Institutions	-	-
Other	-	-
<b>Total</b>	<b>1,291</b>	<b>(350)</b>

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

Standardised exposure classes	Individual & collective provision	Charged to income statement in the year ended 31 December 2017
	€ 000s	€ 000s
Malta	-	-
Europe	1,291	(350)
Rest of the World	-	-
<b>Total</b>	<b>1,291</b>	<b>(350)</b>

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

	Individual & collective provisions
	€ 000s
Opening balance	1,030
Impairment increase	261
<b>Closing balance</b>	<b>1,291</b>
<b>Amounts written off</b>	<b>89</b>

## 6 STANDARDISED APPROACH TO CREDIT RISK

### 6.1 Exposure to Institutions

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

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

Table 6.1 Institutions

Credit Quality Step	Risk Weight	Ratings	Exposure	Exposure After CRM
			€ 000s	€ 000s
1	20%	Fitch AAA to A	20,890	4,178
3	50%	Fitch BBB	811	406

### 6.2 Exposure to Central Government and Central Bank

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

Table 6.2 Central Government and Central Bank

Credit Quality Step	Risk Weight	Banking Regulation	Exposure	Exposure After CRM
			€ 000s	€ 000s
1	0%	Art. 114(4)	1,948	-
2	0%	Art. 114(4)	26,772	-

### 6.3 Exposure to Corporates

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

Table 6.3 Corporates

Credit Quality Step	Risk Weight	Banking Regulation	Exposure	Exposure After CRM
			€ 000s	€ 000s
1	0%	Art. 400(1)g	47,531	-
3	50%	Art. 124(2) / Art. 126(1)	8,460	4,230
5	100%	Art. 122(2)	63,605	63,605

## 7 REMUNERATION POLICY

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

## 8 CREDIT RISK MITIGATION

### 8.1 Collateral

Analysis of collateral is disclosed in Note 4.4.3 of the Annual Report 2017.

Table 8.1 Exposure value covered by eligible financial collateral

	€ 000s
Central Government or Central Banks	-
Corporates	57,369
Institutions	-
Retail	23,219
<b>Total</b>	<b>80,588</b>

## 9. CONCLUSION

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

Statement of Profit or Loss and Other Comprehensive Income

	2017	2016	2015	2014	2013
	€	€	€	€	€
Interest receivable and similar income	<b>4,326,056</b>	4,292,747	4,665,066	4,168,187	3,588,514
Interest payable and similar charge	<b>(2,544,779)</b>	(2,314,406)	(2,273,514)	(2,162,773)	(1,859,492)
Net interest income	<b>1,781,277</b>	1,978,341	2,391,552	2,005,414	1,729,022
Fee and commission income	<b>3,171,335</b>	2,438,376	2,775,879	2,734,690	2,233,827
Other operating income	<b>2,149,619</b>	1,717,951	880,645	412,045	376,804
Other operating charges	<b>(3,195,559)</b>	(2,391,099)	(1,983,298)	(1,562,888)	(1,334,182)
Net impairment losses	<b>(349,741)</b>	(28,431)	(481,736)	(61,860)	(163,643)
Profit before tax	<b>3,556,931</b>	3,715,138	3,583,042	3,527,401	2,841,828
Income tax expense	<b>(1,295,527)</b>	(1,448,751)	(1,197,022)	(1,229,201)	(987,878)
Profit for the year	<b>2,261,404</b>	2,266,387	2,386,020	2,298,200	1,853,950
Other comprehensive income for the year, net of income tax	<b>(117,779)</b>	(431,410)	974,495	1,716,034	47,425
Total comprehensive income for the year	<b>2,143,625</b>	1,834,977	3,360,515	4,014,234	1,901,475
Earnings per share	<b>5.65</b>	5.67	5.97	5.75	4.63



## Statement of Financial Position

	2017	2016	2015	2014	2013
	€	€	€	€	€
<b>ASSETS</b>					
Cash and items in transit	2,587	2,084	1,656,731	29,825	51,353
Balances with Central Bank of Malta	1,948,344	10,351,518	989,261	976,517	3,610,741
Investments	57,213,412	66,925,325	52,537,656	71,079,589	53,260,197
Loans and advances to banks	20,079,499	31,788,316	32,471,446	16,976,777	17,271,494
Factored receivables	48,583,631	20,237,200	19,639,543	21,292,678	21,343,003
Other loans and advances to customers	65,424,805	61,350,109	58,439,875	33,016,654	19,705,987
Property and equipment	10,343,320	3,226,026	3,150,034	2,495,321	2,349,355
Intangible assets	1,634,529	1,560,192	1,100,934	864,951	760,912
Other assets	1,299,677	1,979,181	1,414,231	1,638,357	1,138,499
<b>Total assets</b>	<b>206,629,804</b>	<b>197,419,951</b>	<b>171,399,711</b>	<b>148,370,669</b>	<b>119,491,541</b>
<b>LIABILITIES</b>					
Balance owed to Central Bank of Malta	16,300,000	21,300,000	21,700,000	20,000,000	15,500,000
Amounts owed to customers	145,767,422	132,337,023	107,261,236	90,853,295	70,864,196
Debt securities in issue	11,871,811	11,854,721	11,837,631	8,969,458	8,910,057
Deferred tax liabilities	724,009	1,579,636	1,515,335	1,321,717	397,704
Current tax payable	1,154,671	549,126	286,575	766,297	1,147,112
Accruals and deferred income	1,340,051	1,330,887	1,118,970	1,519,459	1,193,215
<b>Total liabilities</b>	<b>177,157,964</b>	<b>168,951,393</b>	<b>143,719,747</b>	<b>123,430,226</b>	<b>98,012,284</b>
<b>EQUITY</b>					
Called up share capital	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
Property revaluation reserve	2,657,412	961,468	1,048,190	955,479	975,684
Fair value reserve	876,876	2,663,593	3,020,434	2,150,803	433,099
Depositor compensation scheme reserve	354,523	238,387	238,387	160,508	148,109
Reserve for general banking risk	36	217	217	8,544	-
Capital contribution	12,532,675	11,436,521	10,482,904	8,853,898	7,406,946
Retained earnings	3,050,318	3,168,372	2,889,832	2,811,211	2,515,419
<b>Total equity attributable to equity holders of the Bank</b>	<b>29,471,840</b>	<b>28,468,558</b>	<b>27,679,964</b>	<b>24,940,443</b>	<b>21,479,257</b>
<b>Total liabilities and equity</b>	<b>206,629,804</b>	<b>197,419,951</b>	<b>171,399,711</b>	<b>148,370,669</b>	<b>119,491,541</b>
<b>Memorandum items</b>					
Commitments	60,202,304	42,580,312	33,128,620	34,989,271	34,411,709

Statement of Cash Flows

	2017	2016	2015	2014	2013
	€	€	€	€	€
Net cash from operating activities	<b>(23,180,595)</b>	21,140,824	19,126,796	10,956,398	16,324,581
Cash flows from investing activities					
Payments to acquire property, equipment and intangible assets	<b>(5,839,157)</b>	(852,138)	(1,134,576)	(437,520)	(374,605)
Payments to acquire investments	<b>(12,604,899)</b>	(20,884,368)	(16,403,055)	(23,039,901)	(29,030,000)
Proceeds from disposals of investments	<b>21,170,143</b>	7,353,517	10,464,323	8,240,386	20,683,965
Interest received from investments	<b>1,524,330</b>	1,625,087	3,159,361	2,364,716	2,095,012
Dividend received	<b>262,536</b>	227,943	194,820	-	-
Net cash used in investing activities	<b>4,512,953</b>	(12,529,959)	(3,719,127)	(12,872,319)	(6,625,628)
Cash flows from financing activities					
Dividends paid to shareholders	<b>(2,000,000)</b>	(2,000,000)	(2,250,000)	(2,000,000)	(1,500,000)
Net capital contribution received	<b>1,096,154</b>	953,617	1,629,006	1,446,952	1,075,064
Issue of debt securities net of transaction costs	-	-	3,498,144	-	-
Redemption of debt securities	-	-	(669,000)	-	-
Interest paid on debt securities	<b>(540,000)</b>	(540,000)	(481,500)	(481,500)	(482,820)
Net cash from / (used in) financing activities	<b>(1,443,846)</b>	(1,586,383)	1,726,650	(1,034,548)	(907,756)
Increase / (decrease) in cash and cash equivalents	<b>(20,111,488)</b>	7,024,482	17,134,319	(2,950,469)	8,791,197

**Accounting Ratios**

	<b>2017</b>	2016	2015	2014	2013
	<b>%</b>	%	%	%	%
Net interest income and other operating income to total asset	<b>3.44</b>	3.11	3.53	3.47	3.63
Operating expenses to total assets	<b>1.72</b>	1.23	1.44	1.10	1.25
Profit before tax to total assets	<b>1.72</b>	1.88	2.09	2.38	2.38
Pre-tax return on capital employed	<b>13.90</b>	15.10	15.33	16.29	14.22
Profit after tax to equity	<b>7.67</b>	7.96	8.62	9.21	8.63

**Directors' interest in the share capital of the Bank or in any related company as at 31 December 2017**

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

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

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

	Type & class of shares	Issued shares	Percentage paid up	Nominal value per share
<b>IBL I Limited C 16321</b>				
VMT S.A	Ordinary	24,999	100	€24.79
IVM S.A	Ordinary	1	100	€24.79
<b>IBL T Limited C 16322</b>				
VMT S.A	Ordinary	24,999	100	€24.79
IVM S.A	Ordinary	1	100	€24.79
<b>Shareholders holding 5% or more of the Share Capital as at 31st December 2017</b>				
IBL I Limited	Ordinary "A"	1	100	€25.00
IBL T Limited	Ordinary "B"	399,999	100	€25.00

**Number of Shareholders**

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

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





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